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Contents

FDI and development: what is the role of international rules and regulations?

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The "Doha Development Round" of trade negotiations has opened new debates – and reopened old ones – about the appropriate role of international rules and regulations to govern foreign direct investment. How and when might non-discriminatory and most-favoured-nation treatment be extended to foreign investors? Should the World Trade Organization be used to enforce minimum standards of worker treatment in the plants of international investors and their suppliers? What are the advantages and disadvantages of revising the dispute settlement mechanism of the World Trade Organization on investment issues to replicate the arbitration procedures in bilateral investment treaties? Negotiators who must grapple with these broad questions are not best served by a simple reiteration of assertions about the desirability or undesirability of specific negotiating proposals. Rather, in rethinking possible trade-and-investment negotiations in the aftermath of the collapse at Cancun, they need a fresh effort to synthesize the most recent investigations of how to maximize the benefits – and avoid the dangers – of utilizing foreign direct investment for development. This effort must begin by looking at the latest evidence about the positive – and negative – impact of foreign direct investment on the growth and welfare of host countries in the developing world, with a view to reassessing what policies best serve the interests of the recipient countries. It requires examining how lesser and least developed countries might work their way into the circle of host economies that have successfully used foreign direct investment to enhance their growth, and determining whether they must lower their labour standards to do so. It requires dissecting the controversies surrounding Chapter 11 of the North American Free Trade Area to see what light might be shed on the trade-and-investment agenda in the Doha Round.

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Introduction

To attempt an ambitious – perhaps overly ambitious – synthesis of the role of international rules and regulations in affecting foreign direct investment (FDI) and development, this article is divided into five sections. The first one examines new findings about the relationship between FDI and development – within the growing critique of the old "Washington consensus" and the growing concerns about "globalization" – and explores the opportunities and hazards associated with using FDI for growth.

The following section then asks whether relatively poorer countries are fated to be left outside the ranks of those that can successfully harness FDI for development. It examines whether the same host-country policies – and the same international regulations to govern those policies – serve the interest of developing and least developed countries, or whether developing and least developed countries should be accorded "special and differential" treatment.

But attracting FDI to poor countries is hardly appealing, if it entails grave mistreatment of the workers employed in foreign affiliates. The next section examines whether countries with lowest-skilled workforces must engage in a race-to-the-bottom in labour standards as they try to get launched with exports of labour-intensive products like garments and footwear. It investigates whether poor worker treatment might give host countries an "unfair" advantage in attracting FDI and penetrating export markets for labour-intensive products.

Building on the concerns about least-skilled workers, the subsequent section examines the proposal to use the World Trade Organization (WTO) to enforce compliance with rules ensuring reasonable and acceptable treatment of workers. It contrasts a WTO-based enforcement system with the burgeoning voluntary codes of conduct and monitoring arrangements for the affiliates of transnational corporations (TNCs) and their suppliers.

Drawing on the materials in the preceding sections, the following one scrutinizes specific issues included in the Doha trade-and-investment agenda, including non-discrimination and most-favoured-nation (MFN) treatment for investors, dispute settlement and arbitration, compensation, and the right to regulate in the public interest. It examines experiences with Chapter 11 of the North American Free Trade Area (NAFTA) to suggest what might be more advantageous – and less advantageous – modalities for multilateral supervision of investor-host country relations. It concludes with an assessment of what might be most beneficial, and what might most realistically be accomplished, in the Doha Round.

FDI and development: the context for designing rules and regulations

The presumed benefits from globalization – from the growing flows of goods, services, capital, and technology across borders – are being subjected to increasingly critical scrutiny. The "Washington consensus" is being deconstructed and ridiculed.[1]

This article deals with one dimension of globalization: the spread of FDI, as TNCs explore for natural resources, build infrastructure, and establish plants and factories in developing countries. It looks at one element of the "Washington consensus", the presumption that FDI is an unequivocal good (as long as the investors do not pollute the environment or engage in blatantly harmful treatment of workers), and the more FDI the better.

This article begins with the most basic question: is FDI good – or bad – for development?

The answer is "yes".

[1] Stiglitz, 2002.

A careful assessment of the impact of FDI on the growth and welfare of recipient countries in the developing world does not simply yield "mixed results". A careful assessment of the impact of FDI on the growth and welfare of recipient countries in the developing world yields – in some cases – very positive results, and – in other cases – very negative results.

What accounts for the difference in outcomes? And what might be the role of international rules and regulations in avoiding the negative outcomes and promoting the positive?[2]

FDI in natural resources – in oil, gas, copper, nickel, bauxite, gold, diamonds, iron ore, and other minerals – can have a dramatic impact on the balance of payments and the tax revenues of the host country where the natural resources are found. The conventional wisdom for decades has been that abundant natural resource endowments that could be exploited by FDI – if TNCs utilized responsible environmental practices – should be considered an unambiguously positive factor in host country development.

Quite at odds with this conventional wisdom, however, has been the discovery that abundant natural resource endowments are – in general – negatively correlated with host-country growth rates (Sachs and Warner, 2001).

One hypothesis for why this is so has been the possibility that the ability to export oil or copper or other minerals leads to an overvalued exchange rate that suppresses the prospects for other competitive local industries; this is the so-called "Dutch