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Introduction

When a group of businessmen in New York asked Prime Minister Nehru about the Indian government's policy towards foreign investment, he is reported to have looked out of the window and commented on the weather. Similar is the reaction of most influential writers and commentators to the issue of the inclusion of FDI on the agenda of the WTO. This is most unfortunate. Not so much because it is FDI and the multinational enterprise which are the targets of attack from the opponents of globalisation on the streets of Seattle and London, but because FDI is intimately intertwined with trade, especially so with international commercial transactions in services, and so too with trade related investment measures (TRIMS) and trade related intellectual property rights (TRIPS), all of which are now on the WTO agenda. Why then the reluctance to admit that FDI belongs in the WTO and that there is a case for framing a cohesive set of multilateral rules on FDI? One explanation is that FDI is doing well, meaning that the volume of FDI has increased steadily over the years, and that which is not broke should not be fixed. The other explanation is that FDI involves issues of sovereignty, a sacred turf best left untouched. This paper argues that none of this makes sense. In the absence of a cohesive set of rules on FDI, liberalisation of trade with which it is intimately involved will be impeded. And the reluctance of the WTO to discuss and debate FDI, much of which is scattered through out its agenda, will only fuel the flames of opposition to globalisation. Such reluctance will be equated with culpability of the WTO of all the supposed sins of globalisation. This paper examines the principal reasons for the reluctance to include FDI on the agenda of the WTO and makes a case for its inclusion.

II Is FDI doing Well?

The belief that FDI is doing well is based on the observed growth in foreign investment flows in recent years. Inflows of FDI amounted to $865 billion in the year 1999 and the total stock was a sizeable $5 trillion. Save for the year 1996 annual average growth rates of FDI flows were in excess of 20 per cent reaching 39 per cent in the year 1998. Indeed, the volume of production of goods and services on account of FDI exceeds that supplied by international trade. Global sales and gross product associated with international production have increased faster the global exports and GDP -by 3.2 per cent and 4.1 per cent , respectively, during the period 1982-99 (UN 2000). And much of international trade, around 50 per cent, is on account of intra- trade between affiliates of MNEs.

Judged by the volume of foreign investment crossing the borders, and its relatively high growth rate, FDI is indeed doing well. But it is this sort of judgement that provokes hostility and opposition to FDI. It is doing well by the MNEs, but what has it achieved for the host developing countries? The problem is that most discussion of FDI is centred on its volume, the factors which propel these flows, and ways and means of removing obstacles to its continued growth. The OECD inspired draft on a multilateral agreement on investment (MAI) is a case in point. There were a number of reasons for its demise including the vast range of topics it attempted to cover(Henderson, 1999). It was , however, the widespread perception that the sole concern of the MAI was with the liberalisation and growth of FDI that was mainly responsible for its demise.

Admittedly, FDI is a potent ingredient in the development process, it is an acknowledged conduit for the transfer of technology and human skills, it is a purveyor of new ideas and it is a source of capital. The policy makers in most developing countries are not unaware of the contribution of FDI to the development process. Indeed, most developing countries, for a variety of reasons including the decline in bank credit and aid flows, have eagerly sought FDI. Whist they may not have embraced FDI with open arms, most of them now accept it as a necessary evil, more so with the collapse of the Soviet Empire and the demonstrated success of the East Asian countries with FDI. Even so, the OECD draft multilateral agreement, which intentionally or otherwise appeared to take the virtues of FDI as the holy writ and preached it to the developing countries, was bound to come unstuck.

FDI is not a panacea for the development problem. It functions efficiently and contributes to the social product given certain pre conditions. These include a stable macro economic environment including price and exchange rate stability, presence of distortion free product and labour markets, and the availability of a threshold level of human capital and infrastructure facilities. It is now an established fact that FDI is much more effective in promoting growth and technical change in economies open to competition from both external and internal markets. (Balasubramanyam, Sapsford and Salisu, 1996) Further, growth rates of economies pursuing a neutral development strategy, those which do not provide artificial incentives for either the domestic or the export markets, appear to converge to the growth rates of developed countries, whist growth rates of economies pursuing import substitution strategies appear to show no such convergence. And such convergence is promoted by the efficient utilisation of FDI in the countries pursuing a neutral strategy (Silverstraidou and Balasubramanyam ,2000). In sum, FDI is a superb catalyst of development, but not its prime mover. It functions most effectively as a catalyst only in the presence of the right sort of ingredients in sufficient volumes. Very few developing countries, however, are able to provide all these ingredients. It is for this reason that around three quarters of FDI flows to developing countries, out of a total of around $180 billion or so per annum in recent years, is concentrated in around a dozen countries. And these are countries that accommodate FDI with the sort of an investment environment it requires. It is thus that claims such as FDI is doing well sends mixed messages. It is doing well, judged by the growth in its volume, and it is doing well in developing countries which are well placed to provide the sort of environment it demands. It is also doing well in certain countries, which provide an array of artificial and transient incentives such as tax concessions and subsidies of various sorts. In these countries it is doing well in the sense that private rates of return to investment are relatively high. But its contribution to the social product is at best marginal and at worst negative. It is true to say that FDI responds to market forces, but if the markets are distorted its response is not the sort which would augment the development objectives of the recipient countries.

Should we then rest content in the knowledge that FDI is a rich country good as it were, and it is of little significance for the very many developing countries which either receive insignificant amounts of FDI, or from the social point of view, squander what little they receive? The do nothing philosophy suggests as much. More to the point, would a multilateral agreement on investment under the aegis of the WTO facilitate the utilisation of FDI in the promotion of development objectives of the developing countries, especially of those that now receive relatively low volumes of FDI? This can be dismissed as a tall order. Even so, a framework of rules which removes or delimits various sorts of distortions in product and factor markets, and improves the investment climate in general, should go a long way in promoting the efficacy of FDI. It should also provide the least developed countries with an opportunity to compete for increased FDI flows.

It could though be argued that development of poor countries is not the mandate of the WTO, strictly speaking not even the liberalisation of trade and investment, only the promotion of rules based trade. Surely this would be defeatist. Promotion of rules based trade or multilateralism is a means to an end, the end being development of the signatories, especially that of the poor countries. Whatever be the legal nuances and interpretations of the mandate of the WTO, the pursuit of liberal trade polices or multilateralism is not just an end in itself. And there is a voluminous literature, which attests to the benign impact of liberal trade policies on development (Greenaway and Sapsford, 1994). Advocacy of a compact on FDI should not be grounded or seen to be grounded in the objective of paving the way for unrestrained FDI flows. An agreement on

FDI has to take on board the issue of the impact of FDI on development and not just ways and means of augmenting the volume of FDI that crosses the borders.

III The Sovereignty Issue

Any sort of commercial transactions between two or more distinct jurisdictions give raise to issues of sovereignty, broadly defined as the legitimate right of one jurisdiction to protect its citizens against the encroachment from that of the others. The colourful controversies on free trade during the 19 century and the debates on imperial preference during the early part of the 20-century involved issues of sovereignty. Admittedly, issues relating to the protection of indigenously owned factors of production against competition from foreign owned factors of production are much starker, principally because of the presence and establishment of foreign owned factors of production within the borders of the host country. In the case of FDI, foreign firms are intimately involved in the operations of the local economy, unlike in the case of trade and licensing agreements. And when the scale and size of operations of the foreign entity and its endowments of money and skills are relatively large, as in the case of the multinational enterprise, its involvement in the local economy is marked, and perceptions concerning its threat to political and economic sovereignty of nation states are heightened. Such fears were routinely expressed during the decades of the sixties and the seventies when both the advocacy and opposition to FDI ranged to extremes. These debates though were not entirely vacuous. They resulted in a substantial body of academic research which served to identify the costs and benefits of FDI and sift the emotion-ridden arguments from those based on facts. These studies also served to allay the fears of developing countries at a time when they were compelled to turn to FDI, for reasons stated earlier, for their requirements of capital, technology and know-how.

The old debates though have resurfaced in recent years in the context of globalisation, with multinationals and FDI being the target of attack from the antiglobalisation brigade. These are not confined to the slogan mongering protesters against globalisation, academics too have pitched in. Alas, there is nothing new in the arguments produced, they are just old wine in old bottles. The familiar refrain is that multinationals are big, their sales exceed the GDP of some of the African countries, there are no trickle down effects from FDI, multinationals pay abysmally low wages , and the freedom of policy makers in developing countries is increasingly constrained by the need to cater for the interests of big business (Hertz, 2000). The riposte to these arguments from the pro-globalisation lobby is equally familiar. The relevant statistic to assess the size of multinationals relative to that of the countries in which they operate is not their global sales, but their value added, multinationals pay higher wages than comparable locally owned firms in developing countries, and it is the electorate, not the multinationals, which dictate tax and expenditure policies of nation states (Wolf, 2001). Both camps can produce facts and figures in support of their contentions.

These academic jousts do little to progress the debate. There is though ample scope to do so, given that even the most caustic critics of FDI concede the potential of FDI to promote development objectives, broadly defined to include transfer of technology and skills and creation of employment opportunities with adequate remuneration. The dispute relates to the reasons for the failure of FDI to deliver much more than what it has done. Noorena Hertz of Cambridge University, a critic of globalisation, sums up the issue when she writes

" the point is not that inward investment cannot make people of recipient countries better off. It is why there is not a bigger 'trickle down effect'. Why is globalisation- to quote James Wolfensohn, head of the World Bank- ' not working at the level of the people?" Why has the number of people living on less than $1 a day increased in every developing country outside East Asia "

Hertz's answer to the question she poses is that the political process, captured by the big corporations, is unable to protect the interests of the public realm. This may be so, but is it because the politicians and policy makers are captured by the big corporations? Or is it because the political process in most developing countries is flawed for reasons which have nothing to do with the multinationals? How come, on Hertz's own admission, the East Asian countries are able to reduce levels of poverty and prosper, whilst the others are not able to do so? It may be a bit far fetched to argue that democracy thrives in most of the East Asian countries and hence their acknowledged success in combating poverty and promoting development goals. The fact of the matter is that policy makers in these countries have instituted the sort of policies, which not only attract sufficient volumes of FDI but also promote its efficient utilisation. The benefits of FDI can hardly trickle down if countries are unable to attract sufficient volumes of FDI in the first place, and fail to utilise efficiently whatever they do attract. As IMD Little of Oxford University wrote several years ago, " FDI is as good or as bad as your policies"

None of this is to say that multinationals are entirely blameless in all that they do. Admittedly wage rates paid by multinationals in certain areas of activity in some of the developing countries are abysmally low. Indeed, they do seek low wage locations for many of their processing activities. But why do multinationals get away with paying abysmally low wages in certain countries but not in others? Here again it is the failure of policy, or the absence of it, which allows profit maximising multinationals to take advantage of low wage labour. Countries which have failed to institute trade and investment policies designed to create jobs and employment opportunities are also the ones which seek low wage jobs from multinationals. If the opportunity cost of labour is negligible in these countries, it is the overall framework of economic policy which is to be blamed. There is little point in railing against multinationals for seeking low wage locations. It is wishful thinking to expect profit maximising firms to behave as social service agencies, especially so when the domestic market environment is riddled with distortions. Low wage locations, such as the Export Processing Zones in some of these countries, for example, are no more than a feeble attempt at offsetting distortions elsewhere in the economy.

All this is familiar landscape dating back to the seventies. The concern now is with the efficient utilisation of FDI in the promotion of national economic objectives whilst at the same time preserving economic sovereignty cherished by nation states. What is the nature of the threat to their sovereignty from the operations of foreign firms that developing countries perceive? This perception of loss of economic sovereignty differs between various influential groups in the host countries. The late Raymond Vernon identified three influential groups: the government bureaucrats, the local businessmen and the elite. The bureaucrats perceive a threat to their power and control over the local economy from the operations of foreign firms. As Vernon put it " the indigenous bureaucrats are torn between two powerful needs. At times, they have felt the need to safeguard the companies from the untenable demands of their colleagues, in order not to kill the egg-laying goose; at other times, they have felt the need to take a leading role in extracting added benefits from the companies in order to strengthen their claim to continued power " (1994). The stance of the local businessmen has changed over time. With the growth in their ability to compete with foreign firms they have attempted to cut back the scope of foreign firms. Those businessmen whose activities complement that of the foreign firms though seem to tolerate the presence of foreign firms if not actively encourage their growth. The elite is a complex group, consisting of those who are opposed to any form of private enterprise be it foreign or domestic, those who wish to delimit dependence on foreign firms, and those who see foreign firms as a part of the Establishment and the threat it poses to their power and influence. The game plan of the bureaucrats for the most part is to voice their concern and opposition to foreign firms in public fora, but in private negotiations with foreign firms recognise their contribution to development objectives and seek ways and means of attracting FDI. Businessmen, in general, lobby for stringent regulation of foreign firms where they perceive them as a threat, and where they see them as an aid to their power and profits, they seek joint ventures and other avenues of rent sharing. The elite does what they are good at - position themselves as critics of foreign firms in the media and provide intellectual support to activists such as some of the NGOs.

The attitude and perceptions of the bureaucrats and local businessmen in general towards foreign firms are not entirely unreasonable. At the heart of the matter is the control over operations that multinationals exercise. Economic sovereignty is all about delimiting the control over operations or power over decision making which foreign firms exercise. The name of the game is to extract the maximum possible gains from the operations of foreign firms without killing the goose, which lays the egg. And if the goose does threaten their interests, it is natural to attempt to circumscribe its sphere of activity. Control over operations is one of the essential features of FDI. It is this aspect of FDI which theories of the multinational enterprise style as the ability of the firm to internalise operations or by pass the market. And it is internalisation, which enables the enterprise to preserve and exploit the so-called ownership advantages it possesses. It is again the ability to internalise and exercise control over operations, which enables the multinational enterprise to efficiently transfer technology and know how across borders. But it is internalisation, which creates tensions between the multinational enterprises and host countries. Internalisation or the exercise of control over operations and ownership of production facilities by foreign firms is perceived as a threat to their sovereignty by the developing countries. In other words, they face a trade off between increased gains from FDI to the host economy and loss of economic sovereignty, as they perceive it. But any dilution of control over operations limits the efficiency of operations of foreign firms. The higher the degree of control they cede to local interests, by conforming to the rules and regulations imposed on them, less is their ability to transfer technology and know how to the local economy. Here the trade off the foreign firms face is between the loss of control over operations and efficient operations. Multilateral rules governing FDI should assist in arriving at a compromise and resolving the dilemma both groups face.

The problem though arises when the interests of the bureaucrats and the businessmen do not coincide with national objectives. In other words ,if they are intent on safeguarding their private profits and their power base at the expense of the social good which foreign firms , given the appropriate climate, are capable of promoting , they play into the hands of ideologues and the elite. And their actions and the policies they advocate and institute may do more harm than good. It is this group of businessmen and bureaucrats who see a threat to their power and profits from foreign firms who play the sovereignty card for all it is worth.

The thesis that FDI involves issues of sovereignty and therefore nothing should be done, or whatever is done must be gradual, or that the time is not ripe for dealing with the issue, fails to identify the specific problem, which should be addressed. It is that entrenched interest groups invoke sovereignty as an excuse to preserve and perpetuate their interests. In the name of sovereignty they institute rules and regulations which impair efficient operations of foreign firms and delimit their contribution to the social product. The challenge is to identify and eschew policies designed only to promote the narrow self interest of these groups, and devise rules and regulations which promote efficient operations of foreign firms, which in turn bestows on the host economy the maximum possible gains from their operations. What of the elite and their perceptions? They have to be accepted as a fact of life, at best they may serve the purpose of engineering a reasoned debate and at worst continue to muddy the waters . The issue of sovereignty as interpreted here is one, which will not disappear with time, it is an inescapable fact which is likely to grow in complexity with the growth of globalisation. But if one were to shy away from formulating a compact on FDI, because it involves issues of sovereignty, it would only serve to strengthen the hands of the ideologues and weaken the efforts of those who wish to utilise FDI efficiently in the promotion of development objectives.

III A Framework of Multilateral Rules for FDI

The task of devising on FDI under the aegis of the WTO is much more complex than devising multilateral rules on trade, for reasons stated earlier. Even so, the gains from such a compact are likely to be substantial for both the recipients and providers of FDI. The problem is that any suggestion of such a compact is immediately seen as one sided, a set of rules designed to pave the way for unrestrained flows of capital from the developed to developing countries. The framework of rules should recognise the concerns of developing countries, principally the dilemma they face, discussed earlier, and shift the emphasis away from the objective of easing the passage for multinational firms.

Before discussing the form and nature of the compact, which is likely to be acceptable to the recipients of FDI, especially the developing countries, several objections to its inclusion on the WTO agenda require discussion. First of these is that the WTO is not the appropriate fora for framing a compact on FDI as its mandate does not extend to investment, it is confined to trade. This was also one of the objections to the inclusion of services on the agenda of the WTO. This has no basis in fact, simply because a substantial proportion of world trade is on account of the multinationals. In the year 1999 exports of foreign affiliates of multinationals accounted for more than 45 percent total world exports of around $7 trillion. If rules can be devised for trade, there is no reason why they should not be extended to the entities, which generate trade. The latter is unlikely to flourish in the absence of the former. It is now an established fact that trade and FDI are complements for one another and not substitutes. A set of rules which facilitate both the flows of FDI and its efficient operations is more than likely to promote the growth of trade.

In any case, services are on the agenda of the WTO, and save in the case of the so called long distance services, efficient delivery of most services require the presence of the producer in the locale of the consumer. Here production and trade are coterminous. More often than not the presence of the service producer in the locale of the consumer is established through FDI. Again, TRIMS, which are on the agenda of the WTO, are all about the polices of host countries towards foreign firms. They impact on production decisions of foreign firms including sourcing of inputs. Admittedly, the justification for the inclusion of TRIMS in the WTO is that all such measures at one remove or the other impact upon trade. But then there are very few policy measures , which do not impact upon trade in one way or the other. There is no escaping the fact that FDI in one form or the other is already on the agenda of the WTO, but the regulations relating to it are haphazard and scattered through out various agreements relating to services, TRIMS, subsidies and government procurement.

What can a compact on FDI achieve? As argued earlier, the twin objectives of the compact should be to (a) provide access to FDI for developing countries, which receive relatively low volumes of FDI, and (b), help resolve the economic sovereignty dilemma the developing countries face in utilising FDI. First of these requires not only increased volumes of FDI in toto, but also a much more widespread distribution of FDI than that prevails now. Both of these objectives, especially the second one , essentially involves creating competitive market conditions, which foster efficient operations of foreign firms .

The first of these objectives poses much more of a challenge than the second. The literature on the determinants of FDI identifies macro economic stability including exchange rate stability, distortion free product and labour markets which allow for the play of comparative advantage in resource allocation, a stable policy frame work on FDI, and resource endowments including a threshold level of human capital as the main determinants of FDI. No compact on FDI, however ingenious it may be, can promote macro economic stability or the provision of human capital. These belong to domestic policy in the host countries. A compact on FDI, however, may serve to promote the establishment of a stable policy framework and the elimination of distortions in product and labour markets. There is a strong suggestion in the literature that when foreign firms seek political stability, what they look for is stability of policies . In fact, economic stability may more often than not promote political stability. Here the enshrined principles of the WTO relating to trade- MFN, transparency and national treatment may serve to promote stability of policies. Non- discrimination between differing providers of FDI , explicit regulations which are agreed upon and bound and the guarantee that there would be no discrimination in the policy frame work between foreign owned firms and locally owned firms should achieve policy stability which foreign firms seek.

Some of these factors relating to determinants also influence efficient utilisation of FDI, which in turn are intimately related to the economic sovereignty issue discussed earlier. First of these is the presence of distortion free markets defined as markets where prices of factors of production and products reflect social opportunity costs. In most developing countries , especially those that receive relatively low volumes of FDI at present, factor and product market distortions are pervasive. These arise from tariffs and quotas on trade, stringent labour laws designed to protect jobs or more specifically appease labour unions, as in the case of India, and assorted subsidies including export subsidies. It is now the received wisdom that such distortions do not attract large volumes of FDI, and that which is attracted, such as the tariff jumping type of FDI, serves to bolster rents and the private returns to foreign investments, and they also impair efficiency of operations.

What can a set of multilateral rules achieve to reduce if not eliminate these distortions? To the extent agreed upon rules pertaining to trade serve to lower artificial barriers to trade, they also serve to reduce product market distortions. Especially relevant in the context of FDI are Trade Related Investment Measures (TRIMS) which encompass not only regulations such as local content requirements (LCRs) equity regulations tied to exports, and so called incentives such as tax holidays, tax concessions and assorted subsidies. The economic sovereignty issue is also bound up with TRIMS. This complex beast is supposed to serve several objectives - garner the maximum possible benefits from the operations of foreign firms to the host countries, satiate the desire of bureaucrats to retain power and control, provide local businessmen a complementary role in the operations of foreign firms and in some cases protect them from foreign competition. In other words, these measures ostensibly allow host countries to exercise economic sovereignty over the operations of foreign firms. In some cases ,TRIMS are also designed to offset policy-induced distortions elsewhere in the economy. Export subsidies and equity regulations tied to exports are an attempt to offset the attractions of a protected domestic market, so too are the export processing zones pervasive in developing countries.

TRIMS were included on the agenda of the Uruguay Round on the grounds that they had an impact on trade. The Uruguay Round accord on TRIMS relates to local content requirements (LCRs) and incentives such as tax concessions, which are tied to exports. Both of these regulations not only violate the principle of national treatment but also Article XI of the WTO relating to prohibition of QRs. The accord requires member countries to phase out TRIMS, which violate the principles of national treatment and prohibition of QRS.

The agreement on TRIMS in the Uruguay round though amounts to no more than a Pyrrhic victory. It addresses only the LCRs and export obligations. It has nothing to say about several other TRIMS such as the various sorts of subsidies and tax incentives the host countries offer foreign firms, nor does it include regulations relating to employment of nationals, and the requirement of some developing countries that foreign enterprise participation has to be in the form of joint-ventures with locally owned firms. The agreement is much weaker than that concluded in the NAFTA agreement. Even so, the fact an agreement of sorts was arrived at in the Uruguay round negotiations is a major achievement. How best to build on that which has been achieved? A multilateral framework on FDI would inevitably reopen the issue of TRIMS . The developing countries would seek ways and means of preserving their economic sovereignty, as discussed above, and are unlikely to consent to a blanket ban on all TRIMS. But then any suggestion that each and every TRIM should be assessed for its trade distorting effects, as was proposed by the developing countries on the run up to the Uruguay round, would only serve to muddy the waters. The so-called case by case approach, so dear to the hearts of bureaucrats, would only result in protracted negotiations, delay and red tape.

The alternative would be to formulate general rules designed to preserve those aspects of TRIMS, which do promote the development objectives of developing countries. Instead of imposing a ban on all LCRs, developing countries could be allowed to require foreign firms to gradually increase their purchases of locally produced components over time. This would allow foreign firms time to search for indigenous suppliers and impart the technology required to such suppliers. In any case, most multinationals would seek indigenous sources of supply of components rather than incur heavy transport costs which imports would involve, especially so if the former are cost competitive. The problem they face though is the heavy search costs of locating competent local suppliers . LCRS would act as a catalyst for the search process (Balasubramanyam ,1990). Faced with LCRs in several of the host countries, Japanese firms have established competent suppliers of components in the automobile industry. The model they have adopted in India, in the case of the Maruthi car project , provides a good example of how TRIMS can serve development objectives. The Japanese firm contracts out supply of components to local suppliers, provides them with the blue prints and required know-how, and stipulates that the price paid for the components would be reduced over a specified time period to that prevailing in international markets. This scheme nourishes the infant suppliers with all that they need to grow up, but if they fail to do so within a reasonable period of time they are allowed to die.

This scheme is similar to the one in operation, which allows developing countries five years, and the least developed countries seven years to dismantle TRIMS in toto. Instead of the proviso that all TRIMS should be dismantled, it suggests that TRIMS which are geared to promote development objectives should be allowed but with a time constraint.

TRIMS such as those which tie equity participation to exports, though, are much more problematic. These are imposed for narrow balance of payments reasons and not for broader development objectives. In the presence of distortion free markets comparative advantage and market forces would guide the investment allocations of foreign firms. Equity oriented export requirements are put in place to offset distortions elsewhere in the economy, which provide artificial incentives for production oriented towards domestic markets. These restrictions hardly fulfil development objectives . A foreign firm, which does not wish to comply with equity restrictions, may dilute its equity in favour of indigenous suppliers and opt to produce for the protected domestic market. And indigenous capital, whose social opportunity costs could be considerable , will also be oriented towards the protected domestic market. The net result is the creation of rents in a protected markets for both the foreign owned and domestically owned firms. And it would also result in a reduction in trade. There are also instances where foreign owned firms are allowed 100 percent ownership of equity if their entire output is exported. Suppose that export prices are lower than that prevailing in domestic markets and the foreign firm services both markets. In this case the foreign firm operating in the protected domestic market would have an incentive to bridge the price difference between the two markets by raising prices on the domestic market. In essence domestic consumers would provide an export subsidy to the foreign firm. All this and other distortions and social costs these measures impose have been rehearsed often (Greenaway, 1991) These are not measures that promote development objectives and have no place in a compact on FDI.

Then there is an assorted set of incentives offered by developing countries to attract FDI. These include tax holidays , tax concessions and subsidies of various sorts. Most of these incentives are tied to performance requirements of one sort or the other. It is doubtful if these incentives do weigh heavily in the investment decision process of foreign firms. The evidence on the issue is not conclusive. Developing countries may be compelled to offer such incentives only because their competitors for FDI offer them. If none of the countries offer such incentives the location decision of FDI would be based on the resource endowments of host countries , and the climate for efficient operations they provide. Given the nature of these incentives, and the fact that each of the host countries offer such incentives only because others do so, it is likely that they are yet another source of distortions in the market for FDI. It would be in the interests of developing countries to do way with such incentives which only serve to transfer incomes to foreign firms. At the very least they should consent to a set of WTO rules which would limit the distortions incentives generate and eliminate competition between developing countries based on artificial incentives.

Although LCRs, equity and export regulations, and incentives are frequently seen as instruments devised to transfer rents from the multinationals to host countries, they often extend into other areas such as competition policy. Regulations which limit operations of foreign firms to designated regions and areas of host countries, prohibit them from entering designated areas of economic activity and stipulate conditions governing joint-ventures , acquisitions and mergers all fall into the arena of competition policy. These policies go beyond the objective of transferring rents from multinationals to host countries . Here the objective is preservation of economic sovereignty or the retention of national control over production facilities.

This is the principal issue which policy makers are reluctant to discuss and opponents of globalisation make much of. Admittedly debate on these issues cannot be confined to narrow economic considerations such as their impact on resource allocation and economic efficiency of operations of FDI. The concerns of the developing countries have to be heard and rules and regulations devised with a view to preserving the economic sovereignty of developing countries. Whilst exceptions to the general principles of national treatment may have to be conceded , there is no reason why such policies should not be subjected to rules relating to transparency and stability of policy regimes. In developed countries such as the UK there are tried and tested procedures for the adjudication of disputes concerning mergers and acquisitions including cross border mergers and acquisitions. Cases referred to the Competition Commission in the UK are adjudicated on the basis of the impact of mergers on consumer interests and lately on whether or not they interfere with competition in the market place. Admittedly when the concern of the policy makers is not so much with consumer interests or impact on competition, but with loss of control exercised by national governments over the operations of foreign firms the problem is much more complex. In such cases, exceptions to the general framework of rules governing FDI have to be allowed, albeit in the knowledge that host countries may be sacrificing economic objectives for the sake of non-economic objectives. It is though worth noting that much of FDI flows to developing countries are for green-field investments , cross border mergers and acquisitions are, as yet, very much a developed country phenomenon. Mergers and acquisitions of locally owned firms by foreign firms account for around one-third of all FDI flows to developing countries, and these are mostly in East Asia and the Latin American countries. Developing countries such as Malaysia and Korea do have guidelines on mergers and acquisitions, some of these read very much like LCRs. It is worth considering whether or not a generalised framework of regulations on mergers and acquisitions, as opposed to individual country regulations, would be much more effective in promoting both increased flows of FDI to developing countries and its efficient utilisation.

It is worth noting in this context that the GATS accord in the WTO, which is essentially an agreement relating to FDI, as services necessarily entail presence and establishment, provides a framework for a multilateral agreement on FDI. The GATS takes account of many of the concerns of developing countries whist at the same time subjecting trade in services to MFN, national treatment, market access and transparency. Perhaps , the next step would be to extend GATS to cover FDI in other areas. In the past suggestions for a separate agreement on FDI have been made. It may though be judicious to aim at one cohesive set of rules and regulations on FDI which would encompass the GATS accord. The new set of rules to be incorporated would include TRIMS and other national regulations relating to FDI discussed earlier. It would be neither necessary nor practical to establish a separate code of rules for FDI when one already exists in the form of GATS.

Conclusion

This brief paper has argued the case for an agreement on FDI in the WTO. It rejects the argument that the WTO is not the forum for such an agreement, on the grounds that FDI is very much a part of the WTO , it already exists in the form of agreements on TRIPS and TRIMS and trade in services. Furthermore much of international trade which the WTO oversees is generated by FDI. It would make little sense to deny that which already exists in the WTO. But that which exists is patchy and haphazard. The various agreements do no more than tinker at the edges of the problem. A cohesive compact which incorporates TRIMS and GATS under one umbrella should be much more efficient and manageable than that which exists.

The argument that FDI is doing well by market forces cannot be sustained. It may be doing well in terms of the steady growth in the volume of FDI , but it is unevenly distributed amongst the developing countries and there is no reason to believe that it contributes to development objectives everywhere and anywhere. It has the potential to be a major force in development, it is an excellent catalyst of growth and perhaps the one and only tested and tried conduit for the transfer of technology and know-how. But it falls far short of its potential for reasons outlined in the paper. A compact on FDI under the aegis of the WTO should create the necessary investment climate for FDI to fulfil its potential. The argument that FDI involves issues of sovereignty and therefore a multilateral framework should not be discussed or that the time do so is not yet ripe does not also hold water. Any sort of international commerce involves issues of sovereignty. It is unavoidable and the time will never be ripe, the ostrich can't bury its head in the sand forever. The issue has to be met head on. The paper has argued that economic sovereignty can be interpreted in many ways and there is more than one group in developing countries for whom the issue is of interest. The challenge the developing countries face is one of a trade off between economic sovereignty and the fruits that FDI yields. A compact on FDI on the lines suggested in the paper should help resolve this trade off to a large extent.

Finally and most importantly any attempts at forging a compact on FDI based on the thesis that it would facilitate increased flows of FDI and protect the interests of multinationals are unlikely to succeed. The agreement or the argument for an agreement has to be couched in terms which reflect developing country interests, recognises the trade off between sovereignty and gains from FDI they face, and emphasises the potential of FDI for development. A blanket ban on TRIMS will not be acceptable to developing countries nor should a discussion on TRIMS be confined to those TRIMS which impact on trade. The discussion has to be centred on the role of TRIMS in promoting development objectives including rent transfers to developing countries from the foreign firms. Any of the TRIMS which do not satisfy this criteria, irrespective of their trade effects, have to be abolished. In any case, with the growth in the liberalisation of international trade the rationale for TRIMS will fade. Most TRIMS are in existence to counter factor and product market distortions caused by trade policy in developing countries. The compact on FDI should explicitly recognise the interdependence between trade and FDI and this is the most powerful rationale for a compact on FDI under the WTO. No doubt an attempt at forging multilateral rules on FDI will extend the remit of the WTO beyond its traditional role as the guardian of fair trade or rules based trade, but such is the nature of the beast that a wider role for the WTO has to be accepted.

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