VOLUME 6 NUMBER 3 DECEMBER 1997

TRANSNATIONAL CORPORATIONS

United Nations
United Nations Conference on Trade and Development
Division on Investment, Technology and Enterprise Development

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Transnational Corporations (which replaces *The CTC Reporter*) is a refereed journal published three times a year by UNCTAD. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and by the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). The basic objective of this journal is to publish articles and research notes that provide insights into the economic, legal, social and cultural impacts of transnational corporations in an increasingly global economy and the policy implications that arise therefrom. It focuses especially on political-economy issues related to transnational corporations. In addition, *Transnational Corporations* features book reviews. The journal welcomes contributions from the academic community, policy makers and staff members of research institutions and international organizations. Guidelines for contributors are given at the end of this issue.

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ISSN 1014-9562
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Building a multilateral framework for investment: comparing the development of trade and investment accords

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John M. Kline and Rodney D. Ludema*

Global policy makers are scrambling to catch up with the expanding role of foreign direct investment which has outpaced world trade and GNP growth while linking 45,000 parent firms with 280,000 foreign affiliates. No multilateral framework for investment exists, comparable to the international regime that developed to govern trade relations over the past half century. As foreign-direct-investment issues are debated in various international forums, useful comparisons can be drawn between contemporary multilateral framework for investment issues and the historical development of the General Agreement on Tariffs and Trade. This article analyses how the movement from a system of bilateral trade treaties to an international trade regime contrasts with the current juxtaposition of the proliferation of over 1,300 bilateral investment treaties with the start of discussions about developing a multilateral framework on investment. The analysis discovers important similarities between these situations, especially regarding how key trade and foreign-direct-investment principles found in bilateral treaties can serve as potential building blocks for multilateral agreements. Significant differences also exist, including dissimilar political contexts for negotiations, divergent applications of similar principles and the unique role being played by private transnational corporations in the creation and implementation of foreign-direct-investment agreements. These conclusions point towards key issues that are driving the remarkable expansion of bilateral investment treaties and that will shape the emerging negotiations on a possible multilateral framework on investment.

Dramatic changes in transnational business are outpacing the established framework of intergovernmental agreements that govern global commerce. The creation of the World Trade Organization (WTO) upgraded the international community's capacity to address many issues, but critical problems remain on the agenda, including how to extend intergovernmental cooperation over rapidly evolving investment relationships. In response, governments are negotiating an expanding network of bilateral investment treaties (BITs), and also negotiating a Multilateral Agreement on Investment (MAI) in the Organisation for Economic Co-operation and Development (OECD) (contemplated to be completed by mid-1998), while a WTO working group has opened discussions on international investment issues. The relationship between these bilateral and multilateral actions, however, remains unclear.

This article seeks to address one major aspect of the bilateral/multilateral relationship, i.e., whether or how the proliferation of BITs, numbering over 1,300 at the beginning of 1997, may influence the development of a multilateral framework on investment (MFI). The question is explored by first examining how bilateral trade agreements affected the development of the General Agreement on Tariffs and Trade (GATT): did most-favoured-nation (MFN) treatment

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extended through bilateral trade agreements reach a point where negotiation of an international trade agreement was logical, easier or even inevitable? This historical experience is then compared with currently evolving scenarios involving negotiations on investment issues. Is an MFI likely to develop in a fashion similar to the one in which GATT was created, in terms of agreed principles, functions, institutions and political processes?

The results of this comparison show that, similar to the trade experience, BITs offer a set of basic principles upon which an MFI could draw. However, important contrasts exist in the dramatically different negotiating context of the 1990s, the dissimilar domain for the application of investment principles and the central role of transnational corporations (TNCs) in the formation and implementation of intergovernmental foreign-direct-investment (FDI) accords. The comparisons suggest that although international cooperation on investment issues appears to be evolving along a broadly similar channel set by the previous pattern of international trade agreements, these broad similarities conceal significant differences in both process and substance that will shape possible outcomes. A clearer recognition of the similarities and differences may help inform progress towards the best, mutually beneficial accord on international investment.

Trade and investment at the crossroads

International investment is reshaping the global economy, expanding faster than trade flows or world gross domestic product (GDP). Outward FDI stock reached $3.2 trillion in 1996, linking 45,000 parent firms with 280,000 foreign affiliates (UNCTAD, 1997a). Enterprise strategies reflect the emergence of integrated international production systems that tie trade and investment decisions closely together (UNCTAD, 1993). Intra-firm trade among affiliated firms comprises a growing proportion of trade flows, accounting for as much as 38 per cent of total exports and 43 per cent of total imports in some countries (UNCTAD, 1996a). This expansion of globally integrated business operations contrasts with the traditional segmentation of government trade and investment policies, and highlights the absence of an international agreement on FDI issues.

Competition for private investment funds is intensifying as more nations recognize the potential benefits from FDI (UNCTAD, 1996a). Legislative reforms have liberalized national regulations, while governments are exploring bilateral and multilateral mechanisms to facilitate FDI flows (UNCTAD, 1994, 1996a). Bilateral investment treaties can play a significant role in efforts to create a more hospitable FDI climate by setting forth agreed principles that establish a necessary if not fully sufficient policy basis for attracting FDI. The perceived importance of these mechanisms is reflected in their

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