# International Investment Rules

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**Abstract**

Investment business environment is considered to be vital for international investors, namely for the investment rules for market entry and protection of investment. Despite the economic importance of FDI or maybe due to it, the attempts to rule foreign investment from the multilateral perspective and thus to establish a basis for an effective liberalization of investment flows failed. The study brings an overview of these attempts. The most involved were OECD and WTO, but any of these organizations did not achieve their goals in this area. On this background, the study explains the current international investment framework as for the rules and agreements that cover them. Nowadays, the global capital flows are governed by bilateral investment agreements, by preferential trade agreements, integration agreements (namely EU) and – in the sphere of services – by the WTO General Agreement on Trade in Services.

**Key words**: FDI, rules, OECD, WTO, GATS, liberalization

## Introduction

Foreign direct investment increase is an important feature of the current stage of globalization. FDI attracts interest not only for their worldwide increasing volume and importance, for their ability to promote development and economic growth and for their various impacts for hosting economies, but also because the world lacks multilateral investment rules that could be a reflection of multilateral trading rules that are codified in the World Trade Organization agreements.

International investors cannot rely on international rules that would improve the business climate through legal certainty a would reduce the perceived risk to invest. They have to be aware of individual Bilateral Investment Treaties (BIT) that individual states signed bilaterally. Specific investments agreements on presence and protection of foreign investment create are a basis of a very nontransparent environment that reflects also a negotiation power of parties. It is why conditions in investment agreements of one state could be different for each partner or a group of partners that leads to a situation of different rules for FDI and their protection according to their origin. This situation undermines not only transparency, but also predictability for international investors that could incite speculative investment transfers among countries with a goal to provide the „best“ origin and to achieve the highest level of protection. These reasons lead the world community - already several decades ago – to an attempt to negotiate and agree multilateral investment system.

The most important activities – negotiations and discussions - were run by the Organization of Economic Cooperation and the World Trade Organization, but they lead to an impasse for several reasons. A partial step towards international investment rules and commitments in this area has been accomplished in General Agreement on Trade in Services (GATS/WTO), but these rules concern exclusively foreign direct investment providing services.

As governments try to ensure the best business environment abroad for their subjects, the non-existence of international investment rules leads them to an extension of the scope of bilateral preferential trade agreements, which are based on an exception from the most favored clause according to the GATT and GATS agreements, by an „investment“ part. The mentioned extension is proposed by developed countries which goal for opening foreign markets and protection of their investment is very strong. Other reason why to bind trade preferences and investment rules is in a possibility to commit to investment rules a partner who would be otherwise reluctant to sign a separate investment agreement. Commitment in investment rules and protection could be compensated by concessions in other areas within the bilateral trade agreement, for example through opening of the developed market to agriculture and other importation from developing countries. This aspect has been besides others a reason of the incorporation of investment into the EU Common Commercial Policy.

**OECD**

In 1976, the Organization for Economic Cooperation and Development (OECD) adopted the Guidelines for Multinational Enterprises, as a part of the OECD Declaration and Decisions on International Investment and Multinational Enterprises. The concept of Guidelines lies in “recommendations addressed by governments to multinational enterprises operating in or from adhering countries”. In reality, they consist of voluntary principles and standards, known as corporate responsibility and cover areas of employment, human rights, environment, bribery, consumer interests, science and technology, competition and taxation[1]. The Guidelines were adopted by 43 states and are regularly updated. The mentioned Guidelines, given their voluntary character, do not provide a stable and transparent investment environment – they only provide advices on behaviour of investors.

In the last decades of the 20$^{th}$ century, OECD devoted its activities to investment rules in two stages. In 1992, code of conduct of international corporations had been proposed. In the second stage, a project of Multilateral Agreement on Investment (MAI) started. Its goal was to negotiate and agree rules for investment, namely multilateral framework for international investment with high standards

[1] OECD Guidelines, http://www.oecd.org/document/28/0,3746,en_2649_34889_2397532_1_1_1_1,00.html

for a liberalization of investment regimes and investment protection, including dispute settlement. MAI should have been signed first among developed economies. OECD non-members had been invited to join the agreement as well. The first draft of the text was presented in 1992 and the negotiation was open at the annual ministerial conference in 1995.

Negotiation principle that was applied by MAI negotiations was so called „top-down“ approach. This approach has been used by a majority of international agreements, including the WTO agreements[2]. It is based on a formulation of a rule or commitment which all signatory parties have to respect if they did not enforced an exception from it. In order to be admitted, such an exception have to be a part of existing national legislation of the state the pursue it. This negotiation approach is very demanding in areas that - within a state - are regulated by very many different legal acts at different levels. It is very difficult – namely from the perspective of institutional capacities – to identify all relevant legal norms, interests and related aspects that are or could be in the future concerned by the drafted rule.

Very intense MAI negotiations continued until the first half of 1998, when they were terminated due to a deep disagreement of negotiating governments and due to concerns of developing countries that were invited to participate only in the middle of the negotiations. For these countries and for others, namely for „new“ members of the OECD was completely excluded – for capacity and expert reasons – to draft in complexity exemptions that would protect national economies and to pursue them effectively.  An analysis of MAI lead to a conclusion that it was attempt to misuse a non stable and changing regulatory environment of less developed states and to force them to accept commitments that fulfillment would be very difficult and costly. Other arguments for terminating the MAI negotiations were anti-globalization protests and world economic development, as crisis of 1997 in Asia.

**WTO**

Rules for investment should have been incorporated into world trade order already after the Second World War, together with drafting of Havana Charter as a basis for the establishment of International Trade Organization. This organization has never started to operate and the multilateral trading system has been covered for almost 50 years by the General Agreement on Trade and Tariffs that was signed as a provisional one.

World Trade Organization dedicates several agreements to the investment: in the Trade Related Investment Measures Agreement (TRIMS), in the General Agreement on Trade with Services (GATS), in the Trade Related Aspects of Intellectual Property Rights Agreement (TRIPS) and in the Declaration from the Conference of Ministers in Singapore in 1996.

[2] with an exception of the GATS agreement

TRIMS agreement generally provides for that investment measures should not create trade obstacles, should not undermine non discrimination infringe the national treatment and should not establish a quantitative restriction. From the perspective of investment rules the agreement is not very important. These rules are applicable only for the trade in merchandise. The annex of the agreements lists examples of non acceptable investment measures: supplies with local production content or requirement to maintain a balanced Balance of Payment. The TRIMS agreement does not have very important implication, as the provisions of it are not respected by developing countries that pursue investment measures according to which the national production is preferred with the aim of supporting domestic industry.

Activities of the Working Party for Trade and Investment had been limited to an analytical work on the relationship between trade and investment, based on the declaration from Singaporean conference, the discussion is, however, frozen since 2004. It has been excluded from the negotiations on further trade liberalization (within Doha Development Agenda, DDA) after the failure of the Conference of Ministers in Mexico in 2003, together with issues of competition and transparency of governmental procurements.

Since its establishment, the Working Group had discussed full range of aspects related to investments. Its goal was to draft multilateral investment rules that would allow a major liberalization of investments, namely of FDI. The Group focused its analyses on identification of common aspects, differences and contradictions in existing international instruments related to investments, advantages and disadvantages of bilateral, regional and multilateral rules on investment, including the development point of view, rights and obligations of countries of origin (home countries) and host countries and investors, relation between existing and possible future cooperation in the area of investment policy and competition policy. Ambitions of the Group were reduced after the failure of the WTO Ministerial Conference in Seattle in 1999. It was supposed that the Conference would open a new round of negotiations and the intense preparation for it covered a very broad scope of new trade issues. At that time, it was clear that the OECD activities on the MAI are in impasse, and developed countries tried to shift the negotiations on investment to the World Trade Organization, however with important changes in the approach that should have overcome the main obstacle that had arisen from the OECD discussions. A draft of multilateral investment rules was based on the same concept as the GATS agreement – bottom-up approach within which each member of the agreement defines its commitments in individual areas and if he does not consider its economy to be enough mature for a specific commitment should not include it in its portfolio. At Seattle Conference members of the WTO did not, however, came to any conclusion on opening a new round of negotiations and on issues to be negotiated[3]. As a consequence, the aims in the area of investment rules and liberalization had been reshaped. The new round of negotiations that was successfully open in 2001 in Doha, Qatar, mandated – namely due to its development aspect – only discussion to the trade and investment relation. The discussion included aspects like protection from non correct methods and procedures of multinational corporations or promotion of investment flows according to the interests of developing countries. As already stated, in 2003 these issues - even when targeted only in discussions and not mandated for negotiations - proved to be too ambitious for developing countries and their capacities, and the Working Group was frozen for unlimited period of time

Further area, in which investment appears in the WTO agreements, is the GATS Agreement. The agreement is in force since 1995[4]. GATS provides rules and commitments in 11 sectors (plus others) of services supply, and for four different modes of supply (cross boarder supplies, consumption abroad, presence of legal persons and presence of physical persons at the target market). Rules for presence of legal persons constitute conditions for the market entry of FDI in all sectors of services. Even if it is possible to consider this part of the GATS agreement as rules and commitments for investment, the bottom-up approach that has been applied while negotiating GATS, does not provide any „common“ and „same“ level of investment rules and market access for FDI. Each member opens its market differently for each sector and subsectors of services, and the market access differs significantly also member to member. Except of market access, members also very differently committed themselves to respect the principle of national treatment, as the GATS enables to exclude from this principle individual service (or all services) based on the member’s decision.

The WTO members, by negotiating commitments of legal persons at their market have been limited by already agreed bilateral trade and investment agreements. Respecting the existing investment agreements together with the bottom-up approach established a non transparent system that make the decision about the market entry of potential investors very difficult. It could be considered as rules for FDI in services sectors only with a reservation.

In some literature, the Trade Related Aspects of Intellectual Property Rights Agreement (TRIPS) is mentioned as the agreement establishing investment rules. The TRIPS agreement could be considered as such only for cases when the intellectual property right itself is an investment that should be protected. The agreement provides minimum standards for protection and enforcement of intellectual property rights that have to be implemented into national legislation of all WTO members. The IPR owner, however, has to proceed through legal steps in order to ensure the protection. Even if the IPRs protection and enforcement are an important condition for investors while deciding about a market

[3] Failure of the Conference had several reasons, namely a very high number of new issues that individual members would have liked to negotiate and lacking previous discussion on them, but also a misorganization of the event with anti-globalist demonstrations.

[4] Establishement of the World Trade Organization

entry, they are not rules for investment and its protection, but a part of the less or more favorable business environment.

**Further international organizations**

Except of the OECD and the WTO, the investment issues were on the agenda of other international organizations. World Bank has provided Guidelines for Foreign Investment, but these guidelines were not binding. In the framework of the UN, a specific United Nation Commission on Transnational Corporations has been established. Its goal was to codify rules for behavior of multinational corporations. Both these initiatives were unsuccessful – rules for multinational corporations were rejected by developing countries. Investments are also a subject to dispute settlement that occurred in relation to them, for example the Convention on settlement of investment disputes between states and citizens of other states that are supervised by the International Centre for Settlement of Investment Disputes (ICSID).

Investments, rules for their market entry and protection are also subjects to regional (preferential) trade agreements that allow broader space for negotiating rules, protection, settling disputes and compensations for such commitments in other then investment field. North American Free Trade Agreement (NAFTA) and the newly negotiated preferential trade agreement of EU (with Canada or Mercosur) could be mentioned as examples

European Union reflects the investment issue in the Lisbon Treaty that entered in force the 1st December 2009. The Treaty incorporates investment under the principles and procedures of the EU Common Commercial Policy, with the goal to develop a Common Investment Policy and eliminate differences in the investment environment that exist within the EU. High number of differences is an impact of high number of individual bilateral investment agreements of individual EU states[5]. New principles state that the investment agreements have to be agreed at the supranational (EU) level and provisions of these newly agreed agreements have to be implemented into the EU legislation in the form of regulations[6]. It is not yet clear, how the existing BIT of individual member states will be renegotiated having in mind interests of partners not to undermine the commitment they consist of.

**Conclusion**

Non existence of multilateral investment rules leads to a differentiation within investment policies of individual governments, to different degrees of market access for investment and capital flows and to a different extent of the investment protection in individual countries and according to the origin of

[5] For example, the Czech Republic has signed 95 Bilateral Investment Treaties
[6] Regulation is a legal act that does not need to be implemented into national legislation of individual EU member states.

investment. This situation is accompanied by a high risk of autonomous governmental decisions consisting in discriminatory approach toward foreign investors related to the current crisis

Some of international organizations attempted to draft and establish the multilateral system of investment rules with a goal of further liberalization of FDI flows. These activities proved unsuccessful namely due to its accent on the highest investment protection what have been refused by countries importing capital. Drafts of the system do not reflected also so called „non investment“ aspects of investing abroad, as human rights or environment protection. The overweighting argument of developing countries for refusing multilateral investment agreements was, however, not to loose the autonomous possibility to regulate foreign investment and not to give up an important negotiation „chip“ for bilateral negotiations. On the other hand, proposals for agreements that would pursue rules for „behavior“ of multinational corporations in host countries that have taken into consideration interests of developing countries, were refused by developed economies.

The non existence of multilateral investment rules is a reason why governments protect their investors and try to open foreign markets for them through Bilateral Investment Treaties or through incorporation of investment issue into preferential trade agreements. The intense development of these methods is a barrier for multilateral liberalization of the investment market and is an obstacle for achieving deeper mutual integration of economies. Actually, in the crisis and just after it, initiation for international investment rules would not be productive and it would risk to be refused by the majority of world states. The next global development, together with the development of the WTO negotiations on further trade liberalization will show if the current status quo is or is not the most advantageous stage that could be achieved namely from the point of view of further liberalization of the world investment market.

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