Multilateral Investment Agreements

GRANT D. ALDONAS

This past year witnessed a surge of activity on the international investment front. Negotiations on a Multilateral Agreement on Investment (MAI) within the Organization for Economic Cooperation and Development (OECD) produced a draft text of the first broad multilateral accord on investment disciplines to date. That draft will provide the framework for intensive negotiations designed to meet the May 1997 deadline set for the talks by OECD trade ministers.

The year saw the expansion of a growing network of bilateral investment agreements as well. Preparatory work that may lead to the negotiation of regional pacts on investment continued in various fora, including the Free Trade Agreement of the Americas (FTAA) initiative and the Asia-Pacific Economic Cooperation (APEC) forum.

Investment also played a significant, if controversial, role in the first-ever ministerial meeting of the World Trade Organization (WTO) held in early December 1996. The WTO debate over investment, which centered on whether to initiate a work program leading to negotiations on multilateral investment disciplines within the framework of the WTO, divided along North-South lines.

Some developed countries (the United States chief among them) were less sanguine from the outset about the WTO as a negotiating forum on investment. They promoted an alternative formulation that called for the establishment of a WTO working party to examine a number of trade and investment-related questions over the next two years, without prejudice to whether the working party's efforts might eventually lead to negotiations within the WTO or not. That proposal ultimately succeeded.

The upswing in activity on the investment front reflects changes in both the political climate and the global economy in recent years. The political changes have involved a shift in the conventional wisdom about the benefits of foreign direct investment. Countries that previously pursued policies inimical to foreign investment are now actively pursuing it. The changes in the global economy flow directly from the success of recent rounds of trade liberalization. As barriers to trade have fallen, many companies find themselves competing in a global marketplace, which places a premium on organizing business operations efficiently on a global basis. That

Grant D. Aldonas is with the law firm Miller & Chevalier in Washington, D.C., and he is chair of the Task Force on Multilateral Investment Agreements.

necessarily implies a role for foreign investment, either to be closer to the customer or to find the most cost competitive manufacturing sites.

Of the various initiatives under way, the OECD negotiations represent the most far-reaching attempt to respond to both the current political opportunity and the changes in the world economy. To the extent they succeed, they will form a model for future talks on investment disciplines regardless of the forum. The following discussion focuses on those talks as a consequence.

I. Progress to Date on the MAI

Negotiations on the MAI began in May 1995 at the annual OECD ministerial meeting in Paris. OECD member countries, which include most of the industrialized economies of the world, initiated the talks with a commitment to pursue high standards of investment protection, eliminate investment restraints, and provide for effective dispute settlement.[1] The mid-term review of the negotiations took place a year later at the May 1996 OECD ministerial. At that time, the negotiators had already completed six negotiating rounds and the basic contours of an agreement had begun to take shape.

The initial talks on the MAI centered on five basic concepts which are discussed below.

A. Definition of Investment

Defining the type of investment to be covered by the accord defines its scope. The two basic questions confronting the negotiators were: (1) whether to include portfolio as well as direct investment in plant, equipment, or commercial establishments; and (2) whether to cover both the pre- and post-establishment phases of the investment process.

The consensus among OECD representatives favored including portfolio as well as direct investment within the scope of the accord.[2] That choice was premised on the fact that debt and equity investments represent investments no less deserving of protection in their own right and on the recognition that such investments are often an adjunct to direct investment, even if only as part of the treasury functions of the direct investor.

The choice to include portfolio investment, however, raised a significant definitional question of its own. The challenge is to craft a definition of investment that captured portfolio investment, but nonetheless does not cover financial transactions that bear no relationship to an investment (*e.g.*, credit offered in the context of commercial sales). While the negotiators made progress throughout the year and benefited from consultations with various groups of experts, further negotiations will be required to determine precisely how that line should be drawn.[3]

Many European countries entered the negotiations with a predilection to cover only the post-establishment phase of an investment. In other words, they favored offering guarantees of nondiscriminatory treatment once an investment is in place, but not for the approval of the investment in the first instance. Based on their experience under the U.S.-Canada Free Trade Agreement (FTA) and the investment provisions of the North American Free Trade Agreement (NAFTA), both the United States and Canada pressed for inclusion of the pre-establishment phase of investment regulation as well.

---

1. OECD ministerial Declaration (May 1995); *see also* Multilateral Agreement on Investment, Progress Report of the MAI Negotiating Group, OCDE/GD(96)78 (1996) 3 (MAI Progress Report).

2. MAI Progress Report at 4; *see also* William H. Wetherille, *An Agreement on Investment*, THE OECD OBSERVER (October-November 1996) 8.

3. *Id.*

They were ultimately successful in forming a consensus to include the pre-establishment phase, although there remains some conflict over the extent to which pre-establishment guarantees provided for in any eventual MAI should be subject to mandatory investor state arbitration of investment disputes.

B. Investment Protection

Investment protection became an early target of OECD negotiators. The high degree of consensus among OECD states on the dictates of international law regarding expropriation and other issues of investment protection permitted rapid progress.[4] The draft text of the MAI now includes provisions on the general standard of treatment, compensation in the event of expropriation, protection from strife, and the free transfer of capital.

What remains to be done is largely a function of negotiating the terms of any exceptions that might allow a party to the agreement to derogate from their obligations.[5] One salient example is whether the MAI will include a balance of payments exception that would, in times of balance of payments emergencies, permit parties to derogate from their obligation to permit the free transfer of capital. There, the trick is to craft an exception that would permit parties some leeway to address to balance of payments emergencies, while at the same time avoiding the type of exception that has wreaked such havoc within the framework of the WTO's predecessor, the General Agreement on Tariffs and Trade.[6]

C. Treatment of Investors and Investment

As noted above, by including the pre-establishment phase within the MAI's definition of investment the negotiators opted for a model that would guarantee the same basic treatment to domestic and foreign investors at all stages of an investment's life. In those instances where the treatment will differ, it is likely to favor the foreign investor. That is because the disciplines contained in the current draft of the accord provide for the better of most-favored-nation (MFN) or national treatment.

MFN treatment assures an investor will receive the same treatment as investors from all other MAI member countries (and, potentially, a preference over the treatment extended to non-MAI parties). National treatment implies that a foreign investor will also be treated as well as a local investor in its home state. When the treatment differs, it will most likely be because a member state has opted to afford less preferential treatment to its own investors, and the investor from any MAI country would, as a practical matter, receive better treatment than local investors due to the agreement's MFN clause.

A second important topic taken up by the negotiators under the rubric of treatment of investors was transparency. That choice reflected the negotiators' understanding that the disciplines of the MAI and the promise of MFN or national treatment could easily be rendered a nullity if the process by which their investment was considered was not open and transparent. As currently conceived, the rules would require such items as the publication of standards to be applied in any investment review process and processes open to the investor's participation.

---

4. *Id.*
5. *Id.*
6. *Id.*

D. Additional Disciplines

MFN and national treatment as applied to a government's regulation of foreign investment form the core of the MAI, but they are not materially different from the sorts of rules captured in literally thousands of bilateral agreements on investment. The MAI will, however, be breaking relatively new ground by adding certain other disciplines to the mix between the parties.

The talks have touched on the possibility of including disciplines in a variety of other areas that would be consistent with the over-arching purpose of the MAI. They include such items as the movement of key personnel, participation in privatization of government-owned entities, the provision of investment incentives, actions of state-owned companies or state-sanctioned monopolies, and corporate practices (which are largely taken to mean actions regarding labor and the environment).[7]

The fundamental question in each case is whether the parties will agree to extend national treatment, or whether there will be some limitation or reservation in each of those areas. Plainly, the attempt to provide additional disciplines reaches into areas of public policy, such as immigration and eligibility for state subsidies, that are politically sensitive and the negotiations are likely to proceed cautiously in building a consensus behind any proposed rules as a consequence.

E. Dispute Settlement

The emerging framework for resolving disputes under the MAI takes the familiar nod toward consultation and mediation found in most international trade or investment arrangements.[8] That said, the promise of binding dispute settlement is perhaps more important in the context of international investment agreements than is true of trade pacts. Trade agreements, more often than not, are about striking a balance of advantages in negotiating reductions in tariff and nontariff barriers. Resolving disputes is, as a consequence, often a question of how best to reset the balance when it is upset by one party's infraction.

By contrast, investment agreements are basically about rules. The credibility of the agreement depends on the enforcement of the rules on a consistent basis. That implies the need for binding arbitration of disputes.

In recognition of that fact, OECD representatives have focused on developing binding dispute settlement provisions for both state-to-state and investor-state investment disputes. At this stage, the framework is already in an advanced state of development. While a number of European governments were initially cool to the idea of binding arbitration with foreign investors, a consensus has developed behind investor-state arbitration as well as dispute settlement among the governments that are parties to the accord.

That said, there are clearly difficult issues that remain to be discussed. They include defining which of the agreement's disciplines will be subject to binding arbitration, deciding whether to force investors to make a one-time-only choice of forum between binding arbitration or resolution of the dispute through the local courts, and determining whether to make use of existing arbitral tribunals or to provide for a model unique to the accord.

7. *See id.*
8. *Id.*

II. Next Steps

The MAI negotiators have a significant task ahead of them if they are to meet the May 1997 deadline imposed by OECD ministers at the start of the talks. Their success in meeting that challenge will likely depend on their ability to grapple with three issues: the scope of any exceptions and reservations, the extent to which the agreement will address extraterritorial restraints on investment, and the relationship of the MAI, particularly its dispute settlement provisions, to other international accords such as the WTO.

A. Negotiating Exceptions and Reservations

The negotiators have opted for a model of an agreement that is similar to that in the NAFTA and the WTO's General Agreement on Trade in Services (GATS). That is, the rules will be drafted as measures of universal application, but the actual scope of the disciplines in practice will largely be determined by the individual country schedules that will accompany the accord.

A number of countries, including the United States, have provided a list of areas of current practice that would be inconsistent with the MAI disciplines in order to provide a basis for reciprocal negotiation of commitments to liberalize those restraints. At this juncture, the United States is pressing for a negotiating methodology known as the "44 request-offer" model that would involve the type of horse-trading between states familiar to those with experience in trade agreements.

Many European countries, on the other hand, prefer to "grandfather" existing inconsistent measures and leave further liberalization to a later round of negotiations. They argue that there is insufficient time before the deadline of May 1997 to make the necessary commitments. For the United States, an agreement without commitments on liberalization may not be worth the price. At this stage, the issue is unresolved.

Wholly apart from the country-specific reservations, there are significant differences over the scope of general exceptions to the accord. The European Union, for example, has asked for a broad exemption for so-called regional economic integration organizations or REIOs. Such a carve-out would permit the EU to discriminate against non-EU members. The reaction among other countries, particularly Japan and the United States, has been cool to say the least. Such a provision could potentially gut the accord's application to EU member states.

Canada and France have asked for a broad exemption for cultural heritage, which others oppose largely due to the vagueness of the term. The absence of such an exception may be a deal-breaker from both countries' perspective. The opposite is true for the United States, which opposes any broad cultural exemption.

B. Extraterritorial Measures

The whole issue of how the MAI might discipline the use of extraterritorial restraints on investment and secondary boycotts has been generated by the enactment of two separate measures by the U.S. Congress this past year. They are the infamous LIBERTAD Act (known more colloquially by the names of its principal sponsors as the Helms-Burton Act), which imposes sanctions on companies investing in expropriated property in Cuba, and the Iran-Libya Sanctions Act, which enacts similarly extraterritorial sanctions on investment that might contribute to the development of either Iranian or Libyan oil production.

The jurisdictional hook for such measures is the company's investment in or trade with the United States. Canada and the EU have taken the position, as a consequence, that such measures are a form of investment regulation that should be subject to discipline under the MAI like

any other such measure. The United States, needless to say, has opposed that view. It is not clear, at this juncture, how the two positions can be reconciled.

C. Relationship to Other Agreements

The final prominent hurdle is the potential for conflict with other agreements, particularly the WTO. The issue is most squarely joined in that context. The GATS agreement for example, already contains certain measures regarding investment protection because foreign direct investment is one of the modes of service delivery subject to GATS disciplines. Creating an international investment agreement that would offer preferential treatment to certain states would, on the face of it, be inconsistent with the MFN obligation assumed by all GATS participants.

Where that has a particularly significant potential bite is in the area of dispute settlement. A Brazilian investor involved in an investment dispute with the United States, for example, might argue that it was entitled to binding investor-state dispute settlement provided for under the MAI, even though Brazil is not a member of the OECD arrangement, on the ground that the binding arbitration afforded by the MAI is a preference owed to all WTO members under the GATS MFN commitment. As yet, the OECD parties have not come up with a satisfactory answer to this potential "free rider" problem.

Each of the prospects issues set out above has significant implications for both the shape of the MAI and the ability of the negotiators to meet the May 1997 deadline. That said, negotiators expect a significant push to conclude the accord and the odds are in their favor due to the interest the OECD member countries have in taking advantage of a favorable economic and political climate for such a pact.