WHY INVESTMENT MATTERS

KAVALJIT SINGH

The Political Economy of International Investments

About the Author

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Acronyms

ACP	African, Caribbean and Pacific (group of countries)
AGM	Annual General Meeting
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ATCA	Alien Torts Claims Act
AU	African Union
BIS	Bank for International Settlements
BIT	bilateral investment treaty
BoP	balance of payments
BRIC	Brazil, Russia, India, and China
CACM	Central American Common Market
CAL	capital account liberalization
CARICOM	Caribbean Community
CCC	Clean Clothes Campaign
CEE	Central and Eastern Europe
CMIT	Capital Movements and Invisible Transactions
CNOOC	China National Offshore Oil Corporation
CSR	corporate social responsibility
DTT	double taxation treaty
ECA	Export Credit and Investment Insurance Agency
ECOSOC	Economic and Social Council
ECT	Energy Charter Treaty
EEC	European Economic Community
EPA	Economic Partnership Agreement
ETI	Ethical Trading Initiative
EU	European Union
FCN	treaty of friendship, commerce, and navigation
FDI	foreign direct investment
FLA	Fair Labor Association
FTA	free trade agreement
FTAA	Free Trade Area of Americas
FTC	Free Trade Commission

FSA	Financial Services Agreement
G-7	group of seven highly industrialized countries
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP/GNP	gross domestic product/ gross national product
HGA	Host Government Agreement
IBM	International Business Machines
IBRD	International Bank for Reconstruction and Development
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IFI	international financial institution
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	Investment Promotion Agency
ITO	International Trade Organization
ITT	International Telephone and Telegraph
LDCs	least developed countries
MAI	Multilateral Agreement on Investment
MBTE	Methyl Tertiary-Butyl Ether
MERCOSUR	Mercado Comun del Sur (Southern Common Market)
MFN	most favored nation
MIGA	Multilateral Investment Guarantee Agency
MMT	Methylcyclopentadienyl Manganese Tricarbonyl
MSI	Multi-Stakeholder Initiative
M&A	merger and acquisition
NAFTA	North American Free Trade Agreement
NCP	National Contact Point
NGO	non-governmental organization
NIEO	new international economic order
NT	national treatment
OECD	Organisation for Economic Co-operation and Development
PCB	Polychlorinated Biphenyls

PI	portfolio investment
P&O	Peninsular & Oriental
RTA	regional trade agreement
R&D	research and development
SADC	Southern African Development Community
SAI	Social Accountability Initiative
SME	small and medium-sized enterprise
SOE	state-owned enterprise
SSA	Sub-Saharan Africa
TNC	transnational corporation
TRIMs	Trade-related Investment Measures
TRIPs	Trade-related Aspects of Intellectual Property Rights
UBS	Union Bank of Switzerland
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Center on Transnational Corporations
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
US	United States of America
WAIPA	World Association of Investment Promotion Agencies
WRAP	Worldwide Responsible Apparel Production
WRC	Workers' Rights Consortium
WTO	World Trade Organization

Data Notes

Million is 1,000,000.
Billion is 1,000 million.
Trillion is 1,000 billion.
Dollars are US dollars unless otherwise specified.

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This book is dedicated to Susan Leubuscher (1946-2007).

Foreword

International investment matters. Why? Because investment is not just a blandly apolitical process by which money is mysteriously made to grow, but a process in which companies and governments define and redistribute access to assets, determining who accumulates wealth and at whose expense.

To influence this process, the public needs to know how investment works, who the main players are and what the trends are. In this book, Kavaljit Singh explains the central role transnational corporations (TNCs) play in the investment debate. He sets out in clear and simple language how investment patterns have changed in the last two decades. He debunks some of the myths surrounding investment flows, and he suggests ways in which the vast sums of money sloshing around the global financial system can be brought back under the democratic control of citizens and governments.

It is too simplistic to state that all investments flows are good, or all are bad. Rather, as this book argues, the debate should center on: "Who benefits?", "Who loses?", and "What strategies are needed to ensure foreign direct investment contributes to development"?

Much of the interest of this book lies in the detail. It is well known that TNCs frequently use various tax evasion measures. This book explains how companies make huge profits via transfer pricing: selling products or materials from one part of a TNC to another for fictitious prices to limit tax liability, such as toothbrushes for $5655 each or flash lights for $5000 each.

Most of us are aware in general terms that free market policies have been imposed around the globe, and that de-regulation has worked to the benefit of private investors. But how many of us know that actually the South has become a net exporter of capital to the North, notably the United States, which relies on China and other developing countries to finance its huge deficits?

Foreign direct investment (FDI) is clearly not an automatic route to economic growth, but, as Kavaljit Singh shows, in many cases and for various reasons, FDI leads to an outflow of capital rather, than an inflow: in countries such as DRC, Mali and Nigeria, profit remittances alone are higher than FDI inflows.

In short, with clear examples and ample data, Kavaljit Singh maps out investment flows, trends and regulatory frameworks and shows us where citizens organized collectively can work – and are working – to reclaim investment for the public good.

Change, however, will not come about through individuals acting alone but in concert. We therefore hope that this book will play its part in increasing the effectiveness of such collective action, both through informing movements and their allies in government and, indeed, the financial community itself, of the issues and through identifying areas where policies and practices can and should be changed.

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1

Defining International Investments

REGARDLESS of whether you live in Brussels or Bangalore or Bangui or Bogotá, chances are that you have come across the names of several large transnational corporations (TNCs), such as Wal-Mart Stores, Citigroup, IBM or Toyota Motor or others listed in Table 1.1. It is very likely that you have often used their products and services. As TNCs nowadays play a major role in the global economy, many of you might also have noticed their growing power and influence in the domestic economies.

What are TNCs? What makes these mammoth firms so special? How have they become so powerful in recent years? What does the growing power of TNCs mean for economy, workers and environment? Can TNCs be brought under democratic control and oversight? To answer all these questions, let us begin by defining TNCs now one of the major means through which investments are made throughout the world.

A firm which controls operations or owns assets in more than one country is called a **transnational corporation**,[1] while a corporation involved only in exports of goods and services from home countries is not considered transnational. Thus, not all corporations in the world are transnational. According to UNCTAD, there are about 77,000 parent TNCs with more than 770,000 foreign affiliates.

A transnational corporation engages in several types of foreign investments. **Foreign direct investment** (FDI) is an investment by a firm in a foreign country to acquire real assets such as plant, equipment, and real estate or land with the aim of maintaining control over the management.[2] Unlike bank loans, FDI involves both ownership and control of the foreign entity by the TNC. **Portfolio investment**, in contrast, involves the acquisition of foreign securities such as shares and bonds by firms without their acquiring any direct control over the management of the foreign entity. Portfolio investment is similar to FDI in the sense that it involves the ownership of shares in foreign entities. But since portfolio investment is undertaken for speculative reasons rather than managerial reasons, the behavior of portfolio investors is often different. Unlike FDI, portfolio investment is typically of a more speculative nature, responding quickly to higher returns offered elsewhere and to higher risks in the host countries, as witnessed during the Southeast Asian financial crisis in 1997.

Table 1.1: World's Top 25 Corporations in 2006

Rank	Company	Revenues ($ million)	Profits ($ million)
1	Exxon Mobil	339,938.0	36,130.0
2	Wal-Mart Stores	315,654.0	11,231.0
3	Royal Dutch/Shell Group	306,731.0	25,311.0
4	BP	267,600.0	22,341.0
5	General Motors	192,604.0	-10,567.0
6	Chevron Texaco	189,481.0	14,099.0
7	DaimlerChrysler	186,106.3	3,536.3
8	Toyota Motor	185,805.0	12,119.6
9	Ford Motor	177,210.0	2,024.0
10	Conoco Phillips	166,683.0	13,529.0
11	General Electric	157,153.0	16,353.0
12	Total	152,360.7	15,250.0
13	ING Group	138,235.3	8,958.9
14	Citigroup	131,045.0	24,589.0
15	AXA	129,839.2	5,186.5
16	Allianz	121,406.0	5,442.4
17	Volkswagen	118,376.6	1,391.7
18	Fortis	112,351.4	4,896.3
19	Credit Agricole	110,764.6	7,434.3
20	American International Group	108,905.0	10,477.0
21	Assicurazioni Generali	101,403.8	2,384.0
22	Siemens	100,098.7	2,854.9
23	Sinopec	98,784.9	2,668.4
24	Nippon Telegraph & Telephone	94,869.3	4,404.6
25	Carrefour	94,454.5	1,784.3

Source: *Fortune*, July 24, 2006.

Box 1.1

International Capital Flows

International capital flows are of three main types: private, official, and remittance flows.

Private capital flows originate from the private sector and include foreign direct investments, portfolio investments, bank lending by private banks, securities transactions, bond transactions, and export credits of private banks. Private grants by non-government organizations are also considered as part of private capital flows.

Official capital flows originate from state agencies such as Federal, State, and local authorities and are generally divided into two main categories: official development assistance (ODA) and other official flows (OOF). ODA may be bilateral or multilateral. Flows are classified as ODA if they have a development agenda and a grant element of 25 per cent or more of the total amount. ODA could include several categories such as program aid, technical cooperation, food aid, emergency relief, and debt relief. Other official flows (OOF) consist of credits extended by export credit agencies (ECAs) and other state agencies and the rescheduling of private sector debt by the state sector. Usually, the loans extended under OOF are offered at or near market rates.

Remittance flows – defined as the sum of workers' remittances, compensation of employees and migrant transfers – have become the second largest capital flow (after FDI) to developing countries. Since 1995, remittance flows have surpassed ODA. Officially recorded remittances worldwide reached \$232 billion in 2005, out of which developing countries alone received \$167 billion. Developing countries are benefiting enormously from the migration of their workforce and the resulting foreign exchange remittances. Countries such as India, China, Mexico, and the Philippines are the biggest beneficiaries of this trend. In India, remittance flows are nearly four times larger than FDI flows. If remittances sent through informal channels are added, remittances would become the largest source of external capital in many developing countries. Remittance flows not only improve the economic conditions of the receiving households, but also contribute to the betterment of extended families and local communities.

Transnational corporations are owned (and mostly headquartered) in their **home countries** and invest in **host countries**. TNCs invest in foreign countries through various means. They may acquire an existing firm through a **merger** or **acquisition** or make a **greenfield investment**, which involves the establishment of a completely new business. The setting up of a wholly-owned new factory in a foreign country is an example of a greenfield investment. In addition, there are a whole range of commercial arrangements through which TNCs invest in foreign countries. For instance, firms may share ownership with local investors in the host countries in a **joint venture**.

Cross-border arrangements without equity participation include:

Licensing, under which the firms transfer technologies and rights through contracts;

Franchising, under which a company grants another company the right to do business for a certain period of time in a specified place;

Cartels, which are agreements between independent firms to maintain prices or limit output; and

Strategic alliances, which are arrangements between firms to share facilities or cooperate in new product development.

A TNC can be a **public corporation**, which trades its shares on stock exchanges or at brokerage houses. The public buyers of shares are **shareholders**, and can include individuals as well as institutions such as banks, insurance companies, and pension funds. General Motors and Pepsi are examples of publicly-traded corporations. A TNC can also be a **private corporation**, meaning that it does not have shares that are traded publicly; such firms are usually family-controlled. Sumitomo Corporation of Japan, which is involved in mining, manufacturing, and banking businesses, is an example of a family-owned private corporation. A TNC can even be a **state corporation** in which the majority of shares are owned by governmental authorities. The Chinese oil company, CNOOC, and

Singapore's Temasek Holdings are prime examples of state-owned corporations. In some countries (e.g., China) and in some industries (e.g., oil),

Box 1.2

The English East India Company

In 1600, Queen Elizabeth 1 of England awarded a Charter to a group of London-based merchants, giving them monopoly rights over trade with the 'East Indies'. In the beginning, the merchants were interested only in trading spices such as pepper for the European markets. But subsequently the English East India Company, along with the Dutch United East India Company (Verenigde Oostindische Compagnie) formed in 1602, started dominating the commodity trade between Asia and Europe during the 17th and 18th centuries. In later years, the Company was organized as a joint stock company. By the middle of the 18th century, the Company employed more than 300 head office staff who supervised commodity trading between Europe and Asia. Subsequently, it diversified into silk spinning factories in India. At its peak, the Company generated a higher revenue than the whole of Britain.

In 1765, the Company took over revenue collection rights in the Indian province of Bengal from the ruling Mughal Empire. This gave rise to a process through which the Company started acquiring administrative and political power in India. In the mid-19th century, the Company ceased trading and became entirely involved with the colonial administration of India. On November 1, 1858, the Company was liquidated after the takeover of colonial rule in India by the British Crown.

The Company was notorious for its corrupt and exploitative practices. In the words of historian Nick Robins, "With a single-minded pursuit of personal and corporate gain, the Company and its executives eventually achieved market dominance in Asia, ruling over large swathes of India for a profit. But the Company also shocked its age with the scale of its executive malpractice, stock market excess and human oppression. For me, the parallels with today's corporate leviathans soon became overpowering, with the Company outstripping Wal-Mart in terms of market power, Enron for corruption and Union Carbide for human devastation."[3]

a number of major state-owned corporations are increasingly investing abroad.

If the foreign operations of a firm are incorporated in the host country with a separate legal identity, it is called a **subsidiary**; if they are not incorporated, it is called a **branch**. United Carbide India Ltd., for example, was the Indian subsidiary of the US-based Union Carbide Corporation, while Citibank India is a branch of the global bank, Citigroup. A **parent company**, located in the TNC's country of origin, exercises an authoritative, controlling influence over a subsidiary in another country, either directly if it is a private corporation or indirectly by owning some or all of the shares if it is a public corporation. Parent corporations can exert controlling power even with relatively small share holdings in subsidiaries. Subsidiaries can have a different name than the parent company, and can also be located in the same country as its parent. The style of relationship and the exercise of control between parent and subsidiary companies differ among TNCs' main home regions. More formal, centralized control has typically been a hallmark of US, and to a lesser extent European, corporations rather than of Japanese TNCs.

Origins

The earliest historical origins of foreign investment can be traced to the major colonizing and imperialist ventures from Western Europe, notably England and Holland, which began in the 16th century. State-sponsored trading firms such as the English East India Trading Company, the Hudson's Bay Company, the Royal African Company, the Dutch United East India Company (Verenigde Oostindische Compagnie) were formed to support colonial trading systems. These firms were given monopoly trading rights by their respective governments. For instance, the Royal African Company was given a monopoly over the slave trade by England. Between 1680 and 1686, the Company transported an average of 5,000 slaves a year.

Initially these trading firms differed distinctly from modern-day corporations because they were more involved in trade than in production.

Later on, however, they ventured out into new businesses in foreign jurisdictions including substantial investments in forts, warehouses, land and administrative operations. The involvement of the English East India Company in cotton growing in India illustrates its involvement with production processes as well as with trade.

During the 19th century, there was substantial foreign investment by British-based firms in the colonies of the British Empire. These firms not only opened offices in various parts of the world; they also carried out direct investments involving management control.

Transnational corporations, as they are known today, first appeared with the advent of industrial capitalism in the 19th century. The development of the factory system paved the way for the emergence of manufacturing-oriented TNCs. The rapid increase in cross-border flows of capital in the late 19th century was facilitated by few restrictions on capital movements and the adoption of the Gold Standard exchange system, which provided stability against foreign exchange risks.

During the 19th and early 20th centuries, the search for natural resources including minerals, petroleum, and food supplies led to a large-scale expansion in foreign operations by firms based in the US and Western Europe. The foreign operations were managed and controlled from the headquarters of firms located in their home countries. Firms such as the German-owned Siemens and US-owned Singer Sewing Machines, which established their first overseas plants in the 1850s and 1860s respectively, were among the first manufacturing transnational corporations in history. The banking system was also introduced by British merchants and banks in British colonies during this period.

It is important to highlight the fact that a huge amount of foreign investment took place in the pre-1914 period even though there is no unanimity among economic historians about the composition of this investment. Most estimates believe that the bulk of capital flows in the pre-1914 period were in the form of portfolio investment, which were strongly influenced by the attractive interest rates prevalent in foreign locations. The

Box 1.3

Bretton Woods System

In July 1944, the procedure for fixing exchange rates and managing the international financial system was worked out at a conference held in Bretton Woods, a town in the US state of New Hampshire. The Bretton Woods system was designed to ensure that domestic economic objectives were not subordinated to global financial pressures. Under the Bretton Woods system, all countries were required to fix their national exchange rates to the US dollar, which was in turn fixed at $35 an ounce of gold.

After the US emerged from the Second World War as the world's leading economic power, the dollar replaced the UK's sterling as the dominant currency for foreign exchange. Under this system, private financial flows were regulated by capital controls, and an international institution, the International Monetary Fund (IMF), was set up to monitor the international financial system that was largely dominated by official capital flows. The Bretton Woods system was not universal in its reach, however, as the communist bloc was not part of it.

However, the rise of the Eurocurrency market in the 1960s put strains on the Bretton Woods system. The system suffered a major breakdown on August 15, 1971 when the US – which was unable to deal with a massive speculative attack on the dollar in the wake of a growing balance of payments deficit largely caused by the protracted Vietnam War – unilaterally declared that it would no longer honor its commitment to exchange dollars for gold at $35 per ounce. For a while after this, a few countries attempted to create alternatives to the defunct Bretton Woods system (for example, the Smithsonian Agreement). But on February 12, 1973, Japan decided to float the yen against the dollar, and on March 16, 1973, the European Community followed suit with European currencies. Thereafter, the remaining countries opted for either a floating or a flexible exchange rate system. Undoubtedly, the Bretton Woods system was based on the hegemony of the US as it served the country's foreign policy and economic interests. Surely, the motive was not altruism on the part of the US but was based on the expectation that the country had much more to gain from managing the international financial system.

UK, accounting for more than half of the total international capital outstanding in 1914, was the largest creditor nation. Indeed, in the 50 years up to 1914, the UK invested abroad an annual average of 4 per cent of its national income. Geographically, around 60 per cent of this investment was in the Americas and Australasia.

By 1914, manufacturing was also undertaken in foreign operations of a wide range of products including chemicals, pharmaceuticals, electricals, machinery, motor cars, tires, food products, and cigarettes. However, the First World War and its aftermath had a damaging impact on the economic power of the major European nations. War and reconstruction costs changed the status of Europe from being a net creditor to a net debtor by the 1920s, whereas the US emerged as a creditor country.

International investments again dipped during the Second World War as foreign assets were appropriated. For instance, the entire stock of German and Japanese FDI was lost during this War. The spread of communism in Eastern Europe in the late 1940s, and to China in 1949, also resulted in further falls in the stock of FDI as these countries progressively nationalized privately-owned firms, both foreign and domestic.

The US emerged strongly after the Second World War, and was the only country in the world that witnessed a sharp rise in outward FDI. The period from the beginning of Marshall Plan aid in 1948 to the end of the 1960s witnessed substantial US engagement in both European and international economic reconstruction. US access to foreign countries was fully aided and abetted by the Marshall Plan operations and subsequently by the liberalization of national and international trade and investment regimes. In addition, certain domestic tax policies of the US government encouraged foreign operations. At the international level, the convertibility of the dollar to gold, and the establishment of new international economic organizations such as the World Bank, the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT), also created enabling environments to facilitate investment by US-based corporations. Between 1945 and the mid-1960s, the US accounted for 85 per cent of all new FDI flows. Thus FDI became the major component of capital flows, with the US being the principal source country, and Europe and Canada being the major destinations.

By 1960, the world stock of FDI had reached $60 billion. The big momentum in foreign investment came in the early 1970s when the US unilaterally decided to abandon the Bretton Woods system of fixed exchange rates (*see* Box 1.3). Subsequently, the removal of capital controls in developed countries, coupled with the advent of a floating exchange rate system, encouraged a huge explosion in international financial markets.

To a large extent, all these developments were supported by major technological advances in shipping, air transport, computerization, and communications, which accelerated the internationalization of investment and trade. All these developments meant that, by the 1970s, oligopolistic consolidation and TNCs' role in global commerce was of a far greater scale than earlier in the century. Whereas in 1906 there were two or three leading firms with assets of US$500 million, in 1971 there were 333 such corporations, one-third of which had assets of US$1 billion or more. Additionally, TNCs had come to control 70-80 per cent of world trade outside the centrally planned economies. The character of FDI had also undergone a dramatic change with investors no longer simply running foreign offices engaged in trade, as in the 19th century, but rather integrating their manufacturing operations globally, with different components of a single product being produced in multiple foreign locations.

By 1980, global FDI flows had increased to over $500 billion with almost two-thirds located in Western Europe and North America. The rise of Japanese outward FDI was an important feature of the late 1980s as a result of the Plaza Agreement of 1985, which stimulated foreign investments by Japanese firms in the US, Europe, and East Asia.

In the post-1980 period, international investments flows rose sharply because of a number of developments, some of which are listed below:

- The debt crisis of 1982;

- Liberalization of investment, finance, and trade regimes in both developed and developing countries;
- Large-scale privatization of public-owned assets;
- The completion of the North American Free Trade Agreement (NAFTA) and the Uruguay Round of GATT negotiations;
- Regional integration in the Asia Pacific region;
- The rise in stock prices;
- Growing competition among corporations to take advantage of new investment opportunities abroad;
- An increase in cross-border mergers and acquisitions (M&As);
- The collapse of communist regimes in Eastern Europe and Soviet Union;
- The entry of China into the global capitalist system in 1979 gave a further big boost to FDI flows, particularly in the manufacturing sector;
- Advancements in the technological field, especially in communications and information, have created new possibilities to manage international business systems in an integrated manner.

Notes and References

1. In academic circles, there is an ongoing debate on what should be the minimum criteria for a firm to be considered a transnational. Several terms such as "Multinational Corporation", "Multinational Enterprise", and "Global Corporation" have been used to describe transnational corporations. Since the 1970s, the United Nations has used the term "transnational corporation" to describe such firms. Although technical definitions of TNCs vary, for the purposes of this publication, the term "transnational corporation" is used.
2. Though FDI is used to quantify transnational investment, there is no consensus on the minimum equity required to control a foreign entity. For instance, in the US, an investment is considered as FDI if 10 per cent of the equity is owned by a foreign company. In Germany and the UK, the proportion is 20 per cent of equity. Similarly, there is no consensus on the measurement of investment flows and stocks of FDI as different countries follow different criteria.
3. Nick Robins, *The Corporation that Changed the World*, Orient Longman, Hyderabad, 2006, p. xi.

2

Recent Trends in International Investment Flows

IN the 1990s, private investment flows (both FDI and portfolio investment) scaled new heights while net official flows (concessional loans and grants by multilateral and bilateral donors) witnessed a downward trend. In particular, FDI has become the most important mechanism to deliver goods and services across the world. The global sales of foreign affiliates were $19 trillion in 2001, far exceeding the world trade of goods at $11 trillion.

Beginning with roughly $200 billion in 1990, global FDI flows reached $700 billion in 1998. In 2000, FDI flows reached a new peak of more than $1.4 trillion. The surge in the 1990s was largely accounted for by increased FDI flows *within* developed countries instead of conventional forms of FDI flows from developed countries to developing ones. In the post-2000 period, however, FDI flows have declined with flows falling to just $655 billion in 2003. This decline was concentrated in developed countries, and Central and Eastern Europe. The main reasons behind the decline were a drop in inflows into the US on account of the repayment of intra-company loans by foreign affiliates to their parent firms, and sluggish economic growth in the EU and Japan. However, FDI flows recovered in 2004 and reached $955 billion in 2005. The significant recovery in the FDI flows was largely the result of increased mergers and acquisitions (M&As) activity in the developed countries. In particular, the internal merger and unification between oil companies Royal Dutch and Shell alone contributed $115 billion in the UK's balance of payments as FDI inflows in 2005. Despite the recovery since 2004, FDI inflows still account for just 2.2 per cent of the world's GDP.

It is important to stress that global FDI inflows are highly concentrated. The bulk of global FDI inflows move largely within the developed world (for instance, 60 per cent in 2004). This situation could be aptly described as investment by a developed country TNC in another developed country. The US and the EU (inclusive of intra-EU inflows) continues to be the major recipients of FDI inflows. The rest of FDI inflows (40 per cent) are accounted by the developing countries. However, the concentration of FDI inflows to the developing countries remains highly skewed, with the top ten countries accounting for more than 60 percent of total inflows. Among the top ten countries are the so-called BRIC countries (Brazil, Russia, India and China).

Over the years, the sectoral composition of FDI has also been transformed. In the early post-war period, FDI was largely concentrated in the primary sector (such as agriculture, fishing, and mining) and resource-based manufacturing. But now services, which used to be just one-quarter

Table 2.1: Foreign Direct Investment Flows

(Period averages, per centage of total, unless otherwise noted)

	Outflows by Area of Origin			**Inflows by Area of Destination**		
	1970	**1980**	**1990**	**1970**	**1980**	**1990**
High-income countries						
United States	45.99	20.98	21.79	11.19	29.90	20.10
Europe	42.33	51.63	44.61	43.79	35.64	38.79
Japan	5.40	13.90	5.41	0.63	0.45	0.57
Oceania	0.91	2.17	1.08	5.97	4.71	2.33
Total	**98.98**	**93.84**	**87.50**	**75.93**	**75.19**	**65.23**
Developing and transition countries						
Latin America	0.32	0.93	2.19	12.66	9.02	11.10
Africa	0.41	1.44	0.50	4.29	2.32	1.75
Asia (excluding Japan)	0.29	3.76	9.34	6.60	13.00	18.66
Oceania	. . .	0.01	0.01	0.45	0.17	0.07
Central/Eastern Europe	0.02	0.01	0.27	0.01	0.26	3.05
Total	**1.03**	**6.16**	**12.50**	**24.08**	**24.81**	**34.77**
World ($ million)	**23,678**	**124,407**	**523,293**	**20,956**	**113,917**	**530,174**

Source: *World Economic Outlook*, IMF, 2005.

of global FDI flows in the 1970s, account for nearly two-thirds of FDI flows. Within the services sector, financial, banking, and trading services continue to dominate, but FDI in services such as telecommunications, power generation, real estate and business services have surged in recent years. The expansion of services in FDI flows is largely due to the rise of the service sector in domestic economies as well as the privatization of public utilities. The expansion of offshoring activities in recent years have opened up new avenues for the production and delivery of services across the borders.

The bulk of global FDI inflows are related to mergers and acquisitions (M&As) activity instead of greenfield investments. It has been estimated that nearly two-thirds of FDI flows are related to M&As, largely among developed countries. Cross-border M&As in the developed world accounted for 74 per cent of the global total deals in 2005.

Cross-border mergers and acquisitions reached $1.1 trillion in 2000, before falling back to $392 billion in 2003. Since 2004, the world is again witnessing resurgence in cross-border M&A activity. Nowadays the intense M&A activity is driven by three main factors: surplus of cash held by private equity funds; lower interest rates; and easy financing by banks. Unlike the previous boom, most M&A deals are spread in diverse industries such as property, mining, media and financial exchanges. According

Table 2.2: Global FDI Inflows
(in $ billion)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
World Total	399.0	493.8	717.7	1,122.2	1,413.0	875.1	733.2	655.8	801.7	954.8
Developed Countries	231.9	281.2	498.4	860.3	1,131.1	586.4	539.6	453.9	485.6	555.6
% of world total	58.1	56.9	69.4	76.7	80.0	67.0	73.6	69.2	60.6	58.2
Developing Countries	167.1	212.6	219.3	261.9	281.9	288.7	193.7	201.9	316.1	399.2
% of world total	41.9	43.1	30.6	23.3	20.0	33.0	26.4	30.8	39.4	41.8

Source: The Economist Intelligence Unit, 2006.

Box 2.1

Cross-Border Mergers and Acquisitions Mania

Since the 1990s, TNCs have been widely using the strategy of mergers and acquisitions (M&As) to consolidate and expand their global reach. Instead of launching 'greenfield' projects that create new opportunities for employment and competition, TNCs prefer the easier route of M&A to consolidate their economic power. In reality, M&A add little to productive capacity but are simply a transfer of ownership and control with no change in the actual asset base. The major negative fallout of M&A activity is the promotion of monopolistic tendencies, which in turn curb competition and widen the scope for price manipulations. M&As have become a tool to circumvent regulatory constraints in entering markets abroad. In situations where M&A deals are not possible because of anti-competition regulations, TNCs often form commercial alliances.

After acquisition, corporations often break up the newly-acquired firms, reduce the workforce, and indulge in various malpractices to curb competition. Therefore, M&As have become one of the quickest means to acquire new markets. These deals generally lead to strategic firms and sectors of the economy (for example, infrastructure and banking) coming under the total control of TNCs. As top managements carry out M&A deals with the supposed objective of raising shareholder value (rather than making strategic gains), it is not surprising that M&A deals have flourished in the bullish global financial markets.

At the global level, cross-border M&As account for the bulk of FDI flows. Due to M&As, the landscape of the global corporate world is not only changing rapidly but is also becoming more and more complex. A look at the list of the top global 500 TNCs over the past few years reveals that several well-known corporations have either disappeared from it or merged into a new entity. As a result, the list keeps changing every year. In 2005, Citigroup, Royal Dutch/Shell Group and UBS secured top positions only because of M&As.

The year 2000 was an important milestone in the history of M&A deals. It

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witnessed record M&A deals both in terms of numbers and value. There were as many as 38,292 M&A deals, totaling nearly $3,500 billion in the year 2000. Interestingly, more than half the M&A deals took place in the US, confirming that M&A mania had gripped corporate America. The bulk of M&A activity at the global level is taking place in the financial and telecommunications sectors.

Since the first half of 2001, however, M&A deals have gone down dramatically. There are several reasons behind this decline. Firstly, there has been an exceptional fall in share prices globally, especially with the bursting of the high-tech speculation bubble. Secondly, the specter of global economic slowdown, particularly in the US, is fast becoming a reality. Lastly, the adverse results and experiences of several previous M&A deals have come to light. On paper, mergers and acquisitions sound attractive, but in the real world, synergies often do not materialize. Since each corporation has a distinct work culture and project management structures, it becomes an uphill task for the board, management, and workers to function cohesively in the aftermath of a M&A deal.

to Zephyr (a data company), the total value of global cross-border M&As reached $827 billion in 2005 and $1.3 trillion in 2006. The reasons behind this sharp rise of cross-border M&A deals are essentially three-fold: cheap credit, accumulation of large amounts of cash in the balance sheets of big corporations, and the growing involvement of private equity funds in such transactions. With billions of dollars under management, the private equity funds (e.g., Kohlberg Kravis Roberts & Company, Carlyle Group, Blackstone, Newbridge, and Waburg Pincus) have become very active in global M&A deals. It has been estimated that private equity transactions alone account for nearly 18 per cent of total M&A activity globally. However, private equity funds are not considered long-term investors, as they usually exit their positions with a time horizon of 5 to 7 years.

Since 2004, the bulk of recent cross-border M&A transactions have taken place in Europe and Asia and particularly in the telecommunications and the financial sector. Interestingly, the share of developing countries in the global cross-border M&As has been increasing over the years. It reached 27 per cent in 2005.

However, most M&A deals have not yielded their desired results. Despite the massive layoff of workers and organizational restructuring, two-thirds of M&As have failed to achieve the intended objectives. Several instances have come to light where corporations suffered huge losses after M&A. The 1998 merger of car manufacturers Daimler Benz (Germany) with Chrysler Corporation (US) is a case in point. *Businessweek*'s report, "The Merger Hangover," found that 61 per cent of mergers between 1995 and 2001 actually destroyed shareholder wealth.[1] This puts a big question mark over the intended objectives of M&A deals.

As far as developing and under-developed countries are concerned, private capital flows replaced commercial bank lending as the primary source of foreign capital in the 1990s. Nevertheless, private capital flows still account for a small percentage of GDP (in the range of 1 to 4 per cent) of developing countries, in spite of a sharp increase in absolute numbers in recent years. Much of the economic growth is essentially driven by domestic investment in these countries.

Geographically, Asia continues to attract the bulk of FDI inflows to the developing world, with $177 billion in 2005. China accounts for the major share of the total inflows (with $79 billion in 2005), followed by the Hong Kong (China), Singapore, and India. The growing presence of China

Table 2.3: Completed Cross-border Merger and Acquisition Deals
($ billion)

Year	Developed Countries	Developing Countries	World	Developed Countries (% of world total)
2002	411.1	76.6	487.7	84.3
2003	284.8	106.8	391.6	72.7
2004	473.3	138.6	611.8	77.4
2005	610.8	216.4	827.2	73.8

Source: The Economist Intelligence Unit, 2006.

in capital flows in the region can be gauged from the fact that it attracts almost 90 per cent of net FDI inflows to the East Asia and Pacific region. Flows to Central and West Asia have only recently expanded largely because of higher oil investment. In the case of Latin America, too, just two countries (Mexico and Brazil) together account for almost half of the capital flows. With the entry of ten more countries as members of the European Union in 2004, there has been a significant increase in FDI inflows to Central and Eastern Europe.

For Africa, access to private capital flows has remained elusive. Portfolio investments are almost negligible in the continent, except in South Africa. FDI, a mere 3 per cent of global inflows, is highly concentrated in the oil, gas, and mining sectors of natural resource-rich countries such as Algeria, Angola, Libya, Mauritania, Nigeria, and South Africa. The dependence of investment in such extractive industries grossly undermines the stated benefits of FDI flows as there is hardly any transfer of technology, knowledge, and skills. However, FDI inflows to Sub-Saharan Africa reached $18 billion in 2005, almost 50 per cent higher than in 2004. This was largely due to large M&A transactions (particularly in the banking sector) in South Africa. Concern about energy security and higher prices for many commodities are also stimulating new investments in extractive industries in resource-rich countries.

Portfolio investment (PI), which was negligible during the 1970s and 1980s, became sizeable in the early 1990s. From $3 billion in 1990, PI flows increased to $49 billion by 1996. After a sharp decline in the wake of the 1997 Southeast Asian financial crisis, net portfolio investment flows have registered an increase since 2001. The bulk of the net increase was to the Asia and Pacific region, with China and India being the main attraction. Like FDI flows, portfolio flows are also highly concentrated in just a few countries – China, India, and South Africa together accounted for 82 per cent of all portfolio investment flows to developing countries in 2004. A number of factors, including low interest rates in the developed world and the liberalization of financial markets in the developing world, have facilitated the global integration of financial markets. However, the higher volatility associated with portfolio investments indicates that reliance on such financing could be very expensive.

Conventional theory suggests that if there are no restrictions on capital mobility, it *should* flow from the capital-rich countries (e.g., US) to relatively capital-poor countries (e.g., China) where the supply of capital is scarce, labor is abundant, and therefore returns are higher. Experience, however, tells us that capital flows in the real world often do not fit theory. In recent years, there has been a net transfer of financial resources from developing countries to the developed world (*see* Box 2.2). In the case of Latin America, negative net transfers have been the rule rather than the exception.

The world is also witnessing a lending boom, but nowadays much of the lending is to corporations rather than to countries. Instead of raising capital through equity or bond markets, corporations are increasingly raising capital through privately issued loan instruments. As a result, the syndicated loan market has grown much faster than bond and equity markets in recent years. The issuance of syndicated loans reached $3.5 trillion in 2005. It is private lenders such as hedge funds and unregulated offshore financial institutions that are carrying out large amounts of lending to leveraged buy-out firms and other private firms.

Another recent development is the mushrooming of private equity funds. According to Thomson Financial (a data firm), the number of acquisition deals involving private equity funds reached 2,677 (worth $326 billion) in 2005, up from about 1200 deals (worth $108 billion) in 2002. Seeking quick profits, investments by private equity firms are usually short-term. After taking over companies, equity firms reduce the costs within a short span by firing workers and restructuring the debt. Then the restructured company is sold to new buyers or other equity funds. It has been estimated that private equity funds have acquired more than 5000 companies in Germany alone since the late 1990s.

Due to the substantial use of complex financial instruments (such as credit derivatives, *see* Box 3.2) as well as the poor regulation of hedge

Box 2.2

The Developing World as Exporter of Capital

According to the textbooks, capital should flow *from* the developed countries with abundant capital (such as the United States) *to* the poor and developing countries where capital is scarce (for example, China). But the world is witnessing exactly the opposite. Since 2000, the developing world has now become an exporter of capital to the developed world. For developed countries as a whole, global capital imports exceeded US$300 billion in 2004.

The US remains the most important FDI recipient among developed countries. The US imported approximately $650 billion in 2004, almost half of which came from developing countries. What is worrying is the fact that US capital imports failed to decline as much as expected during the 2001-02 recession. This suggests that the US economy has become structurally attuned to receive the bulk of the world's savings.

Most capital exporters from developing countries to the US are located in East Asia and the Middle East. These countries continue to export capital to developed countries (mostly the US) in the form of rapidly growing accumulations of foreign reserves. Unlike previous decades, current account balances in many developing countries have turned into surpluses in recent years. As a result, these countries are accumulating huge foreign exchange reserves. Developing countries hold as much as 70 per cent of global foreign-exchange reserves, largely in US dollars. Foreign reserves held by developing countries grew by $378 billion in 2004. China maintains the largest foreign exchange reserve in the world, exceeding $980 billion in September 2006.

Instead of using these reserves to finance productive investment in their domestic economy, China, India and a host of other developing countries are financing a large share of the US current account deficit, which swelled from $531 billion in 2003 to $805 billion in 2005. Holdings of US long-term securities by residents (both official and private) of Asian countries (excluding Japan) were estimated to Even though the US is the richest country in the world, it is the most indebted country with an external debt of $2.1

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trillion. The US is now a net debtor as its external liabilities exceed its external assets. By borrowing more than $2 billion a day from the rest of the world, the US economy has become the most parasitical in the world. Instead of correcting its imbalances, the US has been blaming China for its currency undervaluation and Europe for its slow economic growth.

So far, the US economy has not faced a serious crisis because almost all of its debt is in US dollars. However, if its external borrowing continues unabated, the US dollar will look increasingly vulnerable, and any reduction in foreign investment may trigger a substantial devaluation that, in turn, may lead to a sudden exodus of capital from the country.

funds and other credit investors, such private lending poses a serious risk to the global financial system. Therefore, the growing role of private equity firms, hedge funds, and offshore financial institutions in corporate financing requires closer scrutiny by policy makers.

The Resurgence of Petrodollars

Since 2004, the world is again witnessing a boom in petrodollars due to a sharp rise in oil prices. It has been estimated that the net oil revenues of major oil exporting countries reached $676 billion in 2005, and are forecast at almost $750 billion for 2006. In the previous boom in the 1970s, oil exporting countries deposited their surplus petrodollars with US and European banks, which, in turn, lent to Third World countries, thereby sowing the seeds of the debt crisis. But nowadays a significant proportion of oil revenues have been invested directly into the global financial markets through private equity, hedge funds, and offshore financial institutions rather than through international banks.

Several oil-exporting countries have created state-owned oil stabilization and investment funds, which are directly investing in financial markets. These investment funds, profiting from record oil prices, are looking for assets abroad to expand their sources of income. Dubai International Capital (DIC), a subsidiary of Dubai Holding, is a case in point. Established in 2004, DIC is an international investment company that primarily focuses on private equity investments. DIC invested $1 billion in Standard Chartered Bank in a series of large investments in 2006, including a $1 billion investment in DaimlerChrysler, the $1.2 billion acquisition of The Tussauds Group (a theme park firm), and the $1.2 billion buyout of Travelodge (a budget hotel chain). Similarly, the Bahrain-based Arcapita Bank acquired utility Viridian Group for $3 billion in 2006. The state-owned Abu Dhabi Investment Authority invests all of Abu Dhabi government's oil revenues and assets in global financial markets. With estimated assets in the range of $200-$500 billion, the Authority is considered to be among the top five institutional investors in the world.

Since many of these funds are not part of the official reserves of their countries, it is hard to track their actual investment patterns. Despite the lack of hard data, many economists assume that a significant portion of petrodollars is also being invested in the US economy through the purchase of US government bonds and securities.

Transnationals from the South: The New Kids on the Block

The mid-1990s witnessed the dramatic emergence of transnational corporations from the developing world. Although much of the investment by these corporations is concentrated in other developing countries (South-South), they are increasingly investing heavily in developed countries (South-North) as well. The South-South and South-North FDI flows are growing much faster than the traditional North-South FDI flows. However, 87 per cent of the total outward FDI flows in 2004 originated from just 10 developing countries.

In terms of foreign assets, the majority of top 50 Southern TNCs are headquartered in Asia (32), followed by Latin America (11) and Africa (7, all of them in South Africa). What is interesting to note is that the increase in FDI outflows is concentrated in many of the same countries that receive the bulk of FDI inflows to developing countries such as China, Brazil, India, South Africa, and Mexico. Outward FDI from China increased from a meager $400 million in 1980 to $38 billion by the end of 2004. China is also the second largest investor in Africa, after the US. In the case of India, there were 136 outward investment deals valued at $4.3 billion in 2005. The value of outward foreign investment by Indian firms almost nears the level of inward foreign investment. With the lifting of international sanctions and the relaxation of capital controls, South African TNCs such as the Anglo American Corporation, De Beers, and SABMiller have become dominant players in the African region. In the words of Graham Mackay, CEO of SABMiller, "If there was any more of Africa, we would be investing

Table 2.4: Recent Merger and Acquisition (M&A) deals by Southern Transnationals (2004-2006)

Year	Acquiring Company (Country)	Acquired Company (Country)	Sector of the Acquired Company	Value ($ billion)
		SOUTH-NORTH INVESTMENT DEALS		
2006	Tata Tea (India)	Energy Brand Inc. (US)	Beverages	$0.7
2006	Suzlon Energy (India)	Hansen Transmissions (Belgium)	Gear Box	$0.5
2006	Dr. Reddy's Lab (India)	Betapharm (Germany)	Pharmaceutical	$0.5
2005	Cemex (Mexico)	RMC (UK)	Cement Industry	$4.1
2004	AmBev (Brazil)	John Labatt (Canada)	Malt Beverages	$7.8
2004	Gold Fields (South Africa)	Noriment Ltd (UK)	Metal Services	$1.3
2004	Tata Motors Ltd (India)	Daewoo Vehicle (South Korea)	Motor Vehicles	$0.1
		SOUTH-SOUTH INVESTMENT DEALS		
2006	ONGC (India)	Brazil Oilfields (Brazil)	Oil	$1.4
2005	America Movil (Mexico)	TIM Peru (Peru)	Telecom	$0.5
2005	Tata Steel (India)	Millennium Steel (Thailand)	Steel	$0.4
2004	Telefonos de Mexico (Mexico)	Columbia Telecomunicaciones	Telecom	$0.4
2004	Anglogold Ltd (South Africa)	Ashanti Goldfields (Ghana)	Gold Ores	$1.5
2004	Sinergy (Brazil)	Avianca (Columbia)	Air Transportation	$0.4
2004	YTL Power (Malaysia)	Jawa Power (Indonesia)	Electric Services	$0.2

Source: Compiled by the author from various newspaper reports and documents.

in it. The return on investments here (Africa) has been fantastic."[2]

The motivations behind cross-border investments by Southern TNCs are not different from others. To a large extent, competition pressures arising from globalization processes (such as liberalization of imports and inward FDI) drive Southern corporations to invest abroad. Like their Northern counterparts, the Southern TNCs are investing abroad to gain access to natural resources, markets, skills, and technology. In some recent cases, acquiring brand names (such as the acquisition of IBM's personal computer division by China's Lenovo) seems to be the prime motive.

To a large extent, the expansion of South-South and South-North investment flows reflects the increasing integration of developing countries into the world economy. A number of important factors including regional integration through trade and investment agreements, trade and financial liberalization, increasing wealth as well as limited market size and resource base at home have encouraged Southern TNCs to invest abroad.

Instead of investing in greenfield projects, however, Southern transnationals are increasingly undertaking investments through acquisitions. Recently announced buyout deals (such as Beijing-based Lenovo's purchase of IBM's PC business and the acquisition by Mexican company Cemex of the UK's RMC) suggest that Southern TNCs are more actively engaged in M&A deals (*see* Table 2.2). The bulk of India's outward FDI is in the form of mergers and acquisitions, mainly in telecommunications, energy and pharmaceuticals. Even though most of the buyouts by Southern TNCs may still be under the billion dollar range, they portray an increasing outward orientation of big business in the developing world.

According to Joseph Battat and Dilek Aykut of the World Bank, South-South FDI increased from $15 billion in 1995 to $46 billion in 2003, accounting for some 35 per cent of total FDI flows in developing countries.[3] Despite their small size, South-South FDI flows are significant to many poor countries such as Lesotho, Mongolia, and Nepal. As far as South-

North FDI flows are concerned, OECD countries received $16 billion of FDI in 2001, up from a mere $1 billion in 1995.

The bulk of South-South FDI flows are regional. For instance, nearly two-thirds of FDI into China originates in Hong Kong, Singapore, and Taiwan. Similarly, transnational corporations from Chile, Brazil, and Argentina operate largely in the Latin American region. Russian investments abroad have primarily been in the countries of the former Soviet Union while South African investments are almost completely located in Southern Africa.

In addition, the majority of South-South FDI flows are concentrated in the infrastructure and extractive sectors such as oil and gas. It is mainly state-owned corporations that dominate investments in these sectors. State-owned oil companies from China and India are rapidly acquiring oil and gas fields in Sub-Saharan Africa, Central Asia, and Latin America. For instance, almost half of China's outward FDI went to acquire natural resource projects in Latin America in 2004. Similarly, India's state-owned firm, Oil and Natural Gas Corporation, invested heavily in oil and gas fields in the Russian Federation and Angola.

Given that state-owned corporations are a significant source of South-South FDI flows (particularly in extractive industries and infrastructure), such investments may be driven not only by economic but also by political, strategic and diplomatic factors. The billions of dollars worth of investment by China in Africa is a case in point. The Chinese companies are involved in the building of oil refineries, dams, roads, and big infrastructure projects in several African countries including Sudan, Liberia, Angola, Chad, and Central African Republic. However, China's investments in Africa are not purely driven by economic factors. To some extent, such big investments also help China in earning international goodwill and securing political support for its own agenda, particularly to isolate Taiwan diplomatically (out of total 26 countries that have full diplomatic relations with Taiwan, seven belong to Africa).

It is interesting to note that outward investments by Southern TNCs are also supported by their respective governments through removal of capital controls, fiscal incentives, and investment protection measures. China, Malaysia, Thailand, and Singapore have created special mechanisms to provide preferential treatment and insurance against risks through credit guarantees schemes. For instance, the Chinese government adopted a policy ("Go Global") in 2000 to encourage its firms to invest abroad. China's Export-Import Bank provides loans to firms for outward investments in resource development and infrastructure. If the investment is undertaken in an aid-recipient country, Chinese firms also receive preferential loans. Fiscal incentives are also provided to firms which bring machinery, plant, and equipment to their overseas ventures.

Some regional arrangements, such as the Southern African Development Community (SADC) and the Association of Southeast Asian Nations (ASEAN), also provide various incentives (including lower tax and tariff rates) for outward investment within the regions. Apart from fiscal and financial support, bilateral investment treaties and double taxation treaties between developing countries are growing.

To secure access to strategic assets, some Southern TNCs have also invested in developed countries such as Australia and Canada. In addition to the extractive and infrastructure sectors, there are also a few cases of large-scale South-North investments involving M&As. In particular, Chinese corporations have been active in acquiring several well-known consumer brand names, such as Thompson, RCA, and IBM.

Interestingly, tax havens are favorite destinations for many Southern TNCs as they are for Northern TNCs. The Cayman Islands, Bermuda, and Cyprus are the main destinations for Brazilian, Indian, and Russian outward FDI. Hong Kong plays an important role for the overseas expansion of Chinese corporations.

However, it needs to be emphasized here that some South-North investment deals have been subjected to intense political backlash in

Northern countries. As discussed in detail in Chapter 4, recent cross-border investment bids by Southern TNCs (for instance, the proposal by a Chinese company, China National Offshore Oil Corporation (CNOOC) to take over US oil company, Unocal) reflect growing unease among policy makers in the North.

Given the fact that most developing countries are usually capital importers, the rise of Southern TNCs poses new policy dilemmas. The policy makers in the developing world are increasingly finding it difficult to strike a balance between the country's interest as a host country and its newly-found interests as a home country.

How should the new and growing phenomenon of outward FDI from the South be assessed? Are South-South FDI flows favorable to the host economy? Are the strategies and behaviors of Southern TNCs different from their Northern counterparts? Do Southern TNCs maintain better transparency, environmental, and labor standards than their Northern counterparts? What are the developmental impacts of investments by Southern TNCs? Who benefits from South-South investments? Who loses? Should South-South investment be promoted as an alternative to North-South investment flows? Unfortunately, the answers to such pertinent questions are hampered by the lack of in-depth studies and reliable data on South-South and South-North FDI flows. Despite such information gaps, one thing is certain: this new and growing phenomenon is going to play an important role in the global economy in the coming years.

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3

Are International Investment Flows Beneficial?

NEOLIBERAL approaches advocating unbridled liberalization of investment flows take it for granted that the free flow of investment across borders offers immense benefits to countries in terms of the transfer of technology, creation of jobs, quality products and services, along with managerial efficiency. These perceived benefits may hold true for some investments, but it would be a serious mistake to make broad generalizations because hosting investment flows is not without its potential costs. There is no denying that the trans-border movement of capital offers new opportunities to the owners and managers of capital to penetrate and expand their operations on a global scale. Nevertheless, it has important implications for governments and domestic firms as well as for workers, consumers, and communities in the host countries. Unfortunately, neoliberal approaches do not give adequate attention to these economic, social, and environmental costs and thus fail to establish the links between foreign investment and poverty reduction and development.

Given that investment flows have been one of the foremost economic, political, and social influences in the present world economy, the debate should move beyond the rhetoric that all investment flows are good or all investment flows are bad. Rather, the debate on investment flows should be situated in the wider context of global political economy, and therefore, should be centered on the moot questions: Who benefits? Who loses? What strategies are needed to ensure that FDI flows contribute to the fulfillment of wider developmental objectives, many of which are country specific?

These questions become even more relevant in the present context when attracting foreign direct investment flows is seen by policy makers as an important instrument to achieve higher economic growth and to reduce poverty. It is assumed that global investment flows will ensure large-scale employment opportunities, transfer of R&D, entrepreneurial skills, and new export opportunities. Particularly in the aftermath of the Southeast Asian financial crisis, the new global policy framework is cautious on inviting short-term portfolio investment flows but calls for a liberalized regime of FDI flows. This new emphasis in the global policy framework has not been adequately addressed by the critics of FDI flows.

Investment Inflows or Outflows?

The term 'foreign direct investment' usually symbolizes investment by a foreign entity in a domestic company, but recent empirical evidence suggests that foreign capital does not always flow into the host country. The foreign company can finance the equity buyout of a domestic company through domestic banks and lenders. For instance, when the Japanese-owned tire company Bridgestone took control of the US-based Firestone in 1988, the equity purchase was largely financed by US domestic lenders. In such instances, there is no investment expenditure but only an international transfer of control of corporate assets. Take another example: Enron's Dabhol power plant in the Indian state of Maharashtra. The bulk of debt funds for this power plant were provided by Indian banks and financial institutions. Both these examples highlight a growing trend of transnational corporations to raise equity and debt funds through domestic banks and financial institutions in the host countries.

In this context, it is important to debunk another myth that FDI should be encouraged because it is a non-debt creating capital. It is true that FDI does not involve the direct repayment of debt and interest, but at the same time, it does involve substantial foreign exchange costs. Capital can move out of a country through remittance of profits, dividends, royalty payments, and technical fees. In the case of Brazil, foreign exchange outflows in the form of profits, royalty payments, and technical fees rose steeply from $37 million in 1993 to $7 billion in 1998.

Due to rapid financial liberalization, the trend of significant foreign exchange outflows with a resulting negative impact on a country's balance of payments has gained additional momentum. This trend is most evident in several African economies such as Botswana, Democratic Republic of Congo, Gabon, Mali, and Nigeria where profit remittances alone are higher than FDI inflows during 1995-2003 (*see* Table 3.1).

If FDI is not related to exports, it can have serious implications for developing countries which are usually short of foreign exchange reserves. In India, a recent study by the central bank, the Reserve Bank of India, found that over 300 TNCs were net negative foreign exchange earners. In other words, these TNCs were spending more foreign exchange than they were earning. Moreover, nearly three-quarters of these outflows were related to the import of raw materials and technology.

Most services are not tradable, meaning that they need to be produced and consumed domestically. Given that the share of services in total FDI

Table 3.1: FDI Inflows and Profit Remittances in Selected African Countries, 1995-2003

Country	FDI Inflows ($ million)	Profit Remittances ($ million)
Angola	10,761	7,169
Bostwana	943	5,621
Cameroon	577	421
Congo, Dem. Rep. of	1,623	2,773
Côte d'Ivoire	2,500	2,366
Gabon	-822	3,432
Guinea	244	332
Kenya	411	361
Mali	807	817
Nigeria	10,784	12,387
Senegal	712	541
Sudan	3,868	1,164
Tunisia	4,287	3,516
Zambia	1,158	362
Zimbabwe	910	837

Source: UNCTAD, *Economic Development in Africa: Rethinking the Role of Foreign Direct Investment*, New York, 2005.

inflows has increased in recent years, foreign investments in the telecom, energy, construction, retailing, financial services, and other non-tradable sectors would involve substantial foreign exchange outflows over time in the form of imports of inputs, technology, royalty payments, and repatriation of profits. Thus, any cost-benefit analysis of foreign investment in the service sector should include such capital outflows based on an initial investment.

In addition, capital can also move out of the country via illegal means such as transfer pricing and creative accounting practices. It is an established fact that transnational corporations indulge in manipulative transfer pricing to avoid tax liabilities (*see* Box 3.1). Only recently, tax authorities, particularly in the developing world, have taken cognizance of widespread abuse of transfer pricing methods by TNCs. In the US, which has developed elaborate regulatory procedures to curb this activity, it has been estimated that annual losses in tax revenue are in the order of $30 billion on account of transfer pricing alone.

Thanks to creative accounting practices, firms can undervalue their levels of profits in order to reduce their tax burdens in host countries. For instance, oil giant Exxon never paid any taxes in Chile as it had never declared any profits during its 20 years of operating in the country. Even in developed countries, the recent spate of corporate scandals (from Enron to Worldcom to Parmalat) has brought to public notice pervasive corrupt TNC practices carried out in collusion with accountants, investment bankers, and regulators. In the real world where markets are imperfect and oligopolistic tendencies are significant, the predatory business practices of TNCs and their adverse consequences on domestic businesses, particularly infant industries, need no elaboration here.

Is Investment Liberalization a Panacea?

Another common notion, that international investment liberalization is vital for higher economic growth, requires closer scrutiny. There is little evidence linking investment liberalization to growth. Liberalization of investment by itself cannot enhance growth prospects because it is a complex

Box 3.1

The Abuse of Transfer Pricing

Transfer pricing is the price charged by one associate of a corporation to another associate of the same corporation. When one subsidiary of a corporation in one country sells goods, services or know-how to another subsidiary in another country, the price charged for these goods or services is called the transfer price. All kinds of transactions within the corporations are subject to transfer pricing including raw material, finished products, and payments such as management fees, intellectual property royalties, loans, interest on loans, payments for technical assistance and know-how, and other transactions.

Transfer pricing, one of the most controversial and complex issues, requires closer scrutiny not only by the critics of TNCs but also by the tax authorities in the poor and the developing world. Transfer pricing is a strategy frequently used by TNCs to book huge profits through illegal means. The transfer price could be purely arbitrary or fictitious, therefore different from the price that unrelated firms would have had to pay. By manipulating a few entries in the account books, TNCs are able to reap obscene profits with no actual change in the physical capital. For instance, a Korean firm manufactures a MP3 player for $100, but its US subsidiary buys it for $199, and then sells it for $200. By doing this, the firm's bottom line does not change but the taxable profit in the US is drastically reduced. At a 30 per cent tax rate, the firm's tax liability in the US would be just 30 cents instead of $30.

TNCs derive several benefits from transfer pricing. Since each country has different tax rates, they can increase their profits with the help of transfer pricing. By lowering prices in countries where tax rates are high and raising them in countries with a lower tax rate, TNCs can reduce their overall tax burden, thereby boosting their overall profits. That is why one often finds that corporations located in high tax countries hardly pay any corporate taxes.

A study conducted by Simon J. Pak of Pennsylvania State University and

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John S. Zdanowicz of Florida State University found that US corporations used manipulative pricing schemes to avoid over $53 billion in taxes in 2001.[1] Based on US import and export data, the authors found several examples of abnormally priced transactions such as toothbrushes imported from the UK into the US for a price of $5,655 each, flash lights imported from Japan for $5,000 each, cotton dishtowels imported from Pakistan for $153 each, briefs and panties imported from Hungary for $739 a dozen, car seats exported to Belgium for $1.66 each, and missile and rocket launchers exported to Israel for just $52 each.

With the removal of restrictions on capital flows, manipulative transfer pricing has increased manifold. According to UNCTAD's *World Investment Report 1996*, one-third of world trade is basically intra-firm trade. Because of mergers and acquisitions, intra-firm trade, both in numbers and value terms, has increased considerably in recent years. Given that there are over 77,000 parent TNCs with over 770,000 foreign affiliates, the number of transactions taking place within these entities is unimaginable. Hence, it makes the task of tax authorities extremely difficult to monitor and control each and every transaction taking place within a particular TNC. The rapid expansion of Internet-based trading (E-commerce) has further complicated the task of national tax authorities.

Not only do TNCs reap higher profits by manipulating transfer pricing: there is also a substantial loss of tax revenue to countries, particularly developing ones, that rely more on corporate income tax to finance their development programs. Besides, governments are under pressure to lower taxes as a means of attracting investment or retaining a corporation's operation in their country. This leads to a heavier tax burden on ordinary citizens for financing social and developmental programs. Although several instances of fictitious transfer pricing have come to public notice in recent years, there are no reliable estimates of the loss of tax revenue globally. The Indian tax authorities are expecting to garner an additional US$111 million each year from TNCs with the help of new regulations on transfer pricing introduced in 2001.

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In addition, fictitious transfer pricing creates a substantial loss of foreign exchange and engenders economic distortions through fictitious entries of profits and losses. In countries where there are government regulations preventing companies from setting product retail prices above a certain percentage of prices of imported goods or the cost of production, TNCs can inflate import costs from their subsidiaries and then charge higher retail prices. Additionally, TNCs can use overpriced imports or underpriced exports to circumvent governmental ceilings on profit repatriation, thereby causing a drain of foreign exchange. For instance, if a parent TNC has a profitable subsidiary in a country where the parent does not wish to reinvest the profits, it can remit them by overpricing imports into that country. During the 1970s, investigations revealed that average overpricing by parent firms on imports by their Latin American subsidiaries in the pharmaceutical industry was as high as 155 per cent, while imports of dyestuff raw materials by TNC affiliates in India were overpriced in the range of 124 to 147 per cent.[2]

Given the magnitude of manipulative transfer pricing, the Organization for Economic Co-operation and Development (OECD) has issued detailed guidelines. Transfer pricing regulations are extremely stringent in developed countries such as the US, the UK, and Australia. In the US, for instance, regulations related to transfer pricing cover almost 300 pages, which dents the myth that the US espouses 'free market' policies.

However, developing countries are lagging behind in enacting regulations to check the abuse of transfer pricing. India framed regulations related to transfer pricing as late as 2001. However, in Bangladesh, Pakistan, and Nepal, tax authorities have yet to enact regulations curbing the abuse of transfer pricing mechanisms. But curbing transfer pricing is not an easy task as it requires international coordination to build standardized invoicing and customs procedures besides harmonizing tax and arbitration systems.

process, subject to a wide range of factors including capital accumulation and economic diversification. If one tries to match the periods of investment liberalization with the economic performance of countries, the results may appear contradictory. Growth started deteriorating around the

1970s when many countries moved towards liberalized investment regimes. The 1980s and the 1990s witnessed a sharp deterioration in the economic performance of many developed and developing countries. The worst decade for growth performance occurred in the 1990s. Restrictions on investments have not necessarily led to poor economic performance. Many countries enjoyed high growth without liberalizing their investment regimes, Japan, Taiwan, and South Korea being prime examples. These countries used a combination of policy measures (such as reverse engineering, technology screening, performance criteria, domestic content agreements, and exchange controls) to link FDI policy to their wider national development strategy.

To a large extent, the quality of investment determines growth and productivity rates. As mentioned in the previous chapter, the composition of private capital flows has undergone a rapid transformation in the last two decades. Although FDI has remained constant, short-term portfolio investment (which was negligible in the 1970s and 1980s) has become sizeable since the 1990s. Portfolio investments now surpass loans as the most important source of cross-border finance. Since most portfolio investments have only tenuous links with the real economy and are speculative in nature, their contribution to economic growth is highly questionable. Besides, the bulk of portfolio investment and other speculative funds are highly volatile and therefore are prone to reversals. A sudden withdrawal of capital can negatively impact on exchange and interest rates. Volatile capital inflows can substantially complicate economic management and threaten macroeconomic stability. The boom-bust cycles of portfolio investment flows not only induce macroeconomic instability but also reduce the policy space to adopt counter-cyclical macroeconomic policies. Several episodes of financial crisis in Mexico, Southeast Asia, and Turkey in the 1990s not only point to the severe economic and social costs, but also to the preeminent role of unregulated short-term portfolio flows in precipitating a financial crisis.

In the last two decades, the attributes of FDI flows, known for their supposed stability and spillover benefits, have also changed profoundly.

The stability of FDI flows has been questioned in the light of evidence suggesting that as a financial crisis or devaluation becomes imminent, transnational corporations indulge in hedging activities to cover their exchange rate risk, which in turn generates additional pressure on exchange rates. In the present context of rapid financial liberalization, the use of derivative instruments by TNCs for hedging and speculative purposes has become common. The increasing use of financial derivatives by corporations also adds to volatility.

Not all components of FDI flows are stable. It has been found that two components of FDI flows, namely, non-repatriated earnings and inter-firm loans, have a tendency to be highly volatile and pro-cyclical as TNCs reduce their exposure in deteriorating economic conditions in the host countries, thereby further exacerbating the financial crisis. In the aftermath of the Southeast Asian financial crisis of 1997, there was a significant increase in repatriation of earnings by TNCs. Similarly, TNCs can reduce or recall loans to foreign subsidiaries in anticipation of devaluation, as witnessed during the Brazilian financial crisis of 1998.

Does FDI Trigger Economic Growth?

Foreign direct investment is not an automatic route to economic growth. There is hardly any reliable cross-country empirical evidence to support the claim that FDI *per se* accelerates economic growth. On the contrary, there is growing evidence suggesting that FDI does *not* play a catalytic role in the growth process. Instead of creating economic growth, FDI responds to a 'success story' of economic growth. In the present circumstances, it is quite difficult to establish direct linkages between FDI and economic growth if other factors such as competition policy, performance requirements, labor skills, ownership ceilings, employment requirements, and comprehensive regulatory frameworks are not taken into account as well. Therefore, any assessment of the positive impact of FDI flows should be based on each project and its links with wider development objectives, such as income growth and distribution; employment expansion; the absorption of new skills and technology; and balance of payments stability.

What is good for a particular TNC may not be good for the host country. If the foreign company is not creating new assets, but merely acquiring existing, locally owned ones, then the net benefits of such investments are almost negligible to the host country. Corporate objectives do not always match those of governments. In contrast to transnational capital with its single-minded pursuit of profit maximization, governments undertake diverse social, economic, and political tasks to meet the needs of their citizens.

The positive impact of FDI also depends on several other factors, including the sector in which the investment is taking place. For instance, if the bulk of FDI flows are directed towards exploitation of natural resources in the host countries (as is the case in African and Latin American countries), then the benefits in terms of transfer of technology, knowledge, and skills would be negligible. Therefore, steps must be taken to ensure that the FDI in extractive industries contributes to poverty alleviation.

Since the bulk of FDI flows are associated with cross-border mergers and acquisitions, their positive impact on the domestic economy through technological transfers and other spillover effects has been significantly diluted. The prospects of technological transfers to host countries are slim on two counts. First, TNCs employ the technology that best suits their strategic needs, rather than the development needs of host countries. Second, much of the research and development by TNCs is carried out in their home countries rather than in host countries.

The other potential developmental gains from attracting FDI flows are dependent on a host of implicit assumptions. For instance, it is often assumed that the entry of foreign firms is going to solve the problem of unemployment in the host countries. But recent evidence and future prospects are not very optimistic on this aspect for three reasons. Firstly, TNCs usually employ highly capital-intensive processes that do not create large-scale employment opportunities. Although TNCs are believed to pay higher wages, their bias towards highly-skilled labor is well-known. Secondly, in the manufacturing and service sectors, TNCs and their affiliates

Box 3.2

The Complex World of Derivatives

A derivative product is a contract, the value of which depends on (that is, 'derived' from) the price of some underlying asset (for example, a commodity, an interest level, or a stock market index). Financial derivatives are financial contracts whose value is based upon the value of other underlying financial assets such as stocks, bonds, mortgages or foreign exchange. They are contractual agreements for the future exchange of assets whose present values are equal. However, the value of the derivatives will change over the term of the contract as market valuation changes the value of each side of the contract. The key element in these derivatives is that one can buy and sell all the risk that the underlying value of an underlying asset will change without trading the asset itself.

Financial derivatives have become an important factor in the growth of cross-border capital flows. In fact, the growth in derivative markets has been more dramatic than that in equity and bond markets. Trading of derivatives in raw minerals and goods dates back to the 19th century, while financial derivatives started in 1972 with currency trading.

There are three forms of derivatives: options, futures and swaps.

Options are the rights (without obligation) to buy or sell a specific item – such as stocks or currency – for a preset price during a specified period of time. The option can be freely exercised or disregarded, with no obligation to transact. Where the right is to buy, the contract is termed a **Call Option**; where the right is to sell, it is termed a **Put Option**. The holder of the option is able to take advantage of a favorable movement in prices, losing only the premium payable for the option should prices move adversely. Trade in option contracts has long been practiced between banks but it really developed after options began to be traded on the Philadelphia Stock Exchange in 1982. Currency options were introduced on the London International Financial Futures Exchange (LIFFE) and the London Stock Exchange in 1985. Options on three-month sterling futures were introduced on LIFFE in November 1987; trade in Japanese government bond futures began in July 1987. The chief centers for trade in options are the

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Chicago Board Options Exchange, the American Stock Exchange, the European Options Exchange in Amsterdam, and markets in Australia, France, Sweden, and Switzerland.

Futures are contracts that commit both parties to a transaction in a financial instrument on a future date at a fixed price. Unlike an option, a futures contract involves a definite purchase or sale, not simply an option to buy or sell. Often futures are used to speculate in the financial markets and are therefore considered risky. A forward contract differs from a futures contract in the sense that each forward contract is a once-only deal between two parties, while futures contracts are in standard amounts traded on exchanges. Unlike forward contracts, futures are traded face to face at exchanges and are regulated by the authorities.

Swaps are agreements in which two counterparties undertake to exchange payments within a specified time period. For example, a Japanese company may find it easy to raise a Yen loan when they really want to borrow Singapore Dollars; a Singaporean company may have exactly the opposite problem. A swap will enable them to exchange the currency they possess for the currency they need. Recent years have witnessed an explosive growth in currency swaps and interest rate swaps. The first currency swap was between the World Bank and IBM in 1981.

Trading in financial derivatives is also distanceless and borderless. Financial derivatives are either transacted over-the-counter (OTC) or traded at exchanges. There are specialist exchanges (for example, London International Financial Futures Exchange) in which financial derivatives are traded. However, in recent years, the value of OTC instruments has increased sharply compared to exchange-traded instruments. While exchange-traded instruments are strictly regulated, OTC contracts are informal agreements between two parties and therefore carry more risk. The main users of financial derivatives are banks, forex dealers, corporate treasurers, institutional investors, and hedge funds.

While derivatives are supposed to help reduce risk, they have become one of the biggest sources of volatility and instability in global financial markets.

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Derivatives pose additional risks because many of the contracts are highly speculative, thereby increasing the chances of heavy losses if a bet goes sour. Speculators play an important role in the trading of financial derivatives. They keep buying and selling contracts, depending on their perceptions of the movements of financial markets. Rumors also play an important role in their decision making.

The risks posed by derivative markets are twofold: firm-specific risks and systemic risks. Since derivatives are highly leveraged, a small change in interest rates, exchange rates or equity prices can cause huge financial losses to a firm. Depending on the extent of its integration with the larger financial system, firm-specific risk can easily spread to the entire system. Systemic risk refers to the vulnerability of the financial system to shocks. The rapid growth of derivative markets has increased the threat of systemic failure. Since many derivatives involve cross border trading, systemic failure can spread on a global scale. By the time the firm or regulatory authorities are able to react and take appropriate steps, the damage may already have been done as the speed at which market shocks are transmitted globally has increased many times in recent years due to technological innovations.

Some important disasters associated with derivatives include the bankruptcy of UK's Barings Bank in 1995 and the near collapse of two large US-based hedge funds, Long Term Capital Management in 1998 and Amaranth in 2006.

employ a variety of subcontractors and suppliers, which further limits the opportunities of direct employment. Thirdly, instead of creating jobs, M&A activity has contributed to massive job losses, particularly in the developed world where this activity is largely concentrated.

It is well-established that extractive industries involve huge long-term environmental and social costs, which are not taken into account as part of investment decisions. The bulk of large-scale mining, for instance, is undertaken by TNCs and their affiliates, which have failed to mitigate the environmental and social problems they cause, such as forest loss and the eviction of people from their land. Some of these impacts can be very long-lasting, thereby creating long-term liabilities to host countries. As backward (input-oriented) and forward (output-oriented) linkages of mining projects are weak, the much-touted benefits of attracting FDI in the mining industry are highly debatable. Although there are many reasons behind the relocation of industries, several recently reported instances suggest that foreign investors are relocating their polluting industries from developed countries to countries with lower environmental standards. A study conducted by the author found that several German investors were influenced by this factor in relocating their dye industry to India.[3]

One of the guiding principles that determines the impact of FDI on national economic growth is whether foreign capital complements or substitutes for domestic capital. In several developing countries, it has been observed that foreign investment often displaces domestic investment. According to one recent study, the tendency of FDI to crowd out local investment rose in all developing regions, including sub-Saharan Africa, in the period 1990–1997 compared with 1983–1989.[4] In Latin America, the increase in real investment has been only to the tune of one-third of the net capital inflow.[5] In fact, if one takes the Latin American region as a whole, external savings have crowded out national savings. In New Zealand, both household and corporate savings have witnessed a steep decline since liberalization.[6] There is ample evidence of lower private saving rates following liberalization in Argentina, Chile, Colombia, and the Philippines.[7]

There are several instances where liberalization and globalization policies have contributed to a consumption boom. In Mexico, the inflows sustained a boom in private consumption after the country's capital account was liberalized in the late 1980s. In 1992-93, capital inflows were estimated at 8 per cent of GDP. With higher interest rates in Mexico, the international investment banks and fund managers invested billions of dollars in financial markets and real estate, thereby creating a boom. Higher but unrealistic valuation of stocks and real estate coupled with the appreciation of the exchange rate fuelled the private consumption boom. There was a substantial hike in consumer lending after liberalization in Mexico as banks rapidly expanded credit card businesses and loans for consumer items. As a result, investment stagnated and foreign savings crowded out domestic savings. National savings as a proportion of GDP plummeted by more than 4 per cent between 1989 and 1994. Mexico had to pay a high price for liberalization as its GDP contracted by 7 per cent in 1995.[8]

It is high time that policy makers move away from the idea of a 'race to the bottom' in order to attract FDI flows. Dictated by international financial institutions, market-oriented macroeconomic reforms coupled with good governance conditionalities have failed to attract FDI flows, as is clearly evident in the case of Africa. The entire continent attracts only a fraction of global investment flows despite widespread implementation of such reform packages as part of structural adjustment programs. It is not the lack of market-oriented reforms and good governance institutions that prevent the flow of foreign investment to Africa; rather it is the small size of domestic markets, lower income per capita, poor infrastructure, insufficient growth prospects, locational disadvantages, civil unrest, and political instability in the continent that are responsible for meager investment inflows. By stalling economic diversification and shrinking public investment, a liberalized policy regime has contributed to the process of deindustrialization in several African countries. The share of manufacturing output in Gross Domestic Product (GDP) dropped sharply in Sub-Saharan Africa between 1980 and 1990 under the liberalized policy regime.

Despite a gradual erosion of policy space, policy makers should evolve a new strategy based on appropriate policy instruments and institutional arrangements to link FDI with their wider developmental goals suiting their local conditions. However, this would not be an easy task given the constraints posed by the international policy regime.

Is the Entry of Foreign Banks Beneficial?

The entry of foreign investment in the banking sector deserves detailed analysis since this sector has definite linkages with economic growth and development. As more and more developing countries are easing restrictions on the entry of foreign banks, the costs in terms of allocation of credit and financial efficiency have not been critically assessed. The impact of allowing foreign banks to acquire stakes in the domestic banking sector has been more dramatic in Central and Eastern Europe (CEE) where most domestic banks have already become, or are likely to become, subsidiaries of large foreign banks. In the wake of massive privatization programs in these countries, foreign banks have rapidly taken control over the domestic banking sector. In the nine CEE countries,[9] foreign bank holdings rose from 20 per cent in 1997 to over 60 per cent by the end of 2001. In the Baltic states of Estonia, Latvia, and Lithuania, foreign banks (particularly from the neighboring Scandinavian countries) have captured the domestic banking market within a short span of time. In Estonia, for instance, foreign-owned banks increased their market share from 2.3 per cent in 1997 to over 97 per cent by 2000. The top three banks of Estonia – Hansapank, Uhipank, and Optiva – are now all foreign-owned. In Latvia, Poland, and Slovakia, foreign-owned banks accounted for more than 65 per cent of the total market share in 2000. In terms of assets, over 90 per cent of the Czech banking sector has come under the control of foreign banks.[10]

In Latin America, similar trends are also visible. For instance, all the three top banks in Mexico (Bancomer, Serfin, and Banamex) have come under the control of foreign banks through M&A deals. With the recent takeover of Bital by a transnational bank, HSBC, the total foreign ownership in the Mexican banking industry has touched 90 per cent of total banking assets in the country.

The rapid market-driven consolidation in the global banking industry has important implications for the allocation of credit, which in turn affects economic growth. Rampant competition in the domestic financial sector due to the entry of foreign banks could enhance the risks. Fearing erosion of the franchise value due to increased competition, domestic banks and financial institutions have a natural tendency to lend more money to risky projects in order to remain in business. Fierce competition in the banking sector has given rise to a situation where banks are increasingly resorting to speculative and risky activities (for example, foreign exchange speculation). A study by Andrew Sheng of the World Bank found that increased competition was responsible for bank failures in Chile, Argentina, Spain, and Kenya.[11]

Moreover, the entry of foreign banks in the domestic market does not necessarily lead to more credit in the domestic economy. Analysts have reported that, in several countries, the amount of real credit has actually declined in the wake of the increased presence of foreign banks. Based on the study of two of the earliest transition economies, Hungary and Poland, Christian Weller established a link between greater international financial competition and less real credit.[12] Weller found that while the number of financial intermediaries, particularly foreign-owned ones, grew in both economies, the amounts of real loans declined.[13] The decrease in total credit was more pronounced in Hungary. While real loans decreased by 5.2 per cent in Poland from 1990 to 1995, and by 47.5 per cent in Hungary between 1989 and 1994, the number of multinational banks increased from 0 to 14 in Poland and from 9 to 20 in Hungary.[14] These economies experienced considerable deterioration in their growth rates during the same period.

While the entry of foreign banks is generally considered beneficial as they offer better quality services and more sophisticated products, and have 'deep pockets' to support losses, they can put domestic banks – whose long-term interests are aligned with the local economy – at a competitive disadvantage. Studies by UNCTAD have also shown that financial liberalization and the entry of foreign-owned banks into Africa have fragmented capital markets in which access to sizeable credit is biased in favor of larger foreign firms. It has been observed in some instances that the rapid entry of foreign banks could stall the development of the local banking sector, as witnessed in Australia in the 1980s. By neglecting small- and medium-sized enterprises (SMEs), foreign banks can even jeopardize the prospects of economic growth. If recent experiences are any guide, foreign banks have a tendency to serve the needs of less risky segments such as transnational corporations and 'cherry-picked' host country corporations. Therefore, the consequences for the real economy could be disastrous for many developing economies where small- and medium-sized enterprises constitute the backbone of the manufacturing and service sectors.

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4

The Regulatory Framework

NOTWITHSTANDING the liberalization of national investment rules in recent decades, every country has used a variety of regulations to control foreign investment depending on its stage of development. Both developed and developing countries have imposed such regulations to meet the wider objectives of economic policy, particularly those related to national development.

Traditionally, control on foreign investment has been vested in national governments. The State has the right to regulate the activities of foreign investors operating within its sovereign territory. The right to regulate foreign investment is delineated in the Resolution on Permanent Sovereignty over Natural Resources approved by the UN General Assembly on December 14, 1962, which recognizes permanent sovereignty over natural wealth and resources as a basic constituent of the right to self-determination. While conferring the right to retain control over economies, the Resolution emphasizes that foreign investment should not be subject to conditions that are contrary to the interests of the recipient states.

Since the Second World War, governments have imposed regulations on foreign investment because of their countries' past experiences in which some foreign firms not only indulged in restrictive and predatory business practices but also interfered in the domestic political affairs of the host countries. Consequently, several countries undertook measures like nationalization and appropriation of assets of foreign companies in the aftermath of their independence from colonial rule.

Unlike trade, foreign investment is a much more politically sensitive issue since it essentially means exercising control over ownership of national assets and resources. It is not only poorer countries that are extremely concerned about foreign companies acquiring control over their assets and resources. Even developed countries, which are demanding that other countries remove their investment regulations, are equally sensitive when it comes to foreign companies acquiring their domestic assets and resources.

The Double Standards of the Developed World

A close look at some recent cross-border investment bids – the proposal by CNOOC, a Chinese company, to take over US oil company, Unocal; Mittal Steel's bid to take over the largest European steel company, Arcelor; and the Dubai Ports World's takeover of P&O, a British company that also manages six US ports – reflects the growing unease within the developed world about foreign companies taking control of *their* domestic assets and resources. By resorting to all kinds of arguments including "national interest", "security considerations", "values", and "culture" in order to block these investment bids, the double standards on international investment issues adopted by legislators and policy makers in the developed world have been thoroughly exposed.

To illustrate further, take the case of the US, which advocates a liberalized global investment regime but, at the same time, maintains several legislative and regulatory measures, both at the federal and local levels, to restrict inward FDI. For instance, under the 1998 Exon-Florio Amendment to the Defense Production Act, Industrial Security Program, and the Arms Export Control Act, the US can bar foreign investment in any sector on the grounds of national security. In addition, the Cuban Liberty and Democratic Solidarity Act of 1996 – popularly known as Helms Burton Act – empowers US citizens and corporations whose property was expropriated by the Cuban government after January 1, 1959, to claim damages against anybody who transacts in their former property. Moreover, there are several local level restrictions on foreign investments in the banking, insurance, and real estate sectors.

Three recent attempted mergers and acquisitions illustrate the growing backlash on foreign inward investment in the US. In 2005, the US Congress intervened to thwart the Chinese state-owned oil company, CNOOC, from acquiring the US oil company, Unocal. The major argument against the Chinese offer was that the country's "strategic assets" should not be controlled by foreign companies. This is despite the fact that CNOOC's offer was much more lucrative than those of other bidders. Under intense pressure from the US Congress, CNOOC withdrew its bid, and Unocal eventually merged with the US-based Chevron Corporation on August 10, 2005.

In March 2006, the furor in the US Congress against the proposed $6.8 billion takeover of a British company, Peninsular & Oriental (P&O), by the Dubai Ports World (a company owned by the government of the United Arab Emirates) reflects similar protectionist tendencies. The proposed takeover of P&O by Dubai Ports World would have brought six US ports, including those of New York and Philadelphia, under its management. What is surprising is that, as long as these six US ports were managed by the British firm, P&O, there was no opposition within the United States. But the moment Dubai Ports World proposed to take over P&O, all kinds of protectionist arguments (some with racist overtones) were cited against the bid. Even though the UAE government has been a key ally of the US for several decades, and port security would still be handled by the federal authorities, the idea of a company from an Arab country managing and controlling US ports was strongly opposed by the US Congress. The House of Representatives Committee voted against the deal. According to a poll conducted by Gallup, as many as two-thirds of US citizens opposed the proposed deal.

Due to political furor, the Dubai Ports World sold off the US assets acquired under the takeover of P&O to insurance and financial services giant, AIG. It is important to stress here that such concerns in the US are not new. In the 1980s when Japanese corporations made huge investments to acquire US companies, similar protectionist arguments were also made.

Mittal Steel's $22.7 billion takeover bid for Luxembourg-based Arcelor in 2005 also faced stiff political resistance from the governments of Luxembourg, France, and Spain. Registered in Luxembourg, Arcelor is a European steel company created by a merger of the Spanish Aceralia, the French Usinor, and the Luxembourg-based company Arbed in 2001.

Although Mittal Steel is controlled by an Indian-born family, it is essentially a European firm registered in The Netherlands and listed on many European exchanges. Strictly speaking, Mittal Steel's takeover bid was one made by a European company over another European rival company. Despite the fact that Mittal Steel runs no steel plants in India, Arcelor CEO, Guy Dolle, called it a "company of Indians" and warned Arcelor shareholders to stay away from Mittal's "Monkey Money" (a French expression that means worthless money). He even went so far as to compare his company's steel to "aristocratic perfume" and Mittal's to cheap "Eau de Cologne." While France's Finance Minister, Thierry Breton, expressed apprehensions about a potential clash of civilizations if Mittal's offer were accepted. Since the offer made by Mittal Steel was financially lucrative, the majority of Arcelor shareholders ignored such xenophobic concerns and approved the takeover in June 2006.

The above three recent examples reveal the double standards adopted by the developed world. While seeking liberal foreign investment regimes in developing countries, some developed countries are not ready to open up their own regimes to foreign investment.

The Objectives Behind Regulating Foreign Investment

There are several objectives behind investment regulations, including national economic welfare measures achieved through higher economic growth with equity. When a foreign investor enters a host country, the investor is supposed to follow the regulatory measures of that country. Several countries have devised special measures for foreign investors (both negative and positive) to distinguish between foreign and domestic investors. Most investment agreement proposals have been attempts at disciplining those regulatory measures that negatively discriminate against foreign investors in host countries. Such discriminatory forms of regulatory measures on foreign investment vary from country to country. For instance, host countries often impose pre-admission regulations on foreign investment, such as screening all foreign investment on case-by-case basis; not allowing foreign investment in certain sectors of the economy (for instance, telecommunications, aviation, media, or atomic energy); or putting general and sectoral equity limits on foreign investment.

The rationale behind pre-admission regulations is connected with sovereignty: to ensure that foreign investors do not control productive or strategic sectors of a country's economy. It is important to highlight here that pre-admission regulations are not confined to developing and poorer countries. Several developed countries (for instance, the US and Japan) have extensively imposed pre-admission regulations on foreign investment, and many of them still regulate the entry of foreign investment in strategic sectors such as media, atomic energy, telecommunications, and aviation. In fact, a large number of bilateral investment treaties reserve the right of host countries to regulate the entry of foreign investors. Contrary to popular perception, rapid economic development occurred amidst tight regulations on the entry of foreign investments in the two most successful cases of the post Second World War period, namely, Japan and South Korea. China – the latest 'success story' – has also imposed stringent pre-admission restrictions on foreign investment, including screening, a negative list, and sectoral limits.

In addition, countries have imposed post-admission restrictions once a foreign investor enters the host country. Designed to maximize economic gains from foreign investment, these restrictions could include compulsory joint ventures with domestic counterparts, restrictions on remittance of profits, royalty and technical fees, additional taxes, and performance requirements.

Performance Requirements

Performance requirements are conditions imposed on investors, such as local content requirements, export obligations, preference to local people in employment, location of an industry in a 'backward' region, and mandatory technology transfer.

Performance requirements deserve special mention because developed countries have been advocating their elimination on the grounds that they are inefficient and harmful, thereby hampering foreign investment and economic growth. But evidence points to the opposite result: performance requirements such as local content and technology transfer help to establish industrial linkages upstream (for instance, with suppliers) and downstream (for instance, with buyers) and contribute significantly towards the host country's economic development. In the absence of local content requirements, a foreign corporation is likely to source many inputs from outside the country, which could impede the development of local clusters in the host countries. As discussed in Chapter 3, TNCs, particularly those that have very high levels of intra-firm trade, manipulate transfer pricing to avoid taxes. With the help of transfer pricing, TNCs can underprice imports of inputs, thereby circumventing tariff restrictions in the host countries. Since many developing countries lack the capacity to check any abuse of transfer pricing, local content requirements could serve as an alternative mechanism to curb such manipulations.

Take the case of India where the authorities have extensively imposed performance requirements in the form of export obligations on TNCs to ensure that the corporations earn enough foreign exchange to balance foreign exchange outgoings via repatriation of profits, royalty, and other payments. For instance, Pepsico was allowed to operate in India in 1989 with the performance requirement that it will export products worth 50 per cent of its total turnover for 10 years. In addition, at least 40 per cent of this export obligation has to be met by selling the company's own manufactured products.[1] Similar performance requirements have been imposed by other developing countries.

However, recent investigations have revealed that foreign investors make all kinds of false promises to honor performance requirements in order to gain entry into the host country. But once they step in, they show

Box 4.1

Coca-Cola's Divestment in India: A Mockery of Performance Requirements

The US soft-drink giant, Coca-Cola, re-entered India in the 1990s after abandoning its businesses in the late 1970s in the wake of the Foreign Exchange Regulation Act of 1973. The Act, meant to "Indianize" foreign companies, made it mandatory for foreign companies to dilute their shareholdings to 40 per cent. Instead of diluting its shareholdings to the required limit prescribed by the Act, Coca-Cola decided to discontinue its operations in India altogether. However, taking advantage of the liberalized and deregulated environment of the 1990s, Coca-Cola re-entered India through its 100 per cent owned subsidiary, Hindustan Coca-Cola Holdings. Coca-Cola's re-entry was based upon several post-admission performance requirements that the company agreed to implement in due course. One of the major requirements was that Hindustan Coca-Cola Holdings must divest 49 per cent of its shareholding in favor of resident shareholders by June 2002.

For several months prior to the deadline, Coca-Cola lobbied the Indian political establishment hard to ensure that its Initial Public Offering (IPO) be deferred by another five years because of its accumulated losses and depressed market conditions. Its real motive, however, had little to do with either of these. Rather, Coca-Cola was apprehensive that by offering its shares to the public, all its activities would come under the ambit of public scrutiny.

To mould public opinion in its favor, Coca-Cola launched a propaganda blitz in the financial media. When it became evident that all its arguments had failed to generate support, Coca-Cola approached two senior US officials, Robert D. Blackwill, then US Ambassador to India, and William J. Lash, Assistant Secretary for Market Access and Compliance, Department of Commerce, to plead on its behalf. Media reports have confirmed that the Indian authorities succumbed to these pressures by waiving the mandatory IPO requirement and subsequently acceding to the company's request for a private placement of shares. One wonders why the US administration decided to support Coca-Cola's unreasonable demand despite being fully

continued on next page...

conscious of the fact that the agreement is essentially between two entities – Coca-Cola and the Indian Government.

Under the new arrangement, the Indian Government has allowed Coca-Cola to divest 39 per cent of its equity to private investors and business partners and the remaining 10 per cent in favor of local resident Indian employees' welfare and stock option trusts. The off-loading of shares to 'friendly' investors has made a mockery of the divestment process and is contrary to the spirit of the divestment clause of Coca-Cola's agreement with the Indian authorities. To dilute the divestment conditions still further, Coca-Cola denied voting rights to the Indian shareholders. The proposal to offer voting rights to Indian shareholders is "substantive and onerous", stated the company. Denial of voting rights militates against the very purpose of the mandatory condition ensuring Indian shareholding. By refusing to grant voting rights to Indian shareholders, the parent company wants to retain complete control over the subsidiary.

This sordid episode has exposed the hypocritical stand of foreign investors and their lobbies, who preach sermons on corporate governance, social responsibility, and corporate citizenship. By allowing Coca-Cola to go ahead with private placement and non-voting rights to shareholders, the Indian authorities have sent out signals to foreign investors that agreements with India can be breached with impunity. On March 21, 2003, the then Finance Minister, Jaswant Singh, admitted in the Indian Parliament that 21 TNCs had violated the mandatory guidelines of granting equity to the Indian public. These murky episodes make a mockery of regulations governing the operations of foreign investment in India.

scant regard for fulfilling these requirements. Several instances have been reported in which foreign investors openly flouted their post-admission commitments in the host countries. For instance, Coca-Cola has openly violated its commitment to divest 49 per cent of its equity to the Indian public after five years of its operations in the country (*see* Box 4.1). Unfortunately, the regulatory authorities in the host countries often refuse to take any action against the TNC as it may deter other foreign investors from investing in the country. This is a serious issue and should not be neglected by policy makers of the host countries if they wish to derive benefits from foreign investments.

In the context of investment liberalization, countries have also started offering incentives to foreign investors in the form of tax holidays, exemption of duties, direct subsidies, loan guarantees, and export credits. Many of these incentives are often tied to performance requirements. The governments of capital exporting countries use financial incentives in the form of loan guarantees and export credits to support the foreign ventures of their corporations, while capital importing countries offer tax holidays to attract foreign investments. Countries have set up specialized investment promotion agencies (IPAs) to lure foreign investment. However, at present, there are no effective rules at the international level to discipline the proliferation of investment incentives.

Notes and References

1. For a detailed analysis of Pepsico's commitments in India, see Kavaljit Singh, *Broken Commitments: The Case of Pepsi in India*, PIRG Update, No. 1, Public Interest Research Group, New Delhi, June 1997.

5

The Governance of International Investments: A Historical Perspective

IN the last five decades, there have been dramatic swings in the policy pendulum governing investments at all levels – national, bilateral, regional, and multilateral. This chapter critically examines these developments in the wider political economic context.

Post Second World War Beginnings

The widespread perception that the exponential growth in foreign investment in recent years gave the impetus to launch a multilateral investment agreement in the 1990s is erroneous. The first attempt to forge a multilateral agreement on foreign investment was in fact made in the immediate post War period. In early 1943, even before the Second World War had ended, efforts were made at the international level to create a new integrated world economic system, which would have included investment along with trade and competition policy. These efforts culminated in the form of a draft Havana Charter to establish an International Trade Organization (ITO), which was presented at a meeting in Havana in 1948. The draft Charter was signed by 54 countries on March 24, 1948. The ITO was meant to be the third institution for promoting post-war economic cooperation along with the International Monetary Fund and the World Bank, which had been established in 1944. Besides tackling trade issues such as tariffs and quotas, the draft Havana Charter had provisions under Articles 11 and 12 to address foreign direct investment issues. Had the Havana Charter been ratified, the ITO would have played a decisive role in the investment policies of many countries worldwide.

Earlier proposals for this Charter made by the US contained extensive rights for investors, including the obligation on host countries to extend national treatment and most-favored-nation treatment. In addition, the US wanted limitations on the right of expropriation. Its proposals were supported by several countries including Australia, Belgium, France, and The Netherlands. But these measures were strongly opposed by other countries. For instance, the Czech government was not in favor of giving German investors the same status as investors from other countries. Similarly, India objected to the provision for national treatment for foreign investors. In response to such opposition, the US had to dilute several rights it wanted to grant to foreign investors in its earlier proposals. But at the same time, the Charter faced the wrath of US corporations because of provisions under Chapter V regulating anti-competitive policies of private businesses. Compared to today's practices, the scope of investment policies that came under the Havana Charter was rather limited. For instance, the Charter did not incorporate any rules related to performance

Table 5.1: The Political Context (Mid-1940s – Late 1960s)

Issues	Whether to create international institutions for governing investment and competition policies or not.
Ideologies	Keynesian economics.
Conflicts	Developed countries emphasized liberalization while developing countries were concerned with developmental issues.
Power relations	US hegemony in international economic affairs. Emergence of France, Germany, and UK as European leaders. Independence of former colonies.
Institutional Outcomes	
Multilateral	Defeat of ITO. Creation of GATT, IBRD and IMF.
Regional	Establishment of EEC.
Bilateral	Development of BITs.

Source: Adapted by author from Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002. p. 268.

requirements nor to a dispute settlement mechanism between governments and foreign investors.

Notwithstanding the fact that the US government was one of the driving forces behind the Havana Charter, the US Congress refused to ratify it. It perceived the wide-ranging authority of an ITO as too powerful, potentially posing a threat to the country's national sovereignty and the interests of US corporations. Consequently, the proposal for establishing an ITO was abandoned and the General Agreement on Tariffs and Trade (GATT) launched as a temporary measure instead in 1947. For nearly four decades from its inception, GATT never brought investment issues under its rubric and prudently maintained the dividing line between trade

Table 5.2: Other International Investment Agreements, 1943-1968

Agreement	Organization	Year
Draft Statutes, Arbitral Tribunal for Foreign Investment	Foreign Investment Court (International Law Association)	1948
International Code of Fair Treatment for Foreign Investment	International Chamber of Commerce	1949
Treaty establishing European Community		1957
Agreement on Arab Economic Unity		1958
Convention on Recognition and Enforcement of Arbitral Awards	UN	1958
General Assembly Resolution 1803: Permanent Sovereignty of Natural Resources	UN	1962
Model Tax Convention on Income and Capital	OECD	1963
Convention on Investments, Customs, and Economic Union of Central Africa		1965
Draft Convention on the Protection of Foreign Property	OECD	1967

Source: UNCTAD, *World Investment Report 1996*, New York, 1996.

and investment. This was largely because GATT was conceived in narrow terms as a forum for negotiating tariff reductions for trade in manufactured goods. Investment issues were not considered a part of the GATT framework. It was only during the Uruguay Round renegotiations of the GATT from 1986 to 1994 that the issue of investment was brought within its framework.[1]

The failure to establish an ITO in the 1940s was one of the major reasons why many countries shifted their attention from multilateral to bilateral investment agreements. In the 1950s and 1960s, bilateral agreements were the dominant instruments dealing with foreign investment issues. In those decades, the majority of bilateral investment agreements were geared towards protecting foreign investors against the threat of expropriation because many developing countries had undertaken nationalization measures in the aftermath of their independence from colonial rule.

Despite the collapse of the ITO, a number of other international investment agreements were ratified during the 1950s and 1960s, though their focus was arbitration and dispute settlement rather than investment liberalization (*see* Table 5.2). For instance, within the World Bank, the International Centre for Settlement on Investment Disputes (ICSID) was set up in 1966 to facilitate the settlement of disputes between states or between investors and states. ICSID provides a mechanism through which host countries, home countries, and foreign investors can agree to submit investment disputes to third-party arbitration. Despite the launching of ICSID, the World Bank (along with the IMF) did not show much concern over foreign investment issues during this period.

The Shift to other International Fora

In the 1960s and 1970s, international investment negotiations shifted to other fora, such as the United Nations and the Organization of Economic Cooperation and Development (OECD), thereby reflecting the main concerns of these organizations at that time.

Developing countries started raising investment issues at the United Nations in the 1970s from an entirely different perspective. The UN became the obvious choice for developing countries to raise international investment issues since its influence was considerable; besides which, it ensured equal voting rights for member-countries in its General Assembly. The drive to address investment issues at the UN originated in the bitter experiences of several developing countries of foreign investors meddling in their domestic political affairs. A notorious example was the alleged involvement of International Telephone and Telegraph (ITT) and the US Central Intelligence Agency in the overthrow of the democratically-elected Salvador Allende government in Chile in the early 1970s.

When similar instances of TNC intransigence in other countries came to international notice, the UN Economic and Social Council (ECOSOC) recommended the establishment of a Group of Eminent Persons in 1972 to formulate appropriate international action. The Group submitted its report in June 1974 in which it recommended the establishment of a new and permanent commission on transnational corporations as well as an information and research centre to study TNCs. Based on these recommendations, the United Nations Commission on Transnational Corporations and the Center on Transnational Corporations (UNCTC) were set up in December 1974. The Commission assigned the UNCTC to formulate a UN Code of Conduct on Transnational Corporations (taking into account the work of UNCTAD and ILO) to curb abuse of corporate power and establish a comprehensive information system on TNCs.

Despite the fact that the Code was meant to serve as a voluntary measure (not legally binding), it highlighted the growing clout of developing countries in the governance of international economic relations. In fact, these attempts were an integral part of a broader initiative to launch a New International Economic Order (NIEO) to address the concerns of the developing world. It needs to be highlighted here that trade unions played an active role in the development of this Code of Conduct and other policy measures to regulate the activities of TNCs. The 1977 Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy issued under the auspices of the ILO is an example. Even though the Declaration is voluntary and modest, it reflects the bargaining power of trade unions in pushing minimum standards on employment and labor relations at the ILO during that period.

When drafting of the UN Code of Conduct began in 1977, it was supposed to cover only the activities of transnational corporations, but it later incorporated the conduct of governments as well, largely under pressure from developed countries. At the sixth session of the Commission on Transnational Corporations held in Mexico in 1980, a resolution was passed stating that any code should "include provisions relating to the treatment of transnational corporations, jurisdiction and other related matters", thereby making it clear that any code would also be applicable to governments.

However, the international economic situation changed dramatically in the early 1980s. An excessive build-up of external loans by the state sector triggered the debt crisis as many developing countries became unable to service their huge external debts. This debt crisis paved the way for

Table 5.3: The Political Context (Late 1960s – Early 1980s)

Issues	Whether and how to control TNCs.
Ideologies	TNCs pose a threat to national sovereignty. North-South inequalities to be removed.
Conflicts	North-South differences on roles of TNCs.
Power relations	Growing economic interdependence enhances bargaining power of developing countries.
Institutional outcomes **Multilateral**	Prolonged but inconclusive negotiations on UN Codes. Establishment of OECD Guidelines and the ILO Tripartite Principles.

Source: Adapted by author from Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 268.

national investment rules to be liberalized as part of the structural adjustment programs supported by the IMF and the World Bank that were offered to indebted countries. The drying-up of commercial bank lending forced developing countries to accept the terms of IMF and World Bank support and open their doors to foreign investment. As a result, developing countries that had once nationalized foreign companies started wooing foreign investors to come back, setting back attempts to increase developing country bargaining power as part of a NIEO.

At the same time, the US, concerned that the UN draft Code of Conduct was unlikely to serve the interests of capital exporting countries, persuaded other developed countries to block it at the UN. The Code was not approved, and the UNCTC eventually dissolved in 1992. Since then, work within the UN on investment issues has been carried out by UNCTAD's Program on Transnational Corporations with an entirely different agenda of promoting foreign investments. At the UN's 1992 Conference on Environment and Development (UNCED) – dubbed the Earth Summit – another attempt was made to introduce TNC regulation under the auspices of the UN. But developed countries along with corporate lobbies scuttled the move to incorporate environmental regulation of corporations within Agenda 21 – a declaration issued at the Earth Summit. With the ascendancy of neoliberal ideology, the tide had started to turn against regulation of TNCs.

In addition, largely to counteract moves towards establishing a Code of Conduct on TNCs at the UN, big capital exporting countries, led by the US, initiated discussions on investment issues at the OECD, whose membership at that time consisted solely of developed countries, most of whom were in favor of a liberalized investment regime. The OECD had attempted to bring investor protection issues within its remit in the 1960s with a multilateral convention on the protection of foreign property, but it was never adopted. An attempt to enact a non-binding code for transnational corporations at the OECD began in the 1970s. In 1976, the Guidelines for Multinational Enterprises were adopted by OECD member-countries. As discussed in detail in Chapter 7, the OECD Guidelines are non-binding and implementation procedures are weak, thereby severely restricting their use as an accountability mechanism.

Initiatives at the UN did not deter the US from aggressively pursuing an investment liberalization agenda. It not only negotiated bilateral investment agreements with strategic partners to secure its investment interests; it also started pursuing the investment liberalization agenda in non-UN fora where it was confident of manipulating the outcome. Under the aegis of the Joint Development Committee of the IMF and the World Bank, the US launched discussions on the distortionary effects of investment regulations (such as performance requirements) in host countries. These discussions provided an impetus for what was to become the Agreement on Trade-Related Investment Measures (TRIMs) under the WTO.

Meanwhile, the structural adjustment policies supported by the World Bank and the IMF also had an important influence on the investment policies of borrowing countries. In the 1980s and 1990s, both these institutions expanded their mandate by launching large-scale privatization and investment liberalization programs in borrowing countries. In the World Bank, discussions on investment issues led to the establishment in 1998 of the Multilateral Investment Guarantee Agency (MIGA). The Agency was set up to encourage the flow of private investment (rather than of public or state funds) to developing countries by guaranteeing the investment of foreign corporations against risks such as civil war, currency restrictions, or nationalization. As a specialized component of the World Bank, MIGA reviews the FDI policies of host countries as well as the features of specific projects before providing guarantees. MIGA is thus deeply involved in investment policies at both the macro and micro levels.

Interestingly, because the GATT (unlike the OECD) had provisions to make its rules binding among member-countries, the US returned in the early 1980s to the multilateral forum of the GATT renegotiations to push its investment liberalization agenda. Despite its failure to include investment in the Tokyo Round of GATT renegotiations during 1973-79, the US remained resolute in attempting to push a comprehensive agreement on investment within the GATT. In the early 1980s, it proposed a work program within GATT to bring both trade in services and trade-related performance requirements imposed on foreign investors within the GATT ambit with the sole aim of addressing investment issues. But the proposal was vehemently opposed by developing countries, particularly India and Brazil.

Nonetheless, the possibility of including investment issues and trade in services within the GATT renegotiations became apparent in the mid-1980s as opposition from developing countries waned due to bilateral trade pressures exerted by the US as well as domestic pressures to liberalize investment regimes due to the debt crisis. The GATT ruling on the Foreign Investment Review Agency of Canada in 1984 is considered to be one of the most significant developments related to investment issues in the period before the 1986-1994 Uruguay round negotiations. In settling this dispute

Table 5.4: The Political Context (Early 1980s – Mid-1990s)

Issues	Whether to include investment issues in trade agreements or not.
Ideologies	Investment liberalization is desirable for economic growth.
Conflicts	Differences over methods and pace of liberalization. Conflicts among developed countries (US-Japan and US-EU). Conflicts between developed and developing countries.
Power relations	US economic hegemony in decline.
Institutional outcomes	
Multilateral	Inclusion of investment issues under GATT. Establishment of WTO with several investment provisions.
Regional	Investment provisions included in NAFTA.
Bilateral	Large increase in number of BITs.

Source: Adapted by author from Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, pp. 268-9.

between the US and Canada, the GATT panel found that the Canadian Agency's decision to screen investment proposals and impose certain performance requirements (for example, local content) on foreign investment was in violation of Article III: 4 of GATT (National Treatment). To a large extent, this ruling was responsible for giving momentum to the subsequent negotiations on TRIMs. By incorporating both the TRIMs Agreement and the General Agreement on Trade in Services (GATS) within the Final Act of the Uruguay Round of GATT renegotiations, the developed countries were successful in bringing investment issues under the ambit of the multilateral framework.

The 1990s: Major Swings in Policy Pendulum

The 1990s witnessed major swings in the investment policy pendulum towards greater liberalization of the regulatory framework at the national level. The swing was more pronounced in developing countries, particularly in Asia, Latin America, and Central and Eastern Europe. Countries unilaterally (sometimes voluntarily) undertook liberalization measures such as lifting their controls on foreign ownership, removing performance requirements, and liberalizing their capital account. An increasing trend towards privatizing public sector companies in developing and transition countries added momentum to investment liberalization processes. Several countries also offered various guarantees and subsidies to foreign investors.

Table 5.5: Worldwide Trends in Expropriation

Indicator	Mean number per year						
	1960-64	1965-69	1970-74	1975-79	1980-84	1985-89	1990-2002
Acts of Expropriation	11	16	51	34	3	0.4	0.0
Countries involved in Expropriation	6	9	23	15	2	0.4	0.0

Source: Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 53.

The extent of these swings in policy can be measured in several ways. For instance, expropriations had increased in the 1960s and early 1970s, but almost disappeared in the 1990s (*see* Table 5.5). According to UNCTAD, a total of 1,393 regulatory changes were introduced in national investment regimes during 1991-2001, out of which 1,315 (almost 95 per cent) were meant to create a favorable investment environment. In 2001 alone, as many as 208 regulatory changes were made by 71 countries, of which only 16 changes were less favorable for foreign investors.

The 1990s witnessed a surge in the number of bilateral investment treaties (BITs) as more and more countries started adopting liberalized investment policies. The highest number of BITs were negotiated and concluded during this decade.

Regional initiatives on investment liberalization also emerged in the 1990s. In 1991, negotiations took place between the US, Canada, and Mexico to launch the North American Free Trade Agreement (NAFTA). In many aspects, NAFTA was simply an extension to Mexico of the existing

Box 5.1

Investment Promotion Agencies

Since the 1990s, more and more countries are setting up investment promotion agencies (IPAs) to attract foreign investment. There is hardly any country which does not have investment promotion agency. Even the communist Cuba has set up its own agency, Centro de Promoción de Inversiones, to attract foreign investment. More than 200 IPAs from 152 countries have become members of the Geneva-based World Association of Investment Promotion Agencies (WAIPA). Apart from establishing IPAs at the national level (e.g., UK Trade and Investment of the UK), many countries have also set up such agencies also at sub-national, regional, and city levels (e.g., Durban Investment Promotion Agency of South Africa and Selangor State Investment Centre of Malaysia). China alone has dozens of such agencies at various levels which provide investment incentives and assistance to foreign investors. This reflects the growing competition among various state agencies located within a country to seek foreign investment.

Canada-US Free Trade Agreement. Formally established in 1994, NAFTA contains comprehensive investment measures that are discussed in the next chapter.

The MAI Negotiations

Developed countries started investment negotiations under the aegis of the OECD in the early 1990s when the neoliberal doctrine was at its peak. At the time, thorough liberalization of controls on foreign investment was not only considered a desirable but also a necessary precondition for economic development. Trade and investment issues were deemed essential complements to advance the global system of production. It is in this context that the US called upon the OECD to launch a comprehensive binding investment treaty known as the Multilateral Agreement on Investment (MAI), which included a heavy dose of investment liberalization, protection of investors, and a dispute resolution mechanism. It is important to highlight here that a substantial part of the investment commitments in NAFTA was simply lifted and dropped into the proposed MAI.

Since most OECD member-countries had already liberalized their investment rules, opposition to MAI was not expected. Twenty-nine OECD member-countries participated in the negotiations on the MAI from 1995 to 1998. In 1997, the OECD identified certain other countries (Argentina, Brazil, Chile, Hong Kong, China, and Slovakia) as likely candidates for OECD accession and invited them to become observers at the MAI negotiations. The three Baltic countries – Estonia, Latvia, and Lithuania – were later invited to join as observers as well.

The draft MAI definition of "investment" was even broader than that adopted in Chapter 11 of NAFTA as it included every kind of asset owned or controlled, directly or indirectly, by a foreign investor. Despite a high degree of consensus among OECD member-countries on the principles of MAI, questions were raised about the timing and preferred venue for investment agreement negotiations. In particular, the European Union and Canada were in favor of WTO rather than the OECD because it could offer an enforceable dispute resolution mechanism. Initially, the US was not in favor of shifting the venue to the WTO because it was convinced that such an investment agreement would face stiff resistance from heterogeneous member-countries of WTO. But eventually the US supported the proposal with the caveat that Canada, the European Union and Japan should reaffirm their support for negotiations of MAI at the OECD.

In the mid-1990s, efforts to launch a multilateral investment agreement at the WTO intensified. Simultaneously, a number of international corporate lobbies (for instance, the International Chamber of Commerce) started supporting efforts at both the WTO and the OECD to work out international investment rules. At the WTO Ministerial Conference held in Singapore in 1996, a proposal for multilateral negotiations on investment along with those on competition policy, government procurement, and trade facilitation was mooted. However, strong resistance by some developing countries (particularly India) led to a compromise whereby a Working Group on Trade and Investment was set up under the WTO to examine the relationship between trade and investment issues. Working groups on other new issues were also set up at the Singapore Conference.

While the Working Group on Trade and Investment made slow progress at the WTO, differences between OECD member-countries on MAI became more apparent in 1997. In spite of a consensus on the broad parameters of the proposed agreement, including investor protection, national treatment, and an extensive dispute settlement process encompassing disputes between investors and governments, disagreements cropped up on other specific issues, such as the US Helms-Burton Act (*see* below) and the French demand for exemption from national treatment for culture. These differences could not be resolved and made it well nigh impossible to meet the deadlines set for completion.

In the midst of the MAI negotiations, the US Parliament enacted the Cuban Liberty and Democratic Solidarity Act – popularly known as the Helms-Burton Act – in 1996. The Act empowered US citizens and corporations whose property had been expropriated by the Cuban government after January 1, 1959 to claim damages against anybody making a transaction on their former property. The Act also prohibited persons transacting in confiscated property from entering the US. This Act became a bone of contention between the US, EU, and Canada in the middle of the MAI negotiations. The underlying problem was that the Act operated extraterritorially and discriminated against foreign investors from non-US countries operating in Cuba. After the EU filed a complaint against the US over the Helms Burton Act in the WTO in 1996, a dispute settlement panel was established. However, the work of the panel was later suspended and the two parties sought to find a solution through joint negotiations instead. By then, however, France had withdrawn from the MAI negotiations. With the addition of widespread popular opposition from NGOs, trade unions, and others, the negotiations stalled and the MAI was finally shelved at the OECD in November 1998.

Investment Negotiations at the WTO

After the collapse of the MAI negotiations, the WTO's Working Group on Trade and Investment remained the only multilateral forum discussing investment issues. Despite serious doubts raised by critics as to whether the WTO was the appropriate venue for hammering out an extensive international investment agreement, efforts were made to do so at the Fourth Ministerial Conference held in Doha, Qatar, in 2001. The Ministerial Declaration, also known as the "Doha Development Agenda," recognized "the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment." The Declaration further stated that "negotiations will take place after the fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations."

However, there was widespread confusion over the exact meaning of this part of the Ministerial Declaration. Developed countries conveniently interpreted it as a mandate to launch negotiations on investment at the Ministerial Conference in Cancun, Mexico in September 2003. But some developing countries, including India, expressed strong reservations about such an interpretation.

What is important to note is that WTO became the preferred choice for investment negotiations of some powerful countries because they could pursue their agenda more aggressively in this forum. For instance, the EU preferred the WTO because it could bargain as a united bloc against heavyweight countries like the US. But despite the growing influence of the EU at the WTO, the road towards negotiating a multilateral investment agreement was still a bumpy one. Strong opposition from poor and developing member-countries of WTO, coupled with public protests, thwarted attempts to create a consensus. The stalemate continued until the WTO's

Table 5.6: The Political Context (Late 1990s onwards)

Issues	Whether to expand the investment agenda under OECD and WTO. How to manage market failures and financial crises.
Ideologies	A mix of liberalization and self-regulation.
Conflicts	Increasing conflicts between US and EU. Widening divide between developed and developing countries.
Power relations	Rise of EU as a major economic power. US economic power in decline. Rise in the clout of some developing countries (such as Brazil, India, and China) in international economic affairs.
Institutional outcomes	
Multilateral	Collapse of proposed MAI in the OECD and WTO despite some expansion in existing agreements.
Regional	Increase in number of regional agreements.
Bilateral	Proliferation of BITs.

Source: Adapted by author from Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 269.

2003 Fifth Ministerial Conference at Cancun, which unexpectedly ended with no agreement on a Ministerial Declaration.

Why did Negotiations Collapse at Cancun?

The many factors behind the collapse of trade negotiations at the 2003 Cancun Conference are beyond the scope of this publication. The negotiations did not collapse over the contentious agriculture issues, however, despite the fact that the first three-days of the five-day Conference were spent discussing these issues. Rather, the main reason for the collapse was the failure to reach agreement on what had become known as "the Singapore issues", in particular investment issues.

Developing countries were disappointed that their views had been completely ignored in the initial Draft Text for the Cancun Conference, which proposed launching investment negotiations. The subsequent Draft Text had proposed de-linking the Singapore issues from each other: it called for immediate negotiations on two less contentious issues (trade facilitation and government procurement) and dropped the other two issues (investment and competition) from the agenda.

The EU, one of the main *demandeurs* of the Singapore issues, reportedly agreed to this proposal, and even the US was not averse to it. Some developing countries including India were also willing to start negotiations on these two issues as part of a *quid pro quo* deal on agriculture. However, over 60 WTO member-countries belonging to the African Union, the ACP (African, Caribbean and Pacific grouping of countries) and the Least Developed Countries (LDCs) stayed firm and stated their unwillingness to compromise on the Singapore issues. In contrast, South Korea (backed by Japan) remained adamant that it would not accept investment and competition being dropped from the negotiations, insisting that all four Singapore issues should be negotiated together. Realizing that no consensus on the Singapore issues could be achieved, the negotiations simply fell apart. In fact, the real credit for stalling negotiations on the Singapore issues should go to the tiny ACP, African Union, and least-developed countries, which remained united despite severe pressure exerted on them by developed countries. This is not an insignificant achievement given that these African countries are heavily dependent on the EU and US for aid and trade flows.

Sensing the strong opposition of poorer countries, developed countries did not even raise the investment issue at the Sixth Ministerial Conference held in Hong Kong in December 2005. But one should not forget that opposing countries have not demanded that the Singapore issues be dropped altogether from the WTO agenda. They have only demanded that the clarification process continue in the WTO working groups. One should also not forget that, although the Doha Round of negotiations have reached an impasse, they have not been abandoned and the WTO itself still remains.

Developed countries are likely to employ myriad strategies to push forward the investment agenda. In a strong message to the poor and developing world immediately after the collapse of the 2003 Cancun Conference, the then US Trade Representative, Robert Zoellick, threatened that the US would "move on multiple fronts" to open up world markets through bilateral and regional agreements. In his words, "we are going to open markets one way or another." Thus, it would be naïve to assume that the prospects for international investment agreements have receded.

Is the Pendulum Swinging Back?

Despite the dominant trend towards greater liberalization of investment flows, certain kinds of investments have come under closer scrutiny by policy makers. In several countries (both developed and developing), there are moves to tighten existing investment rules or to enact new rules to regulate foreign investments and protect "strategic sectors" from foreign investors.

Unlike the 1990s, nowadays the costs and benefits of foreign investments are being evaluated in a much more balanced manner, keeping in mind not only economic factors but also social, political, and strategic factors. It is increasingly becoming clear that the benefits of foreign investment have been fewer than anticipated while the costs have been much bigger. In some host countries (such as Bolivia and Malaysia), there is a greater realization of costs involved with foreign investment. The initial euphoria associated with the benefits of foreign investments seems to be subsided. To a large extent, disappointment with certain kinds of foreign investment has put a big question mark on the benefits of investment liberalization.

The growing unease with foreign investments could be grasped from several recent developments, some of which are summarized below:

- Several Latin American countries (such as Bolivia, Ecuador, Argentina, Ecuador, and Venezuela) are renegotiating contracts with TNCs to bring economic equilibrium between the foreign company and the host country. In Bolivia, for instance, the government successfully renegotiated contracts with ten foreign energy companies (mostly from the region) in October 2006. Under the new contracts, majority ownership of gas fields has been transferred to the state and government's energy tax revenues are expected to increase by four times. The renegotiation of contracts was the outcome of the nationalization policy announced by President, Mr. Evo Morales, on May 1, 2006, under which foreign companies were asked to sign new contracts giving the government majority control or leave the country. In March 2006, Ecuador passed a new law that gives the government 60 per cent tax on oil profit of foreign companies if the oil prices exceed certain benchmarks.

- Cross-border M&As deals have become the bone of contention in recent years. As discussed elsewhere, several important M&As deals have been blocked by policy makers in both the developing and the developed world. In many countries, attempts are being made to screen foreign investments from a security perspective.

- In 2006, India's National Security Council suggested a new law, National Security Exception Act, which would empower the government "to suspend or prohibit any foreign acquisition, merger or takeover of an Indian company that is considered prejudicial to national interest."

■ Russia is considering new rules to protect its strategic resources, particularly oil and gas. Despite strong pressure from the EU (the main consumer of Russian energy resources), Russia has refused to ratify the Energy Charter Treaty which covers the key areas of trade, investment protection, environmental issues, and dispute resolution. Though Russia signed the charter in the early 1990s, it has refused to ratify it. Russia has refused to provide non-discriminating access to foreign companies to the country's pipelines, primarily the gas transportation network controlled by state-owned gas company, Gazprom.

■ Although China's foreign investment regime is significantly open but acquisitions of Chinese firms by foreign investors are increasingly being questioned amidst a growing mood of "economic patriotism." The National Development and Reform Commission of China has emphasized the need to shift to a "quality, not quantity" approach towards attracting foreign investments. The Commission asked the government to encourage foreign investments in higher-value-added sectors and discourage low-value export-processing and assembly-type manufacturing. In its policy document for the 11th Five-Year Plan released in November 2006, the Commission suggested closer scrutiny of future mergers in sensitive sectors and called for new legislations on foreign takeovers. Since 2005, the rapid entry of foreign banks in the Chinese financial sector has raised serious concerns in the policy circles about the benefits of a liberalized financial regime.

■ There has been a phenomenal increase in the disputes between TNCs and host governments in recent years. Of the 219 known international arbitration cases concerning investment projects brought by November 2005, some two-thirds were initiated during the past three years.[2] The disputes are expected to increase further given the rethinking on the benefits of foreign investments by some host governments.

■ Of late, the growing engagement of private equity funds (such as Kohlberg Kravis Roberts & Company, and Carlyle Group) in the cross-border mergers and acquisitions has generated considerable public criticism in some developed countries. In 2005, Mr. Franz Müntefering, the then chairman of the Social Democratic Party (SPD), described private equity funds and hedge funds as "swarms of locusts that fall on companies, stripping them bare before moving on." In the case of South Korea, the activities of private equity funds came under scrutiny following reports of non-payment of taxes. Private equity funds earned billions of dollars by taking over sick banks in the post-crisis period and later re-floated them in the Korean financial markets. After the strong public outcry, the regulatory authorities in Korea undertook stern actions against such funds. In the US, there are growing calls for strict regulation of private equity funds following the failed $50 billion takeover bid of Vivendi Universal of France by Kohlberg Kravis Roberts & Company in 2006. In the UK, the Financial Services Authority (FSA) reviewed the operations of private equity funds and found several areas of potential risk to the financial system because of their market abuse and anti-trust practices. The FSA called for closer regulation and supervision of private equity funds.

■ Similarly, the phenomenal rise of hedge funds, known for their short-term investment strategies and lack of transparency and accountability, has come under considerable criticism in many developed countries. The UK's FSA has taken a tough stand against hedge fund industry. In a discussion paper, the FSA warned that "some hedge funds are testing the boundaries of acceptable practice concerning insider trading and market manipulation." The FSA also announced the establishment of a dedicated new unit which would monitor and supervise the trading behavior of hedge fund industry. This is a significant development given the fact that the bulk of European hedge funds are located in the UK and they account for at least 30 per cent of trading at the London Stock Exchange, which is the biggest stock market within the Europe. Even in the US, the Securities and Exchange Commission is examining new measures to increase its surveillance on hedge funds.

■ The corporate scandals (from Enron to Worldcom to Parmalat) have further dented the benign image of TNCs worldwide. The scandals have exposed systemic flaws in the corporate governance model based on self-regulation. Despite much-touted claims of corporate transparency and disclosures, the basic norms of governance were completely flouted by these corporations. Regulations related to accounting and reporting were either circumvented or followed in letter rather than in spirit. What is even more disturbing is the fact that most of these corporations had their own codes of conduct, illustrating that voluntary codes of conduct are clearly insufficient to ensure that TNCs conduct their business operations responsibly. Such codes therefore should not be considered as a substitute for state regulations (*see* Chapter 7 for more detail).

■ Outsourcing has become a contentious political issue in many developed countries (for instance, US) because of the fear of white-collar job losses in the service sector.

How far these developments could lead to a major backlash against foreign investment remain to be seen. Nevertheless, there is an increased onus on the foreign investors and their advocates to prove (both theoretically and empirically) that foreign investments are always beneficial to the host country. Nowadays there are now very few supporters of the earlier market-friendly approaches that focused exclusively on investors' rights and nations' obligations. Even within the corporate world, questions related to investors' obligations in both home and host countries are being raised. Thus, any multilateral investment agreement that intends to serve the interests of foreign investors exclusively at the expense of weakening the regulatory framework is unlikely to succeed in the present geopolitical context.

Notes and References

1. Since the inception of GATT, there have been seven renegotiation sessions: the Conference of Annecy, France, 1949; the Conference of Torquay, UK, 1950; the Conference of Geneva, 1956; the Dillon Round, 1962; the Kennedy Round, 1964-67; the Tokyo Round, 1973-77; and the Uruguay Round, 1986-94.
2. Karl Sauvant, "Is foreign direct investment still a welcome tool?," *Taipei Times*, September 7, 2006.

6

International Investment Frameworks: A Fragmented Landscape

THE landscape of investment frameworks is highly fragmented at three broad levels: bilateral, regional, and multilateral. In addition, there are 'plurilateral'[1] sectoral agreements (for instance, the Energy Charter Treaty) and 'minilateral' sub-regional agreements (for instance, the G3 of Colombia, Mexico, and Venezuela), which not only make relationships among all the different agreements more problematic, but also add complexity to the investment landscape as a whole.

Bilateral Agreements

After negotiations to set up an International Trade Organization collapsed in the late 1940s, bilateralism prevailed over multilateralism. Bilateral investment treaties (BITs) became the dominant instruments of investment agreements. Although their numbers grew rapidly in the 1980s and 1990s, BITs have been in existence since the late 1950s. Germany was the first country to sign BITs with the Dominican Republic and Pakistan in 1959. Initially, bilateral agreements were treaties of friendship, commerce, and navigation (FCN) with a very limited scope, but later on developed into comprehensive legal instruments.

During the 1960s and 1970s, colonial powers such as Germany, Switzerland, France, the UK, and The Netherlands also signed BITs with their former colonies. A 1967 Draft Convention on the Protection of Foreign Property (which was drafted by the OECD but never adopted) was used as a model for many BITs by these European countries. The US government, however, developed its own kind of BIT, signing the first one in 1982 with Panama. Despite several commonalities between them, there are key differences between a 'European Model' and an 'US model' BIT. For instance, a typical 'US model' BIT includes a more expansive notion of national treatment (pre-establishment and post-establishment phases) and most-favored-nation (MFN) treatment.

Until the late 1980s, most BITs were signed between a developed and a developing country, usually at the initiative of the former to secure protection of its investors. Recent years have also witnessed the ratification of BITs between developing countries. As many developing countries undertook investment liberalization measures in the 1990s, the number of BITs increased to 2,495 by the end of 2005, involving over 170 countries. Along with BITs, countries have also signed double taxation treaties (DTTs). Although bilateral investment agreements are seen by many countries as the most important instrument to attract foreign investment, the evidence shows that they have squarely failed to do so.

A bilateral investment agreement covers a number of issues, including the scope of application of the agreement, definition of investments and investors, and provisions related to dispute settlement. As a complementary measure, a number of countries have also signed bilateral agreements on avoiding double taxation.

Nowadays, bilateral investment agreements incorporate a broad definition of "investment" that includes intellectual property rights. In particular, the US has been pushing for incorporating provisions on intellectual property rights in BITs since the 1980s. For the first time, the recent bilateral trade agreements signed by the US with Chile and Singapore incorporate a wide range of policy measures related to financial liberalization such as removal of capital controls, which go far beyond the scope of any international trade agreement.

Bilateral agreements also serve as building blocks for the greater integration of trade and investment flows. For instance, just as the Canada-US trade agreement led to the creation of the North American Free Trade Agreement (NAFTA), so NAFTA has influenced negotiations for a proposed Free Trade Area of the Americas covering 34 countries. At the political level, bilateral agreements fragment the coalitions of developing and poor countries and thereby weaken their bargaining power in regional and multilateral negotiations. After accepting a liberalized investment policy regime under a bilateral agreement, how can a developing country oppose the investment liberalization agenda of regional and international negotiations?

Among developed countries, the US has been the most active player in recent years in initiating and signing bilateral agreements on trade and investment issues with other countries. Since the inception of the Bilateral Investment Treaty program in 1982, the US has concluded 46 BITs, 39 of which have come into force. The US negotiates BITs on the basis of a model text, which was updated in 2004. The 2004 model text incorporates several basic investment principles (as did its predecessors) and some investment provisions from NAFTA. The US has concluded BITs and free trade agreements (FTAs) with Australia, Jordan, Singapore, Chile, and Morocco. There are ongoing negotiations with Bahrain, the Southern African Customs Union, Thailand, Panama and four Andean countries (Bolivia, Ecuador, Peru, and Colombia).

Some of the key features of the US model of BITs are the following:

- Protection of investment abroad in those countries where investors' rights are not already protected through existing agreements.

- Promotion of market-friendly domestic policies to support private investments.

- Expansive notion of national treatment and most-favored-nation treatment for the full life cycle of investment, that is, from entry to disposition. In particular, the US insists on "pre-establishment National Treatment" provisions for US investors.

- Limitations on the expropriation of investments and provision for payment of prompt and adequate compensation when expropriation takes place.

Box 6.1

A European Model Bilateral Investment Treaty?

Most Member States of the EU have signed a number of Bilateral Investment Treaties (BITs) with other countries. The EU as such, however, is not a party to any bilateral investment treaties in the usual sense. Rather, the EU enters into a variety of free trade and association agreements with other countries and/or regions: for example, Euro-Med, Mexico, the ACP (African, Caribbean and Pacific Group of States) and Chile. These agreements contain provisions directly related to the treatment of investment and profit repatriation, and may touch on political dimensions such as human rights. Unlike the US, where a 2004 model BIT lays down standard language, EU agreements have varied from country to country and over time. The EU-Chile Association Agreement, for instance, contains provisions related to public hearings, third party submissions, and temporary compensation in cases of dispute. Economic partnership agreements currently being negotiated with the six ACP regions, however, have dropped the human rights language that was present in earlier agreements.

There have been recent discussions about the possibility of an EU model BIT, but the EU approach thus far has been to consider BITs as an agreement between parties rather than a set framework. This also serves to circumvent potential problems regarding disputes. Current agreements provide for dispute settlement by joint committees between the EU and its partner State(s) rather than referring to international arbitration by ICSID or the International Court of Arbitration (ICC). This reflects the supreme legal status of the EU Treaty and the European Court in EU affairs.

Among EU Member States, practices related to BITs also vary. Germany, which has concluded more than 100 BITs, has recently revised its BIT with China to provide a much broader right for investors to pursue international arbitration against host states. The UK has also concluded some 100 BITs. Key elements of these include provisions for equal and non-discriminatory treatment of investors and their investments, compensation for expropriation, transfer of capital and returns, and access to independent settlement

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of disputes. France is another country that has signed about 100 BITs, with provisions for a wide definition of the investments covered, guarantee of just and equitable treatment, national treatment, and most favored national treatment, guarantees covering expropriation and nationalization, and free transfer of payments.

The Netherlands, meanwhile, has included far more draconian conditions in some of its BITs. In the 1990s, it signed an investment treaty with Bolivia that considers 'investments' to comprise title to money, goodwill and other assets, and to any performance having an economic value; rights in the field of intellectual property, technical processes and know-how; and rights granted under public law, including rights to prospect, explore, extract, and exploit natural resources. Article 10 of this BIT states that its provisions also apply to investments made before the date when the BIT entered into force.

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- Limitations on the circumstances under which performance requirements can be imposed.

- Removal of restrictions on the transfer of funds into and out of the host country using a market rate of exchange.

- The right to hire senior management personnel, irrespective of nationality.

Through BITs, the US aims to achieve several key economic policy objectives. Such binding treaties not only serve the interests of US corporations, but, more importantly, they also curtail the policy space of host countries to adopt investment policies based on their own needs and development strategies.

Regional Agreements

The bulk of regional agreements deal with trade issues, but over the years a growing number of them also deal with investment liberalization, competition policy, government procurement, and services. Some 250 regional trade agreements (RTAs) had been notified to the GATT/WTO up to December 2002. It is estimated that over 170 RTAs are currently in force. By the end of 2006, if the RTAs reportedly planned or under negotiation are concluded, the total number of RTAs in force might approach 320.

The 1990s witnessed the mushrooming of investment agreements at regional levels, particularly in the Western hemisphere. The European Union (EU) and North American Free Trade Agreement (NAFTA) are the two major regional blocs that have become a model for international trade and investment liberalization. Although the EU is the most advanced regional grouping in the world to date, it does not have a foreign investment policy *per se*. EU policy measures concerning foreign investment and TNCs have different objectives and therefore are covered under other policy measures, such as competition policy. In addition, there is a sectoral agreement in the form of the Energy Charter Treaty (ECT), which has been signed by more than 50 countries and the EU. The Treaty not only liberalizes trade and investment policies in the countries of Central Europe and the former Soviet Union, but also contains comprehensive measures on

Table 6.1: Summary Characteristics of Regional/Sectoral Investment Agreements

Characteristics	**Energy Charter Treaty**	**NAFTA**	**APEC**
Binding	Yes	Yes	No
Year	1994	1993	1994
Coverage (number of countries)	51	3	18
Objectives	Liberalize energy trade and investment in Central and Eastern Europe	Liberalize regional trade and investment	Liberalize regional trade and investment

Source: Adapted by author from Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 257.

investment protection and post-establishment investment matters. Although many countries outside Europe have also signed the Treaty, the US rejected it on the grounds of its lower standards of investment protection measures than its own.

NAFTA has been viewed as a state-of-the-art investment framework because it sets out the most comprehensive rules on foreign investment. Using NAFTA as a case study, the US has been pushing for greater trade and investment liberalization in various other negotiations. For instance, the US wanted to replicate NAFTA across all 34 countries of South and North America (except Cuba) through the establishment of the Free Trade Area of the Americas Agreement (FTAA) in 2005, but strong opposition by Brazil and other countries halted the process. If it ever came into force, the current version of the FTAA would include comprehensive trade and investment liberalization measures, but would exclude the free movement of labor. Three smaller regional pacts already exist in the Americas, namely, the Caribbean Community (CARICOM), the Central American Common Market (CACM), and the Andean Pact. Although focused on trade, these three agreements have significant differences in terms of their investment liberalization measures.

Elsewhere, there has been very little progress on investment issues at the regional level, except for the Asia-Pacific Economic Cooperation (APEC) agreement established in 1989. Most regional investments are legally binding treaties, but there are exceptions, such as APEC. Although the definition of investment varies from treaty to treaty, a strong tendency has developed in most of them over the years towards granting a right of entry and establishment. As in BITs, standards of treatment and protection after entry are similar in most regional agreements.

Almost every regional agreement includes elements of protectionism and discrimination since they treat outsider countries and companies less favorably than those from within the region. Therefore, many critics argue that regional investment agreements often have investment-distorting effects instead of investment-creating effects.

Investment Liberalization under NAFTA

NAFTA is a unique agreement in the sense that it not only contains a comprehensive definition of investment and investment liberalization measures but also, and more importantly, provides new provisions for the settlement of investment disputes. In particular, it provides not only for state-to-state disputes but also investor-to-state disputes to be settled. The inclusion of both types of disputes under NAFTA marks a significant departure from existing WTO dispute settlement procedures, which allow only state-to-state disputes to be considered. Several cases filed by private corporations under the NAFTA regime are a pointer to how the agreement severely restricts the ability of governments to pursue public interest policies. Individual private corporations from NAFTA member countries have used provisions of the agreement to challenge those regulatory measures that infringe on what they consider to be their investment rights (*see* below for examples). The growing conflicts between private corporations and regulators stem from investment provisions in Chapter 11 of NAFTA, which provide for non-discriminatory treatment of foreign investors. Analysts have surmised that any negotiators of a multilateral agreement on investment are likely to look to the NAFTA framework as a model.[2] Hence, it is imperative to examine Chapter 11 of NAFTA in more detail as it contains the most comprehensive rules yet on foreign investment.

Chapter 11 of NAFTA has four main components:

(i) Scope of Application: Article 1101 deals with the coverage of NAFTA provisions. It encompasses the geographical spread of the agreement (Canada, US, and Mexico) and adopts a very broad, asset-based definition of investment extending well beyond FDI to include portfolio investments, debt finance, and real estate.

(ii) Investment Liberalization: Articles 1102, 1103, 1104, and 1106 stipulate specific measures related to investment liberalization. Designed to ensure non-discriminatory treatment, they provide for foreign investors to be given national treatment (NT) and most-favored-nation Treatment

(MFN), which extend to both pre-admission and post-admission stages. NAFTA adopts a 'top-down' approach, which means that commitments by a NAFTA member country cover all economic sectors unless a sector is specifically exempted by that country. Commitment of a sector under NAFTA entails an outright prohibition on the use of certain performance requirements (for instance, technology transfer requirements) by member countries. Article 1106 restricts the capacity of member countries to link the use of incentives to certain performance requirements.

(iii) Investment Protection: Like bilateral investment agreements, NAFTA contains rules related to investment protection under Articles 1110 and 1105. NAFTA incorporates strong guarantees of investment protection, even though in practice the threat of expropriation of foreign investment has receded. Article 1110 does not allow nationalization or expropriation of foreign investment except for a public purpose. But to offset the possibility of expropriation, NAFTA has an in-built obligation to compensate the foreign investor of a NAFTA member country if their investments are expropriated. The Article also provides an obligation to compensate when state regulatory measures are "tantamount to nationalization." But there is no clear definition in NAFTA as to just what constitutes this type of indirect expropriation. Article 1105 stipulates a minimum standard of treatment "in accordance with international law, including fair and equitable treatment and full protection and security" for investors. However, there is no clear definition in the NAFTA text as to what constitutes "fair and equitable treatment" or "full protection and security".

(iv) Dispute Settlement: This section deals with procedures relating to the settlement of investment disputes if a NAFTA member country violates NAFTA rules. In addition to the usual state-to-state dispute resolution mechanism, Chapter 11 also incorporates an investor-to-state dispute resolution process. This means that an investor from a NAFTA member country can take legal action against another member country if it believes that the member country has violated any of the provisions in Section A of Chapter 11. This is a major departure from other existing investment agreements. The investor-to-state dispute resolution mechanism under NAFTA has become controversial since foreign investors use it so frequently, as the examples below illustrate.

Indeed, since its inception in 1994, NAFTA has been mired in a host of controversies. Although a majority of them relate to the investor-to-state dispute settlement mechanism, some pertain to conflicting interpretations of the agreement and undefined areas of investment liberalization and protection measures. Most problematic is the interpretation of the concept of "expropriation", which can restrict the ability of governments to carry out social and developmental measures that might adversely affect the businesses of foreign investors. Since a listing of all litigations under Chapter 11 is beyond the scope of this publication, four representative cases are cited here to highlight the conflicting interpretations of its several investment-related Articles.

1. Metalclad Corporation vs. United Mexican States: The US company, Metalclad Corporation, acquired land in the Mexican Municipality of Guadalcazar in order to establish a waste landfill. In 1993, Metalclad was granted a permit by Mexico's National Ecological Institute to construct a hazardous waste landfill. However, this permit was subject to compliance with certain technical requirements and the caveat that the permit did not authorize the actual operation of project. The location of the hazardous waste site led to strong protest by local residents. Under strong public opposition, the local government ordered Metalclad to stop all construction work and apply for a municipal construction permit. The company applied for a permit, but continued to work on the site, completing the landfill in 1995. The Municipality of Guadalcazar refused to accept Metalclad's application for a permit and subsequently the Governor of the State issued an ecological decree declaring the entire area as an environmental reserve and thereby prohibited the use of the waste disposal facility.

In 1996, Metalclad began legal proceedings against Mexico under Chapter 11 of NAFTA. At the NAFTA Tribunal, the company argued that Mexico and its political sub-divisions and local authorities had violated

Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) of NAFTA. The NAFTA Tribunal voted unanimously in favor of Metalclad, ruling that the Mexican government had violated both Articles 1105 and 1110 of NAFTA. The Tribunal concluded that the creation of an environmental reserve by decree of the State Governor amounted to an act of expropriation of Metalclad's property. The Tribunal awarded $16.7 million in compensation to Metalclad in August 2000. Initially, Mexico refused to accept the ruling of the NAFTA Tribunal, but later agreed to pay the compensation to Metalclad.

2. Ethyl Corporation vs. Government of Canada: In April 1997, the Canadian Government banned the import and transport of MMT, a potentially toxic gasoline additive, on environmental grounds. The ban did not, however, prohibit the production and sale of MMT in Canada. Ethyl Corporation, a US company, was an importer and distributor of MMT in Canada. The company sued Canada under Chapter 11 of NAFTA for $251 million for the "expropriation" of its "property" and the "damage" to its "good reputation" caused by the public debates. The corporation filed the suit on the grounds that the ban breached Articles 1102 (National Treatment), 1106 (Performance Requirements) and 1110 (Expropriation). However, anticipating an adverse decision, Canada agreed to settle the dispute in July 1998. Under the settlement, the Canadian Government lifted the ban on MMT, agreed to pay $13 million in compensation to Ethyl Corporation, and publicly announced that "MMT poses no health risk." The settlement took place in the midst of an NGO campaign against the OECD's proposed Multilateral Agreement on Investment (MAI) (*see* Chapter 5).

3. S.D. Myers Inc. vs. Government of Canada: Another US company, S.D. Myers Inc., engaged a Canadian entity to transport hazardous waste (PCB) from Canada to its treatment plants in Ohio. The company claimed that Canada's blanket banning of PCB exports from November 1995 to February 1997 breached Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment), 1106 (Performance Requirements) and 1110 (Expropriation). In November 2000, the NAFTA Tribunal's verdict concluded that Canada had breached the first two claims but found no violation of Article 1110 on expropriation. The Tribunal ordered Canada to pay $50 million to the company in 2000.

4. Methanex vs. United States: In 1999, a Canadian corporation, Methanex, filed a Chapter 11 suit against the US because the State of California had decided to phase out a cancer-causing gasoline additive known as MBTE. The decision to ban MBTE was based on a study undertaken by the University of California, which found that there were significant risks of water contamination due to the use of MBTE. Methanex filed the suit under Chapter 11 on the grounds that the measure violated Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) and claimed damages of $970 million. The US vehemently opposed the claim by pointing to the detrimental impact on the regulatory autonomy of the NAFTA member countries. It is noteworthy that, until the Methanex case, the US was generally opposed to clarifications on Chapter 11.

The above-mentioned cases not only reveal the inherent shortcomings of Chapter 11, but also raise the issue of regulatory autonomy to deal with environmental and developmental issues. In July 2001, NAFTA member countries, under the aegis of the NAFTA Free Trade Commission (FTC), adopted new interpretations to clarify the meaning of certain provisions of Articles under Chapter 11.

To conclude, the experience of NAFTA highlights the inherent difficulties faced by its three member countries to pursue their own developmental policies. One can well imagine the complicated intricacies that could be encountered if an international agreement on investment incorporating similar provisions was formulated at a heterogeneous conclave such as the WTO whose membership now extends to 149 member countries.

Multilateral Agreements

Although there is no comprehensive multilateral agreement on foreign investment, such as that envisaged as the (failed) MAI in the OECD and through the Singapore issues in the WTO, investment-related provisions are contained in a number of existing multilateral agreements. Nowadays there is hardly any free trade agreement which does not contain provisions related to investment liberalization. By the end of 2005, there were 232 international agreements which contained investment-related provisions. The multilateral investment landscape is governed by diversified sets of institutions, including the World Trade Organization, the World Bank, the International Labor Organization, and the OECD.

The OECD Liberalization Codes were the first ones to be established in the early 1960s. They were followed by the International Centre for the Settlement of Investment Disputes (ICSID) at the World Bank in 1966; the OECD Declaration on International Investment and Multinational Enterprises in 1976; and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy in 1977. The several WTO agreements that have investment-related provisions came out of the Uruguay Round GATT negotiations that were completed only in 1994.

Not all rules outlined in these agreements and institutions are legally binding. For instance, the ILO Declaration of Principles and the OECD's Declaration on International Investment and Multinational Enterprises are non-binding on signatories. In contrast, WTO rules, World Bank rules on dispute settlement, and OECD rules on the liberalization of capital

Table 6.2: Summary Characteristics of WTO Investment Agreements

Characteristics	GATS	TRIMs	TRIPs
Binding	Yes	Yes	Yes
Year	1994	1994	1994
Coverage (number of countries)	149	149	149
Objectives	Establish services trade and investment framework	Limit performance requirements in manufacturing	Protect intellectual property rights

Source: Adapted by author from Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 256.

movements and of current invisible transactions are legally binding on their member countries.

There is a considerable divergence as to the issues covered by these agreements. For instance, within the WTO, performance requirements are covered by TRIMs, intellectual property rights by TRIPs, and services by GATS. Insurance coverage for political risks in developing countries comes under the World Bank's MIGA, and settlement of disputes under the Bank's ICSID. Employment and labor relations come under the ILO's principles while operational aspects of TNC activities come under the framework of the OECD Guidelines on Multinational Enterprises. In WTO agreements such as TRIMs and GATS, there is a greater interrelationship between trade and investment issues.

Given that the WTO and OECD agreements already exist and could act as a driving force for a multilateral investment agreement in future, the investment-related provisions of these agreements are discussed below in detail.

Investment Issues under the WTO Regime

Although there is no comprehensive multilateral agreement on foreign investment under the present WTO regime, investment-related provisions are contained in a number of existing WTO agreements. As mentioned earlier, these provisions were introduced and concluded during the 1986-1994 Uruguay Round of the GATT negotiations.

1. Trade-Related Investment Measures (TRIMs) Agreement: This Agreement came into effect on January 1, 1995 and was enacted, as its name suggests, to address trade-related investment measures. The Agreement did not define these measures, but provided an illustrative list with the goal of abolishing those investment measures that adversely affect trade, such as requirements on domestic content, and the balancing of trade between imports and exports. As mentioned earlier, trade-related investment measures were included in the Uruguay Round GATT negotiations largely at the insistence of developed countries, while many developing countries, including India, opposed them on the grounds that a domestic content requirement is a useful and necessary tool of economic development.

Under the TRIMs Agreement, existing GATT disciplines relating to national treatment (Article III) and the prohibition of quantitative restrictions (Article XI) were reaffirmed. TRIMs introduced standstill and rollback mechanisms applicable only to local content rules, trade balancing, and foreign exchange balancing. Export performance requirements were not dealt with since several developed and developing countries still use investment incentives and performance requirements.

A committee was set up, as provided for in the Agreement, to monitor the implementation of TRIMs' commitments. WTO member countries were given 90 days after the entry into force of the Agreement to notify the WTO of any existing TRIMs, and then granted a transition period during which their notified TRIMs were to be eliminated. The duration of the transition period was based on a country's level of development – developed countries were given two years; developing countries five years; and the least-developed countries were granted seven years. Article 5.3 of the

Box 6.2

Highlights of the Trade-Related Investment Measures (TRIMs) Agreement

- Explicitly establishes linkage between trade policy and investment policy.
- Applies only to investment in manufacturing and trade in goods.
- Prohibits domestic content, import-export balancing, and foreign exchange balancing requirements that could otherwise be imposed on FDI facilities.
- Provides for phase-in periods of 2 years (for developed countries), 5 years (for developing countries), and 7 years (for least developed countries).

Source: Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 125.

Agreement allows developing and least-developed countries to apply for an extension of their transition periods. Several member countries (for instance, Argentina, Chile, Malaysia, and Pakistan) have done so. Under accession protocols, however, any new WTO member countries are required to comply with TRIMs upon accession and are not granted any transition period. For instance, China gave specific commitments to foreign investors without any transition period when it joined the WTO in 2001.

The TRIMs Agreement provides some exemptions for developing countries to deviate from the Agreement temporarily if they have balance-of-payments problems. Any dispute under TRIMs is subject to the WTO's Dispute Settlement Understanding that governs other WTO agreements as well.

2. General Agreement on Trade in Services (GATS): This is the first multilateral, legally enforceable agreement that covers trade and investment in services. GATS covers over 160 service activities including banking, telecommunications, energy, and education. GATS outlines obligations on WTO member countries that trade in services in a similar manner to those that GATT earmarked for trade in goods. GATS is aimed at eliminating governmental measures that prevent services from being freely traded across national borders or that discriminate against locally established service firms that have foreign ownership. It incorporates the "right of establishment", under which service providers have the right to enter another market by establishing a commercial presence in sectors in which countries have made specific commitments under GATS.

Critics have rightly pointed out that GATS is an indirect way of introducing an agreement on investment, since one of the four "modes" in which services can be traded is 'commercial presence'. Commitments under commercial presence imply not only opening up commercial services (such as banking and insurance) to foreign investment but also, and more significantly, vital social services like health and education.

Under GATS, the three important principles are most-favored-nation (MFN) treatment, market access, and national treatment. MFN treatment means a country has to treat the service supplier of another member country no less favorably than it treats the service supplier of any other member country of the WTO. Market access obligations imply that a country is bound to allow foreign service suppliers to enter its market for providing services. National treatment refers to treating foreign suppliers under the same terms and conditions as laid out for domestic suppliers.

GATS employs a unique approach under which some obligations (such as MFN) are applied to *all* service sectors unless specifically exempted, while some others (national treatment and market access) are not applicable to service sectors unless specifically included in the 'schedules of commitments' notified by a member country. Countries are bound to

Box 6.3

Highlights of the General Agreement on Trade in Services (GATS)

- Establishes framework agreement for all service industries.
- Includes separately negotiated agreements for several sectors – telecommunications, transportation (air and maritime), and financial services.
- Provides for many industry-specific and country-specific exceptions to the application of most-favored-nation treatment and national treatment principles.
- Covers all modes of supply-investment as well as cross-border trade, movement of consumers, and movement of persons as service suppliers.
- Limits restrictions on joint ventures and percentages of foreign ownership.
- Opens previously protected domestic services sectors to foreign competition through investment and/or trade.

Source: Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 128.

liberalize only those sectors for which they have provided schedules and to the extent of the commitments undertaken in those schedules. This process is called a 'positive listing' or a 'bottom-up' approach. In contrast, a 'negative listing' or 'top-down' approach implies that the obligations apply to *all* sectors unless a country specifically lists an exception.

It is often claimed by proponents that the GATS bottom-up approach is flexible and development-friendly. But this claim requires fresh thinking in the light of power relations between countries. Given unequal power relations, developing countries have often been compelled to undertake greater and greater commitments over time, thereby narrowing down the flexibility to regulate available to them. For instance, during the last set of GATS negotiations, many developing countries had placed restrictions on commitments in several service sectors or kept them outside of the purview of GATS rules. But the 2001 request list put forward by the European Commission sought removal of a wide range of regulatory measures in several sectors (including telecommunications, education, retailing, environmental, and financial services) in 109 WTO member countries, most of

Box 6.4

Highlights of the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement

- Establishes uniform standards for national laws for the establishment of intellectual property rights.
- Includes copyrights, trademarks, industrial designs, patents, and designs of integrated circuits.
- Mandates transparent and equitable domestic judicial procedures for the enforcement of intellectual property rights.
- Provides for interception at borders of counterfeit trademark or pirated copyright goods in international trade.
- Establishes phase-in periods of 1 year (developed countries), 5 years (developing countries), and 10 years (least developed countries).

Source: Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, p. 129.

them developing and least-developed countries.

Since most services are usually subject to tight regulatory measures in many countries, GATS became a WTO Agreement only after a protracted negotiating process. Although many developing countries were initially keen to keep services outside the purview of the WTO so as to protect local firms, the negotiators were eventually able to bring them within the WTO. All members of the WTO are signatories to the GATS framework and have made different commitments for different service sectors. The GATS Agreement itself mandated a new round of negotiations for the year 2000 and every five years thereafter in order to achieve a higher level of liberalization. This round commenced in 2000, was linked in 2001 to the other WTO renegotiations, and is still incomplete because of deadlock over the Doha Round of negotiations. Since the biggest exporters of services are the US and EU, they are the driving forces behind attempts to expand the scope of GATS through progressive rounds of negotiations. Developing countries, on the other hand, are advocating that safeguard provisions (for instance, exemptions from the obligations for allowing the free transfer of payments when a country is facing difficulties in balance-of-payments or low levels of foreign exchange reserves) be included in the GATS to ensure that global service providers do not pose a threat to domestic entities. But developed countries are not interested in including such emergency provisions.

At the end of the Uruguay Round, extended GATS negotiations were also mandated in four particular service sectors: basic telecommunications, financial services, movement of natural persons, and maritime transport services. Negotiations for telecommunications and financial services were concluded in 1997 and on the movement of natural persons in 1995, but negotiations on maritime transport were suspended in 1996.

The Financial Services Agreement (FSA) came into force in March 1999. By covering financial services such as banking, securities, and insurance, the FSA marked a major departure from the past as member countries had agreed to a legal framework for cross-border trade, market access, and dispute settlement mechanism in these sectors. In this subagreement under GATS, countries made binding commitments to provide national treatment and market access in financial services, as specified in their country schedules, to financial services firms from any WTO member country. It has been estimated that the FSA now covers nearly 95 per cent of global trade in banking, insurance, securities, asset management, and other financial services. Although several countries have not undertaken comprehensive reforms as envisaged under the FSA, developed countries, particularly the US, have used the Agreement to open up the financial sector in developing countries and emerging markets.

The dispute settlement mechanism of the WTO deals with any violation of commitments by member countries. Under the dispute settlement mechanism, a country may be required to compensate another if the tribunal finds that the member country has not adhered to its commitments and is not making the necessary changes in policies.

In addition to TRIMS and GATS, the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement also has provisions for

Table 6.3: Summary Characteristics of OECD Investment Agreements

Characteristics	CAP	CUR	NTI	MNE
Binding	Yes	Yes	No	No
Year	1963	1963	1976	1976
Coverage (number of countries)	30	30	30	30
Objectives	Liberalize restrictions on capital transactions	Liberalize restrictions on capital transactions	Establish national treatment principles	Establish guidelines for firms' behavior

Notes: CAP-Code of Liberalization of Capital Movements; CUR-Code of Liberalization of Current Invisible Operations; NTI-National Treatment Instrument; MNE-Guidelines for Multinational Enterprises.

Source: Thomas L. Brewer and Stephen Young, *The Multilateral Investment System and Multinational Enterprises*, Oxford University Press, Oxford, 2002, pp. 256-7.

liberalizing investment policies as it incorporates protection of intellectual property (patents and copyright) – a form of intangible asset. In addition, other less well-known WTO agreements (such as the Anti-Dumping Agreement, Subsidies and Countervailing Measures Agreement, and Agreement on Government Procurement) also cover investment issues.

Investment Issues under OECD

Unlike the WTO or the World Bank, membership of the OECD has remained small and less diversified (both economically and geographically) since its establishment in the early 1960s. Nevertheless, due to the strong economic clout of its members, the OECD has played important roles in various capacities in the evolution of an international investment regime.

The OECD was the first international organization to promote the liberalization of both current and capital accounts among its member countries through the establishment of its Codes for the Liberalization of Capital Movement and of Current Invisible Operations in the early 1960s. As their names suggest, both Codes require liberalization of capital movements across borders.

The Codes are legally binding on their signatories and their acceptance is a precondition for membership of the OECD. However, the Codes allow for obligations to be suspended if a member country experiences temporary difficulties such as a balance-of-payments crisis. The member countries that are not in a position to remove all their restrictions can lodge reservations in the case of the Codes of Liberalization, and exceptions in the case of the National Treatment Instrument. The enforcement of these Codes is carried out by two committees: the Committee on Capital Movements and Invisible Transactions (CMIT), and the Committee on International Investment and Multinational Enterprises (CIME).

The OECD investment liberalization measures were phased in over a long period. In the 1970s and 1980s, the concept of foreign investment was broadened under the OECD to allow reciprocity requirements (a member country allowed residents of another member country to invest under

Table 6.4: Progress of International Investment Rules at the OECD

Year	Event	Comment
1961	Code of Liberalization of Capital Movements	Since 1964 signatories obligated to progressively liberalize inward and outward direct investment.
1961	Code of Liberalization of Current Invisible Operations	Introduced notion of equivalent treatment concerning FDI by insurance companies. Current transfers (for example, profits, interest payments) liberalized.
1967	Draft Convention on the Protection of Private Property	Not formally an 'instrument' as never signed but used as a model for bilateral investment treaties.
1976	Declaration and Decisions on International Investment And Multinational Enterprises	
	● Guidelines for Multinational Enterprises	Established voluntary standards of conduct for behavior of TNCs.
	● National Treatment	Provided that OECD members treat foreign-controlled enterprises in their territory no less favorably than domestic enterprises. Excludes monopolies.
	● International Investment Incentives and Disincentives	Encouraged transparency and provided for consultation and review.
	● Conflicting Requirements	Designed to avoid imposition of conflicting requirements on TNCs.
1984		Expanded definition of inward direct investment adopted, including main features of the right of establishment.

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1986		Code of Capital Movements extended to permit reciprocity requirements.
1994	Possible Multilateral Agreement on Investment (MAI)	Aimed to conclude MAI by 1998. However, the proposal was shelved in 1998 because of opposition by some member-countries.
2000	Guidelines on Multinational Enterprises	The Guidelines were reviewed and revised to include new provisions.

Source: OECD and various publications.

similar terms to those applied to its residents by the other member country) and non-binding guidelines for TNCs were established (*see* Table 6.4).

It would not be erroneous to state that the OECD played a vital role in establishing an open investment regime among its member countries in the 1960s and 1970s. Subsequently other agreements formalized under the OECD paved the way to launch negotiations for a multilateral investment agreement in 1998, even though these were not ultimately concluded.

Notes and References

1. A plurilateral agreement differs from a multilateral agreement in that the former is signed by only those member countries that choose to do so, while all members are required to sign a multilateral agreement.
2. Jurgen Kurtz, "A General Investment Agreement in the WTO?: Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment," *Jean Monnet Working Paper 6/02*, New York University School of Law, New York, 2002 .

7

Regulating Investments: Voluntary or Mandatory Approaches?

THE globalization of trade and investment flows has been paralleled by the emergence of Codes of Conduct. Although the first corporate code of conduct was created by the International Chamber of Commerce (ICC) in 1949, the 1990s witnessed a plethora of voluntary codes and corporate social responsibility (CSR) guidelines. There is no consensus on the precise definition of a code of conduct. Codes can range from one-page broad statements to detailed benchmarks and guidelines on how to conduct business practices globally. Voluntary approaches are based either on a self-regulation model or a co-regulation one between firms, citizen groups, and governments.

It is important to underscore that voluntary approaches did not emerge in a vacuum. Their emergence has more to do with a change in the paradigm of how global capital should be governed. Voluntary approaches, such as the OECD Guidelines on Multinational Corporations (*see* below), were a direct response to UN initiatives in the 1970s to regulate the activities of TNCs. However, it needs to be emphasized that, unlike the UN initiatives, the OECD Guidelines were not aimed at protecting national sovereignty or addressing developmental concerns of the host countries, but at circumventing the UN initiatives.

The deregulation and 'free market' environment of the 1980s gave greater legitimacy to the self-regulation model embedded in the Anglo-Saxon business tradition. Many developed countries, particularly the US, encouraged TNCs to adopt voluntary measures rather than enacting and enforcing strict laws governing their activities and behavior. The argument against regulation was based on the belief that TNCs would undertake greater social and environmental responsibilities through voluntary measures.

In the late 1980s, campaigns launched by NGOs and consumer groups brought significant changes in the public perception of corporate behavior, which in turn facilitated the further proliferation of voluntary initiatives. Campaigns in the developed countries focusing on popular consumer brands such as Nike and Levi's brought to public notice some of the appalling working and environmental conditions in some of these companies' overseas production sites. Realizing that bad publicity could seriously damage corporate and brand reputations and that their products could face consumer boycotts, many corporations suddenly started adopting codes of conduct and other CSR measures. Since the early 1990s, the majority of voluntary measures have been undertaken by individual corporations. US-based corporations were the first to introduce codes of conduct with jeans manufacturer Levi's adopting one in 1992.

Pressures generated by the 'ethical' investor community and other shareholders also contributed to the proliferation of voluntary measures.

Given that there is often a considerable discrepancy between a corporation undertaking to follow a voluntary code and its actual business conduct (e.g., Nike), many critics argue that CSR measures have become corporate public relations tools used to create a positive corporate image. In today's competitive world, a positive image as a responsible company adds significant value to a company's business and reputation and helps it manage various risks. Thus, the growing popularity of voluntary measures in recent years has not ended debates on how to regulate TNC corporate behavior.

Types of Codes

Over the years, a variety of codes of conduct governing whole corporate sectors have emerged. Some of those to emerge from international organizations include the International Labor Organization's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social

Policy; the OECD Guidelines on Multinational Enterprises; UNCTAD's Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices; the Food and Agriculture Organization's Code on the Distribution and Use of Pesticides; and the World Health Organization/UNICEF Code of Marketing Breast Milk Substitutes. Business associations have also drawn up codes, such as the US Chemical Manufacturers Association's Responsible Care Program and the International Chamber of Commerce's Business Charter for Sustainable Development. A diverse range of players have been involved in the development of voluntary codes of conduct. These include corporations, business associations, NGOs, labor unions, shareholders, investors, consumers, consultancy firms, governments, and international organizations.

Broadly speaking, codes of conduct can be divided into five main types: specific company codes (for example, those adopted by Nike and Levi's); business association codes (for instance, ICC's Business Charter for Sustainable Development); multi-stakeholder codes (such as the Ethical Trading Initiative); inter-governmental codes (for example, the OECD Guidelines), and international framework agreements (such as the International Metalworkers Federation agreement with DaimlerChrysler).

Despite their diversity, the majority of codes of conduct are concerned with working conditions and environmental issues. They tend to be concentrated in a few business sectors. Codes related to labor issues, for instance, are generally found in sectors where consumer brand image is paramount, such as footwear, apparel, sports goods, toys, and retail. Environmental codes are usually found in the chemicals, forestry, oil, and mining sectors.

Codes vary considerably in both their scope and application. Very few codes accept the core labor standards prescribed by the ILO. Although codes increasingly cover the company's main suppliers, they tend not to include every link in the supply chain. Codes rarely encompass workers in the informal sector even though they could form a critical link in the company's supply chain. In terms of ensuring compliance, only a small

Table 7.1: Some Key Features of Multi-Stakeholder Initiatives

MSI	Industries Covered	Stakeholder Representation	What is Certified	Monitoring & Certification	Public Disclosure
Social Accountability International (SAI) **www.sa-intl.org**	All industries.	NGOs; trade unions; socially responsible investors; government and industry.	Individual factories.	Monitors accredited and selected by SAI perform certification audits of factories. Certification lasts for 3 years.	SAI publishes certified facilities and locations on its website, list of complaints, corrective action, monthly newsletter.
Fair Labor Association (FLA) **www.fairlabor.org**	Apparel industry; college and university licensees.	Industry; NGOs; colleges and universities.	Brands, colleges and universities.	Monitors accredited and selected by FLA conduct audits of 30% of a company's supplier factories (chosen by FLA staff) during initial 3-year participation.	FLA issues an annual public report on compliance record of each affiliated company. Names of individual factories and full monitor reports not disclosed.
Worldwide Responsible Apparel Production (WRAP) **www.wrapapparel.org**	Apparel industry.	Non-apparel industry related individuals; top apparel industry executives.	Individual factories.	Factories choose a monitor and schedule an audit in advance. WRAP Board decides on unannounced audits. Certification lasts 1 year.	None. Audit reports given only to factories and WRAP Board, which does not disclose certified factories or factories that fail.

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Worker Rights Consortium (WRC) **www.workersrights.org**	College and university licensees.	Colleges, universities; labor rights experts (academics, union officials, NGOs); students.	Does not certify.	WRC investigates factories about which it receives complaints. Investigations conducted by Collaborative Investigative Team of local labor NGOs, academic experts, and staff.	WRC makes results of all investigations public; maintains web database of college and university affiliates; names and locations of factories producing goods bearing logos.
Clean Clothes Campaigns (CCC) **www.cleanclothes.org**	Apparel industry.	Coalitions of consumers, trade unions, human & women's rights organizatoins, researchers, solidarity groups and activists.	Does not certify.	5 pilot projects in monitoring and verification underway.	CCC gathers information about workplaces from a variety of sources (factory workers, independent research, media) and makes it public.
Ethical Trading Initiative (ETI)s **www.ethicaltrade.org**	All industries including apparel, food, beverage, horticulture.	Companies; unions; NGOs; observer from UK Department for International Development.	Does not certify.	Pilot projects complete and several underway. Each pilot project operates according to a different model of internal or external monitors of academics, unions, and NGOs.	ETI "support [s] the principle of public disclosure as a long-term goal," but does not require companies to make ETI annual reports public.

Source: Ivanka Mamic, *Business and Code of Conduct Implementation*, ILO, Geneva, 2003, p. 43.

proportion of codes include provisions for independent monitoring.

It is interesting to note that various types of codes have gradually evolved in response to developments in the governance of TNCs. When the limits of self-regulatory voluntary codes adopted by companies became apparent in the late 1990s, the focus shifted to co-regulation in the form of multi-stakeholder initiatives (MSIs) under which corporations, NGOs, labor unions, and even governments draft and monitor codes. Unlike company codes, MSIs address a vast range of issues and provide independent monitoring mechanisms and, therefore, are increasingly viewed as a credible alternative. MSIs are set up as non-profit organizations consisting of coalitions of companies, labor unions, and NGOs that develop specific standards. Some MSIs (such as Social Accountability International) have developed elaborate guidelines under which they certify that a company complies with the standards. Initiatives such as the Ethical Trading Initiative and the Clean Clothes Campaign are increasingly seen as progressive MSI models by both corporations and NGOs. Some key features of important MSIs are listed in Table 7.1.

International Framework Agreements also emerged in the late 1990s. More than 30 have been signed since 1999 in a variety of sectors, including mining, retailing, telecommunications, and manufacturing. The framework agreement signed between the International Federation of Building and Wood Workers (IFBWW) and Swedish retailing giant IKEA in 2001 is an example. An Agreement is negotiated between a transnational company and the trade unions of its workforce at the global level. It is a global instrument with the purpose of ensuring fundamental workers' rights in all of the TNC's locations as well as those of its suppliers. A Framework Agreement includes special reference to international labor standards and follows similar structure and monitoring procedures to those of MSIs. Since they are negotiated on a global level and require the participation of trade unions, International Framework Agreements are considered preferential instruments for dealing with the issues raised by globalization of investment flows by many social movements.

International Codes: Three Case-Studies

Given their wider coverage, scope, and applicability, key features of three important international codes are discussed below:

1. OECD Guidelines on Multinational Enterprises

In 1976, the OECD adopted a declaration on International Investment and Multinational Enterprises under which these Guidelines were included. Although legally non-binding, the Guidelines have been adopted by the 30 member-countries of the OECD and 8 non member-countries (Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania, and Slovenia). Thus, the coverage of the Guidelines is vast, and most big TNCs fall under their remit. Addressed to businesses, the Guidelines provide voluntary principles and standards to encourage companies to follow responsible business practices. The stated objectives of the Guidelines are to ensure that TNCs operate in harmony with the policies of host countries and make positive contributions to them. Compared with company codes, the issues covered under the Guidelines are wide-ranging; they include employment and labor relations, environment, information disclosure, combating bribery, consumer interest, science and technology, competition, and taxation.

The Guidelines have been reviewed and revised five times in 1979, 1982, 1984, 1991 and 2000. After the 1991 review, a new chapter on Environmental Protection was added, while implementation procedures and supply-chain responsibilities on TNCs were included after the most recent review in 2000.

Even though the OECD does not provide any independent monitoring and verification processes for the Guidelines, it does mandate signatory countries to set up a National Contact Point (NCP) to deal with the promotion, management, interpretation, and dispute settlement of the Guidelines. Since 2000, more than 70 complaints regarding violations of the OECD Guidelines have been filed by several labor unions and NGOs at various NCPs. But very few complaints have succeeded to date, indicating the inherent weakness of this institutional mechanism. A number of reports by NGOs and labor unions have highlighted the technical and administrative ineffectiveness and inability of NCPs to handle complaints against TNCs. The Guidelines' confidentiality clauses and lack of transparency further restrict their use in creating public awareness on complaint cases.

Some NGOs consider the Guidelines a potentially powerful tool to put pressure on TNCs that they believe are violating social and environmental norms. There is no denying that, compared to individual company or business association codes, OECD Guidelines have better value because of governmental involvement, but they are still voluntary and non-binding in nature. The Guidelines do not confer any rights on citizens in the signatory countries to take legal action against TNCs for not implementing them. In the long run, a strategy exclusively based on filing complaint cases will not be sufficient to hold TNCs accountable to the general public for their actions.

2. The ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy

The policy measures implementing the ILO's labor principles for TNCs are mainly contained in the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. Adopted in 1977, the Declaration is voluntary in nature, despite efforts made by labor unions to make it legally-binding. Concerned with employment policy, job security, and health and safety issues, the Declaration calls upon governments, employers, labor unions, and TNCs to work towards the realization of economic and social development. It calls for formulating appropriate national laws and policies and recommends the principles to be implemented by all concerned parties. It seeks to promote consistent standards for both domestic and international corporations. In addition, the Declaration makes specific reference to the United Nations Universal Declaration of Human Rights, International Covenants adopted by the UN, and the Constitution of the ILO.

The ILO has established a bureaucratic system to implement the Declaration. Investigations are carried out by the ILO secretariat, which sends a questionnaire to governments to complete in cooperation with employers and employees. The secretariat then compiles various national reports that it presents to the Board of Directors of the Committee on Multinational Enterprises. The national reports are usually vague with no reference to any specific TNC. Attempts made by labor unions for strict implementation procedures of the Declaration have not yielded any results so far.

In addition to the Tripartite Declaration, several other conventions and labor standards adopted by ILO have a direct bearing on the operations of TNCs. For instance, the Declaration on Fundamental Principles and Rights at Work adopted in 2000 seeks the contributions of TNCs to achieve basic labor rights, including freedom of association and the right to collective bargaining.

3. UN Global Compact

Launched in 2000, the Global Compact is a recent initiative by the UN aimed at engaging TNCs to support and implement ten principles covering human rights, labor, environmental protection, and anti-corruption. These principles are derived from the UN Universal Declaration on Human Rights, the ILO's Declaration on Fundamental Principles of Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption. The stated goal of the Global Compact is to create "corporate citizenship" so that business can become part of the solution to the challenges of globalization.

To date, nearly 1,200 companies (both domestic and transnational) have indicated their support for the Global Compact in addition to some international business associations, labor union bodies, and NGOs. The Global Compact runs a small secretariat, liaising with other UN agencies. Companies join this initiative by sending a letter of commitment to the UN Secretary-General. Each year, the company is expected to publish in its annual report a description of the methods through which it is supporting the principles of the Global Compact.

While some NGOs have welcomed the Global Compact as a forum to engage with the corporate world, critics have expressed their apprehensions that it would be largely used as a public relations tool by TNCs. Some of their concerns cannot be overlooked. Firstly, no one can deny that the Global Compact is a purely voluntary initiative. Secondly, there are hardly any effective mechanisms in place to ensure that companies comply with its ten principles. In other words, there are no monitoring and accountability mechanisms. It is for the company to decide which principles they wish to abide by in which of their activities. Thirdly, there is no procedure to screen companies – several TNCs that have long been charged with environmental and human rights abuses in host countries have joined the Global Compact (such as Nike, Royal Dutch Shell, and Rio Tinto).

Critics also fear that initiatives like the Global Compact would further increase corporate influence within the UN system in terms of policy advice. Little wonder that many critics see the initiative as more of an image-building exercise ("blue-washing" after the blue of the UN logo) than an attempt to improve social and environmental standards on the ground.

The Limits of Voluntary Approaches

Voluntary approaches have several inherent weaknesses and operational difficulties, some of which are summarized here. First, as discussed above, corporate codes are purely voluntary, non-binding instruments. No corporation can be held legally accountable for violating them. The responsibility to implement the code rests entirely on the corporation. At best, corporations can be forced to implement codes only through moral persuasion and public pressure.

Second, despite being in existence for many years, the number of companies adopting such codes is still relatively small. Moreover, corporate codes are limited to a few sectors, particularly those in which brand names are important in corporate sales, such as garments, footwear, consumer goods, and retailing businesses. A large number of other sectors remain outside the purview of corporate codes.

Third, many codes are still not universally binding on all the operations of a company, including its contractors, subsidiaries, suppliers, agents, and franchisees. Codes rarely encompass the workers in the informal sector, who could well be an important part of a company's supply chain. Further, a company may implement only one type of code, for instance, an environmental one, while neglecting other important codes related to labor protection, and health and safety.

Fourth, corporate codes are limited in scope and often set standards that are lower than existing national regulations. For instance, labor codes recognize the right to freedom of association but do not provide the right to strike. In many countries, such as India, the right to strike is a legally recognized instrument.

Fifth, the mushrooming of voluntary codes in an era of deregulated business raises serious doubts about their efficacy. There is an increasing concern that corporate codes are being misused to deflect public criticism of corporate activities and to reduce the demand for state regulation of corporations. In some cases, codes have actually worsened working conditions and the bargaining power of labor unions. Moreover, increasing numbers of NGO-business partnerships established through corporate codes and CSR measures have created and widened divisions within the NGO community and sharpened differences between NGOs and labor unions. Voluntary codes of conduct can never substitute for state regulations. Nor can they substitute for labor and community rights. At best, voluntary codes can complement state regulations and provide an opportunity to raise environmental, health, labor, and other public interest issues.

Implementation Issues

Despite the recent proliferation of codes, their actual implementation and monitoring remain problematic. Information about codes is generally not available to workers and consumers. Researchers have found that labor codes have often been introduced in companies without the prior knowledge or consent of the workers for whom they are intended. A key issue regarding the implementation process is the independence of the monitoring body. Since large auditing and consultancy firms usually carry out the monitoring of company codes with little transparency or public participation, whether the codes are actually being implemented or not remains a closely guarded secret. Besides, auditing firms may not reveal damaging information since they get paid by the company being audited.

Recent voluntary initiatives, such as Multi-Stakeholder Initiatives (MSIs), are considered more credible because NGOs and labor unions are involved as external monitors. But the authenticity of such monitoring cannot be guaranteed by the mere involvement of NGOs and civil society. Researchers have found that the development of standards by some MSIs has taken place in a top-down manner without the involvement of workers at the grassroots level.[1] For instance, concerns of workers in India and Bangladesh were not taken into account in the standards created by MSIs such as the Ethical Trading Initiative and Social Accountability International.[2]

If recent experience is any guide, the struggle to implement codes could be frustrating, time-consuming, and ultimately futile. It dissipates any enthusiasm to struggle for regulatory controls on TNCs. This was evident in the case of the decade-long campaign in India on a national code to promote breast-feeding and restrict the marketing of baby food by TNCs along the lines of WHO code.[3] Therefore, voluntary codes require serious rethinking on the part of those who consider them as a cure-all to problems posed by TNCs.

The unveiling of corporate scandals (from Worldcom to Enron to Parmalat) underline the important role of strong regulatory measures. One cannot ignore the fact that all these corporations were signatories to several international codes while some of them (for instance, Enron) had developed their own codes.

Why State Regulation?

The proponents of neoliberal ideology argue that states should abdicate their legislative and enforcement responsibilities by handing them over to NGOs and civil society organizations which should develop voluntary measures in collaboration with business. Without undermining the relevance of such voluntary approaches, it cannot be denied that the primary responsibility of regulating corporate behavior of TNCs remains with nation states. It is difficult to envisage the regulation of TNCs without the active involvement of states. State regulations are the primary vehicle for local and national government and international institutions to implement public policies. National governments have the primary responsibility of protecting and improving the social and economic conditions of all citizens, particularly the poorer and more vulnerable ones.

There is no denying that all states are not democratic and that supervisory mechanisms are often weak, particularly in developing countries. Despite these shortcomings, however, states remain formally accountable to their citizens, whereas corporations are accountable only to their shareholders. National regulatory measures are also necessary to implement international frameworks. The additional advantage of national regulatory measures is that they would be applicable to all companies, domestic or transnational, operating under a country's jurisdiction, thereby maximizing welfare gains.

The national regulatory framework is very important and it will not wither away under the influence of globalization. On its own, transnational capital lacks the necessary power and ability to mould the world economy in its favor. Rather, it strives for the support of nation-states and interstate institutions to shape the contemporary world economy. State policies are vital for the advancement and sustenance of transnational capital on a world scale. Investment decisions by TNCs are not always influenced by the degree of national liberalization but are also governed by state regulations in areas as diverse as taxation, trade, investment, currency, property rights, and labor.

A stable economic and political environment is also an important determinant. Transnational capital looks upon legislative, judicial, and executive institutions not merely to protect and enforce property rights and contract laws, but also to provide social, political, and macroeconomic stability. In the absence of such a policy framework, contemporary globalization would not have taken place. Social and political conflicts are also resolved primarily through state mechanisms. The fact that a strong and stable state is a prerequisite for the development and sustenance of the market economy is evident from the failure of economic reforms in transition countries. In addition, state intervention is also necessary to prevent and correct market failures. There are innumerable instances of market failures with huge economic, social, and environmental costs throughout the world. Pollution and monopoly power are the most popular examples of market failure. The government can introduce pollution taxes and regulate monopolies to correct the distortions created by market failure. Besides, the government is expected to provide public goods and services (for example, schools, hospitals, and highways) to all citizens because the market has failed to do so.

In the context of global capitalism, nation-states provide the legal framework within which all markets operate. The notion of a 'free market' is a myth because all markets are governed by regulations, though the nature and degree of regulation may vary from market to market. Even the much-claimed self-regulation or co-regulation model would lack legitimacy if it was not backed by a government decree. In fact, it is impossible to conceive of contemporary neoliberal globalization without laws, which do not exist outside the realm of nation-states. Even the global rules on trade enforced by international institutions (for instance, WTO) are not independent of nation-states.

Whither Regulatory Framework?

The first step towards regulating TNC behavior begins at the national level. Host countries in particular should adopt appropriate regulatory measures on transparency, labor, environmental, and taxation matters.

At the same time, home countries should put in place regulations to ensure that the same standards are followed by their TNCs irrespective of where they operate in the world. The Foreign Corrupt Practices Act of the US, which penalizes US-based corporations for their bribery and corrupt practices in foreign countries, is a case in point.

National regulatory measures could be supplemented by new forms of regulatory cooperation and coordination between states at regional and international levels. By providing the overall framework and guiding principles, regional and international efforts should enhance the policy space and powers to regulate TNCs and foreign investment in order to meet national developmental objectives.

At the domestic level, the political climate in many developing countries has drastically changed in the past two decades. Neoliberal policies now frame almost every political process and go unchallenged even among some ranks of the left. There is a strong lobby in many developing countries (for instance, India) consisting of big business, the upper middle classes and the media, which supports the entry of foreign capital and demands fewer regulatory mechanisms. Some developing countries like India and China are also witnessing the emergence of 'Third world TNCs' that are expanding their businesses in other countries. These developments make the task of regulating corporations still more difficult. How can such countries demand greater regulation of private capital flows? Besides, it fragments the coalitions of developing countries and weakens their collective bargaining power in international economic policy arenas such as the WTO. Nonetheless, even though the task of re-establishing the authority of states over TNCs may be difficult, it would not be impossible provided efforts were backed by strong domestic political mobilization. Herein the role of NGOs, labor unions, and other civil society organizations becomes important to strengthen domestic political processes.

It needs to be stressed here that a robust, transparent and efficient supervisory framework is also required to oversee the implementation of national regulations. Otherwise expected gains from a strong regulatory framework would not materialize. India provides a classic example of having a strong regulatory framework but poor supervisory structures. In the present world, there is a need for greater international supervision of private investment flows based on cooperation between home country and host country supervisors.

While acknowledging that voluntary approaches could be used as tools for leverage on corporate behavior and therefore are worth testing, this chapter underscores the need for enhancing the state regulatory and supervisory frameworks. Any strategy aimed at privatizing regulation is bound to fail; even the limited gains made in the past through voluntary approaches always rested on governmental backing. Voluntary codes of conduct can never be a substitute for state regulations. Nor can they substitute for labor and community rights. At best, voluntary codes can complement state regulations and provide space for raising environmental, health, labor, and other public interest issues. As rightly pointed out by Rhys Jenkins, "Codes of conduct should be seen as an area of political contestation, rather than as a solution to the problems created by the globalization of economic activity."[4]

Notes and References

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8

Strategizing Campaigns

SINCE the 1980s, a number of popular campaigns raising questions about international investment issues and the activities of TNCs have been launched globally by social activists, community organizations, labor unions, NGOs, consumer groups, human rights groups, and political movements. Some prominent campaigns include international consumer boycotts against food company Nestlé because of its unethical marketing of baby food formula, the community struggle for justice against Union Carbide in Bhopal (India), workers' resistance against Coca-Cola in Guatemala, the NGO campaign against the proposed MAI, the anti-incinerator movement in the US, and the global struggle by AIDS patients against "Big Pharma" because of its high drug prices.

It is true that not all popular campaigns against TNCs have been successful. It is also true that many victories are defensive in nature. Nevertheless, one cannot deny their influence in revitalizing the agenda of regulating TNCs at both national and global levels. The achievements of campaigns against TNCs are all the more striking because they went against the global tide that was rushing towards deregulation and market economy.

Such campaigns also reaffirm the hope that popular movements can weaken and, on occasion, render powerless the mightiest of transnational corporations. The prospects of regulating the behavior of TNCs are not as gloomy as often perceived by the proponents of corporate power. In addition, it is true that not all campaigns directed at TNCs can be clubbed together because they vary in terms of their strategies, worldview, and ideology. Despite these important variations, most corporate campaigns have a common understanding that TNCs should be made accountable and subservient to the needs of society.

Some Lessons Learnt

Diverse popular campaigns directed at TNCs offer a number of valuable lessons that could be put effectively to use in the formulation of strategies.

First and fundamentally, there is no "one-size-fits-all" approach to campaigning. Different strategic goals have been used by campaigners to suit their particular circumstances. Even within a national context, corporate campaigns have followed different objectives. For instance, in the case of India, the popular campaigns against Cargill's salt manufacturing plant, DuPont's nylon tire project and Enron's power project were primarily aimed at stopping these projects from going ahead, whereas activists focusing on Nestlé and on deep sea fishing aimed at bringing legislative measures to regulate the activities of TNCs.[1]

Second, since their strategic goals are different, many corporate campaigns highlight the need for using diverse tools and points of leverage. For instance, legal action (both at the national and international level) has been used as an important strategic tool by the gas victims of the Union Carbide plant in India. On the other hand, the campaign against DuPont centered on local level mobilization.

Third, in specific sectors where brand image is important, such as apparel, toys, and retailing, TNCs are vulnerable to bad publicity and therefore are willing to change their behavior. But there are several limitations to this strategy as it is not feasible to target each and every corporation involved in such businesses. Nonetheless, the spillover effects of this strategy cannot be denied. The brand attack strategy may also prove futile in sectors such as forestry, power generation, and mining where brand image is irrelevant.

Fourth, there are several inherent limitations to voluntary approaches, as discussed in the previous chapter. Left to themselves, TNCs would not carry out their social and environmental responsibilities in any meaningful manner. It is largely pressure generated by an enhanced state regulatory framework that would bring about the necessary changes. Even while targeting a campaign at a particular TNC, efforts should be made to strengthen regulatory standards.

Fifth, any campaign should not be exclusively focused on TNCs alone. There are a large number of domestic interest groups supporting the influx of foreign capital. These include big business, the upper and middle classes, domestic industry and trade lobby bodies, technocrats, politicians and business media. While strategizing, campaign groups should be aware of the influence of such domestic players. This involves targeting players other than the TNCs itself.

Sixth, any campaign that is backed by strong domestic public mobilization can have a long-lasting impact. It adds to the political will in a government to tame TNCs. It has been found that even supporting activities (such as lobbying and advocacy) yield better results if they are backed by public mobilization.

Last, cross-sectional solidarity, both at the national and the international level, is essential to support local campaigns, particularly in the present context of increased capital mobility. The experience of almost all campaigns indicates how beneficial it can be to broaden the base of support and to include groups and individuals from different socio-economic, cultural, and political backgrounds. The collective learning of diverse strategic goals and campaign tools further strengthens the political processes of building a wider movement.

Key Elements of Building a Campaign

An attempt has been made here to list a set of working instruments for launching a campaign on international investment issues. The main purpose behind this exercise is to enhance debate and discussion as part of collective learning and it should not, therefore, be considered prescriptive. The actual use of these instruments would vary from campaign to campaign and from country to country, depending on particular circumstances.

Mapping Spaces: It is very important for corporate activists and movements to demarcate the various spaces in which investment issues could be addressed. This exercise would help immensely not only in terms of analyzing the 'big picture', but also of identifying potential allies, opponents, leverage points, and campaign targets operating within various spaces. Broadly speaking, investment issues operate at three main levels: local, national, and international. Some of the major players operating within these spaces and at these levels are mentioned in Figure 8.1. It is important to stress here that none of the players operate in a vacuum. Several complex systems interlink these players in addition to numerous areas of agreement and of conflict. The players are also not politically neutral, as their activities are greatly influenced by pressures generated by power relationships at local, national, and international levels.

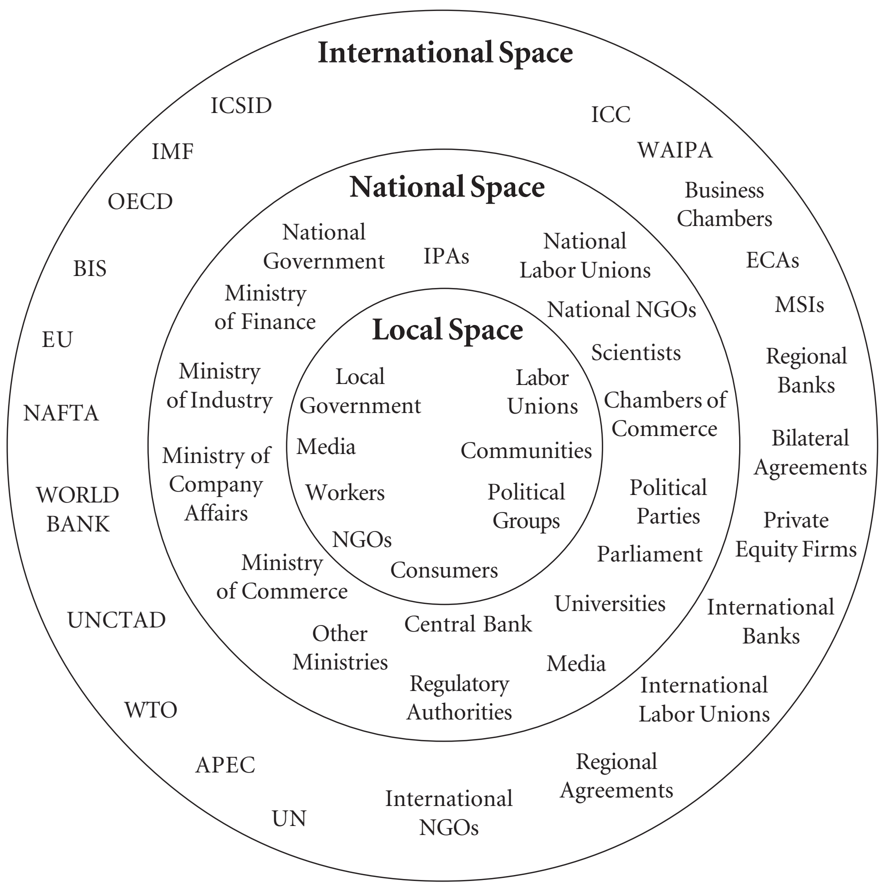
At each of these three levels, a diverse set of players are involved, depending on the issue. For instance, key players to be targeted in a campaign directed at the behavior of pharmaceutical TNCs would be notably different from one focusing on transnational banks.

Amongst the key players, the role of the state in the governance of international investment remains paramount at all levels. At the local level, sub-state authorities still have some powers to regulate TNCs operating within their territories. At the national level, the regulation of international investments is carried out by diverse ministries, such as trade, finance, company affairs, and industry. Other ministries, such as those of agriculture, environment, health, labor, social welfare, and law, play an important role in formulating rules and policies concerning international investments. Central banks also play a major role in managing inward and outward investment flows. Independent regulatory authorities are meant to enforce rules to curb monopolistic tendencies and to ensure that corporations should not exploit consumers. At the international level, several inter-state organizations such as the G-7, World Bank, IMF, WTO, OECD, APEC, EU, and MERCOSUR are concerned with the governance of investment issues.

In addition, there are non-state players in the form of business lobby organizations, NGOs, labor unions, media, universities, and self-regulatory bodies (such as the Global Reporting Initiative that develops global standards in sustainability reporting frameworks) influencing the governance of investment issues.

However, it needs to be pointed out that the power to govern international investments is not always democratically exercised. The growing

Figure 8.1: Some Key Players influencing Investment Issues



Source: Adapted by author from Annelies Allain, "Fighting an Old Battle in a New World," *Development Dialogue*, Uppsala, 2002, p. 21.

democratic deficit is deeply manifest at all levels: local, national, and international. Local state authorities have often been lax in enforcing rules and standards, even though much is expected from them to protect local communities and environment. Investment policies are usually designed by a handful of bureaucrats without any semblance of public debate and discussion. There is very little direct public participation in the working of ministries, central banks and independent regulatory authorities operating at the national level. Many inter-state regional and international bodies, such as the OECD, IMF, World Bank, and WTO, lack democratic accountability mechanisms to hold them responsible for their actions.

In the case of non-state players (such as the International Accounting Standards Board), democratic accountability is arguably worse. The structures of such private regulatory bodies do not usually provide mechanisms for public consultation. Partly due to their invisibility, there is hardly any public participation in the working of such bodies. Recent evidence also suggests that there is nothing inherently democratic about NGOs and civil society players as stories related to incompetence, class bias, and mismanagement of funds illustrate.

What is the right level to regulate the activities of TNCs? Some analysts argue that TNC corporate behavior should be preferably regulated by local state authorities because of their proximity to affected communities and workers. There is no denying that local authorities are more proximate to deal with such issues, and there have been instances where local state authorities took strict action against TNCs for violating rules. Nonetheless, there are several limitations to this approach. For instance, important policy decisions related to limits on foreign investment, performance requirements, technology transfer, export obligations, taxation, outflows of dividends, and several other matters are beyond the jurisdiction of local authorities.

In some civil society circles, there is a tendency to over-emphasize the importance of international level. Although there is nothing *per se* wrong in internationalizing investment issues, every issue cannot be resolved at the international level. The process for creating an international regulatory framework could also be time-consuming, given the strong opposition of some countries, such as US. At best, international efforts could provide the overall framework and guiding principles on regulating global corporations. These efforts should not be seen as a substitute for national regulatory measures. National governments should retain the right and power to regulate global corporations operating in their territories.

An important point sorely overlooked in such debates is that the different spaces and levels are interlinked and therefore should not be viewed as either/or options or avenues. Rather a combination of local, national, and international levels is needed to discipline international investments.

Issue Interlinkages: Investment issues cannot be analyzed and addressed in isolation from other policy issues such as trade, technology transfer, competition policy, and finance. Although the relationship between investment and trade issues has been strengthened by the present WTO regime, efforts were already made back in the 1940s to link trade and investment issues, as illustrated by the discussions on creating an International Trade Organization. It was only in the 1980s and 1990s when trade and investment became intertwined in the global production processes of TNCs that pressures for creating an investment-trade regime gained momentum. Investment-trade linkages received a major fillip under the TRIMs and GATS agreements of the WTO and under NAFTA, which is essentially a trade-investment regional agreement. Trade-investment relationships have also been institutionalized in several bilateral trade agreements. As FDI-trade relationships are becoming more intense under such institutionalized frameworks, any campaign strategy that treats them in isolation is likely to remain ineffective.

Technology transfer is one of the key determinants guiding the location policies of TNCs. Given the control over technology by TNCs, investment and technology transfer are increasingly seen as complimentary. The TRIPs Agreement builds links between intellectual property, technology transfer, and investment issues within the overall framework of WTO.

Competition policy also becomes very important to ensure that the liberalization of trade and investment rules is not used to curb competition. However, except for the EU, there are no other institutionalized frameworks on investment-competition policy at the international level. Aimed at creating a common market as well as ensuring that consumers are not exploited, the EU competition policy has both harmful and beneficial aspects. However, issues concerning competition policy have not been adequately addressed by activists and NGOs. This is an important issue that requires a variety of interventions such as monitoring restrictive business practices of TNCs and enhancing pro-competition policy tools and strong competition institutions.

Reclaiming the State: The much-touted claim that states have become powerless and obsolete in the wake of globalization is grounded in false assumptions. First, not all states have become powerless under the influence of transnational capital as there are significant variations across countries. As noted by Ha-Joon Chang, the influence of transnational capital on individual states is highly uneven and varies from issue to issue.[2] The degree of influence is largely dependent on the size, military strength, and power of states. Powerful states (for instance, the US) still retain considerable clout to pursue domestic and international investment policies suiting their national interests.

It is not always that foreign investors enjoy an upper hand in bargaining. If TNCs can play countries off against each other, countries can also play TNCs off against each other to maximize benefits. Countries with a large domestic market (for instance, China and India) can bargain for better terms and conditions from TNCs than those with small domestic markets (for instance, Bangladesh and Ethiopia). To illustrate, China has demonstrated greater bargaining power over TNCs by providing market access to France's Alcatel in exchange for compulsory technology commitments. Under the agreement signed in 2002, Alcatel agreed to provide full access to its worldwide technology base and resources in the areas of communications, computer networking, and multimedia solutions to a Chinese company not wholly owned by Alcatel. Another recent example is

Bolivia which successfully renegotiated existing contracts with ten foreign energy companies in 2006 in order to get a fair deal.

Further, bargaining power is determined by the nature of industries. Unlike mining and forestry where production sites are very limited, transnational capital holds greater bargaining power in industries such as garments and toys due to an abundance of alternative sites.[3]

The national policy response to investment flows also varies across countries. For instance, some governments have allowed a complete take-over of domestic assets by foreign firms while other governments have forced mergers and acquisitions among domestic entities to ensure that they can effectively compete with transnational corporations. There are also several instances where governments, particularly those belonging to the developed world, have resorted to protectionist measures to safeguard domestic economic sectors.

However, it is also true that states have become an important instrument in the advancement and sustenance of transnational capital on a global scale. Instead of upholding popular sovereignty, states are increasingly becoming subservient to the interests of foreign capital. Therefore, any demand for re-establishing and strengthening the regulatory powers of nation-states must be accompanied by strengthening democratic accountability of the decision-making processes.

As emphasized elsewhere in this publication, the primary responsibility of regulating investment flows remains with nation-states. Bypassing states would be not only politically counter-productive but also strategically detrimental in terms of missing numerous points of leverage. Reclaiming the state from corporate interests should be an important element of the campaign strategy. There are ample success stories where state institutions were targeted through a variety of campaign tools. A democratic and accountable state could act as a bulwark against the present trajectory of contemporary globalization besides broadening the political space for alternative developmental strategy.

Identify Key Campaign Targets: As mentioned earlier, there are multiple players influencing investment issues at different levels, though some are more powerful than others. By not focusing campaigns on key players at the appropriate space or level, the entire intervention could be a time-consuming and frustrating process. Since the capacities of campaign activists and groups are often limited, it makes sense to identify key campaign targets, which could be institutions, investment agreements, TNCs, states, or lobby groups. This process would also help activists to develop understanding on where to intervene and which players to target.

Among the key multilateral institutions to target, the WTO remains one of the most important institutions. In addition, there are bilateral and regional trade and investment agreements pushed by the US and EU, some of which have 'WTO plus' provisions related to investments, intellectual

Box 8.1

International Centre for Settlement of Investment Disputes

The World Bank's ICSID has only recently attracted critical attention because of the rise in the number of investment disputes brought under NAFTA and BITs. Between 1966 and 1997, ICSID arbitration panels dealt with just 6 BIT cases, while in 2001, 43 NAFTA and BIT cases came under its purview.

Cases brought to ICSID, 1987-2003	Under NAFTA	Under BITs
Cases registered	10	87
Cases concluded (including settlement)	6	31
Final awards rendered	6	18
Cases in which investor prevailed	2	10
Cases in which state prevailed	4	8

However, there is a complete lack of transparency and public participation in the activities of ICSID. The arbitration proceedings are kept confidential with no public hearings and disclosure of important documents. This makes it difficult for campaign groups to intervene in investment disputes where the public interest is involved.

property rights, and capital controls. The ICSID, part of the World Bank, is also an important institution for popular campaigns to focus on as it deals with disputes arising out of bilateral and regional agreements (*see* Box 8.1). The IFC and MIGA are two other constituents of the World Bank group that are active on investment issues. Increasingly, home countries are providing government-backed loans, guarantees, and insurance through Export Credit Agencies (ECAs) and Investment Insurance Agencies to corporations investing abroad. These offer new points of leverage to expose and dismantle a corporate welfare system that has been institutionalized through ECAs.

The political context of the governance of international investments is set by states. But there are deep hierarchies within states that further complicate the governance of international investments. These hierarchies could be well illustrated in the context of 'North-South' imbalances. However, within the 'North', the influence of the US has been dominant in shaping global investment policies. There is no denying that US economic hegemony has been declining over the past two decades, but its influence on international investment issues continues to be greater than any other single country. Over the years, there has been a marked shift in US policy preferences from multilateralism to bilateral, regional, and plurilateral agreements on trade and investment issues. The US's active engagement in NAFTA, APEC, FTAA, and several bilateral agreements exemplifies this trend. Investment issues are an important constituent of such agreements. In addition, the investment agenda of the US has remained focused on certain key sectors, such as finance and insurance, where it has competitive advantage. This sectoral emphasis is visible in many agreements. The underlying approach of the US behind this trend needs to be properly analyzed and addressed by campaign activists and groups.

Of late, the EU is also pursuing investment protection and liberalization under the framework of bilateral agreements and Economic Partnership Agreements (EPAs). The EU member states are negotiating several bilateral treaties with individual developing countries as well as regional groupings. Some recent EU treaties (such as with Chile and Mexico) contain 'WTO plus' provisions on investment liberalization and capital controls. Initially, the EU was the main political force behind the proposed investment treaty within the WTO but, for purely tactical reasons, it has now shifted its focus to bilateral agreements, realizing that bilateral agreements are much easier to negotiate than multilaterals. As highlighted elsewhere in this publication, bilateral investment agreements serve as a building block to launch comprehensive regional and multilateral agreements at a later stage.

Amongst the international business lobby groups, the International Chamber of Commerce (ICC) is the most influential one and therefore needs elaboration here. Founded in 1919, the ICC was created to serve world business by promoting trade and investment, open markets for goods and services, and the free flow of capital. At present, its membership extends to thousands of companies and business associations in more than 140 countries. Some of its prominent member companies include Coca-Cola, Exxon, Ford, and General Motors. The ICC describes itself as "the world's only truly global business organization" and offers "direct access to national governments all over the world through its national committees." The ICC is the main business partner of the UN and its agencies.

The ICC's secretariat is based in Paris and its main activities include advocating a liberal trade and investment regime, arbitration and dispute resolution, and business self-regulation. It created an International Court of Arbitration in 1923. The ICC was the first lobby organization to issue a corporate code of conduct in 1949.

Since the establishment of the WTO, the ICC has been aggressively pushing investment liberalization agenda at various levels. It played a key role in the formulation of the Multilateral Agreement on Investment (MAI), in close cooperation with the Business and Industry Advisory Council of the OECD. The ICC published a report entitled *Multilateral Rules for Investment* in April 1996. This report, which outlined the road map for launching negotiations on the MAI, was wholeheartedly endorsed by most negotiators of the OECD. The ICC's influence in steering MAI negotiations could also be gauged from the fact that its Court of Arbitration was proposed as one of the bodies for settling disputes. The ICC was also a strong proponent of launching investment rules at the WTO. It not only sought higher protection of investor rights but also demanded the inclusion of an investor-to-state dispute settlement mechanism, in addition to the existing state-to-state dispute settlement procedure within the WTO.

Box 8.2

Export Credit Agencies

There are a number of ways through which TNCs are offered subsidies and concessions. Export Credit and Investment Insurance Agencies (ECAs) have emerged as some of the world's biggest public institutions providing government-backed loans, guarantees, and insurance to private corporations to export and invest abroad. The main purpose of ECAs is to subsidize transactions that private corporations would not undertake because of their high financial or political risks. It has been estimated that ECAs are providing support worth $400 billion in trade and investments. In recent years, ECAs have become major players in infrastructure project financing in the host countries. The controversial Enron power project in India was financed and insured by two US agencies, the Export-Import Bank and the Overseas Private Investment Corporation.

Most home countries have their own ECAs, usually operating as an official arm of government. In some countries, export lending and investment insurance are undertaken by the same agency. In the US, the ECA is the Export-Import Bank; in Japan, the Export Credit Agency; in the UK, the Export Credits Guarantee Department; and in Germany, HERMES. In addition, the Multilateral Investment Guarantee Agency (MIGA) of the World Bank undertakes similar activities at the multilateral level. Although the majority of ECA-supported trade and investment projects originate from developed countries, recent trends indicate that some developing countries (for instance, India) are also providing government-backed loans, guarantees, and insurance to their own private firms investing abroad.

No less significant is the role played by national business lobby organizations, such as United States Council for International Business, and the Confederation of Indian Industry. Because of their close proximity to national policy makers, such lobby groups exert tremendous pressure to create a liberal investment regime. Unfortunately, the powerful role played by such lobby organizations in shaping investment policies at the national and international levels has received scant attention. Therefore, it becomes imperative for campaign activists to closely monitor the activities of business lobby groups.

Government-supported ECAs are a classic case of the corporate welfare system operating on a global scale. But the growing nexus between state and private corporations institutionalized through ECAs provides new points of leverage to dismantle this corporate welfare system. Already there is a growing movement in both home and host countries seeking fundamental reforms in the operations of ECAs. More than scandalizing, the nexus between state and private corporations offers new opportunities for campaign groups focusing on TNCs to build alliances with movements campaigning on ECAs.

Focus on Services: In many countries, services sector is the driving force behind the economy. In developed countries, the services sector accounts for over two-thirds of GDP. In the US, services account for approximately three quarters of GDP and provide 8 out of 10 jobs. The services exports from US were $340 billion in 2004, almost 30 percent of the total exports. Even in several developing countries (such as India), services sector now accounts for more than half of GDP and is the fastest growing sector of the economy.

As mentioned in Chapter 2, over two-thirds of FDI flows are now in the services sector. As many services are still not tradable, which means that they could only be provided across the borders through FDI, the share of services would remain dominant in the FDI inflows. Besides, almost every TNC involved in agriculture and manufacturing also undertakes significant service activities such as marketing and accounting.

Unlike manufacturing, many services (such as banking and telecommunications) are still heavily regulated in most countries. However, the implementation of liberalization and privatization policies would further drive the opening up of services sector. The recent technological advances particularly in information and communication sectors have also opened up new opportunities for offshoring and outsourcing a number of services across the borders. Therefore, it becomes imperative for activists and campaigners to recognize the growing role on services sector and focus their campaigns on service TNCs.

Since developed countries dominate the global services industry, they are seeking greater market access for their firms under the framework of bilateral investment agreements and GATS negotiations of the WTO. In particular, the US and the EU are demanding market-access commitments in key areas of services sector such as financial services, telecommunications, education, energy, retailing, and audio-visual services.

In the coming years, the EU services market is expected to be rapidly liberalized under the framework of proposed "Directive on Services in the Internal Market", commonly referred to as the Bolkestein Directive. The objective of the Directive is to remove legal and administrative barriers for the free flow of service activities between Member States of the EU. Though the Directive was diluted compared with initial drafts, it would still pave the way for large-scale M&A activity and cross-border trade of services, particularly in the financial sector. The draft Directive became controversial because it applies the same rules to healthcare and social services as it does to restaurants, estate agents and advertising companies. Critics argue that the Directive would erode many regulations governing services sector within the EU and would undermine wages, health and safety, and environmental standards.

It is also important to recognize that some developing countries (for instance, India) are also seeking greater cross-border liberalization of services sector under the framework of GATS negotiations and bilateral agreements as they view immense benefits for their economies through outsourcing and offshoring activities.

Building Coalitions: The fact that the credibility and reputation of many TNCs has sunk to a low point among many sectors of society offers new points of leverage. Since investment issues cut across several sectors, it becomes imperative for campaign groups to build formal and informal coalitions consisting of labor unions, NGOs, citizens groups, human rights groups, political groups, and fair trade and consumer groups. In addition, students, academics, and middle class professionals could also be potential allies. The coalitions could be geographically-based or issue-based, depending on the particular circumstances. The coalitions could also be formed on specific TNCs and their subsidiaries. The present era of globalization offers new opportunities to build cross-border alliances with like-minded groups. For instance, the Internet provides a cheaper communication tool to exchange information and develop international solidarity. However, there is a growing concern that 'virtual' solidarity would be meaningless if it is not backed by popular mobilization.

Building coalitions may not be an easy task given the historical, ideological, and cultural differences among various organizations. For instance, there are sharp ideological differences between environmental NGOs and labor unions on several matters, including use of technology, and models of development. Even within the NGO community, there are several tensions regarding strategic tools. Many NGOs prefer the use of voluntary measures, such as codes of conduct and MSIs. Such NGOs believe in building strong NGO-business partnerships and are often in odds with other NGOs who demand corporate accountability through state regulatory mechanisms. Being well-aware of these differences within the NGO community, corporate interests are building 'partnerships' and conducting 'dialogues' with some NGOs but not others in order to dilute critical positions and to 'divide and rule'.

Without belittling the activities of such NGOs cooperating with business, it cannot be ignored that there is a danger of cooption given the strong desire by corporate interests to 'capture' the public spaces. Already there is a growing concern over the 'institutional capture' of several UN agencies as a result of their partnerships with TNCs and their lobby organizations. More than anything, this further complicates the task of building coalitions to address the detrimental effects of TNC activities and to regulate corporations. Therefore, any coalition-building exercise would have to address such inherent tensions and constraints.

Conducting Research and Documentation: Research and documentation activities are very important tools in exposing corporate misdeeds. Such research could include overarching foreign investment trends; individual TNCs; corporate sectors such as chemicals or fisheries; the role of TNCs in influencing public policies; their involvement in business lobbying groups, corruption, and political financing; and several other issues such as business lines, finances, legal problems, labor, health and safety, and environmental records. Research could also be undertaken to map out the points of leverage that could be used by activists and groups.

Researching TNCs involves the same skills as every other research project: patience, persistence, and an open minded approach to any and all possible sources that might be useful. These sources can include: corporate business directories; national, regional, and local newspapers; wires from press agencies; company annual reports and promotional materials; interviews with or speeches of corporate executives; human sources such as workers, community members, journalists and lawyers; industry association literature such as trade journals; business or economic magazines; scientific journals; magazines that cover a particular geographic region; magazines, newsletters, or other information – including corporate case studies and reports – from trade unions, environmental groups, voluntary associations, or other non-governmental organizations; activist network publications; videos; United Nations documents; data and records from governments; publicly available testimony given before government committees; court records ... and so on and so forth.

The word 'research' does not mean gathering information simply for the sake of gathering information, although it certainly can – and in some

Box 8.3

How to Investigate an Individual TNC?

There are obviously numerous issues you can investigate about a particular TNC. What are its main products? How has its business performance been in recent years? Who are the company's major stockholders and sources of financing? Where are the corporation's subsidiaries? Are the parent firm or subsidiaries violating occupational safety and health, environmental, financial, or other regulations? What is the company's relationship with workers and trade unions? Do the firm's manufacturing processes or other activities impact the lives and livelihoods of a wider community than just its employees? Are the TNC's policies or activities in conflict with any national, state, or local political forces? The list of possible questions could be endless.

When starting out, therefore, it often helps to have some organizational framework to shape your investigation of a given TNC. The following broad framework provides a wider range of areas than you would likely need, but which you may want to consider as you structure your corporate informational needs:

- **General and Administration:** company history; management structure and salaries; board members; corporate ownership (if a subsidiary, the parent firm; if a publicly-traded parent firm, the main institutional investors; if a private company, the individual or family); law firm; bankers; insurance company; relationship with government; political connections; membership in trade or business associations.
- **Company Business:** product lines; major markets and customers; rank in sector by production or market share; distribution channels; main competitors; mergers/acquisitions; strategies and future plans.
- **Company Structure:** divisional breakdown; number, location, and activities of facilities including foreign subsidiaries; plans to add or eliminate facilities.
- **Finances:** domestic and foreign sales, profits, and assets; indebtedness; new stock issues; foreign exchange transactions; litigation involving financial activity.

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- **Labor Relations:** attitudes and tactics towards trade unions domestically and outside home country; contracts including collective bargaining agreements; employee profile; pension and insurance programs; labor law and occupational safety and health records including past or current litigation.
- **Environment:** attitudes and advertising; pollution record including violations and litigation, at facilities including foreign subsidiaries; overall ecological impacts of company's industrial sector; double standards between practices in home and host countries.
- **Consumer Protection:** marketing practices and pricing; record on product safety; anti-competitive arrangements including intellectual property regimes.
- **Human Rights:** social impacts, especially of foreign subsidiaries; benefits from oppressive governments that violate internationally accepted human rights standards.

The sources of information for inquiries into the above areas could be publications and data sources; the corporation and its executives; and other human sources.

cases should – include a general background study. But even one TNC is often a big, diverse, and complex subject, and corporate information sources may be widely scattered. So it is important to decide early on not just *why* you wish to learn more about a company or companies, but also *how* you wish to organize and use the information you discover. Thinking this way will provide direction and focus for your work, and thereby set limits to the investigation. You may still go through a large amount of material, but you will do so more efficiently and effectively. Given that TNCs operate on a global scale, research activities would involve international liaison with diverse sources.

Conducting research is one task. Using it effectively and persuasively is another. In this context, a variety of capacities need to be developed. For instance, use of popular educational tools such as posters, pamphlets, fact sheets, handbooks, activists' guides, documentary movies, and street theatre could be used to mobilize public opinion. Research findings could also be disseminated in the form of technical papers to address policy makers and academicians.

Legal Action: A new wave of legal actions has emerged in the US, UK, Canada, and Australia in recent years, which can be potentially useful for activists working on investment issues. These actions aim to hold parent companies legally accountable in the home countries for their negative environmental, health and safety, labor, and human rights impacts in foreign locations. Particularly in the US, the domestic law, Alien Torts Claims Act (ATCA) of 1789, gives federal courts jurisdiction over "any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." Under this law, Burmese villagers sued US oil company Unocal for human rights violations. The villagers alleged that Unocal hired highly repressive Burmese military units, which used forced labor and committed grave human rights abuses in support of Unocal's gas pipeline project. Several other cases have also been filed against big TNCs, including a case against the Anglo-Dutch oil company, Shell, for its alleged role in human rights abuses in Nigeria.

Outside the US, similar law suits have been filed against TNCs in Australia, the UK, and Canada seeking greater responsibilities from the parent companies. However, concerted efforts are being made by corporate lobby groups such as the ICC and big US business groups to repeal or amend such legal instruments so that companies cannot be sued.

In addition, foreign investors are increasingly inserting clauses in infrastructure contracts with governments that protect their companies from potential liabilities arising from any policing of projects and from environmental and social legislation.[4] Such clauses – typically embedded in contracts for the construction of dams, roads, oil fields and pipelines – are prevalent in the mining, oil and gas industries. The contracts include: Production Sharing Agreements specify who gets what revenue in oil and gas fields; Power Purchase Agreements commit state utilities to buying minimum amounts of electricity from a dam or power plant at a particular price; while Host Government Agreements establish a common legal regime for pipelines that cross national boundaries. The contracts are increasingly nested within inter-governmental investment treaties, thus removing potential arbitration from the domestic courts.

Under the Host Government Agreements (HGAs) that underpin the BP-led Baku-Tbilisi-Ceyhan oil pipeline in the Caspian region, the three signatory governments – Azerbaijan, Georgia and Turkey – have all but surrendered sovereignty over the pipeline route to the oil consortium.[5] The HGAs supersede all existing and future laws in the three countries

Box 8.4

Freedom of Information and Public Participation

There is a direct relation between citizen access to information and the ability to ensure TNC accountability. Once a systematic and concerted transfer of knowledge is assured, there can be full and informed community involvement in decisions pertaining to corporate investment proposals. The 'right to know' is an essential prerequisite to public participation and legal remedy. Freedom of information includes open public access to all government files and statistics, film, video, and computer information relevant to the TNC and its proposal, and copying rights to such information available at a reasonable rate. It requires that business confidentiality, "proprietary information", and "trade secrets" are never used as a rationale for denying information that is relevant to the public interest.

Ensuring corporate accountability can be assisted by meaningful public participation in investment and production decisions. Such public participation should include: public hearings on all project and investment decisions that may impact upon a community; the public right to participate and submit comments as part of the environmental impact assessment and audit procedures; the right to public voting procedures such as initiatives and referenda regarding investment issues; the right to interview and question governmental officials involved in investment decisions; and the right to legal redress and remedies for environmental or personal damage.

(other than the respective constitutions) and impose obligations that severely limit the state's ability to act in the interests of its citizens. If a state introduces new environmental or social legislation that impinges on the pipeline's "economic equilibrium" (read profit), the oil consortium has a right to demand compensation.

As taking legal action against a TNC in its home country for human right abuses in a host country has historically been extremely difficult, recent lawsuits filed under ATCA have generated new hope that TNCs could be held accountable in their home countries. The law gives foreigners the right to seek compensation for violations of international law in US courts. The supporters believe that the ATCA could become a powerful tool to increase corporate accountability.

Even though most cases filed against TNCs under the ATCA have not resulted in victories, legal action still offers an important tool to generate negative publicity about corporate behavior and to attract the attention of the international media and public at large. At the same time, this legal instrument has its limitations. Each and every case against human rights abuses by TNCs cannot be addressed by litigation in the US courts alone. Since 1979, only 25 cases against TNCs have been brought under the ATCA. Besides, there is a danger of US courts adjudicating disputes about violations abroad while the US itself refuses to join international legal initiatives such as the International Criminal Court. There is also a danger of conceiving of TNC accountability in narrow legal terms, overlooking vital political dimensions. This does not mean that home country regulations have no importance. Some of the measures such as the OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the US Foreign Corrupt Practices Act (FCPA) are positive steps towards curbing corrupt practices by TNCs and their subsidiaries in the host countries.

Some campaign activists are also demanding fundamental changes in the legal charters of TNCs. In the US, corporations are granted charters by local authorities so that they can conduct their businesses legally. The charter of a corporation could be amended or revoked if there is a misuse or abuse of it. Activists are demanding that charters should reflect the interests of all stakeholders including workers, suppliers, consumers, communities, and people at large.

There is no denying that such legal initiatives in the home countries offer much optimism about being able to hold TNCs accountable for their activities, but it would be erroneous to consider these initiatives as an alternative to legal actions in the host countries themselves. Therefore, the use of legal mechanisms in both home and host countries should not be viewed as an either/or option.

Labor Action: Even though the clout of labor unions has been weakened by the deregulation of capital, unions have used creative ways to combat corporate power and capital mobility. For instance, labor unions representing Coca-Cola workers in Colombia have forced the company to accept contract clauses protecting union rights, job security, and better health and safety conditions through collective bargaining coupled with international solidarity. Moreover, labor unions are an authoritative source of information about industries and individual corporations. Both unionized and non-unionized workers at a TNC's factory have better information about its practices from the inside.

In the past two decades, labor unions and other groups, notably in the US but elsewhere as well, have supplemented their traditional workplace tactics against corporate employers (strikes, slowdowns, and working-to-rule, that is, doing the bare minimum required) with efforts that are external to the workplace. Commonly referred to as 'corporate campaigning', these efforts include lobbying or otherwise putting pressure on a company's sources of financing and key institutional investors as well as shareholder activities such as participating or demonstrating at the firm's annual general meeting.

Corporations often obtain credit financing from banks and insurance companies, which may in turn have representatives on the firm's board of directors. In the US and a number of Western European countries, banks and insurance companies, along with pension funds and investment vehicles (such as mutual funds), are major institutional investors in publicly traded corporations. By virtue of such relationships with various firms that have been targeted, these institutions can themselves become targets. Those institutions financing the company can be asked to distance themselves – by tightening credit terms or withdrawing credit completely – and stockholders are subject to pressure and appeals for support through face-

Box 8.5

The Importance of Media

It is well recognized that private corporations use media and public relations to influence public debates, legislation, and political processes. Thus being able to use the local, national, and international media effectively is as vital a part of campaigning to hold a TNC accountable as any other campaigning tool. Corporations, particularly those that rely on their brand names, are often very sensitive about their public image. By using the media successfully to expose corporate wrongs, campaigns could dent their positive image, sometimes seriously.

Over the years, the media industry has undergone a rapid transformation with the growing trend towards concentration and formation of conglomerates controlled by a handful of TNCs. In an advertisement-based, profit-driven commercial media, the public space for information exchange and discussions that is so essential to a democratic society is becoming further constricted. Despite this growing trend, non-commercial media in print, radio, television, book publishing, and Internet also exist at various levels. New opportunities to share news and views to a wider audience have been opened up by the Internet. Not long ago, corporate activists used the Internet as a medium to launch a campaign against the MAI. With the increased networking of corporate activists and groups through email and the Internet, the operations of TNCs have come under close scrutiny. Despite some serious concerns related to its governance and access, the potential of the Internet as part of a wider struggle for democratization of information needs to be recognized.

to-face contacts or at annual shareholder meetings.[6]

In the US, labor unions have not merely relied on their arguments to pressure financial institutions; they have also made it known when they have monetary leverage to exert. In one case, labor unions threatened that they would withdraw US$1 billion in deposits from a bank that had ties to a targeted company, a non-violent threat that successfully forced the bank to dissociate itself from the firm.[7]

Shareholder Activism: Shareholder activism refers to efforts by individuals, campaigning groups, and institutional investors to influence corporate decision-making through the shareholder process, usually at the company's annual general meeting (AGM). For individuals and groups that do not already own shares of a firm's stock, such actions include buying stock in the corporation and becoming a shareholder; lobbying existing shareholders of the company to exert influence, notably those involved with socially responsible investing; and staging protests or other activities at the AGM. The point of shareholder actions is not to out-vote a board of directors or otherwise cause an immediate change in company policy, but to generate awareness of issues within the corporation itself and among the general public. Over time, it is hoped that such awareness will prompt the corporation to improve its practices.

Becoming a shareholder with a minimum investment means that the individual or group can try to put particular policy issues on the agenda of an AGM (by filing a resolution to do so) or force a vote on policies at the meeting. In the US and Europe, there are share option schemes to enable employees to purchase stock, which they may then attempt to wield for a collective goal. Through shareholder activism, important issues such as corporate codes of conduct, and improved labor and environmental standards falling within the framework of company could be addressed. One of the prominent examples of shareholder activism is the campaign by a UK-based NGO, People Against Rio Tinto and its Subsidiaries (Partizans), which has been campaigning since 1978 against the destructive social and ecological effects of British mining conglomerate, Rio Tinto. Partizans has

Box 8.6

The Response of NGOs within EU

At the EU level, a wide network of NGOs working on investment issues has developed over the past several years. By undertaking the exchange of ideas, information and campaign strategies, these groups have focused their energies on key institutional mechanisms involved in investment issues such as export credit agencies, multilateral development banks, and bilateral, regional and multilateral investment treaties. Some groups have also focused their campaigns on individual TNCs and monitor their activities within the region and elsewhere.

Though these groups may have sharp differences among themselves in terms of worldview, ideology, campaign strategy, and class bias, their common position is that private investment flows do not serve the interests of poor people in host countries. Instead, private flows create environmental damage, undermine human rights, and prevent host countries from being able to meet their developmental goals.

Recently, some NGOs and civil society groups have recognized that the effectiveness of their campaigns would be greatly enhanced if they were to link up their activities under the broader framework of democratizing investment policies. Moreover, groups working on international trade could benefit from greater coherence concerning work on international financial institutions.

At the same time, however, it is also recognized that for campaigns to be more effective, a better understanding of how private investment flows operate and what role different actors play in policy decisions is needed as well. It is considered important to integrate the local and international work of various NGOs, both in order to strengthen the voice of local communities and to have a stronger presence at the national and international levels. This will require more coherent planning of differentiated activities, in order to allow NGOs with specific areas of expertise to fit into a broad strategy rather than replicating work done by other groups.

There is no denying that the new global setting poses a challenge to NGOs

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and civil society groups in terms of gathering evidence on the impacts of private investment flows and linking them with the wider developmental goals of poverty alleviation. Nevertheless, the onus remains with the investment community and corporate lobby groups to provide hard data that support their claims to be improving the well-being of the world's poorer people.

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held seminars months ahead of Rio Tinto's AGM to familiarize people with the company's practices, to discuss and decide upon the issues that need to be addressed at the AGM and the message put out to the press, and to provide briefing materials. Before the meeting, a few Partizans campaigners purchase and distribute Rio Tinto shares or otherwise arrange access for interested parties. Partizans has used Rio Tinto's AGM to release what they said was a leaked company report criticizing an African subsidiary's safety procedures and embarrass the corporation. Since 1981, Partizans has also invited nearly 100 representatives from other countries negatively affected by Rio Tinto's subsidiaries to the firm's AGM.

Supporters of shareholder actions observe that AGMs are public occasions, indeed major public relations events, when corporations try to present themselves in the best possible light. In this context, AGMs can offer valuable opportunities for activists to call attention to social, environmental, labor, or other concerns. Staging demonstrations or rallies at the site of the AGM but outside the meeting itself is one approach. It is also possible to gain admission to an AGM without owning shares. This can be done by borrowing a shareholder's admission form or by being nominated by a shareholder who is not attending the meeting. Once inside, activists will have the chance to ask questions to the management.

Notwithstanding the fact that shareholder activism could serve as a valuable public education tool, there are some limitations. Firstly, for most workers and campaigning activists, buying even a small amount of stock can be prohibitively expensive. Secondly, corporate managements often have the power to exclude consideration of matters they deem outside a company's "ordinary business operations", thus obstructing shareholders' efforts to place social or environmental issues on an AGM's agenda. This is a serious barrier even to shareholders with significant amounts of stock.

Promoting Alternatives: The oft-repeated assertion that political processes cannot reverse the investment liberalization agenda is more a myth than reality. Investment liberalization has been reversed by domestic political processes in the past and therefore could be reversed in the future. All public policies are the products of pressures generated by social and political institutions in a given society and are liable to change. If labor-friendly policies could be reversed to serve the interests of transnational capital, investor-friendly policies could also face the same fate. There is nothing sacrosanct about investment liberalization processes. History is replete with instances where the pendulum had swung in the opposite direction because of unanticipated events. The advancement of the earlier phase of globalization was scuttled by a series of events including the First World War, the Great Depression of the 1930s, and the Second World War.

As it becomes evident that the underlying political, economic, and social costs of foreign investments far exceed any stated benefits, campaign groups should seek out policy alternatives. Nevertheless, it is the wider national and international context that determines the choice of particular policy alternatives. Within the present context of global capitalism, a strategy calling for the complete delinking of domestic economies from the world economy, or autarky, may not succeed, but a strategy based on curbing unbridled investment liberalization and selective delinking may do so. There have been several attempts by countries to resist short-term, speculative financial flows in the late 1990s. The experiences of countries such as Malaysia, Chile, and China show that selective delinking is not only desirable but also feasible.[8] The terms and conditions of linkages with global investment flows should be decided democratically by people rather than by international institutions and foreign investors. If peoples' movements are strong, alert, and influential, there is every possibility of devising an investment strategy that allows only such investment flows that are beneficial to the domestic economy.

An alternative strategy should include enlarging the rights of governments over transnational capital through policy measures such as tough competition laws, increased corporate taxes, capital controls, taxes on speculative investments, and stricter labor and environmental regulations. There is a need to alter trade and investment agreements that disproportionately benefit transnational capital. The subordination of foreign capital to democratic controls could be supplemented by a fundamental reorientation of the domestic economy. The domestic economy should be restructured to serve the needs of those sections of society that have been marginalized by both state and market forces. Growth must emanate primarily from domestic savings and investments. Rather than focusing on export-led growth, domestic markets should act as the prime engines of growth. In addition, the principle of equity must be given top priority by governments.

A number of tools providing economic leverage could also be employed. Substantial financial resources could be mobilized within the country through a progressive direct taxation system. Such domestic financial resources are generally considered more efficient in contributing to economic growth than foreign investments. Through protection and taxation measures, more incentives should be given to SMEs, which are the backbone of most economies. Domestic mutual and pension funds should be used to finance productive activities rather than for speculation purposes. Where necessary, only limited collaborations for technology transfer and R&D should be undertaken. Emphasis should be on investing funds in professional and technical training, and research and development in order to beef up domestic R&D. Legislative measures to curb monopolistic tendencies and abuse of transfer pricing by TNCs should be enhanced. In many ways, working on alternatives provides an excellent opportunity to activists and groups to develop a holistic understanding of the 'big picture' even though their campaign activities may be limited to using a single tool, such as shareholder activism or legal action.

Notes and References

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2. For details, *see* Ha-Joon Chang, *Globalisation, Economic Development and the Role of the State*, Zed Books, London and New York, 2003.
3. Ibid., p. 11.
4. For details, see Nicholas Hildyard and Greg Muttitt, "Turbo-Charging Investor Sovereignty: Investment Agreements and Corporate Colonialism," in *Destroy and Profit: Wars, Disasters and Corporations,* Focus on the Global South, Bangkok, 2005 (www.focusweb.org/pdf/Reconstruction-Dossier.pdf).
5. For detailed analysis of the legal implications of the agreements, see M. Carrion, "Preliminary Analysis of the Implications of the Host Government Agreement between Turkey and BTC Consortium," Baku Ceyhan Campaign, London, October 2002, (www.bakuceyhan.org.uk); Susan Leubuscher, "The Privatisation of Justice: International Commercial Arbitration and the Redefinition of the State," Brussels, June 2, 2003, (http://www.fern.org/pubs/reports/dispute%20resolution%20essay.pdf); Amnesty International, *Human Rights on the Line – The Baku-Tbilisi-Ceyhan Pipeline Project*, London, May 2003; and A. S. Reyes, "Protecting the 'Freedom of Transit of Petroleum': Transnational Lawyers Making (Up) International Law in the Caspian," *Berkeley Journal of International Law,* 24, forthcoming June 2006 (manuscript on file with author).
6. Lawrence Mishel, "New Tactics for Labor," *Labor Research Review*, Volume 4, Number 2, Midwest Center for Labor Research, Fall 1985.
7. Selections from "A Troublemaker's Handbook" in *Research Methods for Action*, Hotel Employees and Restaurant International Union, 1994.
8. For details, see Kavaljit Singh, *Taming Global Financial Flows: Challenges and Alternatives in an Era of Financial Globalization*, Zed Books, London, 2000.

9

Resources

Recommended Readings

In addition to the works referred to in the text, this section provides other sources of information on investment issues and processes.

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List of Journals, Magazines and Newspapers

BIS Quarterly Review: www.bis.org/publ/quarterly.htm
Businessweek: www.businessweek.com
Economic and Political Weekly: www.epw.org.in
Euromoney: www.euromoney.com
fDi Magazine: www.fdimagazine.com
Finance and Development: www.imf.org/fandd
Forbes: www.forbes.com
Fortune: http://money.cnn.com/magazines/fortune
Institutional Investor: www.institutionalinvestor.com
Investment Treaty News: www.iisd.org/investment/itn
Multinational Monitor: www.multinationalmonitor.org
The Banker: www.thebanker.com
The Financial Times: www.ft.com
The Wall Street Journal: www.wsj.com
Transnational Corporations: www.unctad.org/TNC
World Development: www.elsevier.com/locate/worlddev

Information and Campaign Resources

There are many activist groups, NGOs, research institutes and labor unions working on international investment issues and processes. Some of them are listed below.

Bilaterals.org: www.bilaterals.org
Business and Human Rights Resource Center: www.business-humanrights.org
Center for Corporate Policy: www.corporatepolicy.org
Centre for Research on Multinational Corporations (SOMO): www.somo.nl
Coalition against BAYER-Dangers: www.CBGnetwork.org
Corporate Accountability Project: www.corporations.org
Corporate Europe Observatory: www.corporateeurope.org
Corporate Research Project: www.corp-research.org
Corporate Watch (UK): www.corporatewatch.org.uk
CorpWatch (US): www.corpwatch.org
Critical Shareholders Association: www.kritischeaktionaere.de
ECA Watch: www.eca-watch.org
Essential Action: www.essential.org
FTA Watch: www.ftawatch.org
GRESEA (Groupe de Récherche pour un Stratégie Economique Alternative): www.gresea.be
IBFAN (International Baby Food Action Network): www.ibfan.org
IBON: www.ibon.org
INFACT: www.infact.org
International Confederation of Free Trade Unions: www.icftu.org
International Labour Research and Information Group: www.ilrigsa.org.za
International Union of Food Workers: www.iuf.org
OECD Watch: www.oecdwatch.org

Partizans: www.minesandcommunities.org
Project Underground: www.moles.org
Public Citizen: www.citizen.org
Public Interest Research Centre, New Delhi
The Corner House: www.thecornerhouse.org.uk
Third World Network: www.twnside.org.sg
Transnationale: www.transnationale.org
World Development Movement: www.wdm.org.uk

Glossary

Agenda 21
The Agenda for the 21st Century – a declaration from the Earth Summit (UN Conference on the Environment and Development) held in Rio de Janeiro in 1992.

Antitrust
Laws against monopolies or restrictive practices in uncompetitive market conditions.

Arbitrage
Earning profit from differences in price when the same security, currency, or commodity is traded on two or more markets. For example, an arbitrageur simultaneously buys one contract of gold in the New York market and sells one contract of gold in the Chicago market, thereby making a profit because at that moment the price on the two markets is different.

Asia-Pacific Economic Cooperation
A regional economic forum consisting of 21 countries located in Asia and the Pacific Rim.

Bond
A debt instrument issued by a borrower usually includes regular interest payments plus a final repayment of principal. Bonds are exchanged and traded in financial markets.

Brand
A brand is a product, service, or concept that is publicly distinguished from other products, services, or concepts so that it can be easily communicated. A brand name is the name of the distinctive product, service, or concept (e.g., iPod).

Bretton Woods
An agreement reached in 1944 at Bretton Woods, New Hampshire, that led to the creation of the postwar international economic

order. The monetary system was centered on fixed exchange rates, but ended in 1971. The agreement created the World Bank and the IMF.

Capital Account An item in a country's balance of payments that measures the investment of resources abroad and in the home country by foreigners.

Capital Controls Restrictions placed on the movement of capital across national boundaries.

Cartel A group of firms that enter into an agreement to set mutually acceptable prices.

Current Account This is a summary item in a country's balance of payments that measures net exports and imports of merchandise and services, investment income and payments, and government transactions.

Derivative A financial instrument whose value is contingent on the value of an underlying security. For instance, a futures contract or an option on a stock, stock index, or commodity.

Equity Share in the ownership of a corporation. Also commonly called a stock, as in the stock market.

European Union Formed as the European Economic Community (EEC) as a result of Treaty of Rome (1957) and consisting of France, West Germany, Italy, Belgium, The Netherlands, and Luxembourg. Subsequently known as the European Community and (from 1993) the European Union. Enlarged to include the United Kingdom, Denmark and Ireland in 1973, Greece in 1981, Spain and Portugal in 1986; Sweden, Finland and Austria in 1995; and Cyprus, Czech Republic, Estonia,

	Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia in 2004.
Exchange Controls	The control by governments of dealings in foreign currencies and gold.
Expropriation	The confiscation of assets and property. Expropriation is one of the political risks associated with foreign investments. It is characterized by confiscation of assets by host country governments.
Fixed Exchange Rate	A rate of exchange between one currency and another that is fixed and maintained by governments.
Floating Exchange Rate	Movement of a foreign currency exchange rate in response to changes in the market forces of supply and demand. It is also known as a flexible exchange rate. Currencies strengthen or weaken based on a nation's reserves of hard currency and gold, its international trade balance, its rate of inflation and interest rates, and the general strength of its economy.
Foreign Direct Investment	An investment in a country by foreigners in which real assets are purchased. These include real estate or plant and equipment assets and involve effort to manage and control. FDI flows have three components: equity capital, reinvested earnings, and other capital (intra-company loans as well as trade credits). FDI inflows are capital received, either directly or through other related enterprises, in a foreign affiliate from a direct investor. FDI outflows are capital provided by a direct investor to its affiliate abroad.
Franchising	An arrangement whereby one party gives an independent party the use of a trademark

and other assistance in the operation of the business.

Gold Standard An international monetary system in which the value of national currencies was fixed to gold and national central banks were obliged to give gold in exchange for any of its currency presented to it. This system existed from the 1870s to 1914 and briefly after the First World War.

Greenfield Investment When a transnational corporation opens a new facility in a foreign country as opposed to entering a market by acquiring an existing facility.

Hedging The strategy used to offset investment risk. Investors often hedge against inflation by purchasing assets that will rise in value faster than inflation, such as gold, real estate, or other commodities. For example, Starbucks Coffee Company hedges its supplies of coffee in the futures market to limit the risk of a rise in coffee prices.

Home Country The country where a transnational corporation is headquartered.

Host Country The recipient country of investment made by a transnational corporation.

Intangible Asset Knowledge about a technology or a market owned and possessed by a firm and which yields a rent to the firm.

Intrafirm Trade Trade flows across borders but between affiliates of the same company.

Inward Investment Investment by foreign entities into a host economy.

Joint Venture When two or more firms share the ownership of a direct investment.

Keynesian Economics Named for British economist John Maynard Keynes, it is an economic theory that advocates government intervention, or demand-side management of the economy, to achieve full employment and stable prices. In contrast to laissez-faire economics, Keynesian economics promotes a mixed economy, where both the state and the private sector play an important role.

Licensing An agreement whereby one firm gives to another the use of assets such as trademarks and patents.

Marshall Plan A proposal by US Secretary of State George Marshall in 1947 for massive aid to Europe. The purpose was to secure a US position of strength in Europe and reduce Soviet influence.

Mercosur A regional free trade agreement among the countries of Brazil, Argentina, Uruguay, and Paraguay. Mercosur came into effect on January 1, 1995.

Most-Favored-Nation Treatment The principle of not discriminating between one's trading partners. MFN is a status accorded by one nation to another in international trade. WTO member countries give MFN status to each other. Exceptions exist for preferential treatment of developing countries, regional free trade areas, and customs unions.

Nationalization Ownership and control of assets by the state.

National Treatment The principle of giving others the same treatment as one's own nationals. This principle is incorporated in all the three main WTO agreements (Article III of GATT, Article 17 of GATS and Article III of TRIPS).

New International Economic Order A package of proposed reforms in the international economic order sponsored by Third World countries during the 1970s. Largely rejected by the North, these proposals were intended to direct greater economic resources toward the South while also providing Third World countries with a greater role in managing the rules and institutions of the world economy.

Oligopoly A type of industry in which there are only a small number of producers and in which there are barriers preventing new firms from entering the industry. Usually, firms in an oligopolistic industry are able to affect prices and often engage in at least tacit collusion.

Outsourcing A situation in which a domestic company uses foreign suppliers for components of finished products.

Outward Investment Investment by domestic enterprises from their home economy to a foreign country.

Petrodollars It refers to the profits made by oil exporting countries when the oil price rose during the 1970s, and their preference for holding these profits in US dollar-denominated assets. A significant portion of these dollars were in turn lent by Western banks to the developing world.

Plaza Agreement An agreement reached at a meeting at the Plaza Hotel, New York, in September 1985 of the Group of Five – the US, the UK, Japan, France and West Germany – to the effect that measures would be taken to establish greater international currency stability, and exchange rates more closely

	reflecting the economic situation of the countries involved.
Portfolio Investment	An investment in a country by foreigners in which debt or stock ownership is involved. The result is a claim on resources, but typically no participation in the management of the companies involved.
Reverse Engineering	The process of discovering the technological principles of a product, usually with the motive to construct a new product that does the same thing without actually copying anything from the original.
Securities	It includes stocks, bonds, and other tradable financial assets.
Singapore Issues	It refers to issues on which four working groups were set up during the first WTO Ministerial Conference held in Singapore in 1996, namely, trade and investment, competition policy, transparency in government procurement, and trade facilitation.
Speculation	The purchase or sale of stocks, bonds, commodities, real estate, currencies, derivatives or any other financial instruments to profit from fluctuations in their prices as opposed to buying them for use or for income derived from their dividends or interest.
Strategic Alliance	A collaborative agreement between firms for various reasons, but often concerned with technology or marketing.
Tariff	A government tax usually on imports levied on goods shipped internationally.
Vertical Integration	The undertaking by a single firm of successive stages in the process of production of a particular good.

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Investment matters. The millions of dollars that are moved around the world every minute of day profoundly affect who gets to eat and who doesn't; who has a job and who doesn't; and who accumulates wealth and at whose expense. Influencing investment decisions requires an understanding of how investment works. Kavaljit Singh explains the central role of transnational corporations (TNCs) and other key players in determining investment patterns. He debunks some of the myths surrounding investment flows, and he suggests ways in which investment can be brought back under the democratic control of people and governments. Kavaljit Singh maps out investment flows, trends and regulatory frameworks and shows where citizens can work - and are working - to reclaim investment for the public good.

"Change will not come about through individuals acting alone but in concert. By informing the public of the issues - and through identifying areas where policies and practices can and should be changed - this book will greatly increase the effectiveness of such collective action."

Saskia Ozinga, FERN

"If investment is to contribute to the public good, then it is critical that the public have the means to define that good; to frame the policies and laws that would channel investment in support of that good; and to hold investors to account where their actions undermine that good. This book provides an essential primer."

Nicholas Hildyard, The Corner House

"The time has come for campaigners and civil society to look behind the curtains of international institutions and national governments and see who are the real drivers of the global investment agenda. Kavaljit Singh helps enormously in this crucial exercise by clearly showing how investment is the Achille's heel of the neoliberal globalization agenda."

Antonio Tricarico, CRBM

Kavaljit Singh is Director of Public Interest Research Centre, New Delhi. He is the author of widely published books, *Questioning Globalization*, *Taming Global Financial Flows: Challenges and Alternatives in the Era of Financial Globalization* and *The Globalization of Finance.*

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