

Foreign Direct Investment Regulation: A brief History

HAVANA CHARTER OF 1948



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Overview

- ▶ No multilateral agreement on investment but a patchwork of Bilateral Investment Treaties and Preferential Trade Agreements.
- ▶ First and Second World Wars caused by protectionism and beggar thy neighbor policies
- ▶ Necessitated the negotiation of a more liberal and multilateral framework on economic regulation
- ▶ In Africa South Africa together with the then Southern Rhodesia were original parties to the negotiations that gave birth to the Brettonwoods Institutions.
- ▶ The Havana Charter of 1948 was one of those post WWII agreements which was aimed at liberalising trade and investment and result in the International Trade Organisation
- ▶ The Havana Charter contained investment provisions.



Challenges of the Havana Charter

- ▶ Conflict in normative standards between developed and developing countries.
- ▶ For instance Art. 11 provided thus: ' No member shall take unreasonable or unjustifiable action against investment'. **(Moderate position)**
- ▶ Article 12 in contrast read: ' Members have the right to take appropriate safeguards against foreign investment and to determine whether and to what extent and upon what terms it will allow future foreign investment'. **(Developing country view)**
- ▶ Article 12.2 read ' Members undertake to provide reasonable opportunities for investments acceptable to them and adequate security for existing and future investments and to give due regard to the desirability of avoiding discrimination as between foreign investments' (non-discrimination, pre-establishment rights) **Developed country view**



Challenges (Ideological)

- ▶ The Havana Charter reflected the ideological and normative differences between developed (capital exporting) and developing (capital importing) countries.
- ▶ These differences had played out between the relationship of the US and Mexico about half a century before.
- ▶ The Havana Charter had to be abandoned because of these differences.
- ▶ Business groups opposed the Charter.
- ▶ The US also withdrew from the Charter. The GATT which was focused on a reduction of tariffs succeeded.



Post Havana Capital Exporting Country Efforts at FDI Regulation

- ▶ After the failure of the Havana Charter to have a multilateral agreement on investment they were further efforts by various organizations and institutions to influence the regulation of foreign investments at a multilateral level.
- ▶ The International Chamber of Commerce, a pro FDI institution drafted Guidelines for International Investments. These were perceived by developing countries as being too pro foreign investors.
- ▶ Lord Shawcross was requested by Germany to draft what became known as the Abs-Shawcross Convention which was later submitted to the OECD



Developing Country Efforts at Multilateralising FDI Regulation

- ▶ Decolonisation period and the coalition of developing countries through groups such as the Non Aligned Movement.
- ▶ New International Economic Order with its emphasis on permanent sovereignty over resources
- ▶ A rise of anti-FDI NGOs
- ▶ Developing countries pushed for the United Nations Commission on Transnational Corporations. The UNCTC tried to develop codes on FDI but these were opposed by developed countries
- ▶ The Berlin Wall fell, communism was defeated both in Russia and Germany, Mandela came out of prison
- ▶ Rise of the Washington Consensus and developing countries competed for FDI and abandoned their push for regulation.



Multilateral Agreement on Investment

- ▶ The honeymoon of the Washington Consensus began to subside in the mid to late nineties
- ▶ Developing countries began to be wary of FDI and skeptic of the globalization winds after the Asian crisis
- ▶ Developed countries secretly negotiated a Multilateral Agreement within the OECD. The idea being to present the deal to developing countries as a done deal. And later take it to the WTO.
- ▶ Opposed by civil society and even some developed countries.
- ▶ MAI was then abandoned in 1998.



Main Characteristics of the MAI

- ▶ Premised on that all FDI is good for economic development and needs protection
- ▶ Right of establishment
- ▶ Pre-entry national treatment
- ▶ National treatment after entry
- ▶ Prohibited performance requirements, local content requirements, export requirements, technology transfer, tying of imports to the value of exports, requirements to hire local personnel etc.



Main Tenets of the UN Committee on Transnational Corporations Draft Code

- ▶ Definition of investor to exclude State Owned Enterprises
- ▶ Respect for national sovereignty
- ▶ Renegotiation of contracts when situations change. This goes against the *pacta sunt servanda* principle
- ▶ Non interference in domestic affairs-allegations have been made that some MNCs pursue foreign policy agendas e.g. Nicaragua etc



Other Notable International Efforts to Regulate FDI

- ▶ World Bank's Guidelines on Foreign Investment
- ▶ OECD's Draft Code on Multinational Corporations
- ▶ United Nations' Committee on Transnational Corporations Draft Code
- ▶ UNCTAD's Investment Policy for Sustainable Development of 2012
- ▶ International Chamber of Commerce's Guidelines for International Investment



Regulation of FDI within the WTO

- ▶ As indicated earlier on, efforts to regulate FDI at a multilateral level through the Havana Charter failed in 1948.
- ▶ The GATT which regulated trade in goods and the reduction of tariffs was successful and at the height of the Washington Consensus got institutionalised in the form of the World Trade Organisation.
- ▶ The World Trade Organisation is the premier rules based multilateral institution regulating international economic relations.
- ▶ There are more than 160 countries which are members of the WTO.
- ▶ FDI is regulated indirectly within the WTO through the TRIMS, GATS and to a lesser extent the TRIPS agreements.



Main Principles of the WTO

- ▶ Non-discrimination
- ▶ National Treatment
- ▶ Most Favored Nation Principles



Brief History of FDI Regulation within the WTO

- ▶ After the failure of the Havana Charter FDI regulation was to be indirectly negotiated during the Uruguay Rounds and culminated in the GATS, TRIMS and TRIPS agreements which will be discussed later.
- ▶ There was an effort to negotiate a purely investment regulatory regime within the WTO during the Singapore Ministerial. This was derailed by civil society in Seattle.
- ▶ The matter was continued during the Doha Ministerial but developing countries opposed the negotiations arguing that they concentrated much on investment protection and gave too much rights to foreign investors.



South Africa within the WTO

- ▶ South Africa is an original signatory of the GATT 1947 together with its sister country of Southern Rhodesia...and Cuba among others
- ▶ South Africa signed into the GATT as a developed country. This status could have been changed in 1995 but was maintained
- ▶ The country then became a founding member of the WTO in 1995 when the GATT became institutionalized
- ▶ The WTO is premised on that when a country becomes a member, it signs to all agreements of the organization.
- ▶ There is no cherry picking of agreements
- ▶ South Africa therefore became a signatory to the GATS, TRIMS and TRIPS



General Agreement on Trade in Services

- ▶ The GATS as it is commonly known regulates trade in services.
- ▶ There is a thin line between trade in services and investment.
- ▶ 2/3 of the world FDI stock are in services as UNCTAD data shows year in and year out. This has been referred to as the servicification of production processes.
- ▶ The main objective of the GATS is to liberalise trade in services. This is done through having members such as South Africa submit a schedule of commitments in which they list the sectors that they are liberalising and the extent thereof.
- ▶ South Africa submitted in schedule of commitments on the 15th of April 1995



Regulation of Services as FDI

Regulation in the GATS

- ▶ It is important to note the way in which the GATS defines services and measures in order to understand how the regulation of services dovetails with that of FDI.
- ▶ Article I:1 provides that the GATS '*applies to **measures** by Members **affecting** trade in services*'
- ▶ Measures can be '*in the form of a law, regulation, rule, procedure, decision, decision, administrative action, or any other form*'.
- ▶ This means that legislation such as the PPIB does qualify as measures in this regard.
- ▶ The definition of trade in services to include '*the supply of a service by a service supplier of one Member, through commercial presence in the territory of any other Member*' is akin to a description of an investment



Commercial Presence as FDI

- ▶ GATS Article XXVIII:(d) offers a comprehensive description of what commercial presence entails. It provides thus: 'Commercial presence means any type of business or professional establishment, including through: (i) the constitution, acquisition or maintenance of a **juridical person**.
- ▶ (II) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.
- ▶ The foregoing descriptions fit those of foreign direct investment hence the GATS is taken to be regulating FDI.



Most Favoured Nation Treatment within the GATS

- ▶ Most favoured nation treatment principle. This is an absolute principle that South Africa as a signatory to the GATS cannot prefer or prejudice investors from one country over the other. The only exception here is SADC countries on road transport and financial services
- ▶ The PPIB does not seem to have a provision that is designed in a way that it will favor or prejudice investors of one territory over the other. In this respect the PPIB is compliant with the GATS.



National Treatment

- ▶ This is a cardinal principle of the post WWII global economic regulatory regime.
- ▶ Article XVII:1 of the GATS provides that each Member should accord to...service suppliers (read investors) of any other Member, ...treatment no less favourable than it accords its own service suppliers'.
- ▶ The PPIB is bound to fall foul of this provision with regard to the fact that this statute provides for preferential treatment of local BEE investors over foreign investors.
- ▶ The PPIB establishes a regime in which black owned entities or those that are deemed to be BEE compliant would be exempt from some obligations.
- ▶ This then has an effect of discriminating foreign investors over local black owned investments.



Quo Vadis: Exceptions Clause?

- ▶ Every general rule has an exception. The question is could the GATS exceptions clause as embodied in Article XIV. South Africa is allowed to discriminate against foreign investors if it is '**necessary**' for the protection of public morals, order, health and safety, as well as for consumer protection and privacy.
- ▶ The PPIB is mostly driven by the desire to carve out more policy space for BEE and industrial policy including beneficiation.
- ▶ It is difficult to locate BEE and industrial policy in one of the exceptions. Even if an argument can be made that BEE can be exempt under public morals based on that apartheid was a crime against humanity would that pass the test.
- ▶ The test embodied in the GATS for any of the exceptions is that the measure in this case the PPIB should not result in '**arbitrary and unjustifiable discrimination**'.



- ▶ In addition, the measure (PPIB) should address the particular interest (BEE, Beneficiation and Industrial policy).
- ▶ They should also be a sufficient nexus between the measure and the interest protected.
- ▶ It should go beyond simply making a contribution to public interest.
- ▶ The PPIB may therefore be challenged on these grounds.
- ▶ Whats the way forward then because we have signed into the GATS?



To Withdraw from the GATS or Not?

- ▶ South Africa signed onto many trade and investment agreements during the transitional period and therefore much of what is currently regarded to be the core of public policy/public interest was not carved out of these agreements.
- ▶ Soon after the gazette of the PSIRA, some senior government officials were quoted as suggesting that South Africa could exit from the GATS. How feasible is that?
- ▶ Diplomatically withdrawal will definitely come at a cost by sending negative signals of becoming a closed economy.
- ▶ But is it legally feasible?



To Exit or Not to Exit the GATS

- ▶ The GATS like any negotiated agreement makes provision for an exit.
- ▶ Article XXI:1 provides that a Member can '*modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force*'
- ▶ South Africa must give notice to the Council on Trade in Services, of the proposed withdrawal, at least 3 months before the PPIB comes into effect.
- ▶ Any other WTO Member who might be affected by the proposed modification or withdrawal has a right to object within 45 days of circulation of South Africa's intention to withdraw or modify.
- ▶ Within three months South Africa will then have to agree on appropriate compensation to affected members



Withdrawal from the GATS

- ▶ If there is no agreement the matter will head to arbitration to assess the fairness of the compensation.
- ▶ If South Africa is found to have made a fair compensation, another Member can still object. These are processes that can become circular and drag for years.
- ▶ Government would need to equip itself for a very lengthy and costly exercise.



Agreement on Trade Related Investment Measures (TRIMS)

- ▶ The main objective behind the TRIMS is to prohibit performance requirements also known as local content requirements.
- ▶ These could take the form of use of domestically produced goods, local equity requirements affecting ownership, foreign exchange restrictions, transfer of technology, beneficiation etc.
- ▶ The PPIB might contravene the TRIMS insofar as BEE, industrial policy and beneficiation provisions end up encumbering foreign investors with performance requirements.
- ▶ The TRIMS agreement was borne out of a belief that performance requirements distort trade.



Imagining South Africa's Role in Multilateral FDI Regulation

- ▶ There is some light at the end of the tunnel in the form of a multilateral agreement on investment.
- ▶ Bilateral investment agreements lead to diversion and regulatory complexity
- ▶ Investment through Preferential Trade Agreements leads to power asymmetries
- ▶ State Owned Enterprises and Sovereign Wealth Funds lead to new challenges
- ▶ South Africa is a middle power and has diplomatic capital emanating from its being representative of Africa
- ▶ Membership to the G20 and the BRICS



Conclusion

- ▶ There is no multilateral agreement or regime regulation FDI
- ▶ This has a historical dimension to it.
- ▶ The TRIMS and GATS do regulate investment albeit indirectly.
- ▶ The PPIB could violate some principles of the GATS and TRIMS.
- ▶ There is a need for a multilateral agreement and South Africa could play a role in this realisation



I thank you for your attention

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