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Regionalism, Foreign Investment and Control: The New Rules of the Game Outside the WTO

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Very recent trends in the international economy suggest a shift in the nature of imperialist involvement with the multilateral rules and institutions governing trade and finance. As WTO negotiations are becoming more difficult for the main developed country players to control in the same manner as before, regional and bilateral deals have become the preferred framework for determining patterns of cross-border trade and investment, and for enforcing liberalisation and opening markets in developing countries for multinational capital based in the industrialised nations. Such a shift has both negative and positive implications for the potential for autonomous trade and industrialisation strategies of developing countries. While the recent regional and bilateral deals involving major developed countries along with weaker developing countries have been unequal and have involved even more sweeping opening of markets than is required by the WTO, the uncertainties created by the greater reliance upon such arrangements creates some space for engaging in more South-South deals across developing countries, which may have the potential over time to reduce the domination of large capital from the major developed economies in global trade and investment.

In this brief paper, some of these issues are explored further. In the first section, very recent trends in international trade and FDI are described. The second section considers the emerging pattern of bilateral and plurilateral trade agreements, or FTAs, that now cover the greater part of world trade and FDI. The final section contains an assessment of the international political economy of such changes, and the implications for autonomous development trajectories in the South.

I

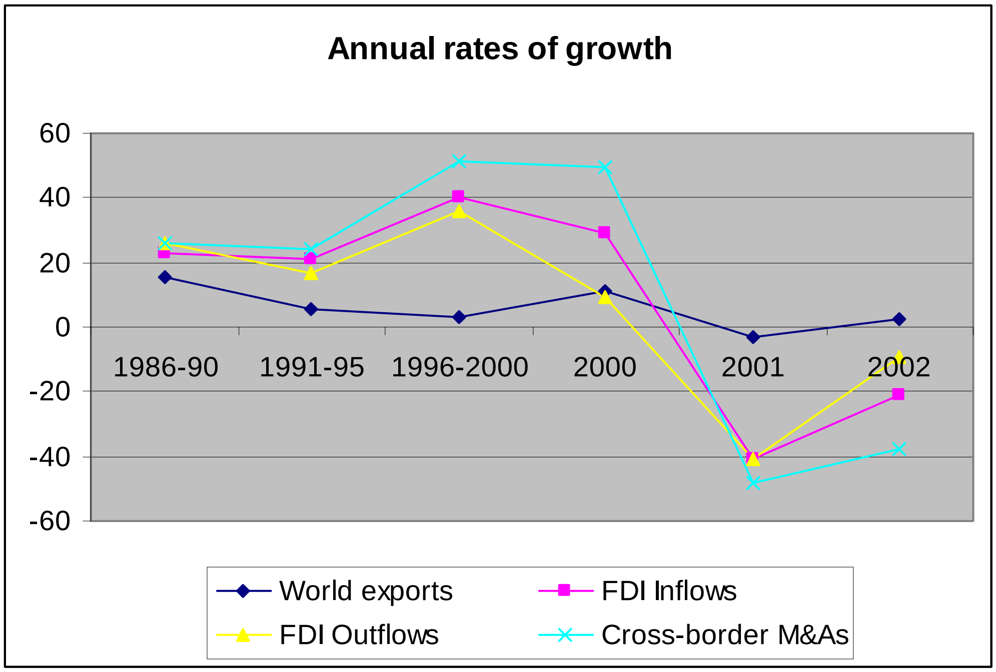
It is now commonplace to believe that international investment drives international trade, in ways that were not recognised in the past. Traditionally, economists considered FDI and trade to be two separate and distinct economic activities, as substitutes rather than complements. However, the expansion of relocative FDI especially from the 1980s onwards allowed for the recognition of a more complex relationship between FDI and trade, such that they are seen to be both (and often simultaneously) substitutes and complements. Such relocative FDI in turn is itself the result of a combination of technological improvements and organisational changes which have allowed for the splitting up of various parts of the production process in a range of manufacturing and service activities, have encouraged the spatial disintegration of production across often distant locations, and have intensified the vertical concentration of management and ownership, such that large firms can now take advantage of global or regional economies of scale along with exploiting national differences in factor costs.

Relocative FDI relies on cheap labour advantages or other benefits to be derived from outsourcing, and these are both typically associated with increases in trade across the concerned economies. Labour-seeking FDI has been found to increase trade in both home and host countries, while outsourcing induces imports of capital goods, components and other intermediate goods and exports of finished products, in the host countries. It has even been found that resource-seeking FDI increases cross-border trade, because of the imports of machinery and equipment required for the investment project, although such trade expansion is usually of shorter duration and involves less benefit to the host country. Of course, FDI directed to host country markets can have an anti-trade bias, although it is usually associated with higher levels of imports of capital goods and other inputs.

It was the expectation of realising the benefits of the positive linkages described above, which created the optimism surrounding FDI in the early years of the recent globalisation phase of international capitalism. Across the world countries were induced (or pressurised) into liberalising rules for both trade and investment, on the grounds that this would lead to a virtuous cycle of expansion of economic activity. It was also felt that the two would feed into each other positively, generating dynamic productivity growth and assisting in the convergence of incomes across rich and poor nations involved in this process.

The experience of the past two decades suggests that this has not been the case, and that global economic disparities have increased in consequence of the opening up of developing country markets and the resulting competitive difficulties of smaller producers in the developing world, as well as the volatilities and periodic crises caused by financial market gyrations. However, even the picture of the trade-investment link appears to be muddier than expected for the recent past, as Chart 1 indicates. At least over the 1990s, there was no clear-cut relationship between export growth and changes in FDI flows.

Chart 1: Annual rates of change of exports (of goods and services) and FDI flows



Source: World Investment Report 2003

It is also clear from Chart 1 that FDI flows decreased dramatically after 2000, and that this was strongly related to the pattern of mergers and acquisitions. A closer look at the data reveals that the huge expansion of FDI in the late 1990s was driven by M&As fuelled by the privatisation drive in many countries, as large multinational corporations snapped up important state assets in a range of public services and utilities. Since most of the FDI was concentrated in such (often non-tradeable) sectors and in acquisition of existing assets rather than greenfield investment, it is hardly surprising that the effect on exports was limited. The peaking of the privatisation process was inevitable – most of the countries which indulged in it now have very few government assets left to sell. But it has also made more transparent, the precise nature of the global integration which was being effected through such FDI.

As Table 1 shows, while aggregate FDI flows peaked, declined and have remained stagnant in the very recent past, almost all of the important host countries or regions have experienced a downturn. China was the only major recipient economy that did not show such a decline, for very specific reasons, and was also the only economy where greenfield FDI accounted for the dominant part of such flows. Apparently, the impetus to most worldwide FDI in the second half of the 1990s (when such flows peaked globally) came from the possibility of corporations acquiring public assets through purchase in the wake of privatisation; once this impetus lost its force because the limits of privatisation were reached, FDI flows have been receding.

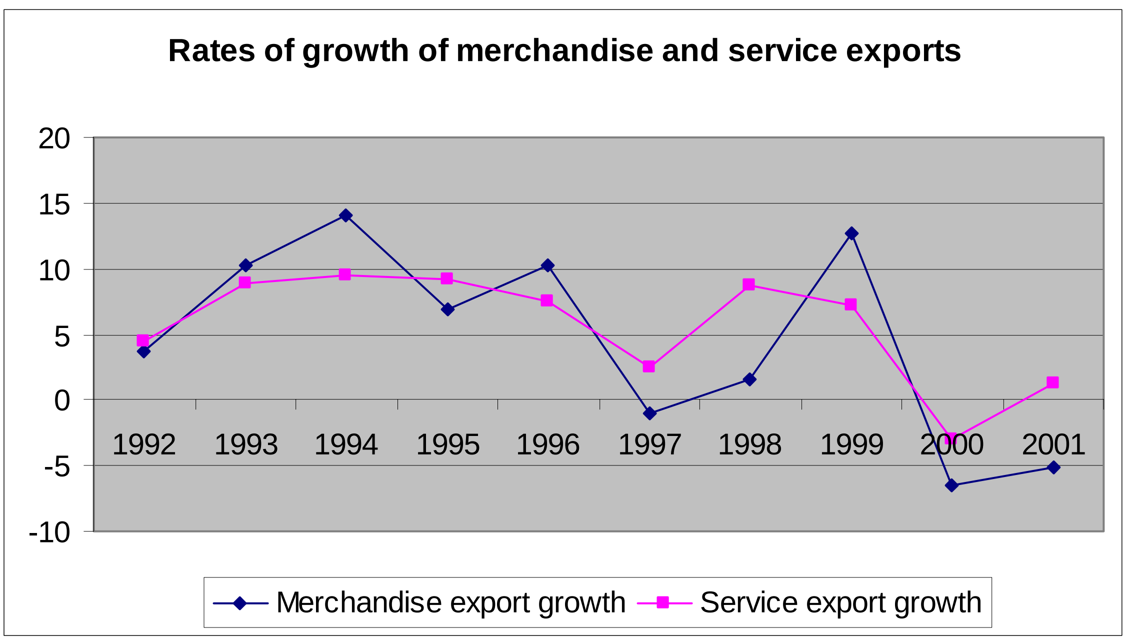
Table 1: FDI Flows into major economies
($ billion)

	2001	2002	2003
European Union	389.4	374.4	341.8
United States	144	30	86.6
Latin America	83.7	56	42.3
Brazil	22.5	16.6	9.1
Mexico	25.3	13.6	10.4
Africa	18.8	11	14.4
Asia	106.9	95.1	99
China	46.8	52.7	57
Hong Kong	23.8	13.7	14.3
India	3.4	3.4	3.4
Central & East Europe	25	28.7	30.3

Source: UNCTAD Handbook of Statistics

Meanwhile, the experience with trade expansion has also been less exciting than was expected by the proponents of globalisation. Chart 2 describes annual rates of growth of trade in goods and services. The two move together. Further, contrary to current perception, services trade does not appear to have increased at a very much faster rate than general merchandise trade. Both are clearly influenced by international business cycle patterns. The post-1999 slowdown in world trade has not yet really reversed itself, despite the massive fiscal expansion in the US which has created a mini-recovery in that economy very recently. Thus, world merchandise exports declined in absolute value terms in 2000 and 2001, and have continued stagnant thereafter. Services exports also declined in 2000, and subsequently have increased only marginally.

Chart 2: World export growth rates in the 1990s



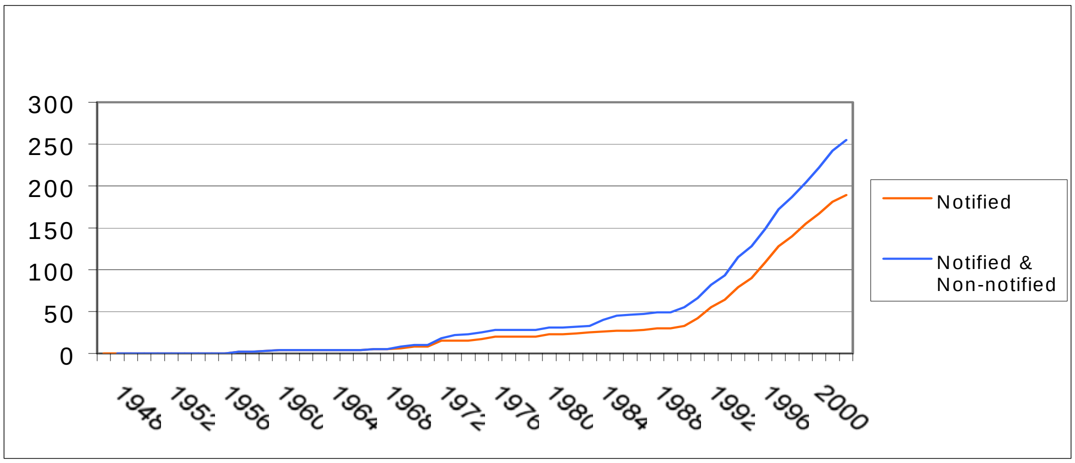
Source: www.wto.org

Clearly, therefore, the promises of the 1994 Uruguay Round Agreement and the WTO have been belied, in terms of failing to generate a sustained expansion of world trade. The reasons for this are well known and are being covered by other papers in this conference. Of course, these patterns in turn have specific features which have generated much more discontent, such as the nature of world agricultural trade, and which have contributed to the slackening pace of negotiation-induced liberalisation through the WTO. It is in this broad context that recent moves towards bilateral and regional agreements must be assessed.

II

The period of globalisation has also been the period of very intensive regionalisation. Regional trade agreements (RTAs) have proliferated at an unprecedented rate compared to previous decades. By the end of 2003, nearly 290 RTAs had been notified to GATT and subsequently to the WTO. Of these, more than 190 are estimated to be in force, and another 60 or so are estimated to be operational but not yet notified. As Chart 3 indicates, the real explosion in RTAs began in the early 1990s, and since January 1995 149 RTAs have been notified to the WTO. The most common category is the free trade agreement (FTA) which accounts for 70 per cent of all RTAs. Partial scope agreements and customs union agreements account for 23 and 7 per cent, respectively. Bilateral agreements dominate in number. All of the WTO's current 146 members, with the sole exception of Mongolia, are either participating in or are actively negotiating RTAs. As a result, the WTO estimates that three-fourths of world trade is currently conducted under bilateral or plurilateral agreements.

Chart 3: RTAs notified to the GATT/WTO (1948-2003)
and non-notified RTAs, cumulative, in force



Source: www.wto.org

Interestingly, in terms of sheer number, developing countries and the countries of Europe are involved in far more RTAs than the US. But it is not necessarily the number of RTAs in which a country participates that is of significance, but the proportion of world trade that such RTAs cover. Thus, while the United States participates in only 3 of the 190 FTAs notified to the WTO as of December 2003, the size and importance of the US economy mean that these FTAs account for a significant share of world trade. For example, in 2002, intra-NAFTA merchandise imports accounted for 9 per cent of world imports and intra-NAFTA merchandise exports accounted for 10 per cent of world exports.

What is more significant is that in the recent past the US and the EU have turned to aggressive promotion of RTAs, and this tendency is now accentuated after the failure of the Cancun Ministerial Meeting of the WTO. Already in 2003 three new trends were apparent with respect to regionalism. First, several countries that were traditionally reliant on the multilateral route have been increasingly turning to RTAs. Second, countries already engaged in RTAs for some time have been looking for new or additional partners, sometimes across distant regions or continents, unlike in the past. Third, there are moves towards the creation of mega-blocs, such as the FTAA or the Euro-Mediterranean FTA, both of which are still under negotiation and both of which attempt to link large numbers of countries in continent-wide groupings.

These moves have been led by the US and the EU, but other countries such as Japan have also initiated efforts to expand FTAs in the region. Meanwhile, there are also efforts by developing country groupings to expand and take on new members or partners with "observer" status, and for particular regional groups to form links with each other, such as the recent moves of Mercosur to forge alliances with Asian countries and trading blocs.

However, all these different moves towards RTAs should not presented as being similar or on par. There is a world of difference between RTAs (especially bilateral agreements) that are initiated and pushed through by the major developed country governments under the influence of large capital, and attempts to forge trading blocs in developing countries in order to resist the hegemony of large powers in world trade. Bilateral and regional agreements are currently being used, most aggressively by the US but also by the EU, to force developing countries to make deeper trade and investment commitments than is now possible multilaterally, given the divisions in the WTO. Such agreements can then become a means of leverage in the WTO as well, allowing the large players to get more developing countries to accept multilaterally what they have already acceded to on a bilateral or regional basis.

This is graphically illustrated by the number and content of bilateral investment treaties that are being signed separately or are increasingly included in RTAs in which the US or the EU is involved. The treatment of investment rules in such treaties is of special significance given the previous failure to impose investment rules in the WTO, and the continuing insistence by the EU on the Singapore Issues, especially investment and competition policy, in the stalled WTO negotiations. There is no doubt that once a substantial number of countries have signed or accepted even more sweeping provisions with respect to investment in bilateral or regional deals, they will find it much harder to resist MAI-type agreements at the WTO, and may even prefer a situation in which they are all in the same adverse situation together, rather than being individually "picked out".

Increasingly, investment rules which give very great powers to multinational capital and reduce the power of host country governments, have been included in RTAs that were recently signed or are being negotiated. For example, NAFTA, APEC and FTAA all contain very substantive and wide-ranging investment provisions that give great protection to corporations. The typical content of such provisions covers issues and rules such as non-discrimination, expropriation, minimum standard of treatment, transfers, performance requirements, establishment, and investor state dispute settlement.

Earlier, NAFTA was widely believed to be the most stringent application of such investment rules. Chapter 11, NAFTA's powerful investment chapter, provides foreign corporations with rights to sue governments for enacting public policies or laws which they claim to affect their profitability. There is no provision for exception even for such goals as safeguarding the environment, protecting the health and safety of citizens, supporting small businesses or maintaining and increasing employment. Under the investor rights guaranteed in the agreement, investors are allowed to demand compensation for "indirect expropriation". This has been interpreted to include any government act, including those directed at public health and the environment, which can diminish the value of a foreign investment. These cases are adjudicated by special tribunals, bypassing the legal system of all three member countries. Already, suits with claims amounting to more than $13 billion have been filed by large companies. In a typical case in 2000, the Mexican government was ordered to pay nearly $17 million to a California firm that was denied a permit from a Mexican municipality to operate a hazardous waste treatment facility in an environmentally sensitive location.

However, while the regional agreements such as NAFTA have received some amount of adverse publicity, the numerous bilateral deals that are been signed have been subject to very little public scrutiny, even though they can go much further. This is especially the case with bilateral investment treaties (BITs) which often receive no international attention and are often not even considered seriously in the legislative bodies that can veto such agreements in individual countries. Over 400 wide-ranging bilateral treaties were signed in before 1995, but these mostly managed to avoid the public eye. However, from the mid-1990s, after the WTO came into existence, there has been an upsurge of such treaties. The number of bilateral investment treaties increased by five times in the 1990s from 385 in 1989 to 1,857 at the end of 1999. By 2002 there were estimated to be 2,200 BITs in operation.

The main provisions of such treaties tend to be broadly similar to those in the abandoned OECD Multilateral Agreement on Investment (MAI), and sometimes they are even more stringent. They usually cover aspects such as the scope and definition of foreign investment; admission of investments; national and most-favoured nation status; fair and equitable treatment clauses; compensation guarantees for expropriation, war and civil unrest; guarantees of fund transfers and the recuperation of capital gains; subrogation of insurance claims; and dispute settlement provisions.

These have far-reaching and typically negative implications for host country governments and citizens, because of the sweeping protections afforded to investors at the cost of domestic socio-economic rights and environmental standards. A common concern about investment agreements is that they subject countries to the risk of litigation by corporations from or based in another country which is a signatory to the same agreement. This might be based on a company's objections to the host government's environmental, health, social or economic policies, if these are seen to interfere with the company's "right" to profit.

These adverse effects are already becoming evident in the increasing litigation which is facing developing country governments who seek to safeguard citizens' rights. For example, the multinational infrastructure company Bechtel (which also deals in water supply services) is currently suing the Bolivian government under a 1992 Holland-Bolivia BIT for loss of profits after the reversal of Cochabamba's disastrous water privatisation following a popular uprising in the area. A number of other developing or formerly socialist countries are facing such disputes brought by multinational companies, ranging from Pakistan to the Czech Republic.

The resolution of such conflicts is not subject to the standard juridical systems of the member countries – rather it is governed by tribunals or similar bodies specified in the treaty. This amounts to the privatisation of commercial justice, with no democratic accountability of the decision makers in this regard. In many bilateral agreements, the provisions state that where a dispute cannot be settled amicably and procedures for settlement have not been agreed within a specified period, the dispute can be referred to another body. The two most important such bodies are the World Bank's private arbitration body for investment disputes, the International Centre for Settlement of Investment Disputes (ICSID) or the UN Commission on International Trade Law (UNCITRAL). Under NAFTA, complainants (usually the dissatisfied investors) are allowed to choose between these two bodies.

Domestic courts and national legal systems are completely marginalised by investors' recourse to these international arbitration panels. ICSID and UNCITRAL only allow for the investor and government parties to the dispute to have legal standing. The public has no right to listen to proceedings or to view evidence and submissions. Both bodies require only minimal disclosure of the names of the parties and a brief indication of the subject matter, which prevents public scrutiny or popular opposition. The record of these bodies thus far has been very investor-friendly, in awarding substantial damages and compensation to multinational corporations for "transgressions" of developing country governments. Under these conditions, there is clearly little incentive or need for international investors to settle disputes amicably, given the highly favourable outcomes for corporations which have initiated proceedings under such agreements.

However, even these BITs do not indicate the full extent of liberalising commitments being forced upon developing countries through bilateral and regional agreements. Many bilateral free trade agreements (FTAs) not only contain similar investment provisions, they also enforce significant coverage of sectors like services, intellectual property, government procurement, and agriculture. Typically, most of these provisions go well beyond WTO commitments, as in the recent US bilateral trade and investment treaties with Chile, Cambodia, Thailand and Singapore.

These so-called FTAs have what are known as "NAFTA-plus" broad definitions of investment, which make it even easier for disgruntled investors to take a case to one of the dispute tribunals. Intellectual property provisions go much further than the WTO's TRIPS agreement. They include limitations on countries' ability to do compulsory licensing, extension of a drug company patent term beyond twenty years, and a 5-year term of data exclusivity. These rules very clearly threaten public access to affordable medicines, including life-saving HIV-AIDS drugs. Under the US-Vietnam bilateral trade agreement, which is supposed to be only sectoral because (conveniently for the US) it does not cover textiles and textile products, US firms get wide market access to Vietnam's market for financial, telecommunications, distribution, audio-visual, legal, accounting, engineering, computer, market research, construction, educational, health and tourism services. Local competitors are likely to be forced out of business. US companies will also get enforceable protection against expropriation. Local content and export performance requirements will be completely eliminated, while US firms will get full trading rights.

In addition, the services liberalisation envisaged in many of these bilateral trade agreements not only goes much deeper than GATS but would also be implemented much faster. The trend is for including more services and asking for substantive liberalisation in particular sectors of direct export interest to the more powerful partner. The EU's recent agreement signed with Mexico has a larger scope with respect to services than any other agreement the EU has ever concluded with a third country, and even exceeds the services, investment and intellectual property provisions in the NAFTA agreement.

III

We may be living in a world economy in which the use of multilateral means by imperialism to further its own aims, is reaching the end of the road, at least for the time being. Widespread popular dissatisfaction across the world with the workings of the WTO and the newfound strength of some developing countries that are willing to work together to prevent complete domination by the developed country groupings in the WTO, have made it a tougher and harder place for imperialist agendas to be pushed through. This does not mean that imperialist strategies at forums such as the WTO have come to an end. Rather, it suggests that these interventions at the multilateral level are now likely to be combined and buttressed with other forms of ensuring control and accessing markets across the world.

Hitherto, large capital based in the US and the EU has dominated the development of the WTO; and it is now leading the trend in which government of these countries strive to achieve their goals through other means, using whatever avenue, including bilateral trade and investment deals, that best suits their current purposes. This has direct implications for the nature of resistance to imperialist globalisation. It means that much greater public vigilance and mobilisation are required within developed and developing countries, to prevent or reverse the signing of such extremely problematic bilateral or regional agreements, and that a focus only on the WTO negotiations may be counter-productive.

However, it is also true that the cracks in imperialist unity, which has hitherto been crucial in maintaining the present hegemonic pattern, are becoming more significant. It can plausibly be argued that the breakdown of the Cancun talks had as much to do with disagreement within the imperial bloc, and in particular between the US and the EU, as with resistance from some developing countries and from civil society. Such fissures are likely to grow, and indeed they provide an underlying motivation behind the competitive rush for bilateral or regional agreements instigated by these two powers.

In addition it is clear that international capitalism today is not capable of preventing generalised deflation and pervasive unemployment across the world, because of the dominance of finance, the nature of the "leader" in the system (the US) and the pattern of concentration of assets, which are all inhibiting more generalised economic expansion. Given this background, it is to be expected that international institutional arrangements which have been in place for some time or even those which have been set up recently, will no longer be able to achieve their stated or unstated goals, and will be subject to a great deal of flux and conflicting pressures. In consequence, the world economy probably faces a period of instability and confusion, as earlier rules of the game are effectively abandoned or sought to be rewritten. This is not necessarily an adverse tendency for developing countries: historically, it is precisely these phases of capitalism which have provided some freedom and opportunity for less developed countries to achieve some degree of autonomous industrialisation. It also provides more opportunity for people across the world to attempt to change both international institutional arrangements and the political economy tendencies in their own countries, towards more democratic alternatives.