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CONSIDERATION OF THE NECESSITY OF MULTILATERAL INVESTMENT RULES FROM DIVERSIFIED VIEWPOINTS

I. INTRODUCTION

1. At the four meetings of the Working Group on the Relationship between Trade and Investment held in 2002, discussion focused on the individual elements described in Paragraph 22 of the Doha Ministerial Declaration and proposed elements in the Working Group. From now it is necessary to continue to further discuss these elements and review outstanding points of discussion.

2. In addition to those technical points of discussion, questions were also raised concerning the role and significance of investment rules, such as the necessity of prospective multilateral investment rules and their relationship with development policies. Now that the first round of discussions have just been completed, it is also important to review the issues regarding the role and necessity of investment rules from a broader perspective again, with the considerations on such issues as the relationship between prospective multilateral investment rules and other investment-related WTO rules.

3. In the first part, this paper takes a further look at the necessity of investment rules from the perspective of actual economic activities, taking into account the relationship with development policies. The second part of this paper aims at considering the necessity of investment rules from the viewpoint of overall structure of WTO system. In this wise, this paper attempt to sort out the issues regarding the role and necessity of investment rules. It should be noted that this paper does not prejudge the position of the Government of Japan in any future negotiations.

A. NECESSITY OF INVESTMENT RULES FROM THE PERSPECTIVE OF ACTUAL ECONOMIC ACTIVITIES

1. Increasing role of FDI and the emergence of untransparency

4. Cross-border investment (FDI[1]) rapidly increased in the 1990s, and their contribution to economies around the world is of increasing significance. The significance of such FDI and its contribution to economic growth has already been pointed out in papers submitted by each member country at the time of the launch of the Working Group on Trade and Investment in 1997. (See Annex, Table 1)

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[1] Throughout this written contribution, consideration is limited to foreign direct investment (FDI). It is only for the sake of convenience and this does not indicate Japan's position as to what the scope of investment should be.

5. Recent macroeconomic data indicates that the share of the contribution of FDI to the gross fixed capital formation is increasing in developing countries. For instance, the above-described share in the Asian region has jumped up from 3-4% at the beginning of the 1990s to about 10% by the end of the 1990s[2]. It goes without saying that investment rules are therefore essential elements for economic growth in each country, and for development policies that underpin the growth of inward FDI and consequently economic growth.

6. One recent analysis of great interest is the research on China undertaken by UNCTAD. In China it is said that foreign affiliates account for half of exports, one-quarter of manufacturing production, one-third of sales of manufactured products, and one-fifth of all tax revenues, demonstrating the fact that FDI is greatly contributing to economic growth of China.[3] (See Annex, Figure 1)

7. On the other hand, with this sharp growth in FDI, many investors concerns about various problems over investment issues on the part of investors, and request on urgent solution to these issues. As was already demonstrated in the Working Group meeting of April 2002 (WGTI/W/112, communication from Japan on "Transparency"), serious concerns are, for example, the lack of transparency and the frequent changes of investment-related rules. (See Annex, Figure 2)

8. From the perspective of development policies in developing countries, it is necessary to make best use of rather than limit FDI, and to this end it is essential that predictability can be secured for investors through the formulation of investment rules and other measures. The improvement of predictability has a positive effect on future increases in investment in host countries. Of course, the necessity of a flexible rule structure in order to resolve conflict between investment rules and development policies has been pointed out in discussions in previous Working Group meetings (July 2002) (e.g. WGTI/W/124, communication from Japan on "Non-Discrimination" and W/125 "Modalities for Pre-establishment Commitments"). In other words, given the different stages of each country's economic development, prospective multilateral investment rules should be flexible enough in order to respond to the specific development policies of each country. For example, it is necessary to consider in the negotiation process a GATS-type approach to national treatment (NT) for pre-establishment and development provisions for developing countries, as has been discussed in the Working Group.

2. Changes in Investment Patterns and the Role of Investment Rules

9. With regard to the role of investment rules, it is necessary to discuss the following two points in relation to the dynamic changes of actual FDI activities.

10. The first point is that the increasing role of FDI in an environment with diversity of FDI activities is increasing. In the paper "Investors' and Home Governments' Obligations" (WGTI/W/152) discussed in the Working Group in December 2002, basic discussion was made on the assumption that the FDI activities are made mainly by multi-national enterprises (MNEs) which have strong market power. However, in reality, FDI trends are changing in a global market. Many companies, not only MNEs are now actively engaged in FDI. For example, in the first half of the 1990s, approximately half of the Japanese manufacturing companies engaging in FDI were small and medium enterprises (SMEs).[4] These SMEs do not necessarily have highly advanced information gathering capacities concerning the investment environment in the host countries. Accordingly, the

[2] UNCTAD World Investment Report 2001, p.24, Fig. 1.13.

[3] "CHINA: WTO Accession and Growing FDI Flows", UNCTAD, 11 December 2002.

[4] "White Paper on Small and Medium Enterprises in Japan, 2000".
The survey uses the definition of SMEs of Article 2 of Small and Medium Enterprise Basic Law (Japan, as of 1973): company of which total amount of its capital is 100 million yen and under / company or person that employs less than 300 full-time employees.

formulation of investment rules and the creation of an investment environment with greater predictability for investors is essential for small and medium sized investors. In addition, from the perspective of the host countries also, the formulation of investment rules would bring about greater diversity in inward FDI in the future and could prove to be of benefit linked to enhancement of the industrial base or job creation in the host countries themselves.

11. The second point is the argument that investment rules are necessary in order to respond to the structural changes in FDI patterns in each country. At the Working Group in July, Hungary made a most interesting comment concerning the possibility of capital importers becoming capital exporters: " In the process of economic transformation that had begun at the end of the 1980s, Hungary relied heavily on FDI. However, after a decade Hungary had become the second largest exporter of FDI in Central and Eastern Europe after Russia." (WGTI/M/18, p.22, para. 89). Such comments will encourage host countries of FDI.

12. Many developing countries as host countries of FDI, while understanding the positive effects of investment rules to increase inward FDI, on the other hand may feel that disciplines on domestic rules imposed by prospective multilateral investment rules would create too much burden for them. However, considering those actual examples as the changes that have taken place in Hungary, developing countries should focus also on the long-term effects that come from multilateral investment rules. That is to say, not only would prospective multilateral investment rules have a positive effect on increasing inward FDI, it is also necessary for developing countries to consider that the rules would provide an important tool for future outward FDI activities of themselves. As a matter of fact, it is already the case that the country in certain sectors could be a capital exporter although a developing country as a whole nation is a capital importer.

13. As a concrete example, it is a fact that five out of the world's top 100 transnational corporations in 2000 were corporations from developing countries.[5] In China, the capital importer in the world, while the great amount of inward FDI flow is continuing, outward FDI has doubled from 2000 to 2001, mainly in natural resources sectors[6]. In addition, according to macroeconomic data, although it is the case that FDI from Japan to China is very large, there are already cases to be seen whereby Chinese companies are investing in the Japanese manufacturing sector. Moreover, the interesting case that Telekom Malaysia has suffered damage in Ghana indicates that establishment or improvement of predictability is also important for FDI activities of developing countries[7].

B. NECESSITY OF INVESTMENT RULES FROM THE VIEWPOINT OF OVERALL STRUCTURE OF WTO SYSTEM

1. Imbalance between service and non-service sectors

14. In the previous section the necessity and role of investment rules was discussed from the viewpoint of actual economic activities, yet there are concrete examples of various investment-related rules inside and outside the framework of the WTO.

15. Within the WTO rules a point of particular importance for the prospective multilateral investment rules is the relationship with GATS. The fact that GATS has already been equipped with substantive disciplines on FDI in the service sector under Mode 3 is important, from the perspective of the coverage regarding FDI activities in each industrial sector under WTO Agreements.

[5] UNCTAD World Investment Report 2002, p. 99.

[6] CHINA：WTO Accession and Growing FDI Flows, UNCTAD, 11 December 2002, p. 23.

[7] See following websites on details: Ghana Online (http://www.ghanaonline.com); BBC NEWS (http://news.bbc.co.uk/2/hi/business/2632509.stm).

16. More than half of FDI is carried out in the non-service sector. In particular, approximately 70% of FDI towards developing countries is in the non-service sector. However, given that there are no disciplines in such areas in which FDI activities are conducted, we can say that the current WTO system is insufficient. (See Japan's written contribution "The Relationship between the Future Investment Multilateral Rules and GATS" (WT/WGTI/W/156), regarding the detailed perspective on the relationship between GATS and prospective multilateral investment rules).

17. From this perspective, many voices in industrial circles are therefore calling for investment discipline in non-service sector. For example, Nippon Keidanren (Japanese Business Federation) issued a proposal in March 2002 concerning the necessity for investment rules.[8] (See Annex, Table 2)

2. Maximizing the Benefits of Trade Liberalization in the WTO

18. Furthermore, from a broader perspective, multilateral investment rules are important because of maximizing the benefit which WTO can bring to the global economy.

19. To be more precise, the balance in the progress of liberalization both in trade and investment is important, taking into account the synergy effect of liberalization in both fields. More specifically, in the previous rounds of the GATT/WTO, liberalization progress has been made in trade aspects, such as reduction or as appropriate elimination of tariffs, as well as non-tariff barriers. However, in order to make the WTO system more effective, it will not be enough merely to liberalize existing aspects of trade, but rather what is called for is the liberalization of investment as well.

20. Regarding the above-described point, the analysis of UNCTAD World Investment Report 2002 is useful. Firstly, for developing countries in which domestic investment is limited by financial constraints, capitals and technologies and trade expansion brought about by FDI is crucially important. Secondly, it is important to host countries that the reception of FDI by MNCs brings the access to their global network, such as customers worldwide. Concerning the second point, the report points out that "an estimated one-third of world trade consists of intra-firm trade," and indicates how great is the role of MNCs played in the world trade[9]. In this manner, developing economies can receive much greater benefit attained by trade liberalization, through their improvement of export competitiveness and market expansion arisen from inward FDI. Therefore, investment liberalization is also important in order to maximize the outcome of trade liberalization.

21. In fact, there is an analysis indicating that the elimination of FDI-related barriers has a significant impact on economic growth and import/export. For example, in APEC, although rules are non-binding, both trade and investment liberalization are being pursued in tandem. In 2002, model analysis was undertaken, combined with the impact analysis of trade liberalization, regarding the impact of the elimination of FDI-related barriers on economic growth and import/export. Result of this analysis indicates that these investment liberalization would increase GDP by 0.3% and increase exports would increase by 0.5% in the APEC region. (See Annex, Figure 3)

22. The same perspective was echoed in the report published by the World Bank in January 2003 "Global Economic Prospects and the Developing Countries 2003". It has been pointed out that if negotiation on prospective multilateral investment rules and negotiations on liberalization in other sectors are mutually advanced, they will bring about merits for developing countries.[10]

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[8] Nippon Keidanren website: http://www.keidanren.or.jp/english/policy/2002/042/index.html).

[9] UNCTAD World Investment Report 2002, p. 153.

[10] "…participating in international investment agreements may have benefits over and above unilateral reforms if those agreements are accompanied by reciprocal market access in areas of importance to developing countries." (p. 118).

II. CONCLUSION

23. Investment rules are essential when considering the positive impact of investment liberalization on the global economy.

24. In the service sector, GATS has already exists as a discipline on FDI, and there is a need to correct this imbalance considering the importance of FDI in other sectors.

25. In addition, so as to further enhance the merits of the progress of the liberalization that has been made through negotiations in previous GATT/WTO rounds in the trade sector, a vital challenge is to promote investment liberalization through the formulation of investment rules. If both trade and investment liberalization are established and promoted, great benefits will be accrued to both developing countries and developed countries.

26. In conducting concrete review of investment rules, it will be necessary to review not only GATS, but also related rules in WTO system, bilateral and regional investment-related rules. And in doing this it will be necessary to consider the flexible structure of rules in a way that enables them to be adopted by developing countries at different stages of development and enables members to enjoy greater benefits.

ANNEX

Table 1: Empirical Analyses from Members

Hong Kong, China	October 1997 WT/WGTI/W/10	"FDI is, in the case of Hong Kong, China, main impetus to its economic efficiency, growth and development."
Poland	December 1997 WT/WGTI/W/13	"10 per cent increase in the flow of FDI gives 0.54 per cent growth of GDP."
Columbia	December 1997 WT/WGTI/W/15	"In Latin America, there has been empirical evidence of a positive relationship between FDI and per capita GDP."
Republic of Korea	September 1997 WT/WGTI/W/8	"The share of FDI's contribution to Korea's GDP growth in the manufacturing sectors was 19.5 per cent during 1970-1990."

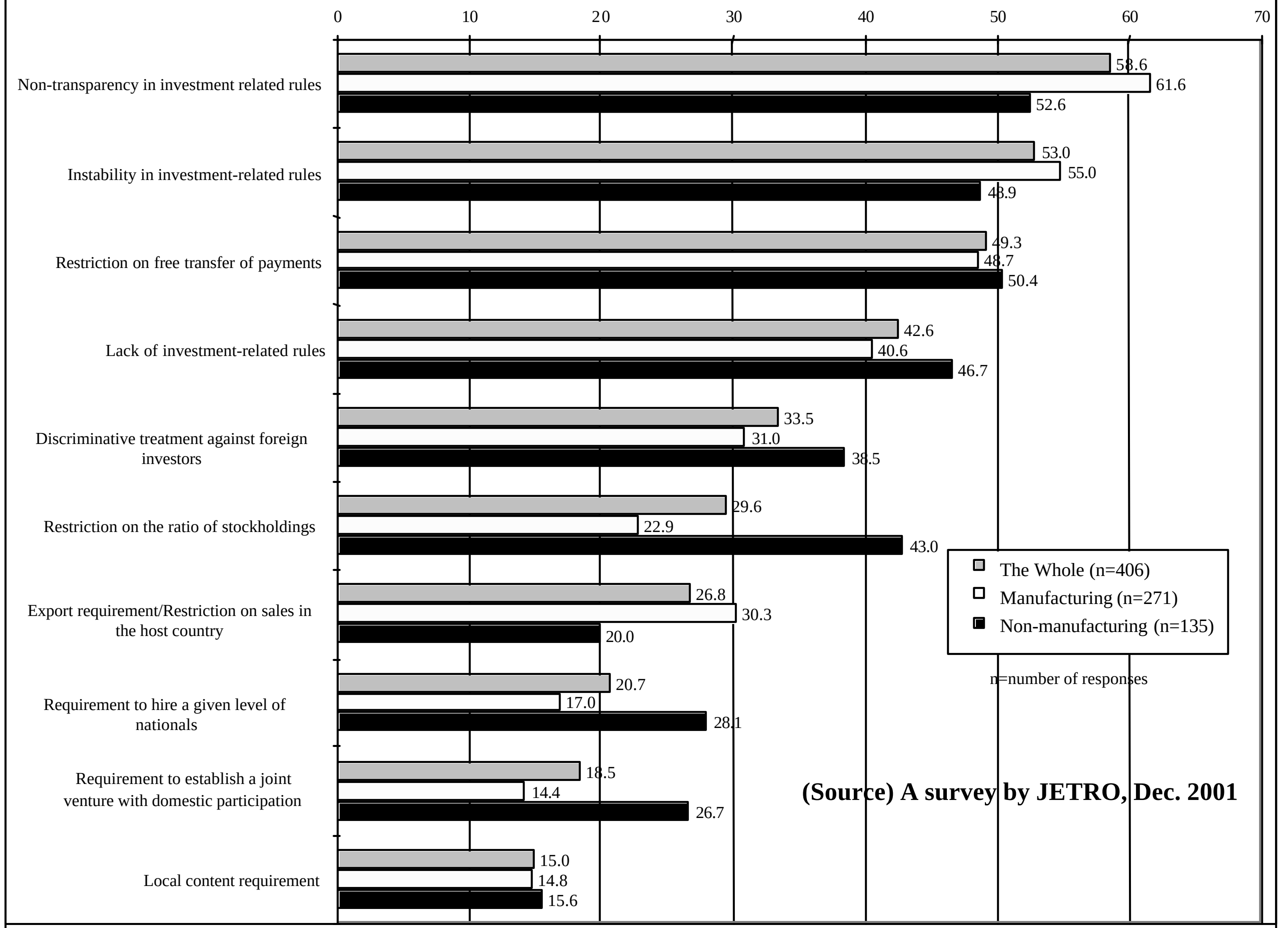
Figure 1. Indicators of importance of foreign affiliates in China, 1999-2001

(Unit: %)

	1996	1997	1998	1999	2000	2001
Share of foreign affiliates in total manufacturing sales	15.1	18.6	24.3	27.7	31.3	-
Share of foreign affiliates in total exports of China	40.7	41	44.1	45.5	47.9	50
Share of foreign affiliates in total industrial outputs	15.1	18.6	24	27.8	22.5	-
Share of foreign affiliates in total tax revenues	11.9	13.2	14.4	16	17.5	-

Excerpted from UNCTAD "CHINA: WTO Accession and Growing FDI Flows" Table 5.
(*Source:* UNCTAD, complied from various tables in World Investment Report 2002 and MOFTEC, Statistics on FDI in China, 2001)

Figure 2. Investment-related problems faced by Japanese companies in host countries



Towards for the Creation of International Investment Rules and Improvement of the Japanese Investment Environment

Table 2. Proposal from Japanese Business Federation

16 July 2002
Nippon Keidanren (Japan Business Federation)

Need for International Investment Rules

Accelerating globalization → Cross-border investment becomes as essential to the international business of Japanese companies as trade in goods and services.
(1) No multilateral investment rules exist → Discussion at the Working Group on the Relationship between Trade and Investment toward negotiations on investment rules in the Doha Development Agenda (DDA).
(2) Rapid increase in BITs (Bilateral Investment Treaties), which amount to 1941 as at the end of 2000, and investment-inclusive FTAs. Japan has only 10 BITs and 1 FTA.
→ Japanese companies disadvantaged against other countries' companies in terms of protection and liberalization of investment in host nations

International Investment Rules sought by Japanese Business

Multi-Faceted Approach
(Utilization of All Available Channels)

Model Agreement

Creation of WTO investment rules in the new round
We strongly urge that investment rule negotiations be launched at the Fifth Ministerial in September 2003 on the basis of explicit consensus, and completed by the deadline for the DDA (January 1, 2005). To encourage participation by all members, due account should be taken of the development policies of developing members and priority placed on *transparency* and *liberalization acceptable to developing countries.*

→ (1) Investment definition and scope (2) Transparency
(3) Investment protection (expropriation, compensation, freedom of remittance), (4) Liberalization (MFN treatment, national treatment*, market access*), (5) Exceptions
(6) Development provisions, (7) Dispute settlement procedures
(8) Relation to BITs

Active conclusion of bilateral and regional investment agreements
(1) ASEAN: Japan should conclude BITs with all 10 ASEAN nations as soon as possible. Over the medium-term, conclude wide-ranging Economic Partnership Agreements (EPAs) which encompass investment.
(2) China: The current BIT with China, which entered into force in 1989, should be revised up to a higher level.
(3) Other regions: Japan urgently needs to form investment-inclusive FTAs with the Republic of Korea and Mexico. Should also consider FTAs or other cooperative frameworks with the US, Canada, Australia, the EU, etc.

→ (1) Investment definition and scope (2) Transparency,
(3) Investment protection (expropriation, compensation, freedom of remittance), (4) MFN treatment, (5) National treatment, (6) Performance requirements, (7) Key personnel, (8) Dispute settlement procedures

* GATS-type positive list commitment

Improvement of the Japanese Investment Environment

The Japanese Government should improve the domestic investment environment to secure the freedom of corporate business activities.
→ Resulting increase in plant and equipment investment by Japanese companies, as well as encouragement of investment from abroad, will stimulate the Japanese economy.

Specific measures: (1) lower costs for energy, distribution, logistics and telecommunications, and formation of social capital; (2) tax reforms, including a lower effective corporate tax rate; (3) simpler and swifter administrative procedures; (4) support for local government efforts, including special regulatory reform zones; (5) simplification of customs clearance procedures; and (6) expansion of external PR activities.

Also important to facilitate movement of key personnel accompanying investment. → Simpler and swifter entry and sojourn procedures.

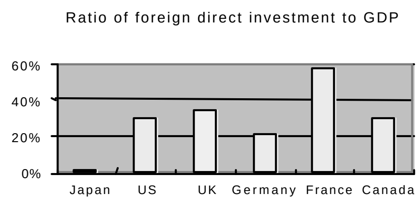


Figure 3. The Benefits of Trade and Investment Liberalization and Facilitation

(Unit %)

	Real GDP	Exports	Imports
World	0.1	0.2	0.2
APEC total	0.3	0.5	0.5
Chile	2.1	2.4	1.8
China	1.0	0.9	0.8
Hong Kong, China	0.1	0.2	0.1
Indonesia	3.1	3.8	3.1
Japan	0.0	0.1	0.2
Korea	0.1	0.2	0.2
Malaysia	1.7	1.4	1.3
Mexico	1.9	1.7	1.6
Philippine	0.9	1.1	0.6
Singapore	0.5	0.6	0.6
Chinese Taipei	0.1	0.1	0.2
Thailand	2.4	2.5	2.0
USA	0.1	0.2	0.2
Viet Nam	1.5	2.0	1.3
Europe	0.0	0.0	0.0

Source: APEC Economic Committee report, August 2002.
"The Benefits of Trade and Investment Liberalization and Facilitation in APEC"

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