THE MULTILATERAL AGREEMENT ON INVESTMENT IS TEN YEARS OLD

BY ALAN M. RUGMAN

The Multilateral Agreement on Investment (MAI) is being negotiated in Paris at the Organization for Economic Co-operation and Development (OECD). Negotiations started in May 1995 and should have been completed in May 1997;

Despite criticism of the MAI by Canadian economic nationalists, the MAI will not bring any significant economic or political changes to Canada. The reason is very simple: Canada already has a MAI with the United States (it is called the Free Trade Agreement (FTA)).

now May 1998 looks like the probable completion date. Despite criticism of the MAI by Canadian economic nationalists, the MAI will not bring any significant economic or political changes to Canada. The reason is very simple: Canada already has a MAI with the United States (it is called the Free Trade Agreement (FTA)).

THE MAI IS BASED ON THE FTA

The investment provisions of the FTA as agreed to ten years ago (in October 1987) are the basis of the draft MAI. The NAFTA investment provisions of 1993 were based upon the FTA and these NAFTA investment provisions are identical in all major respects to those in the draft MAI. For example, both the FTA and NAFTA incorporate the key principle of national treatment, i.e., equal access for foreign (U.S.) investors to the Canadian market (but according to Canadian rules). In return, Canadian investors have equal access to foreign (U.S.) markets, on host country rules. Both the FTA and NAFTA also have exemptions from national treatment for important Canadian sectors, including the big five of health care, education, social services, cultural industries, and transportation.

The MAI is being negotiated along the same lines; countries have already agreed to the national treatment principle but they disagree over the number and type of exempted sectors. The Canadian government has stated that it will continue to insist on exemptions for the five sectors, especially culture, and that the logic of the FTA/NAFTA will be used as a model for the MAI. The underlying structure of the FTA, NAFTA, and MAI is now well understood by Canadians as a clever balance between the pressures of globalization (national treatment) and the need for sovereignty (exempted sectors).

DEEP INTEGRATION

The current challenge in international trade negotiations, somewhat paradoxically, is to negotiate investment rules rather than trade rules. This is because, through seven GATT rounds, and important bilateral agreements such as the FTA, the best known barriers to trade in the form of tariffs have already been reduced to a trivial hurdle, even when calculating effective rates of protection (which takes into account the value-added and labour component of the protected good).

While 54% of Canada's FDI stock is in the United States (and thereby already has national treatment), the MAI will be very useful in setting stable rules for the rapidly increasing stock of Canadian FDI elsewhere, especially in the European Union and Asia.

Today, the bulk of international business is not done by trade in goods, but through services and investments. Over 70% of North Americans work in the service sector, with only 30% in manufacturing. So the new agenda for international agreements is to negotiate rules for trade in services and for international investment. The "shallow" integration achieved by reducing tariff barriers to trade in goods is being replaced by "deep" integration through foreign direct investment (FDI), trade in services, and the international networks of multinational enterprises.

THE CONTENTS OF THE MAI

The structure of the MAI follows that of NAFTA, and is built upon the following platform:

1. Principle of national treatment, with lists of exempted sectors;

2. Transparency, i.e., all regulations on investment are identified as are all exemptions to the principle of national treatment;

3. Dispute settlement mechanisms, to permit individual investors (and companies) to appeal against government regulations and bureaucratic controls;

4. Movement towards harmonization of regulations, although in the areas of competition policy and tax policy not much progress can be expected in the MAI (and none was achieved in NAFTA).

In the draft MAI all of these four areas have been addressed, and a reading of the various drafts shows that the structure of the MAI is based upon NAFTA's investment provisions, as was predictable. The aim of the MAI is to make domestic markets internationally contestable, by providing a basic set of rules for FDI, to which all member countries sign on. The OECD in Paris is the appropriate venue to negotiate the MAI as 98% of all the world's FDI is conducted by multinational enterprises (MNES) based in the 23 member countries of OECD, i.e., all of Western Europe, North America, Japan, Korea, Australia, and New Zealand. There is some opposition to the MAI in a few third world countries, but until the World Trade Organization gets moving on investment issues, there is no practical alternative to the OECD as a venue for the MAI.

THE MAI OPENS DOORS FOR CANADIAN INVESTMENT

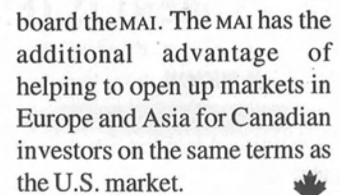
The MAI is not a bad-news but a good-news story. The other side of the national treatment coin is that Canadian outward FDI will be encouraged by a MAI. Indeed, as a non-member of the triad (the United States, European Union, and Japan,) Canada is a small, open economy dependent on access to triad markets. Today this access is more often

continued on page 24

achieved through FDI than through trade (although FDI and trade are highly positively correlated). While 54% of Canada's FDI stock is in the United States (and thereby already has national treatment), the MAI will be very useful in setting stable rules for the rapidly increasing stock of Canadian FDI elsewhere, especially in the European Union and Asia. The MAI, in this sense, should help Canada to continue to diversify its outward FDI away from the United States. Of particular relevance in the MAI will be investment rules to ensure Canadian business has stable access to the European Union in resource-based sectors such as forestry products (where there has been a wave of protectionism in the last four years). The MAI should also help to open up the Japanese, other Asian, and Latin American markets for Canadian FDI.

CONCLUSIONS

In general, because investment has a long-term time horizon, business people need to be assured that political risk is low. New and capricious investment regulations deter FDI and thereby reduce global economic efficiency. Canada has mitigated the worst excesses of left-wing economic nationalism through the investment provisions of the FTA and NAFTA. The MAI is the icing on the cake of globalization for Canada. In short, the MAI is a good-news story. The NAFTA is such an advanced trade and investment pact that it is being used as the model for the MAI. Given that Canada has survived quite well for the last ten years under the investment provisions of the FTA, it is well-placed to take on board the MAI. The MAI has the additional advantage of helping to open up markets in Europe and Asia for Canadian investors on the same terms as the U.S. market.



Alan M. Rugman is Professor of International Business at the Joseph L. Rotman School of Management, University of Toronto. He is on leave as Thames Water Fellow of Strategic Management at Templeton College, University of Oxford.

EDITORIAL

FROM THE HAVANA CHARTER TO THE MAI: INTERNATIONAL INVESTMENT REGIMES

BY DANIEL DRACHE

FIRST THE HISTORY LESSON

The year is 1948. The policy elites from more than fifty countries have come to Havana to put the finishing touches on an all-encompassing proposal to finalize the details of a multilateral investment regime that is the first of its kind. It is comprehensive, forward-looking, and equitable, with "high standards" for the liberalization of investment protection and trade expansion.

Almost all major powers are "present at creation"; those with mixed economies as well as *laissez-faire* ones, the developed no less than the underdeveloped, the imperialist world as well as the colonized. At the table is a highly diverse group of nations including India, Egypt, China, Mexico, Sweden, Portugal, Canada, and the United States, to name but a few. Only the Soviet bloc absents itself, but it too has been present behind the scenes. When ratified, this legal instrument was to become the Charter for the International Trade Organization, the international institution designated to oversee the world's trading system along with the World Bank and the IMF.

At Havana, the U.S. chief delegate signed the final document; but American investors at home and their Republican allies in Congress opposed its provisions, which gave capital-importing countries rights to control investment flows.

So what happened to the Havana Charter? In a word, its fate was decided by U.S. trade politics. Congress killed the broadest multilateral international investment agreement that had ever been negotiated. At Havana, the U.S. chief delegate signed the final document; but American investors at home and their Republican allies in Congress opposed its provisions, which gave capital-importing countries rights to control investment flows. And that was that. Most experts treat Havana as a failed episode in international relations of little relevance for today. But they are woefully wrong.

TWO CRITICAL ELEMENTS

In the rear-view mirror of history, two ideas stand out. First, at the time there was a solid international consensus that a trade and investment regime had to be more than an abstract set of rigid legal principles to defend investors' rights at any price; rather, it had to be functional, efficient, and practical. Nothing less would "ensure the workability of the new order". So the countries of the world chose non-discriminatory trade and, by the end of the negotiations, decided to make foreign direct investment accountable as the lynchpin of international governance. [See box on p. 25, *Key Dates in the Regulation of Foreign Investment*, for the long-term effects of this decision.]

Secondly, as the framework agreement for a new age, it could not be a system of pure commercial gain designed primarily to advance the free enterprise principle. Instead, investment rights had to accommodate the full employment obligation that all states accepted as the cornerstone of the world trading system. Further, countries had to make an equal commitment to eliminate all forms of arbitrary and discriminatory barriers that the state and market actors routinely erected for public or private profit.

Finally, the theoretical understanding behind the Ha-

continued on page 26