**Slide Show Notes**

**Foreign Direct Investment**

"Foreign" investment (investment by persons or firms domiciled in other countries) is usually regulated and the governments of those countries get involved in international negotiations about the regulations. This has led to a variety of international agreements, including one multilateral agreement, and creation of some international organizations.

The goal of this module is to make you aware of some leading elements of these international institutions.

One overall observation based on this survey of agreements and organizations is that the "investment" area does not fall under one controlling agreement or organization. That's because its issues continue to divide the countries of the world.

Investment can refer to various things.

1. Purchase of financial assets, including purchase of a passive interest in a firm, like buying stocks or bonds for income.
2. Expenditures to create a new firm or to purchase of a controlling interest in an existing firm.
3. Expenditures that increase productive capacity, such as expenditures to buy or produce durable goods, and expenditures on research and development.
4. In macroeconomic models, "investment" is the name given to the part of private spending that is "exogenous" in the sense that it doesn't depend on current income.

This module on "foreign direct investment" or FDI refers to the second concept: buying control over a firm or creating a new firm, specifically in a country other than where the investor is domiciled. Later modules will get into regulation of the first thing — passive financial investments — which are usually treated from a "money and banking" point of view.

This slide lists the international agreements and institutions that this module will touch on.

In regulating FDI, the host government may want the firm's management (controlled by a foreign investor) to do things that the government likes, such as in hiring or in generating foreign exchange (exports net of imports).

Some of these regulations affect "trade."

* Requiring that the firm must generate a net increase in foreign exchange may involve restricting imports, which looks like a "quantitative restriction."
* Requiring that the firm hit an export target for the firm to get investment approval looks like paying an export subsidy, in the sense that the government's investment approval is a thing of value that it "pays" the firm in return for the firm's exports.

The WTO calls measures like these "trade related" and naturally is concerned that they should be consistent with member countries' WTO commitments on trade. So, there's a WTO agreement that spells out what this concern implies: the agreement on "Trade-Related Investment Measures" (TRIMs).

TRIMs was adopted at the same time as the overall WTO agreement in 1994. It re-states provisions that, in principle, were already in the GATT and that had been applied to investment policy by settlement of a dispute in the 1980s regarding Canada's investment policy.

Why should the WTO have a separate agreement that hardly adds anything to the GATT? Why isn't there an agreement saying that members would allow more FDI in more industries, the way the GATT says that there should be more market access for imports in more industries?

When negotiations that results in TRIMs started in the 1980s, this is what industrialized countries wanted: an agreement that would roll back limitations that developing countries had traditionally placed on FDI.

But the developing countries couldn't be persuaded.

As a result, the negotiations did not go beyond the trade-related principles on which there had already been general agreement for a long time.

One specific area that industrialized countries would have liked to get agreement was on transfer of technology. Since they didn't get it, the TRIMs agreement allows member governments to require that foreign investors provide the companies they create (or buy) with "intangible" things like brand names and technology. If a government does require that, a prospective foreign investor can negotiate or can walk away, but the investor can't claim that the government is violating a WTO standard.

As is frequently true for WTO agreements, the way TRIMs works is seen most clearly when a complaint is taken to the Dispute Settlement System. The famous case that the textbooks all cite is the Indonesian "National Car" program. With a little research, you can find more details if you want.

Briefly, Indonesia, acting after it became part of the WTO and thus after it had adhered to TRIMs, gave benefits to car companies if they did certain things. Offshore companies could qualify as "national car" companies if they conformed to the rules, but they were treated differently in terms of the benefits they got.

As a result, a WTO dispute panel found that the program violated the "national treatment" principle of both the GATT and TRIMs. Curiously, if Indonesia had established the program earlier, then TRIMs' phase-out provisions might have allowed Indonesia to keep it going longer.

Besides showing that TRIMs was enforceable, the Indonesia national car company case is known among WTO-watchers for being the first one where the parties were allowed to bring private lawyers into panel hearings.

Since negotiations on the multilateral agreement, TRIMs, didn't produce much, countries frequently negotiate about investment policies bilaterally and the number of bilateral investment treaties — BITs — has grown substantially since 1990.

There is no global standard BIT, so I'll use the USG's "model" BIT as an example to show the areas that bilateral agreements may get into, beyond the "trade-related" areas of TRIMs. (The model BIT dates from 2012 and is available on the U.S. State Department's website.)

In my time with USAID, we assisted a couple countries in adjusting policies to prepare for BIT negotiations with the U.S., sometimes using a preparatory agreement, a "Trade and Investment Framework Agreement" (TIFA), as a guide to the issues that the BIT would seek agreement on.

The U.S. model BIT is one of your readings in Canvas. This slide shows a selection of its provisions. As you can see, in addition to endorsing the principles in TRIMs (the fourth item in the list), BITs go beyond "trade-related" items and get into staffing, finance, and so forth.

For any of these provisions to be effective, of course, they would have to be successfully negotiated with another country in a real BIT. You can check the U.S. Department of Commerce's website (under the International Trade Administration) for copies of actual U.S. BITs to see what the U.S. "got" in its various negotiations.

The U.S. model BIT's clauses about outside arbitration refer specifically to ICSID, the International Centre for Settlement of Investment Disputes, which has been widely used. (However, as the Congressional Research Service document in Canvas describes, there is debate about outside arbitration in general, and as regards ICSID, the EU has begun negotiating an alternative — called "Investment Court Systems" — in its RTAs. So, maybe a larger change may be coming.)

As regards ICSID, it is an international agency established in 1966 as a member of the World Bank Group.

The World Bank is a natural choice as the host of this agency. It has credibility both in a technocratic sense and in the sense of being acceptable both to developing countries and industrialized countries. Promoting investment is one of its goals as an institution, and this had led it to act as a conciliating force in disputes in the 1950s and 1960s, the period when the idea of creating an agency like ICSID was being discussed.

Somewhat like the WTO's Dispute Settlement System, ICSID responds when a party who feels aggrieved files a request for arbitration. ICSID relies on outside experts acceptable to the contending parties to serve as arbiters. The parties themselves finance the proceedings. ICSID's internal staff is quite small, only seventy.

Disputes easily grow out of differences between the rules of different countries, or from rules that are unclear. In 1966, the same year that ICSID was formed, the UN General Assembly created its Commission on International Trade Law (UNCITRAL), as a mechanism for harmonizing the laws of its members.

UNCITRAL usually supports groups of experts from member countries to draft model laws. See the list of UNCITRAL Working Groups in Canvas's Files.

Model laws are available in all the UN's official languages, so finding the right way to phrase an idea in each language, so that the provision will be implemented the same way in different countries, requires the expert groups to include members from various countries.

Occasionally, UNCITRAL's own staff has made first drafts of model laws.

If member countries adopt UNCITRAL's models, or at least copy their provisions, it makes trade law more uniform across borders.

UNCITRAL also supports the drafting of international agreements ("conventions"), which themselves become trade law in the countries that adhere to them.

UNCITRAL is based in Vienna, Austria, has a small internal staff assigned from the UN Secretariat, and maintains a legal library to support working groups and members.

Consistently with ICSID's reference to UNCITRAL as a resource, UNCITRAL had a working group on the ICSID's area, arbitration.

Another international agreement affecting investment, which I became aware of while working in Peru, commonly goes by the name "ILO Convention 169" or "ILO 169," although its long title is "The Indigenous and Tribal Peoples Convention, 1989."

ILO 169's relevance to foreign investment principally results from its specifically mentioning (in Article 15) sub-surface resources: minerals, including petroleum. In countries that have ratified it, ILO 169's provisions must be respected to prospect for oil and gas or to do any type of mining, which is prominently done by foreign multinationals.

The situation that gave rise to the convention is that several the world's sovereign territories are divided between a colonial society and indigenous societies, where the colonial society is wealthier and dominates the formal institutions of government, and where the indigenous societies, although they are a substantial part of the population, live separately and don't participate fully in national institutions. In this circumstance, public policy decisions (like recognizing a title to land or granting an oil exploration permit) are taken in processes where the indigenous scarcely participate.

The point of ILO 169 is that special efforts should be made to consult the indigenous in matters that will affect them, in addition to whatever may be the usual legislative processes. Matters that likely affect the indigenous include mining.

Why mining? Because colonial societies, being farming societies (initially), displaced the indigenous from river valleys, with the result that the indigenous live in upland areas where geologically minerals are found. In Peru, the Quechua speakers live in the Andes, while the Spanish speakers live along the coast.

The countries who have ratified ILO 169 are mainly Latin American countries.

The case that engaged USAID's attention in Peru had to do with forestry, which I'll explain more fully in the course's module on endangered species. For now, the point is that the government of Peru decided that, to carry out an environmental commitment it had made in a bilateral agreement with the U.S., it needed a new forestry law. (Some private U.S. companies are involved in logging in Peru.)

Peru's government promptly put a new law in place in 2008, by executive decree. But that procedure that did not conform to ILO 169, which Peru had ratified.

Unfortunately, Peru was in crisis at that same moment because of violent clashes between indigenous and the military over oil exploration. When indigenous objections to the way the forestry law was decreed were added to this situation, the optics of Peruvians dying because of Peru's implementation of an agreement with the U.S. (even if that was not exactly accurate) got the attention of both governments.

So, the Peruvian government revoked the decree-law and started the process of consultation with the indigenous, consistent with ILO 169. On the U.S. side, USAID was tasked with assisting the Peruvian government in those consultations. (USAID's point person for this assistance, by the way, has an MPA from O'Neill SPEA.)

USAID supported a large number of consultation meetings between government and indigenous groups, as well as a month-long study tour of U.S. national forests, conducted by the U.S. Forest Service, so that the governors of the four Peruvian provinces in the Amazon (the forested area) could see how U.S. forest management works. The four governors were accompanied on their U.S. tour by my USAID colleague.

Eventually, Peru passed a new forestry law — which, unfortunately, did not change very much. The point here, however, is that Peru's being a party to ILO 169 created an understanding for how to proceed that was accepted by all the parties even though the Peruvian government had been off-track initially.

Knowing a bit about the ILO, the International Labour Organization, may clarify how it was that it would have been the venue for an international convention on indigenous rights.

Established in 1919, the ILO is one of the oldest UN agencies. It has about 187 country members and its main role is to promote workers' rights in all member states. One of its main tools is international agreements — "conventions" — like ILO 169.

Most ILO conventions have to do with employment policy and working conditions, so the indigenous rights convention is perhaps not typical. A list of the ILO conventions is on the ILO's website. (Labor "standards" are also an ISO topic, in ISO 26000, Clause 6.4 on "Labor Practices.")

The ILO is what I would call a "medium-sized" organization, claiming 2,700 staff across its Geneva headquarters and 40 country offices. One of my Egyptian colleagues in USAID/Egypt left USAID to become a local staff member in the ILO's Cairo office, and she liked it a lot.

The unique thing about the ILO is its "tripartism": its combination of governments with representatives of for-profit businesses and labor organizations. All three parties are represented in each country's delegation to the International Labour Conference.

What will you do to benefit from this module?