THE NORTHERN WTO AGENDA ON INVESTMENT: DO AS WE SAY, NOT AS WE DID

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All the views expressed in this publication are however, their own.
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<td>DNA</td>
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<td>Foreign Direct Investment</td>
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<td>GDP</td>
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EXECUTIVE SUMMARY

Over the last several years, the developed countries have been stepping up their efforts to formulate a viable multilateral investment agreement (MIA) that would restrict countries’ ability to control foreign direct investment (FDI), and possibly portfolio investments.

Initially, this was mainly pursued through the OECD. Since this move was thwarted in 1998, the main battleground has moved to the WTO. At the WTO’s Doha ministerial meeting in November 2001, it was agreed that the 5th WTO ministerial meeting scheduled for September 2003 in Cancún, Mexico would decide whether to proceed with negotiations (as opposed to the current “discussions”) on an MIA.

This paper argues that the answer should be “no”. Based on a historical survey of the experiences of the USA, the EU member states and the East Asian economies, it argues that when they were net recipients of foreign investment, all of today’s developed countries imposed regulations on foreign investment in order to ensure that such investment contributed to their long-term national development. These findings are particularly important because the main “demandeurs” of investment negotiations, the EU and Japan, insist that the WTO “core principle” of national treatment (i.e. that treatment of foreign investors should be no less favourable than that for domestic firms) should be a central aspect of any MIA.

Almost all of the now-developed countries restricted the entry of foreign investment. Very often, the entry restrictions were directly imposed, ranging from a simple ban on entry into particular sectors to allowing entry on certain conditions (e.g. requirements for joint ventures, ceilings on foreign ownership). Bans on entry created space for local producers to establish themselves, while conditional entry made it possible to extract more benefits from permitted foreign investment. In some cases, entry was also restricted through
informal mechanisms that prevented hostile takeovers by foreign investors.

When entry was permitted, governments placed numerous performance requirements on investors in order to maximize the benefits to their economies. Even when there were no formal performance requirements, most developed countries used them informally.

Some of the requirements were imposed for balance of payments reasons, such as export requirements, foreign exchange balancing requirements, or ceilings on licensing fees. However, most were put in place in order to ensure that local businesses picked up advanced technologies and managerial skills from their interaction with foreign investors, either through direct transfer or through indirect spillovers. Local content requirements and explicit requirements for technology transfer were the most obvious means to ensure this.

Some countries, such as Taiwan, went further and explicitly required foreign investors to help their local suppliers to upgrade their technology. In the late 19th century, the USA even banned the employment of foreign workers thus forcing foreign firms to train local workers. Bans on majority foreign ownership or the encouragement of joint ventures were also ways to encourage the transfer of key technologies and managerial skills.

The exact strategies that were used to regulate foreign investment varied from country to country, ranging from the very welcoming (but not *laissez-faire* and increasingly selective over time) strategy of Ireland to the very restrictive strategies of Finland, Japan, Korea, and the 19th-century USA in certain sectors (especially finance and navigation). In other words, there was no “one-size-fits-all” model of foreign investment regulation.

However, one common factor is that they all took a *strategic approach* to foreign investment. This meant that different sectors could be subject to different policies at the same time. For example, Korea and Taiwan applied liberal policies towards FDI in labour-intensive industries while applying very restrictive policies towards
FDI in the more technologically advanced industries, where they wanted to build up local technological capabilities.

Such a strategic approach also meant that their policy stances changed over time, according to their evolving economic structure and external conditions. Only when domestic industry reached a certain level of sophistication, complexity, and competitiveness did the benefits of non-discrimination and liberalization come to outweigh the costs. As a result, countries generally moved towards a greater degree of non-discrimination and liberalization as they developed. In that sense, non-discrimination is better seen as an outcome of development, not a cause, and therefore an MIA founded on this principle is likely to harm the developing countries’ prospects for development.

Even in the absence of an MIA, many of the policy measures on foreign investment adopted in the past by today’s developed countries are already constrained by WTO agreements such as the TRIMs agreement or the GATS. The current GATS negotiations threaten to reduce developing country governments’ policy space still further. If an MIA is added, other measures used by the developed countries in the past are likely to become off-limits to developing countries. These findings are set out in more detail in an appendix to this paper.

The authors find little merit in the most common counter-arguments used by MIA proponents, namely that times have changed, and history is irrelevant; that an MIA would protect developing countries from repeating the errors of the past; and that all development concerns can be dealt with by ensuring that the MIA is sufficiently flexible in its treatment of developing countries.

In conclusion, developing country negotiators and ministers face a momentous decision in Cancún. If they take the next step on the slippery slope to an MIA, they can be sure that, whatever the demandeurs’ protestations to the contrary, the push to restrict governments’ ability to discriminate in favour of local companies, through the application of the WTO core principle of national treatment, will end up at the heart of this or subsequent rounds of negotiations. It is
imperative that they recognize the dangers involved for their countries’ future. Depriving current and future governments of the ability to implement a successful industrial policy aimed at developing national industry could consign future generations to poverty and underdevelopment. The stakes could not be higher.
Not to know what has been transacted in former times is to be always a child. If no use is made of the labours of past ages, the world must remain always in the infancy of knowledge.

Cicero

I. INTRODUCTION

Over the last several years, the developed countries have been stepping up their efforts to formulate a viable multilateral investment agreement (MIA) that would restrict countries’ ability to control foreign direct investment (FDI), and possibly portfolio investments.

Initially, this was mainly pursued through the OECD, where it was proposed that the developed countries adopt an MIA to which willing developing countries would also be allowed to sign up. Since this move was thwarted in 1998, the main battleground has moved to the WTO, where the possibility of a multilateral investment agreement involving all member countries is now under serious discussion.

Consequently, at the WTO’s Doha ministerial meeting in November 2001, whether to commence negotiations on an MIA was one of the most controversial issues. Even as the final declaration was being drafted, there were disputes over the exact meaning of some of the paragraphs on the investment issue. In the end, it was

1 Marcus Tullius Cicero (106-43 BC), Roman statesman, orator, philosopher.

2 Paragraph 22 of the final Doha Ministerial Declaration states:

In the period until the Fifth Session, further work in the Working Group on the Relationship Between Trade and Investment will focus on the clarification of: scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type,
agreed that the 5th WTO ministerial meeting, scheduled for September 2003 in Cancún, Mexico, would decide whether to proceed with negotiations (as opposed to the current “discussions”) on an MIA.

This paper argues that the decision should be “no”.

Paragraph 20 of this Declaration stated:

Negotiations will take place after the Fifth Session of the Ministerial Conference [the Cancún meeting in 2003] on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.

In the closing plenary session of the Doha Conference, in response to concerns raised by a number of developing countries, the chairman, the Qatari Finance, Economy and Trade Minister, Youssef Hussain Kamal, clarified his understanding of paragraph 20, as follows:

“Let me say that with respect to the reference to an ‘explicit consensus’ being needed, for a decision to be taken at the Fifth Session of the Ministerial Conference, my understanding is that, at that session, a decision would indeed need to be taken by explicit consensus, before negotiations on trade and investment and trade and competition policy, transparency in government procurement, and trade facilitation could proceed. In my view, this would also give each member the right to take a position on modalities that would prevent negotiations from proceeding after the Fifth Session of the Ministerial Conference until that member is prepared to join in an explicit consensus.”
There are a number of reasons for opposing the push to begin negotiations on investment in Cancún. They include the following (Oxfam et al., 2003):

- In contrast to the claims of its proponents, an MIA is unlikely to lead to increased flows of foreign investment.
- It will merely add to, rather than replace, the current patchwork quilt of over 2000 bilateral investment treaties.
- The Doha agenda is already overloaded, to the detriment of participation by developing countries that lack expertise in economics, law, and negotiation.
- The initial promises of flexibility for developing countries will be undermined by the realities of negotiations in this and subsequent rounds.
- There is a lack of balancing obligations on home countries and investors.

This paper adds another, in our view rather compelling, argument to this already-long list. Based on a historical survey of the experiences of the USA, the EU member states and the East Asian economies, it argues that during their early stages of development, the now-developed countries systematically discriminated between domestic and foreign investors in their industrial policy. They used, and are still to an extent using, a range of instruments to regulate foreign investment in order to build up national industry. They included: limits on ownership; performance requirements on exports, technology transfer or local procurement; insistence on joint ventures with local firms; and barriers to “brown-field investments” through mergers and acquisitions.

These findings are particularly important because the main “demandeurs” of investment negotiations, the EU and Japan, insist that the WTO “core principles” of non-discrimination, and in particular national treatment (there are fewer problems with most favoured nation treatment), should be a central aspect of any MIA. (National
treatment requires that the treatment of foreign investors should be no less favourable than that for domestic firms.)

The European Commission, for example, argues that:

Non-discrimination, transparency and predictability of domestic laws applicable to FDI should be the guiding principles for the investment framework that we envisage to negotiate.³

The Japanese government claims that:

Placing constraints on investment would not seem to be an appropriate decision even from the perspective of development policy. National development objectives are better achieved by promoting liberalization and thereby stimulating domestic investment activities.⁴

Our historical survey shows that in successful economies, only when domestic industry had reached a certain level of sophistication, complexity, and competitiveness did the benefits of non-discrimination and liberalization come to outweigh the costs. As a result, countries have generally moved towards a greater degree of non-discrimination and liberalization as they develop. In that sense, non-discrimination is better seen as an outcome of development, not a cause, and therefore an MIA founded on this principle is likely to harm the developing countries’ prospects for development.

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II. FOREIGN INVESTMENT REGULATION IN HISTORICAL PERSPECTIVE

This section explores the history of foreign investment regulation in the now-developed countries of North America, Europe, and East Asia. These are countries that are either leading demandeurs of an MIA or its strong supporters. However, did they really pursue the liberal policies towards foreign investment that they now want to impose on the developing countries, when they were in earlier stages of economic development and thus at the receiving end of foreign investment?

II.1 THE USA

A. Overview

From its early days of economic development up to the First World War, the USA was the world’s largest importer of foreign capital.\(^5\) The eminent business historian Mira Wilkins states that during the 1875-1914 period, the USA was “the greatest debtor nation in history” despite its rise as one of the major lender countries in the inter-

\(^5\) Even until as late as 1914, when it had caught up with the UK and other leading nations of Europe, the USA was one of the largest net borrowers in the international capital market. The authoritative estimate by Wilkins (1989) puts the level of US foreign debt at that time at $7.1 billion, with Russia ($3.8 billion) and Canada ($3.7 billion) trailing far behind (p. 145, table, 5.3). Of course, at that point, the USA, with its estimated lending at $3.5 billion, was also the fourth largest lending country, after the UK ($18 billion), France ($9 billion), and Germany ($7.3 billion). However, even after subtracting its lending, the U.S. still had a net borrowing position of $3.6 billion, which was basically the same as that of Canada and Russia.
national capital market at the end of this period (Wilkins, 1989, p. 144).

Given the country’s position as a net importer of capital, there was naturally much concern with foreign investment. While many Americans accepted the need for it, and some sought foreign investment enthusiastically, there was also widespread concern over “absentee management” (Wilkins, 1989, p. 563) and foreign domination of the American economy.

The fear of foreign investment was not confined to the “radicals”. For example, the Bankers’ Magazine of New York remarked in 1884: “It will be a happy day for us when not a single good American security is owned abroad and when the United States shall cease to be an exploiting ground for European bankers and money lenders. The tribute paid to foreigners is … odious … We have outgrown the necessity of submitting to the humiliation of going to London, Paris or Frankfort [sic] for capital has become amply abundant for all home demands” (Bankers’ Magazine, No. 38, January 1884, cited in Wilkins, 1989, p. 565). According to the same magazine, the great majority of Americans believed it was “a misfortune to have its [the country’s] public, corporate, and private securities abroad” (No. 33, April 1879, cited in Wilkins, p. 915, note 67).

Even Andrew Jackson (the seventh president of the USA, 1829-37), a well-known advocate of small government and therefore something of a hero among American free-marketeers today, amply displayed his anti-foreign feelings. He famously vetoed the renewal of the Federal Government charter for the country’s second quasi-central bank, the (Second) Bank of the USA, largely on the ground that “many of its stockholders were foreigners” (Wilkins, pp. 61-62, p. 84; Garraty & Carnes, 2000, pp. 255-258). When he exercised his veto in 1832, he said: “should the stock of the bank principally

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6 However, the Second Bank of the USA was only 30% owned by foreigners, as opposed to 70% in the case of the First Bank of the USA, its predecessor (1789-1811) (Wilkins, 1989, p. 61).
pass into the hands of the subjects of a foreign country, and we should unfortunately become involved in a war with that country, what would be our condition? …. Controlling our currency, receiving our public moneys, and holding thousands of our citizens in dependence, it would be far more formidable and dangerous than the naval and military power of the enemy. If we must have a bank … it should be purely American.” (as cited in Wilkins, 1989, p. 84).

Others went even further. On the eve of the de-chartering of the Second Bank of the USA (henceforth SBUSA), the Jackson administration moved federal government deposits to other banks. One of these banks, the Manhattan Bank, was foreign-owned. But since it was, unlike the SBUSA, not a federally-chartered bank, it did not ban foreign shareholders from voting (which was the case with federally-chartered banks - see below). Therefore, Niles’ Weekly Register, one of the leading magazines of the time, found it scandalous that “IN THIS BANK THE FOREIGN STOCKHOLDERS VOTE [capitals original]!” (No. 45, 16 November 1833, cited in Wilkins, 1989, p. 84). Another article that appeared two years later in this magazine (No. 48, 2 May, 1835) neatly sums up the dominant American feeling at the time - “We have no horror of FOREIGN CAPITAL - if subjected to American management.” (cited in Wilkins, 1989, p. 85, original italics and capitals).

In order to ensure that foreign investment did not lead to loss of national control in the key sectors of the economy, a large number of federal and state laws were enacted in the USA between its independence (1776) and the mid-20th century, when it became the world’s most powerful economy. The legislation was chiefly focused on the main sectors that attracted foreign investment during this period: finance, shipping, and natural resource extraction (agriculture, mining, logging).

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7 Wilkins states (1989, p. 84, n. 264) that similar remarks were made by politicians in the debate surrounding the renewal of the charter of the First Bank of the USA.
B. Federal legislation

Navigation
Upon Independence, one of the first Acts of the new Congress was that effecting the imposition in 1791 of differential tonnage duties between national and foreign ships (Wilkins, 1989, p. 44). Similarly, a navigation monopoly for US ships for coastwise trade was imposed in 1817 by the Congress (Ibid, p. 83). This continued until World War One (Ibid, p. 583).

Finance
In the financial sector, legislative provisions were made in the charter for the country’s first quasi-central bank, the First Bank of the USA (FBUSA) in 1791 to avoid foreign domination. Only resident shareholders could vote and only an American citizen could become a director. Thanks to these provisions, the Bank could not be controlled by foreigners, who owned 62 per cent of the shares by 1803 and 70 per cent by 1811. Despite this, when its charter was considered for renewal in 1811, the Congress did not re-charter the Bank “in large part owing to fears of foreign influence” (Ibid, pp. 38-39, p. 61; the quotation is from p. 61). A similar provision against voting by foreign shareholders was made for the SBUSA, when it was given its Federal charter in 1816 (Ibid, p. 61).

In addition, the 1864 National Bank Act also required that the directors of national (as opposed to state) banks had to be Americans (Wilkins, 1989, p. 455) - this requirement persisted even after the introduction of the Federal Reserve System in 1913 (Ibid, p. 583). This meant that “foreign individuals and foreign financial institutions could buy shares in U.S. national banks if they were prepared to have American citizens as their representatives on the board of directors” and “[t]hat they could not directly control the banks served as a deterrent to investment” (Ibid, p. 583).
Land
From the early days of Independence, many state governments barred or restricted non-resident foreign investment in land (Wilkins, 1989, p. 45). However, particularly strong feelings against foreign land ownership developed, following the frenzy of land speculation by foreigners in the frontier areas in the 1880s. In 1885, the *New York Times* editorialized against “an evil of considerable magnitude - the acquisition of vast tracts of land in the Territories by English noblemen” (*New York Times*, 24 January 1885).

Reflecting such feelings, the federal Alien Property Act (1887) and 12 state laws were enacted during 1885-95 with a view to controlling, or sometimes even banning altogether, foreign investment in land (Wilkins, 1989, p. 235). An 1885 resolution passed by the New Hampshire legislature read: “American soil is for Americans, and should be exclusively owned and controlled by American citizens” (Ibid, p. 569). The 1887 federal Alien Property Act prohibited the ownership of land by aliens or by companies more than 20 per cent owned by aliens in the territories (as opposed to the states), where land speculation was particularly rampant (Ibid, p. 241). However, it must be noted that due to the lack of disclosure rules on ownership, it was practically impossible to check the identities of all corporate owners and therefore the law was not totally effective (Ibid, p. 582).

Natural Resources
There was less hostility towards foreign investment in mining than towards that in land, but considerable ill-feeling still existed (Ibid, pp. 572-573). Federal mining laws in 1866, 1870, and 1872 restricted mining rights to U.S. citizens and companies incorporated in

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8 At the time the territories were North Dakota, South Dakota, Idaho, Montana, New Mexico, Utah, Washington, Wyoming, Oklahoma, and Alaska. The Dakotas, Montana, and Washington in 1889, Idaho and Wyoming in 1890 and Utah in 1896 became States, and thus were no longer subject to this Act.
The USA. In 1878, a timber law was enacted, permitting only U.S. residents to log on public land (Ibid, p. 581). Similar to the Alien Property Act, these laws were not totally effective against foreign corporate investment, due to the difficulty of checking company ownership (p. 129). In 1897, the Alien Property Act was revised to exempt mining lands.

Manufacturing
Restrictions on foreign investment in manufacturing were relatively rare, as such investment was not very important until the late 19th century, by which time the USA had managed to build up a robust position in many sectors of manufacturing behind the world’s highest tariff barriers.

However, there were still concerns about the behaviour of transnational corporations (TNCs) in manufacturing, especially transfer pricing. For example, a U.S. Government investigation in the wake of the First World War expressed grave concerns that the German TNCs were avoiding income tax by understating their net earnings through charging excessively high rates for technology licences granted to their American subsidiaries (Ibid, p. 171).

Interesting in relation to FDI in manufacturing was the 1885 contract labour law, which prohibited the import of foreign workers. This applied also to national companies, but it obviously had more effect on foreign firms, especially in relation to the import of skilled workers (Ibid, pp. 582-583). Many TNCs did not like the law because it restricted their ability to bring in skilled workers from their headquarters.

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9 The 1866 law said that “[t]he mineral lands of the public domain … are hereby declared to be free and open to exploration by all citizens of the United States and those who have declared their intention to become citizens, subject to such regulations as may be prescribed by law, and subject also to the local customs or rules of miners in the several mining districts” (Wilkins, 1989, p. 128).
C. State legislation

Some of the state laws were even more hostile to foreign investment than the federal laws (Wilkins, 1989, p. 579).

In addition to the state laws banning or restricting non-resident foreigners’ investment in land, discussed above, a number of state laws taxed foreign companies more heavily than American companies. There was also a notorious Indiana law of 1887 that withdrew court protection from foreign firms (Ibid).

The New York state government took a particularly hostile attitude towards foreign investment in finance, an area where it was rapidly developing a world-class position (a case of infant industry protection, one might say). A New York law in 1886 required foreign insurance companies to have 2.5 times the minimum paid-up capital of American companies (Ibid, p. 580), while another law required that all certified public accountants should be American (Ibid, p. 580). The New York state also instituted a law in the 1880s that banned foreign banks from engaging in “banking business” (such as taking deposits and discounting notes or bills). The 1914 banking law banned the establishment of foreign bank branches (Ibid, p. 456). These laws proved very burdensome to foreign banks. For example, the London City and Midland Bank (then the world’s third largest bank, measured by deposits) could not open a New York branch, even though it had 867 branches worldwide and 45 correspondent banks in the USA alone (Ibid, p. 456).

On the whole, the federal government condoned anti-foreign state laws. Wilkins (1989) writes: “The State Department and Congress did give an implicit green light to anti-foreign state government laws. Neither was responsive to intermittent diplomatic inquiries from London, requesting the federal government to muzzle state legislators. The Secretary of State John Hay replied (in 1899) in a very standard manner to one such request that was related to discriminatory taxes against foreign fire insurers: ‘Legislation such as that en-
acted by the State of Iowa is beyond the control of the executive branch of the General Government”” (p. 584).

D. Lessons from the U.S. Experience

To sum up, in contrast to its strong support for foreign investment liberalization today, during the period when it was a capital-importing country, the USA had all kinds of provisions at both federal and state level to ensure that foreigners invested in the country but did not control its economy.

There are two main lessons from the historical experience of the USA in regulating foreign investment. First, despite its often-draconian regulations on foreign investment, the USA was the largest recipient of foreign investment throughout the 19th century and the early 20th century. This throws doubt on the common contention that foreign investment regulation is bound to reduce investment flows, or conversely that the liberalization of foreign investment regulation through an MIA will increase foreign investment flows. Contemporary empirical evidence also shows that foreign investment regulations have only a marginal influence, if any, on the determination of foreign investment decisions (e.g. see the review in Kumar, 2001, p. 3156 or Oxfam et al., 2003).

Second, despite - or we would argue, partly because of - its strict regulations on foreign investment (as well as manufacturing tariffs that were the highest in the world), the USA was the fastest-growing economy in the world throughout the 19th century and up until the 1920s. This undermines the standard argument that foreign investment regulation harms the growth prospects of an economy. Taken alongside the fact that many other developed countries (reviewed below) also performed well while imposing strict regulations on foreign investment, it seems more reasonable to conclude that a well-crafted regime of foreign investment regulation can help, rather than hinder, economic development.
II.2 THE MORE ADVANCED EUROPEAN ECONOMIES: THE UK, FRANCE AND GERMANY

A. Overview

Until the early 20th century, the UK, France and Germany (together with the Netherlands and Switzerland) were net suppliers of capital to the less-developed countries, including the USA, Canada, and Russia. Therefore, during this period, the main concern for these countries, especially the UK from the late 19th century onwards, when it was rapidly losing its industrial supremacy, was how to control “excessive” outward foreign investment rather than how to control inward foreign investment.

In the few decades following the end of the Second World War, however, controlling inward foreign investment became a major new challenge for these countries. If they were to close the newly-emergent technological gap with the USA, they had to accept American investment, especially FDI (Servan-Schreiber, 1967, is the most prominent work of the time on this issue).

Until the 1980s, since these countries did not adopt laws explicitly discriminating against foreign investors except in sensitive areas (e.g. defence, cultural activities), the most important element in their control of foreign investment was foreign exchange control, which gave their governments the ultimate say over foreign investment. Of course, this does not necessarily mean that their governments used the control to the same effect. For example, the UK, even before the adoption of its pro-FDI policy under Mrs. Thatcher, took a more permissive attitude towards FDI and rarely used its foreign exchange control law (1947-79) to influence FDI, except in its early years (Young et al., 1988), whereas France was more active in the management of its FDI flows. However, there were other mechanisms of control.
First, in all of these countries (except the UK after the 1980s), the significant presence of state-owned enterprises (SOEs) in key sectors in the economy has acted as an important barrier to FDI.\(^\text{10}\) Also, while not technically SOEs, some of their key enterprises have had significant government ownership - for example, the state government of Lower Saxony is the biggest shareholder in Volkswagen, with a 20 per cent share ownership. Moreover, even when privatizing some of the SOEs in the 1980s, the French Government was careful to ensure that control of these enterprises remained French by reserving a significant proportion of shares for “hard core” (noyau dur) institutional investors close to the government (Dormois, 1999, p. 79).

Second, in the case of Germany, the barriers to hostile takeover, because of the presence of close industry-bank relationships as well as the power of labour exercised through the supervisory board,\(^\text{11}\) have acted as a significant barrier to FDI. Given that in the UK, where hostile takeover is easy, the bulk of FDI has consisted of “brown-field” investment based on takeovers rather than “green-field” investment, based on the establishment of new facilities, FDI in Germany would probably have been considerably higher without the above-mentioned defence mechanisms against hostile takeover.\(^\text{12}\)

\(^\text{10}\) According to an authoritative study by the IMF published in 1984, the average share of the SOE sector in GDP among the industrialized countries as of the mid-1970s was 9.4%. The share was 10.3% for West Germany (1976-7), 11.3% for the UK (1974-7), and 11.9% for France (1974) - all above average.

\(^\text{11}\) In Germany, corporations are governed not simply by a Board of Directors, but also by a supervisory board, which contains equal numbers of representatives of the labour force and of the management. This is called the co-determination system and has been a foundation stone of Germany’s “social market economy” since the Second World War.

\(^\text{12}\) During the 1970s and the 1980s, Germany’s FDI as a share of Gross Domestic Capital Formation (of course, the two numbers are not strictly comparable) was just 1-2%, whereas the corresponding figure ranged between 6-15% in the UK. These figures are calculated from various issues of UNCTAD, *World Investment Report*. 
Third, all these countries, including the ostensibly FDI-friendly UK, have used informal performance requirements for key FDI projects. For example, in the UK, since the 1970s in certain industries, a variety of informal “undertakings” and “voluntary restrictions” have been used to regulate foreign investment (Young et al., 1988). These were mostly, although not exclusively, targeted at Japanese companies, especially in the automobile and electronics sectors. According to Young et al., “[i]t is widely believed that [all investments by Japanese electronics giants in the 1970s and the early 1980s - Sony in 1974, Matsushita in 1976, Hitachi and Mitsubishi in 1979, Sanyo and Toshiba in 1981] were subject to some form of voluntary restraint agreement with the Department of Industry on local sourcing of components, production volumes and exporting, but details are not publicly available. Several of the companies reported particular difficulties in implementing local procurement policies and in the slow build up of production which they were allowed” (p. 224).

This prompted one observer to remark in 1977 that “every Japanese company which has so far invested in Britain had been required to make confidential assurances, mainly about export ratios and local purchasing” (Financial Times, 6 December, 1977, as reported in Young et al., 1988, p. 223). When Nissan established a UK plant in 1981, it was forced to procure 60 per cent of value added locally, with a time scale over which this would rise to 80 per cent (Young et al., 1988, p. 225). Also “[t]here is much evidence that successive ministers in the Department of Trade and Industry have put pressure on [Ford and GM] to achieve a better balance of trade, although details in timing and targets are not available” (Ibid). Young et al. observed in 1988 that “limited use of performance guidelines (if not explicit requirements) are effectively now regarded as part of the UK portfolio” (Ibid).

B. Lessons from the Experience of the UK, France and Germany

In sum, the UK, France and Germany did not need to control foreign investment until the mid-20th century, when they ceased to be capi-
tal-exporting countries. When faced with the challenge of an upsurge in American investment after the Second World War, they used a number of formal and informal mechanisms to ensure that their national interests were not harmed. Formal mechanisms included foreign exchange control and regulations against foreign investment in sensitive sectors like defence or cultural industries. At the informal level, they used mechanisms like the SOEs, restrictions on takeover, and “undertakings” and “voluntary restrictions” by TNCs in order to restrict foreign investment and impose performance requirements.

The tightening-up of foreign investment regulation after the Second World War by these three countries reflected the changes in their status in the world of international investment. As they exchanged places with the USA, becoming net recipients of FDI, rather than net providers, they adopted the same restrictions on foreign investment that they had previously criticized when the USA had used them.

This suggests that countries have used, and indeed should use, different policies towards foreign investment according to their role as investment providers or receivers. Since developing countries are today almost always at the receiving end, it follows that they do need, and should be allowed to have, significantly more freedom to regulate foreign investment in their long-term interest than do the developed countries.

II.3 LESS ADVANCED EUROPEAN ECONOMIES: FINLAND AND IRELAND

In this section, we examine Finland and Ireland, two countries that were among the poorest in Europe until a generation ago, but have since become star performers through very different policies regard-
ing foreign investment, the former very restrictive and the latter very permissive (although not as hands-off as many people believe).

A. Finland

Finland is often overlooked as one of the economic miracles of the 20th century. Until the late 19th century, Finland was one of the poorest economies in Europe. However, it is today one of the richest. According to the authoritative statistical work of Maddison (1989), among the 16 largest rich countries of today, only Japan (3.1 per cent) achieved a higher rate of annual per capita income growth than Finland (2.6 per cent) during the 1900-87 period (p. 15, table 1.2).\(^{13}\) Norway tied with Finland in second place, and the average for all 16 countries was 2.1 per cent.\(^{14}\)

What is even less well known than Finland’s impressive growth performance is that it was built with a regime of draconian restrictions on foreign investment in place - arguably the most restrictive in the developed world.

As a country that had been under foreign rule for centuries and as one of the poorest economies in Europe,\(^ {15}\) Finland was naturally

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\(^{13}\) The 16 countries, in alphabetical order, are Australia, Austria, Belgium, Canada, Denmark, France, Finland, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland, West Germany, the UK and the USA.

\(^{14}\) Despite the massive external shock that it received following the collapse of the Soviet Union, which accounted for over one-third of its international trade, Finland ranked at a very respectable joint-5th among the 16 countries in terms of per capita income growth during the 1990s. According to the World Bank data, its annual per capita income growth rate during 1990-99 was 2.1% (equal to the Netherlands), exceeded only by Norway (3.2%), Australia (2.6%), and Denmark and the USA (2.4%).

\(^{15}\) From the 12th century until 1809, Finland was part of Sweden; thereafter it existed as an autonomous Grand Duchy within the Russian empire until 1917.
extremely wary of foreign investment and duly implemented measures to restrict it (all information in the following paragraphs is drawn from Hjerppe & Ahvenainen, 1986, pp. 287-295, unless otherwise noted).

Already by 1851, Finland had enacted a law prescribing that any foreigner, Russian nobles excepted, had to obtain permission from the Tsar, then the supreme ruler of the country, in order to own land. Later laws were added, including an 1883 law that subjected mining by foreigners to licensing, an 1886 ban on banking business by foreigners, and an 1889 ban on building and operation of railways by foreigners. In 1895, it was stipulated that the majority of the members on the board of directors of limited liability companies had to be Finnish. All these laws remained valid until at least the mid-1980s.

After gaining independence from Russia, Finland’s restrictions on foreign investment were strengthened. In 1919, it was stipulated that foreigners had to get special permission to establish a business and guarantee in advance the payment of taxes and other charges due to the central and the local states. In the 1930s, a series of laws were passed in order to ensure that no foreigner could own land and mining rights. It was also legislated that a foreigner could not be a member of the board of directors or the general manager of a firm. Companies with more than 20 per cent foreign ownership were officially classified as “dangerous companies” and therefore foreign ownership of companies was effectively restricted to 20 per cent. As a result, while there was considerable foreign borrowing, there was little FDI during this period, a pattern that persisted at least until the 1980s.

There was some liberalization of foreign investment thereafter. Foreign banks were allowed for the first time to found branches in Finland in the early 1980s. The foreign ownership ceiling of companies was raised to 40 per cent in 1987, but this was subject to the consent of the Ministry of Trade and Industry (Ballek & Luostarinen, 1994, p. 17). General liberalization of foreign investment did not
come until 1993, as part of the preparations for its EU accession (www.investinfinland.fi/topical/leipa_survey01.htm, p. 1).\textsuperscript{16}

\textbf{B. Ireland}

Ireland is often cited as proof that a dynamic and prosperous economy can be built on the basis of a liberal FDI policy. Its impressive economic performance, especially during the recent period, earned it the titles of “Celtic Tiger” or “Emerald Tiger”, following the “miracle” economies of the “East Asian Tigers” (Korea, Taiwan, Singapore, and Hong Kong).

After the exhaustion of early import substitution possibilities and the ensuing industrial stagnation in the 1950s, Ireland shifted its industrial policy radically from an inward-looking to an outward-looking strategy (for further historical backgrounds, see O’Malley, 1989). The new policy regime focused on encouraging investment, especially in export industries, through financial incentives. The main incentive schemes used were: (1) capital investment grants, which required the recipient firms to be internationally competitive; (2) exemption from taxes on profits earned from export sales above the 1956 level (the law had no new recipients from 1981 onwards and was abolished in 1991); and (3) accelerated depreciation (O’Malley, 1999, pp. 224-225). In addition to encouraging investment, these schemes were also intended to reduce regional disparities by offering higher grant rates for investment in less developed regions. The government also established industrial estates in poor regions at its own expense (O’Malley, 1999, p. 225). However, it is true that the investment grants disbursed during this period were

\textsuperscript{16} Interestingly, the Finnish government’s investment-promotion agency, Invest in Finland, emphasizes that “Finland does not ‘positively’ discriminate in favour of foreign-owned firms by giving them tax holidays or other subsidies not available to other firms in the economy” (the same website, p. 2).
rather unfocused and therefore did not deliver the best value for money (O’Sullivan, 1995; O’Malley, 1999).

While this policy regime did not favour foreign firms per se, it had a certain degree of hidden bias, as foreign enterprises typically had a higher export orientation. The existence of this bias towards TNCs, however, should not be interpreted as the same as a totally laissez-faire approach towards FDI. According to the 1981 US Department of Commerce survey, The Use of Investment Incentives and Performance Requirements by Foreign Governments, 20 per cent of US TNC affiliates operating in Ireland reported the imposition of performance requirements, in contrast to the 2-7 per cent in other advanced countries - 8 per cent in Australia and Japan, 7 per cent in Belgium, Canada, France, and Switzerland, 6 per cent in Italy, 3 per cent in the UK, and 2 per cent in Germany and the Netherlands (Young et al., 1988, pp. 199-200).17

The post-1958 industrial policy ran out of steam by the late 1970s. FDI continued to be mostly in low value-added sectors, while incoming companies failed to create many linkages with indigenous firms. By the mid-1980s, there developed a sense of crisis in the country, when employment in indigenous firms experienced a rather sharp decline (about 20 per cent) from the peak of 1979, while the employment in foreign firms had more or less stagnated since the late 1970s (O’Sullivan, 1995; O’Malley, 1999; Barry et al., 1999).

17 According to McCulloch & Owen (1983, pp. 342-3) the same survey reveals that over one-half of all foreign subsidiaries in Korea and Taiwan benefit from some form of investment incentive. This is high even by the standards of the developed countries, which were in the 9-37% range reported in table 6.1 of Young et al. (1988, p. 200; Japan 9%, Switzerland 12%; Canada and France 18%; Germany 20%; Belgium, 26%; Italy 29%; UK 32%; Australia 37%). Given that Korea and Taiwan are countries that were also infamous for imposing tough performance requirements (see below), this piece of evidence, together with the Irish example, suggests that both carrots and sticks are needed for the successful management of FDI.
As a result, there was another policy shift in the mid-1980s towards a more targeted approach, especially towards the development of indigenous firms. The new policy regime was set out most clearly in the 1984 *White Paper on Industrial Policy* (O’Malley, 1999, p. 228). According to O’Malley (1999), the White Paper recognized that “there were limits to the benefits that could be expected from foreign investment and that the relatively poor long-term performance of indigenous industry called for a greater focus in addressing that problem. More specifically, policy statements since 1984 have referred to the need for policy towards indigenous industry to be more selective, aiming to develop larger and stronger firms with good prospects for sustained growth in international markets, rather than assisting a great many firms indiscriminately. *Policy was intended to become more selective*, too, in the sense of concentrating state support and incentives on correcting specific areas of disadvantage or weakness which would be common in indigenous firms (but not so common in foreign-owned firms), such as technological capability, export marketing and skills. It was intended to shift expenditures on industrial policy away from supporting capital investment and towards improving technology and export marketing” (p. 228; italics added).

As a result, after the mid-1980s, “the award of [capital investment] grants was increasingly dependent on firms having prepared overall company development plans. With a view to obtaining better value for state expenditure, the average rate of capital grant was reduced after 1986, *performance-related targets were applied as conditions for payment of grants*, and there was the beginning of a move towards repayable forms of financial support such as equity financing rather than capital grants.” (O’Malley, 1999, p. 229; italics added). An increasing share of government grants was directed to capability-upgrading activities (e.g. R&D, training, management de-

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18 In the light of Ireland’s high level of performance requirements for TNCs before these changes (see above), it seems reasonable to conclude that performance requirements for the recipients of state grants (domestic or foreign) must have become even greater.
velopment) rather than simple physical investment (Sweeney, 1998, p. 133). Moreover, the government started explicitly targeting industries into which they wanted to attract FDI - in particular electronics, pharmaceuticals, software, financial services, and teleservices (Sweeney, 1998, p. 128).

Following the re-direction of FDI policy, there was a rise in “high-quality” FDI, with higher technological content and stronger linkages to indigenous firms. Largely as a result of this, the economy started to boom again. Manufacturing employment, which fell by 20 per cent between 1979 and 1987, rose by 13 per cent from 1988-96, in large part because of the increase in FDI but also the improvement in the performance of indigenous firms (O’Malley, 1999, p. 230).

C. Lessons from the Experience of Finland and Ireland

Finland and Ireland are arguably among the most impressive cases of industrial transformation in the second half of the 20th century in Europe. At least until Finland’s accession to the EU in 1993, however, their respective policies towards foreign investment could not have been more different. Finland basically blocked any significant foreign investment, while Ireland aggressively sought it out.

The comparison of these two polar cases raises two important points.

The first is that there is no one-size-fits-all foreign investment policy that works for everyone. Finland built its economic miracle under arguably one of the world’s most restrictive policy regimes vis-à-vis foreign investors, while Ireland benefited from actively courting and working with TNCs.

The second is that, however “liberal” a country may be towards foreign investment, a targeted and performance-oriented approach works better than a hands-off approach. Yet the latter is
recommended by the developed countries today. Even in the case of Ireland, a combination of carrots and sticks has been used with foreign investors since the early days. Only when it found the right balance between the two, did Ireland truly start to benefit from FDI.

II.4 THE EAST ASIAN COUNTRIES: JAPAN, KOREA AND TAIWAN

A. Japan

Japan’s restrictive stance towards FDI is well known. From the late 19th century, when it embarked on the path of industrialization, it has discouraged FDI and opted for technology licensing whenever feasible. Even during the first half of the 20th century, when Japan temporarily took a more permissive stance towards FDI (for example, American TNCs dominated the automobile industry during that time), FDI remained small in scale and much of came in the form of joint ventures (Yoshino, 1970, p. 346).

Between the Second World War and the mid-1960s, when there was some liberalization, the FDI policy regime remained extremely restrictive. In particular, before 1963, foreign ownership was limited to 49 per cent, while in some “vital industries” FDI was banned altogether. Consequently, FDI accounted for only 6 per cent of total foreign capital inflows between 1949 and 1967 (Ibid, p. 347).

There was some relaxation in policy over time, but it was a very slow and gradual process. After 1963, foreign ownership of over 50 per cent was permitted, even in some hitherto prohibited “vital industries” (Ibid, p. 349). However, “each investment application had to go through individual screening and was rigorously examined by the Foreign Investment Council” (Ibid, p. 349) and “the criteria for screening foreign investment were stated with characteristic vagueness, giving the government officials and the Foreign Investment Council considerable latitude”(Ibid, p. 350).
In 1967, FDI was liberalized further. However, the regime remained highly restrictive (the following details are from Yoshino, 1970, pp. 361-363). The 1967 liberalization “automatically” allowed a maximum of 50 per cent foreign ownership in 33 industries (so-called “Category I industries”), but only on the condition that: (1) the Japanese partner in the joint venture must be engaged in the same line of business as the contemplated joint venture, and one Japanese partner must own at least one third of the joint venture; (2) the Japanese representation on the board of directors must be greater than the proportion of Japanese ownership in the venture; and (3) there should be no provision that the consent of a particular officer or a stockholder be required to execute corporate affairs - hardly an “automatic” approval! Moreover, Japanese firms were already well established in these industries, which were therefore less attractive to foreign investors (e.g. household appliances, sheet glass, cameras, pharmaceuticals, etc.), as proven by the fact that “more than a year went by before the first joint venture was established” (Ibid, p. 363).

In the 17 “Category II industries”, 100 per cent foreign ownership was permitted, but these were industries where the Japanese firms were even more securely established (ordinary steel, motorcycles, beer, cement, etc.). Importantly, in both categories, “brownfield” FDI was not permitted.

Further liberalization in 1969 added 135 and 20 industries to Categories I and II respectively. This round of liberalization attempted to diffuse foreign criticism, but the industries included were mostly unappealing to foreigners. Some strategic industries (e.g. distribution, petrochemicals and automobiles) were considered, but then rejected, as possible candidates for inclusion. The decision was hardly surprising, after the total output of the Japanese auto industry (which was already the second largest in the world) was less than half that of General Motors (Ibid, 1970, pp. 366-7).

This highly restrictive policy stance was maintained in subsequent periods despite gradual liberalization of FDI at the formal level. As in Germany and a number of other European countries,
FDI was further constrained by the existence of informal defence mechanisms against hostile takeover, especially the cross-shareholding arrangements that locked up 60-70 per cent of the shares in friendly hands (major lending banks, related enterprises).

Consequently, Japan was arguably the least FDI-dependent country outside the Soviet bloc. Between 1971-90 (the post-95 data are not available, but there is no indication that it has drastically changed), FDI accounted for only about 0.1 per cent of total fixed capital formation in the country (data from UNCTAD, various years). The developed country average was 3.5 per cent for the 15-year period of 1981-95, before the late-1990s merger boom.

B. Korea

While Korea has not been at all hostile to foreign capital *per se*, it has clearly preferred, if the situation allowed, to hold it under “national” management, rather than relying on TNCs (the following draws heavily from Chang, 1998; for more detail, refer to Koo, 1993). According to Amsden (1989), only 5 per cent of total foreign capital inflows into Korea between 1963 and 1982 (excluding foreign aid, which was important until the early 1960s, but not thereafter) was in the form of FDI (Ibid, p. 92, table 5). Even for the 1962-93 period, this ratio remained a mere 9.7 per cent, despite the surge in FDI that followed liberalization of FDI policy in the mid-1980s (Lee, 1994, p. 193, table 7-4).

The Korean government designed its FDI policy on the basis of a clear and rather sophisticated understanding of the costs and benefits of dealing with TNCs, and it approved FDI only when it calculated that the potential net benefits were positive. The Korean government's 1981 *White Paper on Foreign Investment* provides a fine specimen of such policy vision (see EPB, 1981). This White Paper lists various benefits of FDI such as investment augmentation, employment creation, the industrial “upgrading” effect, the contribution to the balance of payments and technology transfer, but it is also
clearly aware of the costs arising from transfer pricing, restrictions on the imports and exports of subsidiaries, “crowding out” of domestic investors in the domestic credit market, allocative inefficiencies due to “non-competitive” market structures, retardation of technological development, “distortion” of industrial structures due to the introduction of “inappropriate” products, and even the exercise of political influence by TNCs in the formation of policies (EPB, 1981, pp. 50-64). It is interesting to note that this list includes more or less all the issues identified in preceding and subsequent academic debate about the pros and cons of FDI.

The policies employed by Korea towards TNCs have had a number of elements, but the most important were clearly the restrictions on entry and ownership. Initially, up until the early 1970s, when the level of FDI was low, the government was quite willing to allow 100 per cent foreign ownership, especially in assembly industries in the free-trade zones established in 1970. However, as the country tried to move into more sophisticated industries, where the development of local technological capabilities was essential, it started to restrict foreign ownership more firmly (Lee, 1994, pp. 187-8).

To begin with, there were policies that restricted the sectors which TNCs could enter. Until as late as the early 1980s, around 50 per cent of all industries and around 20 per cent of the manufacturing industries were still “off-limits” to FDI (EPB, 1981, pp. 70-1). Even when entry was permitted, the government tried to encourage joint ventures, preferably under local majority ownership, in an attempt to facilitate the transfer of core technologies and managerial skills.

In sectors where FDI was allowed, foreign ownership above 50 per cent was prohibited except in areas where FDI was judged to be of “strategic” importance. These covered only about 13 per cent of all the manufacturing industries (ibid, p. 70). Foreign ownership over 50 per cent was allowed only in industries where access to proprietary technology was deemed essential for further development of the industry, and industries where the capital requirement and/or the
risks involved in the investment were very large. The ownership ceiling was also relaxed: (i) if the investment was made in the free trade zones; (ii) if the investment was made by overseas Koreans; or (iii) if the investment would “diversify” the origins of FDI into the country - i.e. if the investment was from countries other than the USA and Japan, which had until then dominated the Korean FDI scene. (For details, see Ibid, pp. 70-71.)

As a result, as of the mid-1980s, only 5 per cent of TNC subsidiaries in Korea were wholly-owned, whereas the corresponding figures were 50 per cent for Mexico and 60 per cent for Brazil, countries which are often believed to have had much more “anti-foreign” policy orientations than that of Korea (Evans, 1987, p. 208).

Policy measures other than those concerning entry and ownership were also used to control the activities of TNCs in accordance with national developmental goals.

Firstly, there were measures to ensure that the “right” kinds of technology were acquired on the “right” terms. The technology brought in by the investing TNCs was carefully screened to check that it was not overly obsolete and that the royalties charged to the local subsidiaries were not excessive.

Secondly, those investors that were more willing to transfer technologies were given preference in the selection process, unless they were too far behind in terms of technology.\(^{19}\)

Thirdly, local contents requirements were quite strictly imposed, in order to maximize technological spillovers from TNCs’

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\(^{19}\) For example, the Korean government chose in 1993 the Anglo-French joint venture (GEC Alsthom), organized around the producer of the French TGV, as the partner in its new joint venture to build the country’s fast train network. This was mainly because it offered more in terms of technology transfer than its Japanese and German competitors, who had technologically superior products (Financial Times, 23 August 1993).
presence. One thing to note, however, is that the targets for localization were set realistically, so that they would not seriously hurt the export competitiveness of the country - in some industries they were more strictly applied to the products destined for the domestic market.

The overall result was that, together with Japan, Korea has been one of the least FDI-dependent countries in the world. Between 1971-95, FDI accounted for less than 1 per cent of total fixed capital formation in the country (data from UNCTAD, various years), while the developing country average for the 1981-95 period (pre-1980 figures are not available) was 4.3 per cent.

FDI began to be liberalized from the mid-1980s and was drastically liberalized following the 1997 financial crisis. This was not only because of IMF pressure, but also because of the conclusion, right or wrong, of some key Korean policymakers that the country could not survive unless it allowed its firms to be incorporated fully into the emerging international production network. Whether their decision was right remains to be seen.

C. Taiwan

Taiwan took a similar attitude to that of Korea and used all the measures that Korea employed in order to control FDI (see Wade, 1990, pp. 148-56, and Schive, 1993, for further details).

However, Taiwan’s FDI policy has had to be somewhat more tempered than that of Korea for two reasons. First, due to the relative absence of large domestic private sector firms, which could provide credible alternatives to (or joint venture partners with) TNCs, the Taiwanese government had to be more flexible on the ownership question. In terms of the ownership structure of TNC subsidiaries Taiwan was somewhere in between Korea and Latin America, with 33.5 per cent of the TNC subsidiaries (excluding the ones owned by overseas Chinese) being wholly owned as of 1985 (Ibid, p. 319).
Second, during the 1970s, when the diplomatic winds blew strongly in favour of China, Taiwan made efforts to host big-name TNCs, especially from the USA, offering them exceptional privileges (e.g. guaranteed protection against imports) in order to strengthen its political and diplomatic position (Wade, 1990, pp. 154-5).

Despite these constraints, “[f]oreign investment proposals have been evaluated in terms of how much they open new markets, build new exports, transfer technology, intensify input-output links, make Taiwan more valuable to multinationals as a foreign investment site and as a source for important components, and enhance Taiwan’s international political support” (Ibid, p. 150). The 1962 guidelines on foreign investment, which provided the backbone of Taiwan’s FDI policies, limited FDI to “industries which would introduce new products or direct their activities toward easing domestic shortages, exporting, increasing the quality of existing products, and lowering domestic product prices.” (Ibid, p. 150, f.n. 33). This meant that, as in Korea, the favoured types of FDI changed in line with the country’s economic and political conditions. For example, after encouragement during the 1960s, FDI in labour-intensive industries was discouraged or prohibited in the 1970s (Ibid, p. 151).

Foreign ownership was restricted, although less tightly than in Korea. There was, in particular, a restriction on the extent to which foreign investors could capitalize on their technology. In the case of a joint venture, the technology could not be valued at more than 15 per cent of the TNC’s equity contribution (Ibid, p. 152).

Local content requirements were extensively used, although as in Korea, they were typically less tough for export products (Ibid, pp. 151-152 for details on the operation of local content requirements).20 In some cases, the government gave approval for investment on the

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20 For example, the 1962 guidelines subjected industries such as refrigerators, air conditioners, transformers, televisions, radios, cars, motorcycles, tractors, and diesel engines to local content requirements (Wade, 1990, pp. 150-151, f.n. 33).
condition that the TNC helped its domestic suppliers to upgrade their technology (Ibid, p. 152).

Export requirements were also widely used (Ibid, p. 152). This was initially motivated by the foreign exchange consequences of FDI but the requirements were kept even after Taiwan ceased to suffer from foreign exchange shortages, because it was seen as a way to “ensure that the [foreign] company brings to Taiwan a technology advanced enough for its products to compete in other (generally wealthy Western) markets” (Ibid, pp. 152).

The overall result was that, although somewhat more dependent on FDI than were Japan or Korea, Taiwan was one of the least FDI-dependent countries in the world. Between 1971-99, FDI accounted for only about 2.3 per cent of total fixed capital formation in the country (data from UNCTAD, various years), while the developing country average for the 1981-95 period (pre-1980 figures are not available) was 4.3 per cent.

D. Lessons from the East Asian Experience

Like the USA in the 19th century, the three largest East Asian “miracle” economies have tried to keep foreign capital under national management as much as they could, and consequently have used extensive controls on foreign investment in terms of ownership, entry, and performance requirements, throughout their developmental period. Japan and (until recently) Korea relied very little on FDI. Even Taiwan, the most FDI-friendly of the three countries, was below the international average in its reliance on FDI.

Their approach was decidedly “strategic” in the sense that, taking account of the roles of particular sectors in the overall developmental plan of the time, they applied very liberal policies in certain sectors (e.g. labour-intensive industries established in free trade zones in Korea and Taiwan) while being highly restrictive in others. It goes without saying therefore that the same industries could be,
and have been, subject to relatively liberal treatment at some points but became subject to more strict regulation (and vice versa), depending on the changes in the external environment, the country’s stage of development, and the development of indigenous firms in the industries concerned. The experiences of Korea and Taiwan, which provided significant financial incentives to TNCs investing in their countries while imposing extensive performance requirements, show that FDI brings the most benefit when carrots are combined with sticks, rather than when either carrots or sticks are used alone.
III. IMPLICATIONS

III.1 LESSONS OF HISTORY

*Kicking Away the Ladder*, written by one of this paper’s authors, Ha-Joon Chang, shows that, when today’s advanced countries were in “catching-up” positions and trying to establish their industries against competition from the more efficient producers of the time, virtually none of them pursued the free trade policies that they are so eager to impose on the developing countries today (Chang, 2002, chapter 2). Their policymakers understood that free trade would impede the emergence of local producers in the more “difficult” industries. Accordingly, they used protection, subsidies and other controls in order to give local producers the chance to establish themselves and develop their managerial and technological capabilities.

An examination of their policies in relation to foreign investment reveals the same picture. When they were net recipients of foreign investment, all of today’s developed countries imposed regulations on foreign investors in order to ensure that such investment contributed to their long-term national development.

Almost all of them restricted the entry of foreign investment. Very often, the entry restrictions were directly imposed, ranging from a simple ban on entry into particular sectors to allowing entry on certain conditions (e.g. requirements for joint ventures, ceilings on foreign ownership). Bans on entry created space for local producers to establish themselves, while conditional entry made it possible to extract greater benefit from permitted foreign investment.

Furthermore, in some cases the scope for foreign investment was also restricted through informal mechanisms that prevented hostile acquisitions and takeovers by foreign investors (“brown-field” investment). First of all, they achieved this through the presence of
state-owned enterprises (SOEs) or by the government holding significant minority shares in enterprises in key sectors - for example, 20 per cent of the German automaker Volkswagen’s shares were owned by the state government of Lower Saxony. Even when privatizing the SOEs, some of these governments, notably that of France, made sure that a controlling stake was held by friendly “core” shareholders. Others, such as the USA and Finland, restricted the entry of foreign investment by regulating the forms of corporate governance - they explicitly required, at least in some key sectors, that all members of boards of directors be citizens and that non-resident foreign shareholders could not vote. This clearly discouraged potential foreign investors, who were not given control commensurate with their ownership status. These measures made it easier to ensure that major decisions in key sectors and firms were made in the national interest.

When entry was permitted, governments placed numerous performance requirements on investors in order to maximize the benefits to their economies. Some of the requirements were imposed for balance of payments reasons, such as export requirements, foreign exchange balancing requirements, or ceilings on licensing fees. However, most were put in place in order to ensure that local businesses picked up advanced technologies and managerial skills from their interaction with foreign investors, either through direct transfer or through indirect spillovers. Local content requirements and explicit requirements for technology transfer were the most obvious means to ensure this. Some countries, such as Taiwan, went further and explicitly required foreign investors to help their local suppliers to upgrade their technology. In the late 19th century, the USA even banned the employment of foreign workers thus forcing foreign firms to train local workers. Bans on majority foreign ownership or the encouragement of joint ventures were also used to encourage the transfer of key technologies and managerial skills.

Even when there were no formal performance requirements, most developed countries used them informally. Local contents requirements, which were made “illegal” by the TRIMs Agreement, are still being used by non-Asian developed countries, albeit under a
different guise. The “rules of origin” used by the EU and the North American Free Trade Agreement (NAFTA) countries (the USA, Canada and Mexico) in specifying the local contents of products that qualify for preferential treatment in the regional free-trade agreement, effectively set local content requirements for foreign investors in strategic industries (although “local” here has been expanded beyond old national borders). The EU has strict rules of origin on automobiles, semiconductors, textiles and apparel, photocopiers, and telecommunications switching equipment. NAFTA uses them in relation to colour TVs, computers, telecommunications equipment, office equipment, automobiles, machine tools, forklift trucks, fabricated metals, household appliances, furniture, tobacco products and textiles (for further details, see Kumar, 2001, p. 3152, Box 1).

As in the case of trade policy, the exact strategies that were used to regulate foreign investment varied from country to country, ranging from the very welcoming (but not laissez-faire and increasingly selective over time) strategy of Ireland to the very restrictive strategies of Finland, Japan, Korea, and 19th-century USA in certain sectors (especially finance and navigation). In other words, there was no “one-size-fits-all” model of foreign investment regulation.

However, one common factor is that they all took a strategic approach to foreign investment. This meant that different sectors could be subject to different policies at the same time. For example, Korea and Taiwan applied liberal policies towards FDI in labour-intensive industries while applying very restrictive policies towards FDI in the more technologically advanced industries, where they wanted to build up local technological capabilities.

Their respective policy stances also evolved over time, according to changes in their economic structure and external conditions. In the mid-1980s, after it had exhausted the possible benefits from the inflow of export-oriented labour-intensive FDI, Ireland shifted from a rather permissive and unfocused foreign investment policy to a focused and selective one in order to “upgrade” the contents of FDI. Korea had a relatively open policy towards FDI in the automobile
sector until the mid-1970s, but tightened the policy afterwards in an attempt to promote domestic automobile production. While such tightening led to the withdrawal of some foreign investors (Ford and Fiat), the policy resulted in the establishment of a spectacularly successful automobile industry.

The historical experiences of today’s developed countries show that a well-devised set of restrictions and performance requirements on foreign investment has been a key ingredient in their recipes for success. While only some of these countries were hostile towards foreign investment, none of them pursued policies that were uncritically welcoming to foreign investment, in marked contrast to what many of those same countries recommend to today’s developing countries. History also shows that a strategic and flexible approach is essential if countries are to use foreign investment to pursue long-term national interests. Rather than sticking to one rigid recipe, most successful economies have changed their policies towards foreign investment according to changes in their stages of development, national priorities, and the world economic environment.

In the light of these lessons, we conclude that the current proposals made by the developed countries in the WTO in relation to foreign investment regulation go directly against the interests of developing countries.

III.2 POSSIBLE OBJECTIONS

When criticized along these lines, the proponents of an MIA reply with a few objections that may at first sight seem plausible. However, their objections lack both logic and empirical foundation.
A. “Times Have Changed” - The Irrelevance of History?

The most typical response to the historical criticism advanced above is to claim that “times have changed”. It is argued that, thanks to globalization in recent years, restrictive foreign investment policies that may have been beneficial in the past - say, in Japan in the 1960s or Korea in the 1970s - are now redundant. The MIA’s supporters argue that, with the greater mobility of capital, foreign investment is becoming increasingly important in determining a country’s competitive position in the world economy, and therefore that any regulation of foreign investment is likely to harm the potential host country.

One problem with this argument is that there is no clear evidence that we are now living in such a “brave new world” that all past experiences have become irrelevant. The world may have become much more globalized than, say, in the 1960s and the 1970s, but it is not clear that globalization has progressed so much that we have had a “structural break” with the past. The fact that China has been able to attract a huge amount of foreign investment despite its strategic regulation of foreign investment suggests that there has been no such clean break with past patterns.

In another era of high globalization, during the late 19th and the early 20th century, when the world economy was as much, or in areas like immigration even more, globalized than that of today (Bairoch & Kozul-Wright, 1996, and Hirst & Thompson, 1999, ch. 2), the USA attracted by far the largest amount of foreign investment at the time and its economy grew the fastest in the world despite (or, we would argue, because of) having a restrictive foreign investment policy regime.

Moreover, the current process of globalization can be reversed, if it is not carefully managed. This is because under-regulated globalization can lead to instability and stagnation, thereby leading to political discontent and policy reversals. This is exactly how the earlier phase of globalization was reversed between the First World War
and the Second World War, and we have every sign that the world may be moving that way again.

History is littered with people who thought they could transcend history and build a “brave new world” with an entirely new set of laws and rules. From the Cambodian communist leader Pol Pot, who declared “year zero” for the beginning of an entirely new kind of society, to the now-discredited gurus of the “new economy”, they have all been proven wrong. Over two thousand years ago, Cicero observed, “Not to know what has been transacted in former times is to be always a child. If no use is made of the labours of past ages, the world must remain always in the infancy of knowledge.” We ignore history at our peril.

B. “We Want to Protect the Developing Countries from Harming Themselves”

Some proponents of the MIA admit that in the past some countries have successfully regulated foreign investments to their benefit, although when they say this they are mainly thinking about the more recent examples like Japan, Korea, and Taiwan in the post-war period, rather than the USA in the 19th century or Finland since the mid-20th century.

They argue, however, that these countries were “the exceptions that prove the rule”. An MIA is still required because in many more cases, especially in the developing countries, attempts to regulate and channel foreign investment have had negative effects. If left alone, they argue, many developing countries are likely to repeat the mistakes of the past, and therefore placing constraints on their policy freedom will actually protect them from repeating those mistakes. The more gung-ho MIA supporters sometimes muse on how much better the USA, Japan, or South Korea might have performed, had they not made the error of restricting foreign investment.
This is a curious argument. Primarily, because it is almost devoid of historical foundation - when asked at a seminar in March 2003 to name one country that had developed on the basis of national treatment of foreign investors, the U.S. trade negotiator William Tagliani replied somewhat plaintively “Korea?”

It is also inconsistent - those who want an MIA tend to be free-market economists who criticize various interventionist policies at the domestic level for being “paternalist” and restricting the “freedom of choice”. But when it comes to the choices for the developing countries, they seem to see no contradiction in taking that very paternalist attitude that they so much criticize in other contexts.

Even if strictly regulating foreign investment is likely to bring about “wrong” outcomes - which we do not accept - countries should be allowed “the right to be wrong”, if one is a consistent free-market economist who wants to preserve freedom of choice and who does not believe in top-down intervention.

C. “The Agreement Can Be Made Flexible Enough - We Simply Want Certainty”

Another typical response to our line of argument, which especially comes from the EU negotiators, is that the MIA need not harm the developing countries, as it can be negotiated in such a way that there is sufficient flexibility to guarantee developing countries all the “policy space” they require.

Especially emphasized is the GATS-style positive list approach, where the MIA would apply only to sectors that countries explicitly designate. This way, the proponents argue, countries can shut out as many sectors as they like from foreign investment for as long as they wish. For example, Fabien Lecroz, the EU negotiator, told NGOs at a Geneva seminar on 20 March 2003: “you could be a WTO member, a signatory of an investment agreement, and keep
your market completely closed to FDI, and with no national treatment. That is your policy choice.”

One immediate question that arises is: if so much flexibility is allowed, why bother with an agreement? The proponents of an MIA say they still think an MIA is important because it gives certainty to foreign investors about the host country policies. They argue that enhanced certainty will also help developing countries, because it will increase the flow of foreign investment to them. The World Bank, in its *Global Economic Prospects 2003*, disagrees:

[A]n international agreement that seeks to substantially increase investment flows by increasing investor protections seems destined, on the basis of available evidence, to fall short of expectations. Some key issues are already covered by relatively strong investor protections in BITs. Moreover, it is not clear that any investor protections emerging from multilateral negotiations would add markedly to existing protections found in bilateral agreements. Finally, merely creating new protections does not seem to be strongly associated with increased investment flows. For these reasons, the overall additional stimulus of multilateral rules that apply to new investment over and above unilateral reforms would probably be small - and virtually nonexistent for low-income developing countries. (World Bank 2003, p. 133, emphasis added)

Whatever little additional investment a country attracts would come at the cost of reduced flexibility both on the new investment, and the investment that would have arrived in any case.

The flexibility that is offered by the proponents of an MIA is a very odd sort of flexibility, as it is a one-way street. Once a sector is opened up it is extremely difficult, if not impossible, to re-regulate that sector. It is also far from clear how much flexibility will be permitted within sectors that a country chooses (or is obliged) to include in its commitments. Countries may be able to include exceptions to national treatment in some sectors, but these
will have to be negotiated, at a price, and will have to be included at the outset. If a future government considers that too much has been given away, it will be extremely difficult to introduce new exceptions once the agreement has been signed.

Moreover, since non-discrimination is a “core principle” of the WTO, part of its institutional DNA, however much flexibility is initially provided, there will be an inevitable tendency for negotiators to chip away at developing countries’ national policy space in this and successive rounds of negotiations, forcing them into a developmentally premature application of national treatment to FDI. The recent leak of the EU’s requests under the GATS process amply justifies these fears (World Development Movement, 2003, see also the Appendix).

D. “An MIA in the WTO is the Lesser of the Two Evils” - The Fears of Bilateral Investment Treaties (BITs) and Regional Trade Agreements (RTAs)

Some developing country negotiators who are aware of the restrictions that an MIA is going to place on their countries’ policy freedom still argue that they want an MIA because it is the lesser of two evils. They argue that, in the absence of an MIA, powerful countries, especially the increasingly-unilateralist USA, will put pressure on developing countries to adopt bilateral investment treaties (BITs), which are bound to be more restrictive than any MIA in the WTO. In addition, some countries worry that similar pressure will come through regional trade agreements (RTAs). In particular, the Latin American countries fear that they will be forced to sign a NAFTA-style high-octane investment agreement in a future FTAA (Free Trade Area of the Americas), if they are not protected by an MIA.

While it is true that BITs and RTAs are usually more restrictive than an MIA, this is not always the case. There are well-informed observers who think BITs can provide more flexibility than an MIA. Kumar (2001) argues that the existence of some 1,700 BITs
as of 2000 is evidence that the greater flexibility that BITs give makes them easier to negotiate (p. 3157). Moreover, BITs and RTAs, involving a smaller number of parties, may be slightly more renegotiable than an MIA.

But the developed countries are not going to give up existing BITs and RTAs, or stop pushing for new ones, if an MIA is agreed in the WTO. The MIA will simply be an add-on, rather than a replacement for BITs and RTAs. Indeed, the experience with the TRIPS Agreement shows that, once adopted, a multilateral agreement tends to be interpreted as a “floor” in bilateral negotiations, thereby raising the level of commitments expected in bilateral agreements (Kumar, 2003, p. 223). The likely result is that the MIA will form the floor and developing countries will be put under pressure to concede even more policy freedom in a series of “WTO-plus” BITs and RTAs.
IV. CONCLUSIONS

Even in the absence of an MIA, many of the policies towards foreign investment adopted in the past by today’s developed countries are already constrained by WTO agreements such as the TRIMs agreement or the GATS (see Appendix). The current GATS negotiations threaten to reduce developing country governments’ policy space still further. If an MIA is added, other measures used by the developed countries in the past are likely to become off-limits to developing countries.

Developing country negotiators and ministers thus face a momentous decision in Cancún. If they take the next step on the slippery slope to an MIA, they can be sure that, whatever the demandeurs’ protestations to the contrary, the push to restrict governments’ ability to discriminate in favour of local companies, through the application of the WTO core principle of national treatment, will end up at the heart of this or subsequent rounds of negotiations. It is imperative that they recognize the dangers involved for their countries’ future. Depriving current and future governments of the ability to implement a successful industrial policy aimed at developing national industry could consign future generations to poverty and underdevelopment. The stakes could not be higher.
APPENDIX

HISTORY VERSUS THE WTO

The table below reviews in the first column the measures used by now-developed countries in the course of their development, and asks, ‘would they be allowed under the current or future WTO Agreements?’

The second column reviews the constraints placed by the current GATS and TRIMS agreements, and the likely tightening of restrictions under the current GATS negotiations.

Briefly, the Trade-Related Investment Measures (TRIMs) Agreement applies to trade in goods (not services) and prohibits the use of specific government measures that violate the principle of national treatment or that violate the general obligation to eliminate quantitative restrictions. The TRIMs agreement was intended as confirmation of the scope of GATT Article III on national treatment and Article XI on the elimination of quantitative restrictions. The list of prohibitions includes local contents requirements that limit imports in favour of domestically-sourced products but, for example, does not prevent a government from requiring investors to export more than a certain percentage of its production, regardless of how much they import. Although a review of the TRIMs agreement is currently under way at the WTO, there is so far no agreement among members on the scope and nature of that review.

For its part the GATS Agreement applies to all services from banking and insurance, to retail stores, telecoms and energy distribution; and is based on a ‘positive list’ approach, under which countries choose which sectors they wish to include in their commitments after a bilateral ‘request-offer’ process with other WTO members. When a country commits a sector, it is initially allowed to negotiate the inclusion of exceptions to national treatment or market access obliga-
tions. If it does not do this, then these obligations place a range of restrictions on permitted government policies. The requirements listed under market access are more detailed and specific than those under national treatment, and include a number of the policies used by now-developed countries in the past, such as joint venture requirements, ceilings on foreign shareholding or caps on the total value of individual or aggregate foreign investment. Further negotiations to extend countries’ GATS commitments are part of the current Doha Round of negotiations in Geneva.

The third column reviews the likely implications of an MIA for the future use of national restrictions in both goods and services sectors. Since the shape of any future GATS Agreement remains vague, and that of any MIA much vaguer - and the issue of how any MIA would relate legally to existing WTO Agreements is completely unexplained by its proponents - the conclusions we draw are necessarily tentative. Nonetheless, the exercise amply justifies the concerns of both developing country governments and NGOs, that the WTO is a threat to the policy space that successful countries have used in their own development strategies:

1. A number of measures, for example the French Government’s use of foreign exchange to manage FDI flows, or the UK’s use of informal performance requirements, or South Korea and Taiwan’s use of local content requirements are already illegal under the TRIMs Agreement.

2. The GATS case is less clear-cut, but more all-pervasive, since according to the World Bank, 80-85 per cent of restrictions affecting international investment are maintained in service sectors (World Bank, 2003, p. 126). A number of regulations in the services sector are already coming under severe pressure in the current round of GATS negotiations. A small sample of the EU’s requests to developing countries illustrates this (see World Development Movement, 2003, for further details):
• Chile is being asked to abandon its rule that foreign investors should employ 85 per cent of staff of Chilean nationality, when the U.S. formerly insisted on 100 per cent US nationality
• Pakistan is being pressured to abandon its requirement of maximum foreign equity participation of 51 per cent, when Japan put a 50 per cent ceiling on foreign ownership of 33 key industries
• Colombia is being asked to abandon its preferential treatment of Colombian companies during the disposal of state holding companies, when France reserved shares for French investors during privatizations.

3. The impact of the MIA is more likely to resemble that of GATS than of TRIMs. Further reduction of policy space for development is likely on a creeping basis if investment rules are extended via an MIA.
<table>
<thead>
<tr>
<th>Country and policy measures</th>
<th>Current treatment in WTO and likely treatment in GATS II</th>
<th>Likely status in a Multilateral Investment Agreement</th>
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<tr>
<td>USA (19th century)</td>
<td>Restrictions on foreign ownership of land, mines and logging companies: GATS (land ownership for foreign services enterprises): Violates national treatment and market access provisions, but exceptions to foreign ownership of land can be listed as exceptions in GATS schedules. EU arguing for elimination of limits on foreign ownership in energy services sector in current GATS round.</td>
<td>MIA would in principle apply to mining and logging. Restrictions on foreign ownership would violate national treatment principle. Would require country to specify exceptions in these areas when signing Agreement, but could come under serious pressure from TNC home countries during negotiations.</td>
</tr>
<tr>
<td>All bank directors have to be U.S. citizens</td>
<td>All bank directors have to be U.S. citizens: GATS: Violates national treatment, but many countries put nationality conditions on directors in their GATS commitments for financial services. For several GATS sectors, several OECD countries require that at least some directors be nationals; and residency usually required. Hard to see one-third or half quota of nationals as any country’s priority for removal in current GATS talks, but requirement that ALL directors be nationals would be opposed by big OECD countries.</td>
<td>Bank directors would not be covered by MIA unless it was to subsume GATS investment sections; not likely at this stage. However, similar pressures to remove limits on foreign directors in manufacturing and natural resource sectors are likely under an MIA.</td>
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<tr>
<td>Country and policy measures</td>
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<tr>
<td>State taxes higher on foreign companies than on national ones.</td>
<td>GATS: Violates national treatment, but GATS only urges that national governments make best efforts to ensure compliance. Needs to be listed in schedule as exception to national treatment. Unlikely to be targeted in current GATS round as state independence within federal systems is a sensitive issue. Could expect similar provisions for investment in goods in any MIA.</td>
<td>Likely to be targeted as violating national treatment; and would require country-specific exceptions to national treatment in MIA.</td>
</tr>
<tr>
<td>New York bans foreign bank entry</td>
<td>GATS: Violates national treatment, but many exceptions to market access and national treatment in GATS are state-level restrictions (e.g. US, Canada, Australia, other federal states). Could become an issue: Australia bans foreign entry in retail banking, and is currently a target of US requests, but Australia is expected to refuse.</td>
<td>Not relevant, unless MIA subsumes GATS investment provisions.</td>
</tr>
<tr>
<td>Prohibition on import of foreign workers in manufacturing</td>
<td>GATS: not relevant, since only applies to services sector.</td>
<td>Not clear if MIA would include migrant workers in non-service industries. If so, an outright prohibition would not be accepted, but countries could probably place limits on numbers,</td>
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<tr>
<td>France (up to late 20th century)</td>
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<td>or refuse to go beyond general all-sectors commitments to allow foreign workers in line with existing labour market regulation &amp; temporary visa process.</td>
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<tr>
<td>Used foreign exchange control to manage FDI flows</td>
<td>TRIMs prohibits restricting access to foreign exchange by linking it to FDI inflows. Under GATT Article XV and GATS Article XI members shall not impose restrictions on capital transactions inconsistent with their specific obligations under the IMF except as necessary to safeguard their balance of payments in conformity with GATT/GATS rules.</td>
<td>MIA for goods sectors would either have to incorporate or waive the TRIMs Agreement, so outcome unclear.</td>
</tr>
<tr>
<td>Reserved shares for French investors during privatization</td>
<td>Violates national treatment and market access provisions, but under GATS sector commitment approach, countries can impose conditions on privatization including reserving a share of ownership for national investors.</td>
<td>Non-services privatization processes (e.g. mining, oil &amp; gas) would fall under an MIA. Would require country-specific exceptions to market access and national treatment, even if the sector is currently reserved to the State. Rich country negotiators could be lobbied by companies in their countries to ensure specific upcoming privatisations are targeted for seeking entry commitments.</td>
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<td>Germany (current)</td>
<td>Barriers to hostile takeovers deter “brown-field investment” via M&amp;As</td>
<td>Not covered by GATT, or by GATS with exception of ‘pro-competitive principles’ in telecom sector or if have made any ‘additional commitments’ regarding application of competition law in a particular GATS sector.</td>
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<tr>
<td>UK (current?)</td>
<td>Informal performance requirements on export ratios and local purchasing</td>
<td>The TRIMs agreement prohibits local content and export performance requirements that are either mandatory, enforceable under domestic law or administrative rulings, or as condition to obtain an advantage.</td>
</tr>
<tr>
<td>Finland (until late 20thC)</td>
<td>Ban on foreign-owned banks and railways</td>
<td>GATS: violates national treatment and market access provisions, but allowed if listed as a limitation on market access or national treatment. Likely to come under pressure</td>
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<tr>
<td>Foreign ownership of companies limited to ceiling of 20 per cent.</td>
<td>from other countries if they want access in those sectors (plus bilateral pressure from IMF, World Bank etc). Market access in banking in particular is coming under pressure in current GATS talks.</td>
<td>Under a GATS-type approach to MIA, developing countries would have to negotiate whatever FDI limit they wanted in each sector they include in their positive list of commitments. Thereafter, they would find it extremely difficult to revise this limit upwards, in the light of experience. Likely to come under pressure from negotiators from TNC home countries.</td>
</tr>
<tr>
<td>Foreigners cannot be directors or managers of any public company</td>
<td>GATS: violates national treatment and market access provisions, but allowed if listed by the country concerned as a limitation. Quite a few developing countries currently list ceilings of 20 per cent or 30 per cent, even though they actually allow 49 per cent or more. Likely to become more difficult as GATS proceeds.</td>
<td>Manufacturing and other non-service industries would fall under an MIA. Under a GATS-type approach, developing countries would have to negotiate whatever FDI limit they wanted in each sector. Likely to come under pressure from negotiators from TNC home countries.</td>
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<tr>
<td>Japan (up to 1960s)</td>
<td>GATS: For service industries, violates national treatment and market access provisions. Would require country to specify exceptions in these areas when signing agreement, but could encounter serious pressure from other members. Current EU GATS negotiating position opposes limits on foreign ownership.</td>
<td>Manufacturing industries would fall under an MIA. Under a GATS-type approach, developing countries would have to negotiate whatever FDI limit they wanted in each sector. Likely to come under pressure from negotiators from TNC home countries.</td>
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<tr>
<td>50 per cent ceiling on foreign ownership in 33 key industries</td>
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<tr>
<td>Ban on brown-field FDI (i.e. M&amp;As)</td>
<td>Not covered by GATT, or by GATS with exception of ‘pro-competitive principles’ in telecom sector or if have made any ‘additional commitments’ regarding application of competition law in a particular GATS sector.</td>
<td>If M&amp;As are not excluded from the definition of FDI, governments would have to list exceptions in market access as regards M&amp;As. Unlikely to become illegal under an agreement on Competition Policy.</td>
</tr>
<tr>
<td>Informal defences against hostile takeovers</td>
<td>Not covered by GATT, or by GATS with exception of ‘pro-competitive principles’ in telecom sector or if have made any ‘additional commitments’ regarding application of competition law in a particular GATS sector.</td>
<td>Exceptions/limitations to market access would need to be listed in each country’s schedule on MIA. Unlikely to become illegal under an agreement on Competition Policy.</td>
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<tr>
<td>South Korea (early 1980s)</td>
<td>GATS: violates national treatment and market access provisions. Acceptable under positive list approach to pre-establishment, but could encounter serious pressure from other members. Current EU GATS negotiating position opposes limits on foreign ownership.</td>
<td>Would violate national treatment and market access provisions within an MIA. Acceptable under positive list approach to pre-establishment, but could encounter serious pressure from other members, especially for larger markets and major FDI recipients.</td>
</tr>
<tr>
<td>50 per cent of all industries (including 20 per cent of manufacturing) 'off limits' to FDI</td>
<td>GATS: violates national treatment and market access provisions. Acceptable under positive list approach to pre-establishment, but could encounter serious pressure from other members. Current EU GATS negotiating position opposes limits on foreign ownership.</td>
<td>Manufacturing industries would fall under an MIA. Under a GATS-type approach, developing countries would have to negotiate whatever FDI limit they wanted in each sector. Likely to come under pressure from negotiators from TNC home countries.</td>
</tr>
<tr>
<td>50 per cent ceiling on foreign ownership in strategic industries</td>
<td>GATS: For service industries, violates national treatment. Would require country to specify exceptions on market access and national treatment in these areas when signing agreement, but could encounter serious pressure from other members. Current EU GATS negotiating position opposes limits on foreign ownership.</td>
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<tr>
<td>Strict local content requirents</td>
<td>TRIMs: violates national treatment. For goods, local content requirements whether by specific products, volume or value, or proportion of local goods, or limits on imported goods in ratio to volume or value of local goods exported are not permitted. This applies both to mandatory requirements, enforceable under domestic law or administrative rulings, and to more informal arrangements which constitute a condition to obtain an advantage. For services, any similar requirements have to be specified in the schedule.</td>
<td>MIA would either have to incorporate or waive the TRIMs Agreement, so outcome unclear.</td>
</tr>
<tr>
<td>Taiwan (1960s/70s)</td>
<td>TRIMs: violates national treatment. Requirements to export a particular volume or value of goods are not permitted under TRIMs. This applies both to mandatory requirements, enforceable under domestic law or administrative rulings, and to more informal arrangements which constitute a condition to obtain an advantage. GATS would require any export “quotas” or other requirements on foreign investors to be specified in the schedule.</td>
<td>MIA would either have to incorporate or waive the TRIMs Agreement, so outcome unclear.</td>
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