4

International Agreements to Improve Investment and Competition for Development

Fast-growing developing countries have commonly been successful in setting up investment regimes that facilitate private investment and marshal competition to ensure growth in productivity. As with trade reform, most of the benefit from new sound investment and competition policies comes from unilateral reforms of domestic policies. This chapter explores the potential of international collaboration—collaboration principally in the form of international agreements—to help developing countries consolidate sound investment climates.

International agreements that are associated with multilateral or regional arrangements can potentially provide additional benefits when coupled with domestic reforms. Benefits can take several forms. For investment policies, international agreements usually have the objective of eliciting more investment by locking in reforms and providing additional investor protections. They can also reduce policy externalities that have "beggar-thy-neighbor" consequences. Moreover, participating in international negotiations can prompt partners to undertake reciprocal reforms that would not otherwise occur, as well as strengthen the hand of domestic reformers. For competition policy, international agreements might lead to removal of restraints that inhibit competition, thereby unleashing new price competition that benefits all countries. A central purpose of this chapter is to identify collective actions that have the greatest development effects.

Ministers of the World Trade Organization (WTO) set an agenda for investment and competition when they met in Doha, Qatar, in November 2001, and decided to launch negotiations on a multilateral framework that covers investment and competition. These negotiations are subject to a decision to be made by explicit consensus on modalities at the Cancún Ministerial Conference, to be held in 2003. The purpose of the new framework is "to secure transparent, stable, and predictable conditions for long-term cross-border investment" that will expand trade and "enhance the contribution of competition policy to international trade and development."[1]

The international community, and developing countries in particular, therefore faces two questions: What types of new multilateral initiatives on investment and competition policy can promote more—and more productive—investment, and hence more rapid development? And, which issues are best tackled through voluntary initiatives and multilateral cooperation, and which are best handled through binding commitments, such as those in the WTO and regional arrangements? The answers to these questions require a separate discussion of investment and competition policy.

Can coordinated investment policies increase flows to developing countries and reduce beggar-thy-neighbor policies?

An overall purpose of coordinating an investment policy is to expand the flow of investment

around the world, to minimize distortions that hurt neighbors, and to help improve economic performance. Coordination might contribute to achieving these goals through three main channels: (a) protecting investors' rights in order to increase incentives to invest, (b) liberalizing investment flows to permit enhanced access and competition, and (c) curbing policies that may distort investment flows and trade at the expense of neighbors.

Analysis suggests several broad conclusions. As with trade reforms, unilateral reforms to liberalize foreign direct investment (FDI) are likely to have the greatest and most direct benefit for the reforming country. Beyond this, new international agreements that focus on establishing protections to investors cannot be predicted to expand markedly the flow of investment to new signatory countries. This is because many protections are already covered through bilateral investment treaties (BITs), and even these relatively strong protections do not seem to have increased flows of investment to signatory developing countries. These facts suggest that expectations for new flows associated with protections emerging from any multilateral agreement should be kept low.

International agreements that allow countries to negotiate reciprocal market liberalization and to promote nondiscrimination can reinforce sound domestic policies and contribute to better performance. Because most of the remaining investment restrictions are on services, the existing General Agreement on Trade in Services (GATS) provides an opportunity to meet this objective. Similarly, curbing beggar-thy-neighbor policy externalities can benefit developing countries, especially if agreements focus on two critical issues. The first issue is the reduction of trade barriers that—by depriving developing countries of market access and discouraging their exports—will lessen the attractiveness of opportunities for both foreign and domestic firms to invest in developing countries' export industries. In this regard, reducing trade barriers in developing countries is as important as reducing trade barriers in rich countries. The second issue is the curbing of emerging competition among countries in order to lure foreign investment through incentives. Unfortunately, information on the extent of investment incentives is inadequate to assess their effects. Thus, a high priority for international collaboration is to systematically compile this information.

Finally, participating in international investment agreements may have benefits over and above unilateral reforms if those agreements are accompanied by reciprocal market access in areas of importance to developing countries. These benefits can become clear only in the course of negotiations.

Collective action can improve competition

Greater competition is associated with more rapid development. Lowering policy barriers to trade and foreign investment in developing countries, as shown in chapter 3 of this volume, is a powerful, procompetitive force. International agreements on competition policy might bring benefits beyond unilateral actions—provided that the agreements address the major restrictions that adversely affect developing countries.

Restrictions on competition in the global marketplace that will most hurt development can take three forms. First, policy barriers in markets abroad limit competition from developing countries in these markets. Particularly harmful are the $311 billion in agricultural subsidies and textile quotas, as well as the high border protection, tariff distortions (such as tariff peaks and escalation), and protectionist use of antidumping. Those policy barriers are common in all countries—rich and poor alike. All of these restrictions limit the ability of exporters in developing countries to compete in international markets.

Second, private restraints on competition can adversely affect prices for consumers and producers in developing countries. For example, companies that are based in high-income countries have cartelized some markets;

proven cartels have taxed consumers in developing countries by up to $7 billion in the 1990s. Actions that facilitate prosecution of cartels should be high on the priority list. Such actions can range from more systematic arrangements to exchange information, to granting developing countries the ability to sue under foreign antitrust laws when their trade is adversely affected. Indeed, developing countries would benefit from much greater efforts to identify and to document restrictive business practices that adversely affect prices of their trade.

Third, many governments in high-income countries officially sanction trade restraints by exempting their companies from domestic antitrust laws. For example, many governments permit their companies to cartelize exports. Although these cartels are shrouded in the secrecy of government registries, national export cartels may well raise prices to developing countries. Efforts should be made to make transparent any information on national export cartels. If cartels were found to have adverse price effects, everyone would benefit from reducing these officially sanctioned private restraints on trade. Similarly, antitrust exemptions of ocean transport have given rise to price-fixing arrangements that systematically hurt consumers everywhere, including consumers in developing countries.

Competition policies in developing countries themselves can, in many cases, be improved through increased transparency, nondiscrimination, and procedural fairness. However, international cooperation in this complex area of regulation has to recognize that countries have different capacities and institutional settings, which warrant caution in recommending—much less in mandating—across-the-board policies. This is an area where voluntary programs that facilitate learning and adoption of best practice in developing countries can pay high dividends.

This chapter analyzes first the investment policy issues, and then the global competition issues.

International efforts to promote investment

Any pro-development effort to coordinate investment policies through agreement has as its objectives increasing the flow of investment, minimizing distortions among countries, and helping countries participate in the potential gains from investment and investment-related trade. Chapter 3 of this volume singled out domestic policies that influence the quantity and productivity of private investment, both domestic and foreign. Governments that have provided stable macroeconomic policies and effective property rights for investors, and that have lowered policy barriers to competition have, by and large, enjoyed greater success in creating the conditions for sustained growth. International efforts to support these policies can take several forms: bilateral, regional, and multilateral. They can be binding, as in the case of the WTO and the North American Free Trade Agreement (NAFTA), or nonbinding, as in the case of the Organisation for Economic Co-operation and Development (OECD). The current regimen is a mixture of binding and nonbonding efforts.

Today's international investment framework is a patchwork quilt sewn together over many years

The growing waves of FDI observed in recent decades have been accompanied by a steady rise in international agreements on investment. Agreements are typically founded on the presumptions that cross-border investment provides benefits to both investing and recipient countries, that rules can minimize disputes and provide for their resolution, and that agreed-on rules can enhance both the quantity and quality of investment. The Havana Charter, designed to create the International Trade Organization (ITO) at the end of the 1940s, proposed the inclusion of investment provisions together with trade provisions. The investment provisions were quite limited in scope because many countries—

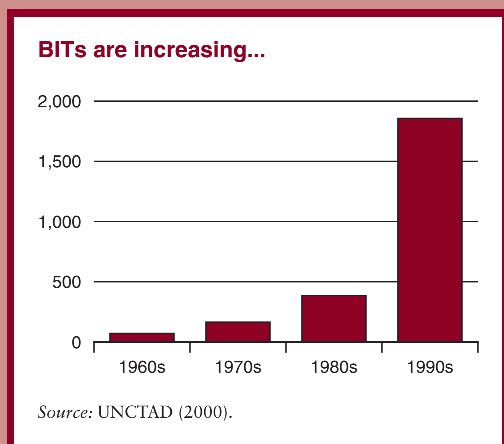
particularly developing ones—feared foreign control over their natural resources and strategic industries.[2] Since then, a patchwork quilt has emerged, made of differing bilateral treaties, regional arrangements, and multilateral instruments relating to cross-border investment. This regulatory quilt stands in sharp contrast to the more comprehensive system of norms and principles that govern international trade.

Bilateral agreements. Recent years have witnessed a surge in BITs. The number of BITs quintupled during the 1990s, reaching 2,099 by the end of 2001 (see box 4.1). During 2001 alone, 97 countries concluded 158 BITs (see

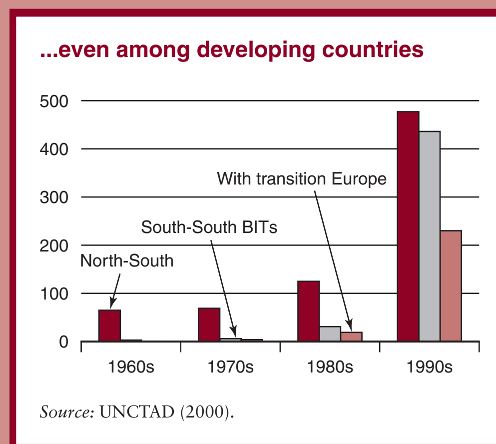
Box 4.1 What is a BIT?

The number of BITs mushroomed in the 1990s (see box figures). These agreements typically contain broad definitions of foreign investment, inclusive of nonequity forms, various types of investment assets (including portfolio investments), and intangible assets such as intellectual property. BITs generally avoid a direct regulation of the right to establishment, referring this matter to national laws (and thus recognizing implicitly the right of host countries to regulate the entry of FDI). Most BITs also do not explicitly address ownership and control issues, though they often cover some operational restrictions, such as the admission of key managerial personnel. Only a few BITs discipline the use of performance requirements.

Most BITs prescribe national treatment, most-favored nation (MFN) treatment, fair and equitable treatment, and treatment according to customary international law. In addition, BITs prescribe specific investment protections, which cover topics such as the transfer of funds, expropriation, and nationalization. They typically provide for the settlement of disputes between the treaty partners and between investors and the host state. Provisions for so-called investor-state arbitration normally refer to pre-existing arbitration rules, notably those under the International Center for the Settlement of Investment Disputes (or ICSID, which is affiliated with the World Bank); the United Nations Commission on International Trade Law (UNCITRAL); or the International Chamber of Commerce (ICC).



Source: UNCTAD (2000).



Source: UNCTAD (2000).

Source: World Bank staff.

UNCTAD 2002). For much of the post–World War II period, BITs tended to be negotiated on a North-South basis. More recently, however, there has been strong growth in the number of South-South BITs. In 2001, for example, treaties between developing countries accounted for 42 percent of new BITs (UNCTAD 2002). BITs covered an average of 50 percent of all foreign investment flows to developing countries in 1999–2001.

Regional arrangements. Investment disciplines have figured prominently in regional trade and integration agreements, particularly the most recent ones. Some of these agreements embed foreign investment into a broader framework of rules that are aimed at promoting economic cooperation and deeper integration. This framework includes the European Union; NAFTA; the free trade agreement linking the G-3 countries (Mexico, the República Bolivariana de Venezuela, and Colombia); the recently concluded Singapore-Japan agreement; and the European Free Trade Area. Other agreements—such as the OECD's Codes of Liberalization of Capital Movements, the Colonia Protocol on the Promotion and Reciprocal Protection of Investments within the Southern Cone Common Market (Mercosur), and the Asia Pacific Economic Cooperation (APEC) Non-Binding Investment Principles—are less comprehensive with regard to their treatment of the trade-investment interface.

A distinguishing feature of regional agreements with investment disciplines is their tendency to address both investment protection and liberalization (entry) issues, together with disciplines on post-establishment operating conditions and means to settle investment disputes (both state-to-state and investor-state disputes). The architecture of the most-advanced regional free trade and integration agreements reflects the complex interrelations among investment, trade, services, intellectual property rights, competition policy, and the movement of business people. Other important issues that are dealt with in some regional agreements include technology transfers, environmental protection, taxation, conflicting requirements, and standards for the conduct of multinational enterprises.

Multilateral accords. Significant multilateral rules for investment were put in place during the Uruguay Round, which concluded in 1994. All of the following agreements either directly or indirectly address key investment issues: the Agreement on Subsidies and Countervailing Measures (ASCM), the Agreement on Trade-Related Investment Measures (TRIMs), the GATS, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), and the plurilateral Government Procurement Agreement.

Numerous multilateral agreements and arrangements that have been concluded outside the WTO also affect investment and can make a positive contribution to enhancing investment climates in developing countries. Among others, these arrangements include efforts to curb bribery and corruption (OECD, Organization of American States [OAS]); rules governing the conduct of multinational enterprises (OECD Guidelines on Multinational Enterprises, United Nations [U.N.] Global Compact); guidelines on corporate social responsibility and corporate governance (OECD, World Bank); and cooperation on best practices in investment promotion activities (U.N. Conference on Trade and Development (UNCTAD), World Bank).

New efforts exist for collective action on investment

The rising tide of FDI around the world has been, in part, a consequence of a progressive receptivity of developing countries to FDI flows. Just as tariffs have fallen, so too have restrictions on incoming investments (particularly in manufacturing) been lifted. Governments once hostile to transnational corporations (TNCs) now actively seek their participation—and even compete for it. One indicator of this is the change in investment regulations. Between 1991 and 2001, a total of 1,393 regulatory

changes were introduced in national FDI regimes, of which 1,315 (or 95 percent) were in the direction of creating a more favorable environment for FDI (figure 4.1). During 2001 alone, a total of 208 regulatory changes were made by 71 countries, only 14 of which (or 6 percent) were less favorable for foreign investors (UNCTAD 2002). This opens the question of whether this evident willingness to improve the investment regime could be leveraged to achieve some additional benefits, through reciprocating in multilateral negotiations, an issue that we take up below.

The potential—and the challenge—of cooperation on investment policies become clearer if it is broken down into the three core subagendas that parallel the investment climate discussions in chapters 2 and 3. These policies relate to *liberalizing investment* to facilitate access and entry, *establishing investor protections* as an incentive to invest, and *curbing investment-distorting* policies that affect trade and investment location.

Liberalizing investment promotes market access—
The inclusion of investment in international negotiations may lead to greater openness of investment regimes that can be accomplished unilaterally. If investment is negotiated as part of a broader set of trade negotiations, rather than in isolation, then the traditional mechanism of reciprocal access concessions can help create support for greater openness at home and abroad. For example, exporters in developing countries who obtain improved access to foreign agricultural markets can be a countervailing force against those who resist the

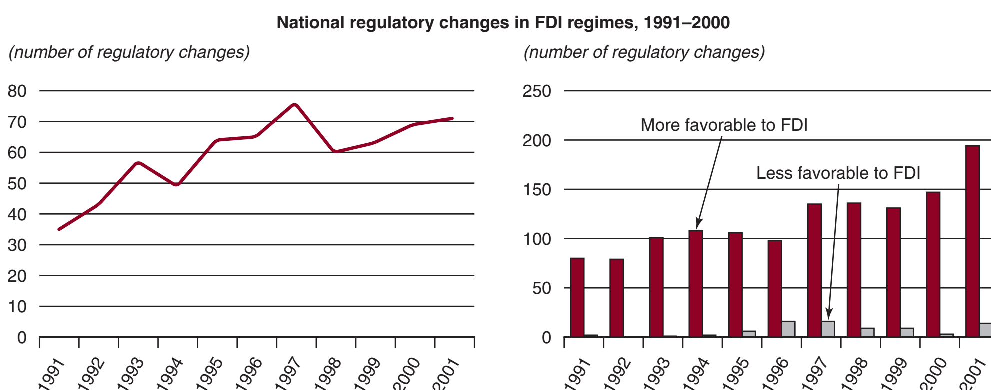
Box 4.2 The Multilateral Agreement on Investment (MAI)

Because investment regulations extend beyond tariffs into domestic regulation, the political difficulties of enticing large groups of countries to harmonize their domestic rules are not trivial. Those difficulties were evident in the latest—and failed—attempt at crafting a multilateral accord. In 1995, developed countries pushed to establish a Multilateral Agreement on Investment (MAI) within the OECD that had the objective of setting "state of the art standards for investment regimes and investment protection with effective dispute settlement procedures."[3] These efforts were unsuccessful, and the MAI was not established.

One reason for the MAI's demise was the waning support within the business community as it became apparent that the level of investment protection afforded to MAI signatories would almost certainly be lower than that offered in BITs. It was apparent that prospects for significant investment liberalization would be held back, first, by concerns of free riding by non-OECD WTO members (which stood to receive many of the benefits of the MAI by virtue of the GATS's MFN requirement without making any reciprocal concessions). Also at play was the reluctance of OECD countries to open up sensitive sectors to foreign investment (for example, to maritime transport and audiovisual services). Labor and environmental groups objected to the fact that the MAI would give TNCs more power to ignore workers' interests and environmental concerns while providing them with extensive rights to challenge domestic regulatory conduct before international arbitration panels. Meanwhile, many developing countries, left out of the discussions because of the MAI's venue in the OECD, protested their unwillingness to accept rules that they had no voice in designing (Gilpin 2000).[4] By the fall of 1998, negotiations on the MAI were formally abandoned, thereby offering sobering insights on the complexity and political sensitivities involved in attempts at comprehensive investment rulemaking.

Source: World Bank staff.

Figure 4.1 Countries are increasingly liberalizing their investment regimes

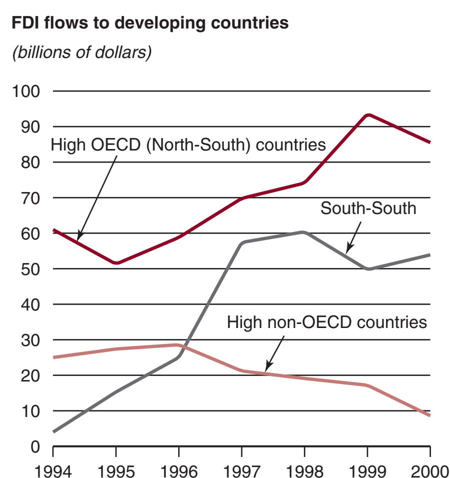


Source: UNCTAD (2002).

elimination of investment barriers in telecommunications. At the same time, the need to fight these battles about the domestic political economy makes a country a credible negotiator for improved access. The process, if it works, could produce a double benefit: liberalizing countries would benefit from the increased competition that is associated with FDI, and their firms would have improved access to foreign markets. A key issue—which can be determined only during the negotiation process—is the extent to which an investment agreement leverages reciprocal commitments among trading partners. Because reciprocal gains are difficult to gauge, an important prerequisite for each country is to ensure that any domestic policy commitment makes sense when seen through the lens of promoting national development.

Even though most foreign investment originates in rich countries and is destined for other rich countries, there may well be some scope for reciprocal agreements that benefit developing countries, even within the narrow domain of investment. Because developing countries are increasingly becoming active as investors themselves, they have a mutual interest in clear rules of access. They tend to invest primarily in other developing countries. Estimates suggest that nearly one-third of foreign investment flows to developing countries originated in other developing countries, up from negligible amounts in the early 1990s (World Bank 2002a), so South-South FDI flows have grown.[5] (See figures 4.2 and 4.3.)

Figure 4.2 South-South FDI is rising

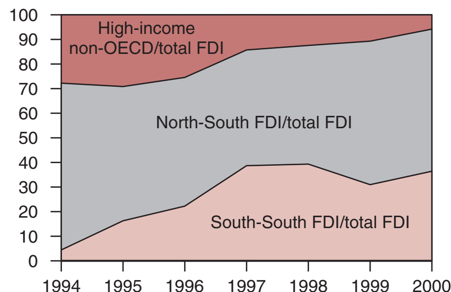


Source: Aykut and Ratha (2002).

Figure 4.3 Share of South-South FDI in total FDI is rising

South-South FDI is rising and so is its share in total FDI

(percent)



Source: Aykut and Ratha (2002).

The preceding argues that the potential for benefits investment agreements to generate merits examination. Coordinated efforts to liberalize investments can subsume two issues: first, *transparency,* and second, *nondiscrimination* in treatment of foreign investment in market access.

Transparency. Transparency involves making relevant laws and regulations available to the public, notifying parties when laws change, and ensuring uniform administration and application. In addition, transparency can be increased by offering affected parties the opportunity to comment on laws and regulations, which implies communicating the policy objectives of proposed changes, allowing time for public review, and providing a means to communicate with relevant authorities.

A nontransparent business environment in a host country raises information costs, diverts corporate energies toward rent-seeking activities, and may give rise to corrupt practices. This environment weighs down both domestic and foreign businesses, though in many cases it may be particularly discouraging to foreigners who are usually less privy to locally available information. This heightened risk of operating in the host country's business environment either translates into higher risk premiums (in the case of pricing corporate assets) or imposes additional information costs on enterprises. To be sure, transparency, alone, can add little if the underlying laws and rules are inadequate or unpredictable.

Case studies suggest that companies may, for example, be willing to invest in countries with legal and regulatory frameworks that would not otherwise be considered "investor friendly"—provided the companies are able to obtain a reasonable degree of clarity about the environment in which they will be operating. Conversely, there appear to be certain threshold levels for transparency beneath which the business conditions become so opaque that virtually no investor is willing to enter, regardless of the extent of the inducement.

These policies do not lend themselves well to including sanction-based dispute resolution procedures in legally binding agreements. Thus, international collaborative efforts should perhaps take other forms such as increasing developing countries' participation in nonbinding best-practice instruments or developing assistance to strengthen institutions. To the extent that transparency obligations are anchored in WTO agreements, monitoring by multilateral peer review and surveillance may provide the best means for promoting governance-enhancing reforms in host countries.

Nondiscrimination in treatment of foreign investment in market access. The practice of placing foreign and domestic sellers on an equal competitive footing is a hallmark of trade agreements. This objective is no less important in investment agreements. Promoting liberalization in international investment essentially boils down to securing nondiscriminatory terms of entry and operation. This approach has elements of both MFN treatment (that is, nondiscrimination as between all foreign entities) and national treatment (that is, nondiscrimination between "like" domestic and foreign entities).

Box 4.3 South-South flows: who invests and who receives?

Most FDI flows within developing countries are between the Association of Southeast Asian Nations (ASEAN) countries, and, recently, among the Latin American countries, especially the Mercosur members (UNCTAD 1999). There are signs that FDI flows from East and Southeast Asia to Latin America and Africa are picking up. According to the Chinese Ministry of Foreign Trade and Economic Cooperation, China attracted $3 billion in investment from 22 developing countries in 1998. Though this figure made up only 7 percent of total FDI inflows to China, the flows originated in a wide spectrum of countries (in terms of size and per capita income levels) and extended to varying sectors (Aykut and Ratha 2002). In addition, Chinese TNCs are becoming prominent in world markets. China has invested, not only in Asian countries, but also in Bangladesh, Brazil, India, the Islamic Republic of Iran, and Poland, in addition to countries in Africa.

The Republic of Korea, an OECD member, invested nearly one-third of its direct investment in developing countries (excluding those in Africa and the Middle East) in 1998. By 1999, Korea had invested nearly 50 percent of its aggregate investment in other developing countries. Malaysian FDI has also expanded its boundaries from East Asia to Latin America and to parts of Africa. Since the second half of the 1990s, almost 30 percent of total FDI inflows into India are from other developing countries—the principal sources being Mauritius, Malaysia, and Korea (Aykut and Ratha 2002). Outflows from Latin America in 2001 were directed primarily at other countries in the region (UNCTAD 2002). Chile continued to be the major player in interregional investment, followed closely by Mexico and Argentina. Some South African TNCs have recently moved to a strategy of international growth, partly through cross-border mergers and acquisitions. A noteworthy example of a global player is South African Breweries, which operates 108 breweries in 24 countries including China, large parts of Africa, and Europe (UNCTAD 2002). FDI outflows from the Central and Eastern European countries such as Croatia, Estonia, and Slovenia are also headed primarily to neighboring countries. A tendency to invest in neighboring countries that are at similar or lower levels of development is another feature of South-South FDI (Aykut and Ratha 2002).

Source: World Bank staff.

Departures from nondiscriminatory treatment essentially take one of two forms: before entry in the "pre-establishment" phase of an investment, and after entry in the "postestablishment" operating conditions of a business. Governments everywhere have been reluctant to extend full pre-establishment privileges to all potential entrants in every sector. Securing nondiscriminatory conditions of treatment is equally important in the postestablishment phase, because foreign investors will typically have significant start-up costs and will be averse to sudden, unanticipated changes in regulatory conditions that may tilt competitive conditions in favor of local competitors. Nondiscrimination commitments in the postestablishment phase can thus send to foreign investors powerful signals of the credibility of a host country's reform efforts.

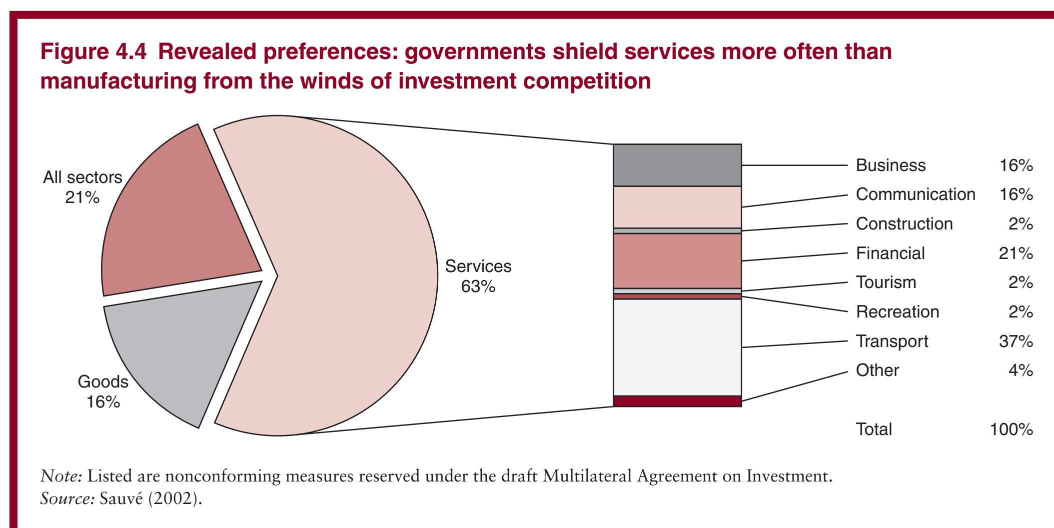
By far the most contentious aspect of liberalization is the pre-establishment commitment to openness, given the tendency to maintain restrictions on entry in a few sensitive sectors. Most countries now permit liberal access to foreign investors in manufacturing. The same holds true—if to a lesser extent—in mining and agriculture. Indeed, as a result of various investment incentive schemes that are not available to domestic firms, foreign investors in manufacturing often enjoy treatment that is better than that available to domestic investors. Most governmental measures that

overtly discriminate against foreign investors and that restrict FDI inflows are maintained in the service sector and concern key industries such as telecommunications, broadcasting and related audiovisual services, satellite services, energy services, financial services (especially banking and insurance), civil aviation, and maritime transport.[6] Sauvé (2002) estimates that 80–85 percent of restrictions affecting international investment are maintained in service sectors. Among the most dynamic sectors of the global economy, services are also where some two-thirds of cross-border FDIs have been directed in recent years (see chapter 2, this volume).

One telling proxy of the potential of services for investment liberalization is provided by the negative lists of measures drawn up by prospective signatories of the ill-fated MAI. The lists identify those sectors in which the negotiators wished to restrict access by foreign investors (see figure 4.4). A similar trend is evident under the NAFTA. Simply put, the market access or agenda for investment is largely centered on services (Hoekman and Saggi 2000; Sauvé and Wilkie 2000).

A multilateral vehicle already exists for realizing the positive externalities that potentially arise from the liberalization of investment in services: the GATS. The GATS has several features that are attractive to countries, potentially making it a useful tool to widen nondiscriminatory access in a reciprocal framework. By having a positive list approach—in which countries voluntarily schedule sectoral commitments to apply national treatment and to grant market access—governments enjoy considerable flexibility to exempt sectors that they deem of special national interest. Once commitments are undertaken, countries accord all suppliers—foreign and national alike—the same conditions of entry and operation in a nondiscriminatory fashion. To date, however, the GATS has fallen short of its liberalizing potential. The coverage of commitments for a large number of countries is limited. About two-thirds of the WTO membership has scheduled fewer than 60 sectors (of the 160 or so specified in the GATS list) (see Stern 2002). In many cases, commitments do not reflect the actual degree of openness (Mattoo 2000). In other cases, countries have not moved actively to schedule sectors—even when domestic policies are open to foreign investments. Finally, sometimes countries' commitments serve to protect the privileged

Figure 4.4 Revealed preferences: governments shield services more often than manufacturing from the winds of investment competition



Note: Listed are nonconforming measures reserved under the draft Multilateral Agreement on Investment.
Source: Sauvé (2002).

position of incumbents, domestic or foreign, rather than to enhance the contestability of markets.

Countries could take greater advantage of the opportunity offered by the GATS to lend credibility to reform programs by committing to maintain current levels of openness or by precommitting to greater levels of future openness. To advance the process of services reforms beyond levels undertaken independently and to lead to more balanced outcomes from the developing countries' points of view, countries could better harness the power of reciprocity by devising negotiating formulas that widen the scope for tradeoffs across sectors (both goods and services) and across modes of delivery, notably temporary movement of workers (Mattoo 2002).

—but protecting investment may not increase flows

A foundation of any country's investment climate is the protection of property rights for its investors. An agreement that encourages countries to improve investor protections has the potential for improving investment flows from abroad and for eliciting more domestic investment. The international community, in general, and developing countries, in particular, might find three benefits from multilateral disciplines on investment protection.

First, an agreement on common standards would promote efficiency by carrying potentially significant economies of scale in making rules: one multilateral agreement could become a "one-stop" substitute for the complex and legally divergent web of existing BITs.

Second, a multilateral regime for investment protection could help counterbalance the bargaining asymmetries built into BITs and into regional agreements conducted along North-South lines. In some cases, the negotiating asymmetries that are common to bilateral agreements have led to treaties in which developing countries have taken on substantive obligations without any reciprocity other than the promise of increases in future private investment. However, there is an important caveat to this argument: To the extent that the power imbalance is redressed in a multilateral agreement in favor of weaker states, then the constituencies within the global business community may well prefer—as was the case in the MAI negotiations—the stronger level of investment protection flowing from BITs, and may lose interest in a multilateral agreement.

Third, a multilateral set of disciplines on investment protection would arguably help developing countries send a positive signal to potential foreign investors regarding the permanence of policy changes, the expected standard of treatment afforded to foreign investors, and recourse to a dispute-settlement procedure.

While these factors suggest that investment flows might increase because of such an arrangement, care should be taken not to overstate the response of investors. Five facts argue for caution. First, the absence of a body of multilateral disciplines on investment protection has hardly deterred cross-border investment activity. Indeed, FDI has far outstripped trade and output growth over the past decade and a half (see figure 4.5).

Second, the absence of an agreement has not prevented substantial unilateral reform (see discussion above, and figure 4.1).

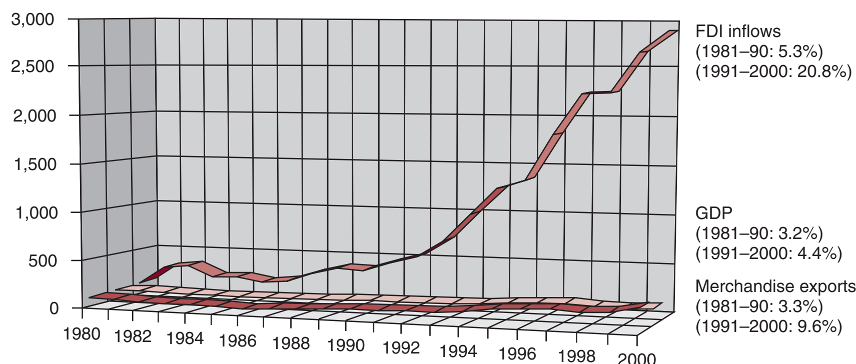
Third, a more precise indicator is the historical experience of the BITs in eliciting new investment. Does the signing of BITs increase the flow of FDI? Hallward-Driemeier (2002) finds few independent effects of BITs on subsequent increases in investment (box 4.4).

Fourth, it is not clear whether multilateral investment disciplines—whether in the U.N., WTO, or OECD—will embody investment protections that are superior—and, therefore, additive—to BITs. In the case of the WTO, the Doha Ministerial Declaration reflects a significantly more-limited approach that clearly does not view a multilateral framework on investment as a substitute for bilateral and regional arrangements. Recent negotiating briefs in the WTO indicate that some major countries have withdrawn support for investor-state

Figure 4.5 FDI is growing faster than exports and output

Developing countries: merchandise exports, output, and FDI inflows, 1980–2000

(index, 1980 = 100; average annual growth rates in parentheses)



Source: UNCTAD (2001), Handbook of Statistics: World Bank (2002), World Development Indicators; and WTO (2001), International Trade Statistics.

dispute settlement, which would tend to lessen the additive value of investor protection in a multilateral accord.

Dispute settlement is another critical—and as yet unresolved—issue that will influence the content of any multilateral agreement to strengthen investor protections. Most BITs contain dispute resolution mechanisms that allow investors to challenge government rulings before arbitration panels or international courts. In the context of the WTO, while there is generally little support for the inclusion of investor-state arbitration provisions in a prospective multilateral investment agreement, WTO rules on investment protection could entail complications even when administered through state-to-state dispute settlement. For example, what would be the appropriate remedy in an instance of unlawful expropriation of a foreign investment? These difficult and contentious issues will take time to resolve in any international agreement.

Beggar-thy-neighbor investment distortions must be minimized

Governments have adopted policies that may affect the location and performance of transnational investment. Three negative policy externalities—when one country's policies adversely affect another—merit discussion. The first and most powerful of these negative policy externalities are investment-distorting trade barriers. Tariffs, tariff escalation, and other forms of protection discourage investment—both foreign and domestic—in export industries in developing countries. Said differently, if developing countries confront impediments to market access abroad, the effect of the barriers is to lower the potential stream of earnings in their export activities. This change reduces the incentive for foreign and domestic investors to invest in production for export in developing countries. Quota arrangements, antidumping actions, subsidies, overly restrictive rules of origin, and other trade restrictions distort not only trade, but also investment, and these distortions are arguably the largest negative policy externality affecting investment in developing countries.

Two other sets of policy externalities figure prominently in investment decisions: performance requirements—to compel multinational companies to locate a greater part of the value added chain in the domestic market—

Box 4.4 Do BITs increase investment flows? Only a bit

BITs are instruments used by countries to protect their foreign investors, while host countries view BITS as an important means of attracting foreign investors. BITs can provide the basis for resolving disputes; they can also impose potentially extensive obligations on the part of the governments hosting the investment. For example, almost all treaties stipulate compensation for the expropriation of investments. In some cases, treaties proscribe any government action—even environmental actions or other regulations—that would reduce the value of the private investment and they establish grounds for compensation. Such compensation could either entail extensive liabilities for the host government or compel it to refrain from making certain policy choices. Against this backdrop, the question of whether BITs actually increase FDI is important.

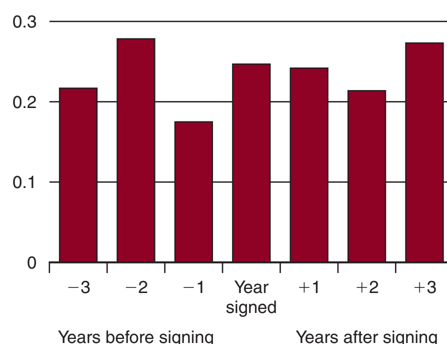
Surprisingly little empirical work has been done to test BITs' role in attracting FDI. UNCTAD, in a recent study, found little evidence that BITs increased FDI (UNCTAD 1998). That work looked at a single year of investments and tested whether the number of BITs signed by the host was correlated with the amount of FDI it received. Hallward-Driemeier (2002) redid that test, but applied it to 20 years of data, looking at the bilateral flows of OECD members to 31 developing countries. The Hallward-Driemeier test covered the vast majority of FDI flows, as well as those relationships that were historically the bulk of such treaties. Overall, the evidence is, at best, weak that BITs increase the amount of FDI. By the end of the 1990s there were many more BITs, and FDI had increased dramatically. However, controlling for a time trend, there was little independent role for BITs in accounting for the increase in FDI. Countries that had concluded a BIT were no more likely to receive additional FDI than were countries without such a pact.

Another question is whether a BIT would draw attention to a particular location, thus leading to an increase in flows in the aftermath of negotiations. However, comparing flows in the three years after a BIT was signed to those in the three years before, there was no significant increase in FDI (see box figure).

A third question is whether the relative amount of FDI that a source country allocated to a particular host country was affected by the presence of a BIT. The evidence here is that concluding a BIT is positively associated with receiving a larger share of a source country's FDI outflows, but that the result is not statistically significant.

The share of FDI received by developing countries is relatively unaffected by the signing of a BIT

(share of annual FDI flow)



Source: Hallward-Driemeier (2002).

Some countries have looked to BITs as a way of signaling their respect for property rights. Particularly if their reputation for protecting such rights is weak, they have seen the signing of a BIT as a way of assuaging the concerns of foreign investors. Conversely, the credibility of such a signal may not be that strong. It may be that the domestic rule of law must be sufficiently strong before foreigners are willing to consider the terms of the BIT as being enforceable. To test between these hypotheses, the study ran regressions that included measurements of the rule of law, government effectiveness, and regulatory quality. These measures were then interacted with the presence of a BIT. The results indicate that in weak investment climates, the BIT does not serve to attract additional FDI. However, in countries with stronger investment climates, the presence of a BIT does weakly increase the amount and relative share of FDI that the host receives.

Source: Hallward-Driemeier (2002).

and investment incentives—usually through tax breaks or direct transfers from the state to attract FDI. Even when these policies benefit the domestic economy, they both have the potential for adversely affecting trade and investment flows with neighbors. Therefore, further international cooperation to curb their negative effects can create positive benefits for all.

Unlike restrictions on entry that primarily affect services, performance requirements and investment incentives usually affect manufacturing. In general, performance requirements have been the instrument of choice for developing countries that are seeking to ensure that TNCs' activities generate the greatest possible spillovers for their economies. OECD countries have been the predominant users of investment incentives to attract investment, though in recent years numerous developing countries have followed suit (see chapter 3, this volume; see also UNCTAD 2002).

The trade-distorting effects of performance requirements—termed TRIMs—have for some time been subject to negotiated disciplines at both the regional and multilateral levels. WTO disciplines on performance requirements were codified with the TRIMs Agreement in 1995. Among performance requirements, the most prevalent measures relate to local content, joint ventures (or domestic equity participation), exports, technology, and employment requirements. The initial rationale for export requirements was in part to relieve the pressure on the trade balance that inward investment—particularly import-substituting investment—was generating. Local content requirements were designed to maximize vertical linkages and development of local skills.[7] Current discussions of changes to the TRIMs Agreement are associated with the review process that is mandated under Article 9 of that agreement.[8] At present, these debates are not on the Doha Agenda.

In contrast with disciplines on performance requirements, disciplines on investment incentives are—with the exception of the European Union's comprehensive set of disciplines on state aids—more limited. The Uruguay Round's ASCM introduced limited disciplines on the granting of investment incentives. These disciplines are largely indirect because they apply solely to export subsidies and other goods-related transactions—that is, a government may invoke the agreement's provisions only when certain types of investment incentives used by certain types of members can be shown to distort trade in goods.[9]

Strengthening disciplines on investment-distorting incentives could benefit developing countries because those disciplines would reduce the scope for this zero-sum tax competition. However, progress in crafting a set of multilateral disciplines on investment incentives has been negligible to date. One reason for this stalemate is that in large federal governments many investment incentive programs originate at the subnational level as instruments to promote regional development. Another reason is that many emerging developing countries have themselves become heavy users of incentives in recent years. Consequently, investment incentives have not figured prominently among topics to be discussed in international forums such as the WTO. The ill-fated discussions in the MAI were also unsuccessful in broaching investment incentives.

Nonetheless, competition among governments for FDI through incentives is becoming increasingly common in many parts of the world. Developing countries often find themselves in competition with each other, but few examples can be found of developing countries in direct competition with developed countries. Also, competing developing countries are often middle-income countries. Four reasons seem to explain these patterns.

First, studies show that the bulk of incentive-bidding activity among governments takes place within regions, rather than globally (Oman 2000; Charlton 2002). Only a handful of developing countries situated close to developed nations experience direct competition with the deep pockets of the treasuries of rich countries. Mexico's automotive industry under NAFTA is perhaps the most prominent example of this situation.[10]

Second, locational competition tends to be strongest between close neighbors with similar economic conditions, factor endowments, and policy regimes. Competition is also strongest in high-skill, technologically intensive industries, particularly for firms producing goods for export. Automakers, silicon chip producers, and pharmaceutical firms are among the most sought-after investments. Only a limited number of higher-income developing countries are likely to qualify for such a category of investment.

Third, competition is likely only when investors are somewhat indifferent about where to locate an investment among alternative locations. This indifference implies that only the more relatively advanced economies (emerging or transition economies) could have cause to bid against developed nations.[11]

Fourth, overt bidding wars between countries are relatively rare—even though bidding may be intense within particular countries—and are typically limited to a few sectors. They generally occur when individual projects are exceptionally large and when the sectors in question (for example, automobiles or electronics) are considered a high priority for national or regional economic strategies (Charlton 2002).

To be sure, striving for a ban on all incentives may be counterproductive because, in some cases, incentives can offset local disadvantages or can be used to capture spillovers from inward FDI (see Hoekman and Saggi 2000). In the case of Ireland and Portugal, for example, incentive programs have played a significant role in attracting investment to less-developed regions. In the case of Brazil, some evidence shows that incentives competition may have contributed to reducing regional disparities, because FDI in some sectors (particularly automobile manufacturing) is increasingly located outside the traditional industrial heartland around São Paulo (Cano 1998). While it is probable that, with respect to incentives, stories of failures and excessive expenditures outnumber successes, agreements must contain some elements of flexibility. A first step is generating adequate information that can be used to assess the trade- and investment-distorting consequences of incentives—and, more broadly, to evaluate their net development benefits.

Taken together, the existing multilateral agreements do provide limited discipline on certain types of beggar-thy-neighbor policies that are currently in use around the world. With respect to curbing incentives, even though potential benefits for countries exist from a multilateral accord, the absence of evident momentum at the multilateral level—when combined with a regional pattern of possible tax competition and trade effects—suggests that regional arrangements may be more promising for international collective actions. However, data are lacking. Multilateral efforts to improve information on investment incentives, perhaps through a WTO mechanism, would help remedy that lacuna and allow better analysis of the extent of investment distortions.

Summary: Getting the biggest development benefit from international collaboration on investment

Developing countries can benefit from international collaboration to liberalize market access for investment, to address investor protections, and to minimize investment distortions. Five conclusions emerge.

First, in each of these areas the primary benefits of attracting high-quality investment from sound investment policies are likely to result from unilateral enacting of domestic reforms. Long a truism for trade liberalizing reforms, this conclusion—given the apparent lack of investor responsiveness to international agreements—is increasingly germane to investment. Many of the remaining restrictions are on services. As we have seen in chapter 3, progressive liberalization in services can produce substantial economy-wide benefits and should be a priority for consideration as part of any development strategy. Better telecommunications, banking, auditing services, retail and wholesale trade, and the other service industries have multiple linkages to the

Box 4.5 Disciplines on corporations can also improve the investment climate

Currently, proposed investment rules in the WTO focus exclusively on disciplines for governments, but they say little about responsibilities of corporations (see Moran 2002). Improper corporate behavior—bribery or improper accounting—can corrode the social fabric of developing and developed countries alike. In the wake of the Enron, Arthur Andersen, and WorldCom accounting scandals in the United States, efforts to improve corporate transparency and good conduct assume a new importance. Many such activities outside the WTO are under way.

To help combat bribery and corruption, the OECD has recently established the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The convention, put into force in 1999, currently includes all 29 OECD members and five nonmembers (Argentina, Brazil, Bulgaria, Chile, and the Slovak Republic) as signatories. The convention makes bribing a foreign public official a criminal offense. It also encompasses noncriminal rules for prevention, overall transparency, and cooperation between countries, and it ends the practice of allowing tax deductibility of foreign bribes. Many countries, however, have yet to modify their national legislation to implement the convention fully. Regional forums of cooperation can also help. For example, the Inter-American Convention against Corruption was established in 1996 in the OAS; in April 2001, the Summit of the Americas created an implementation mechanism for the Inter-American Convention. Experience shows that, for anticorruption initiatives to be effective, participation by civil society, private agencies, and the general public is critical. In this context, cooperative efforts by nongovernmental organizations (NGOs), such as Transparency International, the Global Coalition for Africa, the Novartis Foundation, and the Public Affairs Center, and by international organizations and banks, such as the World Bank, the International Monetary Fund (IMF), the Asian Development Bank, the U.N. Development Programme, and the U.S. Agency for International Development, in developing approaches to counter corruption are noteworthy.

Other programs have a more technical focus. The World Bank's work on corporate governance emphasizes disclosure, transparency, the rights and treatment of shareholders and stakeholders, and the duties of board members. Using the OECD's Principles of Corporate Governance as a benchmark, the Bank prepares corporate governance assessments for its client countries to assess their institutional frameworks for corporate governance. In addition, the World Bank and the IMF together initiated the Financial Sector Assessment Program and the Reports on the Observance of Standards and Codes.

More broadly, the U.N. adopted the Global Compact in July 2000 to allay concerns about the social effects of globalization on the developing world. About 100 major multinationals and 1,000 other companies across the world's regions are currently engaged in the Global Compact. Projects relate to making microcredit more accessible, reducing carbon dioxide emissions, fighting against human immunodeficiency virus/acquired immune deficiency syndrome (HIV/AIDS), and expanding of basic education in local communities. In a similar vein, the OECD significantly revamped its Guidelines on Multinational Enterprises in 2000 by adding recommendations about eliminating child and forced labor, improving internal environmental management, addressing human rights, finding methods to combat corruption, and improving disclosure and transparency.

Source: World Bank staff.

rest of the economy, and can be sources of productivity growth for the whole economy. But the pace and form of investment liberalization necessarily must vary across sectors and across countries, because they require regulations that are consistent with local capacities and national objectives. The international community can assist with these efforts through multilateral and bilateral development assistance, government-to-government

information exchanges, and private efforts to inform and assist governments.

Second, international agreements that focus on liberalizing conditions of entry by removing barriers that discriminate against foreign competition may help consolidate domestic reforms at the same time that they open new avenues for reciprocity abroad. Because of the sensitivity of investment regimes, especially in services, any agreement has to allow for country diversity and must permit governments the flexibility to design liberalization in ways consistent with their development strategies. Because the GATS provides this flexibility and addresses most of the remaining outstanding restrictions, multilateral efforts could concentrate on expanding the still-limited coverage of the GATS by increasing the number and quality of commitments that allow commercial presence. Harnessing the full force of reciprocity—both across modes (especially by putting on the table any temporary movement of workers) and across sectors—may help motivate this expanded coverage.

Third, an international agreement that seeks to substantially increase investment flows by increasing investor protections seems destined, on the basis of available evidence, to fall short of expectations. Some key issues are already covered by relatively strong investor protections in BITs. Moreover, it is not clear that any investor protections emerging from multilateral negotiations would add markedly to existing protections found in bilateral agreements. Finally, merely creating new protections does not seem to be strongly associated with increased investment flows. For these reasons, the overall additional stimulus of multilateral rules that apply to new investment over and above unilateral reforms would probably be small—and virtually nonexistent for low-income developing countries.

Fourth, international agreements can usefully discipline two forms of beggar-thy-neighbor policy externalities that are particularly adverse to development. The first and most important are investment-distorting trade measures. Tariff escalation, tariff peaks, quota arrangements, and other barriers—barriers that are common among developing countries as well as between rich and poor countries—stifle developing countries' exports and the investment needed to supply them. Reducing these trade barriers would precipitate new investment in exports as these activities expand, and some portion of this new investment can be predicted to come from abroad. The second set of externalities concerns disciplines for investment incentives that distort the allocation of investment. Cooperative measures at the multilateral level have the advantage of being conceptually clean and broad based. However, because investments tend to affect countries in close regional proximity, countries may find it easier to work on rules that curb disadvantageous competition on investment incentives through regional arrangements. A prerequisite for collective action is information on the extent of investment incentives and their effects; thus, a multilateral inventory of investment incentives is a high priority. One option is to set up an annual surveillance process, perhaps under the auspices of the WTO or as part of the IMF's annual surveillance.

Finally, if new investment arrangements leverage reciprocal commitments for reforms abroad on other issues on the trade agenda, particularly new market access, then agreements would certainly help developing countries. These matters can be decided only in the course of negotiations.

International agreements to promote competition and competition policy

Promoting development requires not only policies to encourage investment, but also policies to ensure that investment is productive; among these policies, competition is one of the most powerful. Most policies to promote competition are domestic, and an important conclusion of chapter 3, this volume, is that the reduction of policy-related barriers to competition is essential to raising domestic

productivity. Among the many domestic policy barriers to competition, the most prominent often involve aspects of globalization, such as tariffs, restrictions on FDI (especially in services), state monopolies, and competition-limiting regulations in postprivatized sectors. Competition policy that disciplines private restraints in domestic markets is also important. However, competition laws have to be appropriate to local circumstances because they rely heavily on the strength and independence of the judiciary, the enforcement capacity of legal authorities, and probity in public administration. A well-intentioned law in an inappropriate institutional environment can become a source of bureaucratic harassment and corruption.

Governments working together in a multilateral or regional framework may be able to enact policies that widen the scope of competition and thereby confer benefits beyond those obtained from unilateral reforms. Analysis has to begin with the restraints on competition in the global marketplace that most adversely affect developing countries and that, if removed, would provide the biggest stimulus to development.

Three categories of restraints on competition in the global marketplace are particularly adverse. First are those that involve *policy barriers to trade* that disadvantage exporters in developing countries by directly limiting their ability to compete in markets. The most important barriers affect agriculture, textiles, and other labor-intensive manufactures and services. Second are *private restraints on international competition* that can raise prices to consumers or to producers in developing countries. These restraints include international cartels that are commonly illegal in OECD countries when they affect OECD markets. Third are *officially sanctioned restraints* that may adversely affect developing countries' import or export prices. We discuss below the effects of exemptions from antitrust laws that governments grant to their firms national export cartels, and the price-raising effects of ocean transport and aviation arrangements that systematically hurt developing countries. Competition policies in developing countries themselves can, in many cases, be improved through increased transparency, nondiscrimination, and procedural fairness. All of these policies are subjects of international negotiation, but they have quite different potential effects on development.

The most important restraints on competition are policy barriers to trade

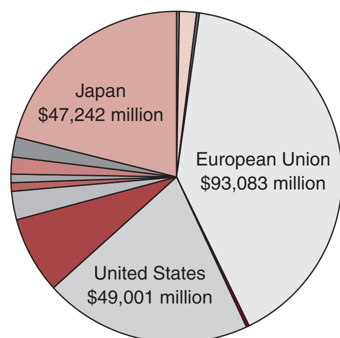
Exporters from developing countries—particularly exporters of agricultural products, textiles, and labor-intensive manufactures and services—confront significant restraints on their ability to compete in global markets. Developing countries generally face higher barriers to exports than do industrial countries (World Bank–IMF 2002). Japan and the United States provide maximum protection against imports from developing countries, while European Union protection is skewed against imports from middle-income countries. Developing countries, with average barriers higher than those in rich countries, also raise barriers against competition from other developing countries. Taken together, protectionist measures such as high tariffs, tariff peaks, restrictive tariff rate quotas on low-tariff imports, and domestic and export subsidies are ubiquitous and raise barriers to competition from all developing countries. Because the world's poor people usually produce agricultural and labor-intensive products, the world trading system is tilted against the poor. The average poor person selling into the global marketplace confronts tariffs that are twice as high as those faced by people who are not poor (World Bank 2002c; see also Oxfam 2002).

Subsidies and trade barriers in agriculture are particularly pernicious. In developed countries tariff rates in agriculture are twice those of manufactures. Sheltering of agriculture by hefty subsidies aggravates the effects of these tariffs (OECD 2001; World Bank–IMF 2002). The costs of such price supports are borne by low-income consumers in

protected markets—those consumers who spend a large proportion of their income on food, while the supports benefit only a handful of large farmers. The U.S. subsidies to cotton producers, for example, cost taxpayers nearly $4 billion a year—three times the U.S. aid budget for Africa—while adversely affecting low-income West African economies that produce cotton. High protection and support of the sugar industry in the European Union and the United States is another example of these harmful policies. Total OECD support for agriculture amounted to 1.3 percent of the gross domestic product of those countries in 2001, with the producer support estimates[12] the highest in the European Union in absolute terms (see figure 4.6). Prices received by OECD farmers were on average 31 percent above world prices (measured at the border) (World Bank–IMF 2002). Though efforts have been made to lower protection for agriculture in OECD countries, the recently enacted 2002 U.S. Farm Bill increases support spending to a projected $45 billion, or 21 percent of producer income during fiscals 2002–07 (see appendix 2). This increase may well aggravate secular deterioration in developing countries' terms of trade through its effects on long-term world prices. Protection of agriculture is also common in developing countries—comparable in weighted ad valorem equivalent terms—but is much lower when subsidies are taken into account (see World Bank–IMF 2002).

Figure 4.6 OECD countries spent $230 billion in 2001 to support agricultural producers

Producer support estimate by the OECD countries totaled $230 billion in 2001



Source: World Bank–IMF (2002).

Policy barriers restrain competition in clothing and textiles with similarly adverse effects on developing countries. Developing countries account for about 50 percent of world textile exports and 70 percent of world clothing exports (World Bank–IMF 2002). Under the Uruguay Round Agreement on Textiles and Clothing, quota restrictions are to be abolished gradually during 1995–2005. The slow pace of removing restrictions on competition in textiles and clothing has resulted in sizable losses in export earnings and productive employment in many developing countries. The combined negative income effect for developing countries caused by quotas and tariffs on industrial-country imports amounts to $24 billion annually, and the export revenue loss is $40 billion (World Bank–IMF 2002).

Impediments to competition take other forms as well. Between 6 and 14 percent of the tariff lines of Canada, the European Union, Japan, and the United States are subject to tariff peaks, in some cases at rates well over 100 percent (Hoekman, Ng, and Olarreaga 2001). Developing-countries' exporters may be displaced by high tariff peaks in Canada and the United States (in textiles and clothing) and in the European Union and Japan (in agriculture, footwear, and food products). Even though France exports 12 times more to the United States than Bangladesh, U.S. tariff revenues on imports from Bangladesh were roughly the same tariff revenues on imports from France (Gresser 2002). Escalating tariffs—in which protection is lower for primary products but increases as the local value added increases—discourage development of forward processing. Chilean firms, for example, can export fresh tomatoes to the United States, paying a tariff of 2.2 percent; however,

if they dry and package the tomatoes, the U.S. tariff is 8.7 percent; and if they make salsa out of the tomatoes for export, the duty is 11.6 percent (Schiff 2001). By reducing the demand for higher-processed imports from developing countries, tariff escalation prevents developing countries from diversifying exports into areas of their competitive advantage. These tariff structures are common in poor as well as in rich countries (see World Bank 2002c: 45).

Another restraint on competition is frequent recourse to antidumping and other types of contingent protection. Antidumping laws were originally created to counteract predatory practices of foreign sellers into a home market. This was the original rationale for U.S. antidumping legislation of 1916. The fear was that a foreign firm (or cartel) could deliberately price products low enough to drive existing domestic firms out of business and to establish a monopoly. Once established, the monopolist could more than recoup its losses by exploiting its market power. For predation to work, the monopolist or cartel would not only have to eliminate domestic competition, but would also have to be able to block entry by new competitors. It would, therefore, need to have a global monopoly, need to convince the importing government to impose or tolerate entry restrictions, or need to be able to raise private entry barriers (Hoekman and Kostecki 2001).

In practice, post–World War II cases of successful predatory dumping are the exception, not the rule. More than 90 percent of all antidumping investigations would never have been launched if a competition standard—potential threat of injury to competition—had been used as a criterion (Messerlin 2000).[13] As it has evolved, antidumping has become a favored vehicle for restricting competition from imports, and it is applied with increasing frequency by developing countries against each other. Since 1995, countries have initiated more than 1,800 antidumping investigations (table 4.1). Although industrial countries have traditionally been the main users of such measures, developing countries have been more active in recent years, led by India, Argentina, Brazil, and South Africa. In the seven years to 2001, developing countries initiated almost two-thirds of all investigations, well in excess of their share in world trade. However, developing countries have also been the target of nearly 60 percent of investigations, mostly initiated by other developing countries. The recent steep rise in antidumping investigations

Table 4.1 Many antidumping investigations were initiated during the 1995–2001 period

	Affected countries					
Initiating country	Industrial countries	United States	European Union	Developing countries	Transition countries	Total
Number of investigations	511	102	313	1,086	248	1,845
Industrial countries	128	17	67	363	114	605
Of which						
United States	79	0	46	146	30	255
European Union	15	6	0	165	66	246
Developing countries	379	85	242	718	131	1,228
Transition countries	4	0	4	5	3	12
Percentage of investigations	28	6	17	59	13	100
Industrial countries	21	3	11	60	19	100
Of which						
United States	31	0	18	57	12	100
European Union	6	2	0	67	27	100
Developing countries	31	7	20	58	11	100
Transition countries	33	0	33	42	25	100

Source: WTO Secretariat, as reported in World Bank–IMF 2002.

puts the predictability and nondiscriminatory application of trade policies at risk.

Removing these restraints on competition from developing countries would have a big development payoff. These issues and detailed policy recommendations have been well analyzed elsewhere (see, for example, World Bank 2002c). Suffice it to say that dismantling both worldwide trade barriers and agricultural subsidies could increase long-term growth in developing countries by as much as 0.5 percent annually, which, when taken together with terms-of-trade improvements, could reduce the number of people living in poverty by as much as 13 percent by 2015. One-third to one-half of the welfare gains would accrue to the developing world (World Bank 2002c). Because of the growing importance of South-South trade and the remaining high barriers among developing countries, removing the barriers to competition among themselves would produce substantial gains (see World Bank 2002a; and World Bank–IMF 2002). These facts underscore the importance of the Doha Development Agenda of the WTO and the various regional efforts around the world that could lower trade barriers to developing countries' exports. Because not all countries will benefit from some reforms (such as removing the textile quotas), a broader reform that covers all trade issues and is linked to development assistance is vital.

Private restraints on international competition can raise prices to developing countries

Besides policy barriers to competition, large international companies with market power can form cartels that fix prices, allocate markets, and restrain competition. Although trade reform and the expansion of potential competitors in markets around the world have undoubtedly reduced the scope for private cartels, the numerous international cartels uncovered in the 1990s suggest that market forces alone do not offer complete protection against price-fixing and market-allocation arrangements that raise prices to developing countries. These cartels are typically illegal when they adversely affect a country's own commerce. However, OECD governments have no authority to prosecute cases when cartel activities function outside their national jurisdictions and cannot be shown to affect prices of imports or domestic goods.

The 1990s saw the uncovering of several international cartels. Prosecutions of international cartels picked up after 1993 when the United States revised its anticartel enforcement practices to grant amnesty to the first cartel member that cooperated with authorities. Before 1993, approximately one firm a year applied for leniency under anticartel laws, and big cases were rare; now, one firm a month applies for leniency. U.S. fines against domestic and international cartels during the 1990s totaled $1.7 billion. The publicity associated with these prosecutions (many of which affected international markets as well as the United States) encouraged prosecutions by other enforcement agencies, including those in several middle-income countries (for example, Brazil and Korea). Antitrust authorities in the United States and European Union alone prosecuted 40 international cartels during the 1990s.

Cartels that have been uncovered through law enforcement have had a substantial role in increasing the prices to developing countries. Although estimates vary, the average international price increases caused by international cartels have been estimated to be on the order of 20–40 percent. The estimated price increases resulting from cartels, as shown in six high-profile international cartel prosecutions (table 4.2), vary widely—from 10 percent for stainless steel tubes to 45 percent for graphite electrodes. Cumulative overcharges to developing countries over the life of the cartels in the six cases ranged from $3 billion to $7 billion, depending on whether SITC or HS codes are used. Developing countries imported 12 products that had a value of sales of $11 billion in 2000 and that were sold by international cartels prosecuted during the 1990s (figure 4.7); if price collusion were to raise

Table 4.2 International cartels can be expensive: estimates of sales and overcharge

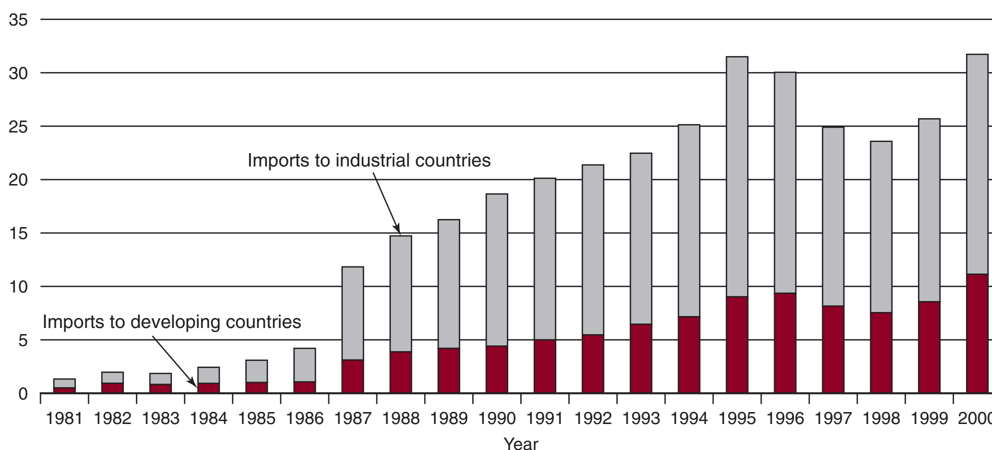
Product	Years of cartel	Number of firms	Cartel sales SITC	Cartel sales HS	Price increase	Possible overcharge to developing countries SITC	Possible overcharge to developing countries HS	Fines
Vitamins	1990–99[a]		$26.4 billion	$10.8 billion	35%	$3.05 billion	$1.71 billion	Almost $2 billion
Citric acid	1991–95	111	$9.9 billion	$447 million	20%	$402 million	$67 million	Over $250 million
Bromine	1995–98	2	$598 million	$409 million	15%	$46 million	$8 million	$7 million
Seamless steel tubes	1990–95	8	$26.6 billion	$21.7 billion	10%	$1.63 billion	$1.19 billion	99 million euros
Graphite electrodes	1992–97	23	$9 billion	$7 billion	45%	$1.35 billion	$975 million	Over $560 million
Lysine	1992–95	5	$4.8 billion	$913 million	10%	$294 million	$43 million	About $200 million

SITC = Standard International Trade Code; HS = Harmonized System Classification.
Notes: Figures for each cartel span the entire period of the conspiracy. Sales are approximated using export statistics from countries of origin of indicted firms and thus exclude domestic sales. If participating firms are multinationals and the locations of their subsidiaries are known, sales are calculated by taking into account the exports of countries of subsidiaries. When that information is unavailable and production is understood to be global, sales are calculated by using exports of all countries producing the cartel product. Overcharge refers to imports to developing countries / (1 + price increase) × price increase. Sales calculations provided are based on the SITC Revision II and the HS 1988.
a. Because the cartel ended in February 1999, sales and overcharge estimates are aggregated from 1990 to 1998.
Source: Connor (2001), Levenstein and Suslow (2001), OECD (2000), and World Integrated Trade Solution database.

prices by an average 20 percent, the total overcharges would have reached almost $2 billion in 2000.

Despite the rise in prosecutions, reining in international cartels remains difficult. The fines imposed by authorities often fall well short of the estimated overcharges, raising questions about the effectiveness of prosecution as a deterrent for cartel behavior. Moreover, 24 of the 40 cartels prosecuted by the United States and the European Union lasted for at least four years, indicating that market forces are not always adequate to rapidly eliminate cartels. The history of cartels

Figure 4.7 Imports affected by cartels rose from 1981 to 2000 for both rich and poor countries



Source: World Bank staff.

Box 4.6 The lysine cartel, 1995–2001

Lysine is a food additive used in hog and poultry feeds. The global lysine cartel lasted from 1992 to 1995. During that period the five participants controlled more than 97 percent of global capacity. Cartel members engaged in price-fixing, allocating sales quotas, and monitoring volume agreements. In 1994, at the peak of the cartel's effectiveness, the price of lysine reached about $1.20 per pound, approximately $0.50 above the competitive price level.

Estimates of the overcharges to U.S. customers during this period vary and are as high as $141 million. Although no formal analysis of non-U.S. overcharges is available, the observed lower prices in Asia suggest overcharges in the rest of the world were lower than those in the United States. According to Connor (2001) a reasonable projection of the global overcharge by the lysine cartel would be in the $200 million to $250 million range. A more conservative estimate assumes a 10 percent overcharge on $1.4 billion in global sales during the life of the cartel, for a total of $140 million (OECD 2000: 16).

The cartel had a significant effect on both potential producers and users of lysine. Lysine production in 1994 was at least 20 percent less than under competitive conditions, resulting in lower production among the feed and meat industries that depend on lysine. Moreover, the cartel limited potential developing-country competitors by using price discrimination across regions, and it froze the relative positions of the leading firms in the market, when compared with the very fluid situation before the conspiracy. Although a few relatively small producers entered the market during the 1990s (mainly in Hungary, the Slovak Republic, and South Africa), most new entrants began production only after the lysine cartel had been broken up in 1995. China, in particular, has been a source of increasing lysine production. Nevertheless, the five original participants in the cartel continued to control 95 percent of global capacity at the end of the decade.

Source: Connor (2001).

indicates that some operate intermittently over decades.[14]

New initiatives to discipline illegal international cartels

Firms will be deterred from price fixing and forming cartels if the fines for doing so, multiplied by the probability of being caught (that is, the expected value of the cost), exceed the extra profits that result from this anticompetitive behavior (that is, if the potential punishments for creating cartels exceed the benefits). Reforms that raise the sanctions on cartels and that increase the probability of successfully prosecuting cartels will tend to dissuade more firms from forming cartels, whether domestic or international. The secret nature of most cartel agreements poses a special problem because it implies that governments must actively search for evidence or must encourage cartel members to come forward with evidence; otherwise, firms will perceive the probability of prosecution to be very low (Evenett, Lehmann, and Steil 2000).

One option for curbing illegal international cartels is to extend further the extraterritorial reach of industrial nations' anticartel laws (Hoekman and Mavroidis 2002). When a competition authority in an industrial economy uncovers a cartel that affects markets both inside its own borders and in other countries, then that authority could take enforcement action on behalf of all affected nations. A stronger version would have the competition authority take action even if the cartel affected a foreign market without affecting the home market. In both cases, the authority could request help in collecting evidence from enforcement bodies in other nations. Fines and sanctions against the cartel would be determined on the basis of its detrimental effects on all affected economies.

Yet another option is to grant governments of developing countries—or their citizens—

standing in the major OECD countries so those affected could initiate private injury suits against companies headquartered under the jurisdiction of a particular antitrust authority. Because most antitrust actions are driven by private complaints and through private suits, such legal changes would markedly strengthen the hand of consumers and businesses in developing countries to curb private restraint practices. The principal attraction of such a proposal is that it would allow developing countries to benefit from the sophisticated investigative powers and regulatory expertise in the OECD competition authorities. The enforcement record in the 1990s suggests that the overwhelming majority of cartel members have their headquarters in industrial economies. A drawback to the proposal is that extraterritorial application is a perennial source of tensions among countries, and the incentives are low for OECD governments to take actions against their own firms for effects in foreign markets.

A more modest option for reform could focus on notification and information exchanges by national enforcement authorities. This exchange would build on the growing number of bilateral cooperation agreements on competition matters, thus expanding their scope to include many more economies. The objective here is to raise the probability of successfully prosecuting cartels by encouraging the sharing of conspiracy-related information between enforcement authorities. The modalities for this type of international cooperation have received considerable attention in recent years, not the least of which is the OECD's nonbinding Recommendation on Hard Core Cartels. However, this approach essentially offers gains only to those economies that have effective competition laws, and many developing economies do not. Furthermore, the amount of information that can be exchanged on cartel cases today is highly constrained because most countries have laws against sharing confidential information. The original intent of those laws was to protect legal business secrets and plans, and the confidentiality provisions have, unfortunately, been applied to illegal conduct uncovered during cartel investigations. These restrictions on information exchange are especially worrisome at a time when so much evidence about international cartels is being collected through national leniency programs, thereby suggesting that the potential for information exchange could be considerable.

Another approach is a multilateral agreement. Proponents of including competition on the multilateral agenda have gravitated toward a relatively narrow focus. They are seeking disciplines on (a) the so-called core issues of nondiscrimination, national treatment, and transparency; and (b) private "hard core" international cartels. These disciplines would apply to all WTO members, both industrial and developing, with technical assistance and capacity building envisaged. Most recent discussions have emphasized the need for voluntary international cooperation (Anderson and Jenny 2001).[15]

In summary, policies that help developing countries discipline international cartels more effectively would have a potentially large benefit, for consumers in rich and poor countries alike.

Officially sanctioned private restraints can hurt trade to developing countries . . .

Officially sanctioned restraints on trade make up the third major category of competition restrictions that adversely affect developing countries. These restraints take the form of exemptions from domestic antitrust laws and pertain to certain types of international activity. Many governments legally permit their own private firms to cartelize export markets—as long as markets affected are outside the country, and export cartels do not provide an opportunity for producers to fix prices at home. Indeed, numerous economies have explicitly exempted export cartels from their domestic competition laws—essentially providing some legal cartel privileges for their national firms, but not foreign firms (table 4.3). U.S. soda ash producers have

Table 4.3 National exemptions to competition law for exporters

Country	Type of exemption	Reporting requirement
Australia	Contracts for the export of goods or supply of services outside Australia	Submission of full particulars to the national authority within 14 days
Brazil	Joint ventures for exports, as long as there are no effects on the Brazilian market	Approval by the national authority
Canada	Export activities that do not affect domestic competition	None
Croatia	Agreements that contain restrictions that aim to improve the competitive power of undertakings on the international market	Notification of the agreement to national authority within 30 days after conclusion of the agreement
Estonia	Activities that do not affect the domestic market	None
Hungary	Activities that do not affect the domestic market	None
Japan	Agreements regarding exports or among domestic exporters	Notification of and approval by the industry administrator
Latvia	Activities that do not affect the domestic market	None
Lithuania	Activities that do not affect the domestic market	None
Mexico	Associations and cooperatives that export	None
New Zealand	Arrangements that relate exclusively to exports and that do not affect the domestic market	Authorization of the national authority
Portugal	Activities that do not affect the domestic market	None
Sweden	Activities that do not affect the domestic market	None
United States	Webb-Pomerene Act: activities that do not affect domestic competition	Webb-Pomerene Act: filing of agreements with the U.S. Federal Trade Commission
	Export Trading Companies Act: strengthened immunities granted by Webb-Pomerene Act	Export Trading Companies Act: Certificates of Review provided by U.S. Department of Commerce

Source: Evenett and Ferrarini (2002); drawn from OECD (1996), OECD (2000), and <http://www.gettingthedealthrough.com> (accessed May 2002).

taken advantage of these provisions in U.S. law to form an export cartel, which has subsequently been the target of European and Indian enforcement actions. Generally, these cartels may attempt to raise prices in their export markets to the detriment of overseas consumers. Their success depends on the number of other foreign competitors in these markets. Because competition is more likely to be limited in the smaller markets of developing countries, it is probable that developing countries are adversely affected disproportionately.

Because cartel registers are secret in Europe and Japan, and virtually secret in the United States, information on their extent, products, and geographic coverage is nil. The legal exemptions are known, and the latest available information—from the OECD in 1974—has indicated a broad proliferation. The initial rationale for export cartel exemptions was that small exporters could join to share the allegedly substantial costs of marketing their products abroad. Even if such arguments were legitimate in the past, most small- and medium-sized enterprises in industrial economies today export without a need for cartels, so the rationale is moot.

Another exemption from OECD antitrust laws is maritime transport, which inadvertently put developing countries at the mercy of price fixing. The exemption in U.S. law extended to maritime transport has facilitated, through shipping conferences, collusive arrangements in ocean-liner shipping. Agreements among private shipping companies have a long history, beginning with trade between the United Kingdom and India in the 1870s. Such arrangements have taken different forms, including the conclusion of agreements on uniform freight tariff rates and conditions of service, the establishment of exclusive or preferential working relationships between shipping lines, or the integration of shipping networks through strategic alliances.

The power of such arrangements has eroded in recent years because outside shipping lines have gained a significant share of

Table 4.4 Breaking up floating cartels could help developing countries

(Economic effects of ending private restrictions on ocean-liner competition)

Effect	Amount
Reduction in price of ocean transport	20%
Projected total savings for U.S. imports	$2.1 billion
Projected savings for developing-country imports	$2.3 billion

Source: Fink, Mattoo, and Neagu (2001); World Bank (2002c).

the market and regulators have moved to encourage greater price competition. Nonetheless, Fink, Mattoo, and Neagu (2001) conclude that a breakup of cooperative working agreements and price-fixing arrangements among the major private carriers could reduce transport prices by 20 percent on U.S. routes, for a savings of $2 billion or more (see table 4.4; see also Francois and Wooton 2001).

If developing countries could save the same percentage of their import costs, then their total import bill would fall by $2.3 billion. This figure is probably an underestimate of the effect of breaking up private constraints on ocean trade services for developing countries. Their freight charges are more likely to be subject to price-fixing than are freight charges on industrial-country routes because low traffic volumes limit the number of commercially viable competitors. For example, the European Commission found that the Associated Central West African Lines abused its dominant position by providing rebates to shippers that complied with its policies, as well as carrying out other anticompetitive practices.[16]

. . . and international agreement could rein in their adverse effects

Multilateral efforts to curb national export cartels, as well as to rein in private restraints in regulated industries that have been rooted in exemption from antitrust laws, are particularly well suited to the WTO. Most governments today either encourage or acquiesce to national cartels that adversely affect markets beyond their borders. Government support for beggar-thy-neighbor export cartels is anachronistic in an era of global trade rules. Reciprocal international agreements offer the promise of reducing foreign distortions to domestic markets in return for commitments to desist from such practices. Agreements on international cartels involve giving up some rents from exporting in return for the benefits of more competitive markets at home.

A multilateral accord to curb export cartels would probably benefit developing countries. An alternative and less-ambitious approach is to narrow the coverage to sectors in which it can be demonstrated that small- and medium-sized enterprises cannot compete internationally without a mechanism to share burdens such as marketing costs, and so on. Because the extent of injury to foreign consumers is not known, a minimalist policy toward export cartels involves disclosure. If export cartels are allowed to retain their legality, governments should agree to require that firms seeking to establish an export cartel publicly register as such—and that those registries be updated annually and made accessible to the public over the Internet. Furthermore, if these cartel exemptions were specifically to aid small firms, then there is no argument for permitting large firms to participate.

Similarly, countries could agree to end antitrust exemptions for maritime transport and, at the same time, give standing so exporters in developing countries that are harmed by subsequent cartel activities can sue under antitrust statutes. This change would have significant effects by unleashing competition in this sector and by altering an arrangement that today drives up the cost of exporting from many developing countries.

International collaboration can strengthen domestic competition policies

Domestic policies in developing countries have a significant effect on competitive conditions. Chapter 3 underscored the particular importance of policy barriers to competition, particularly in trade, in restrictions on

incoming FDI, and in restrictions on new entry (foreign or domestic) in regulated industries. Chapter 3 also concluded that the potential role of a domestic competition agency was shaped largely by the domestic institutional environment. In some countries with strong legal and judicial systems, a competition agency could help augment competition; in other countries with weak legal and judicial systems, establishing a competition agency could be counterproductive if they become a source of rent-seeking and corruption.

International discussions on trade policy have, since their inception, seen domestic competition policy as an issue associated with market access. Competition policy is intrinsically related to the principles of national treatment and MFN treatment insofar as competition law allows recourse to address certain kinds of discriminatory policies and arrangements that deny foreigners access to markets.[17]

The launching in 1997 of the WTO Working Group on Trade and Competition Policy signaled the beginning of the most recent international discussions about the interface between trade and competition, as well as the possibility of multilateral cooperation on competition law. Not all domestic competition matters give rise to international trade problems, and vice versa. There are situations when the lack of, or inappropriate application of, competition law can impede trade and market access, however. After five years of discussions, governments have progressively retreated from ambitious applications (such as harmonization) to proposals that focus on core principles, transparency, nondiscrimination, and procedural fairness. Governments may perhaps also focus on provisions addressing illegal international cartels (see discussion above). Aside from these general principles, the exact content of national competition laws could vary considerably in the range of conduct and structural disciplines that they include.

From a national point of view, for competition law to be a priority it must yield a higher payoff than other choices. Competition law is technical and requires the use of skills that are in short supply in many developing countries. Building capacity to apply competition legislation effectively will take time. Given that competition law is applied on a case-by-case basis, dealing with systemic trade and investment barriers and with government regulations that restrict competition may generate a higher rate of return (see chapter 3). Kee and Hoekman (2002) have investigated the effect of the existence of a competition law on estimated industry markups over cost. They used cross-country, cross-industry time series panel regressions that include data on the number of firms by industry (turnover), sales (market size), and import competition. They concluded that antitrust legislation on its own has no effect on markups, but that imports and entry have a major and statistically significant effect in reducing markups (see chapter 3). Competition law is found to have an indirect effect, however, by reducing the first order marginal effect of imports and by reinforcing the marginal effect of domestic competition. That effect is stronger in the more-developed and larger economies.

The effect of government policies that restrict competition for nontradables may be more important from a development perspective than is antitrust enforcement, because those policies affect the price and quality of key intermediate inputs that determine the competitiveness of industries on world markets (for example, Fink, Mattoo, and Neagu 2002; Francois and Wooton 2001). Depending on the capacity of government, a role may exist for a competition agency that reviews new policy and regulatory barriers to competition (see chapter 3, this volume, as well as Anderson and Holmes 2002).

As Winters (2002) notes, administration of competition law is complex, and its misapplication can have a costly and chilling effect on investment. Issues relating to the institutional design, the independence of investigating authorities, the effective judicial review and appeal mechanisms, and the availability of

expertise—both legal and analytical—are all critical issues for the effective application of antitrust law. Therefore, the development of competition law in many countries has occurred gradually over a long period, and continues to evolve. The necessary administrative apparatus cannot be put into place within a short time frame. The institutional guarantees necessary for a competition authority to be independent from eventual political influence (so that it can concentrate on its mandate) require government acceptance that branches of the national administration will operate outside its direct control. Until a few decades ago most European Union member states had no experience in the field of antitrust. Before a government determines national priorities, both the costs and benefits of competition enforcement ought to be considered, including the possibility of perverse outcomes through capture or corruption.

This discussion suggests that the reciprocal bargaining and enforcement framework of the WTO is less well suited to collective action

Box 4.7 International cooperation aids competition policy

Several entities outside the WTO have activities that are germane to competition policy. For example, the OECD launched a Global Forum on Competition in October 2001 to stimulate a comprehensive policy dialogue about competition, and that goes beyond its previous activity of providing technical assistance. The Forum, backed by the OECD's Committee on Competition Law and Policy, engages in high-level discussions with key officials from member and non-member countries, including countries that do not have well-developed competition enforcement authorities. The objective of the Forum is, first, to encourage common understanding and sharing of experiences among a larger number of competition officials and, second, to generate benefits through cooperation, conflict prevention, and voluntary convergence. Its first meeting successfully highlighted the role of competition policy and of its authorities in economic reform; it also fomented greater international cooperation on such matters. The latest semiannual meeting in February 2002 discussed the merits of competition policy for developing economies, international cooperation in merger and cartel cases, capacity building, and technical assistance. In addition, the forum benefits from contributions of regional organizations such as the Common Market for Eastern and Southern Africa and international organizations such as the World Bank, UNCTAD, and the WTO.

Another example of an entity outside the WTO with activities germane to competition policy is the ICN, created on October 25, 2001, to deal with international antitrust enforcement through regular consultations between government officials, private firms, and NGOs from around the world. According to its mandate, the ICN will "formulate proposals for procedural and substantive convergence through a results-oriented agenda and structure." Its special status stems from the fact that it is maintained by the enforcement authorities themselves, has voluntary membership, and is not bound by rules, but rather by a community of interests. The first annual conference was held in Italy during 2002 and sparked discussions on reforms to the merger review process; the advocacy role and activities of competition agencies (especially in developing and emerging economies); and recommendations on best practices. Individual enforcement authorities will have the flexibility to make decisions on the most suitable means of implementing the recommendations. The ICN will address complex issues, and newly established competition authorities will no doubt benefit from the collective experience of other member agencies.

Though it is too early to gauge the success of the Global Forum on Competition and the ICN in terms of fostering global cooperation, they play a useful role in disseminating information on best practices for implementing a competition law policy.

Source: World Bank staff.

on competition law than international collaboration through development assistance and other venues. To be sure, international negotiations can help reinforce progressive domestic reforms in competition law (see Birdsall and Lawrence 1999).[18] However, in this complex area of domestic regulation, one size does not fit all, and, as many WTO members have noted, cooperation on competition-law policy requires establishing a domestic enforcement capacity that at present is beyond the reach of many developing countries. Other channels can help disseminate best practices to countries wishing to strengthen their competitive conditions. Several agencies and forums have work programs on international competition policy. These agencies include the OECD, UNCTAD, and the International Competition Network (ICN) (see box 4.7). The OECD and UNCTAD have developed their own guidelines or recommendations for tackling international cartels, but they have no powers of enforcement or investigation. The nascent ICN has focused more on international mergers and acquisitions, and it is intended to facilitate information exchange and dissemination of best practices.

Conclusions

For both investment and competition policy, domestic reforms that are implemented unilaterally in the national interest of promoting a sound investment climate and a more competitive economy are likely to yield the most direct and positive effect on growth and poverty reduction. The international community can assist the reform process through multilateral and bilateral development assistance, government-to-government information exchanges, and private efforts to inform and assist reform-minded governments. Countries may be able to use regional and multilateral agreements to motivate progressive reforms at home at the same time that they use reforms to leverage reforms abroad to promote development. Yet to be effective, these agreements must be designed to achieve specific objectives that will be important to developing and reinforcing positive domestic policies rather than distorting them.

For investment policy, international agreements may help increase flows of foreign investment, but evidence suggests that these benefits are likely to be limited unless they focus on creating nondiscriminatory terms of liberalization and on eliminating adverse policy externalities. Agreements that curb beggar-thy-neighbor investment policies that distort investment location are particularly important in two areas. One critical area is investment-distorting trade barriers—that is, border protections, agricultural subsidies, tariff escalation, and other practices that bias investment flows away from developing countries' export activities because such barriers discourage imports from those countries. A second critical area is disciplining competition among governments to lure foreign investment through wasteful investment incentives. An important initial step is developing an inventory of the extent, costs, and distorting consequences of those incentives. Agreements should be carefully designed to limit their scope to areas where international externalities exist. In the case of the WTO, the design should focus on reducing discrimination and increasing market access. International cooperation on the design of domestic regulation is more effectively provided through development assistance—whether bilateral, regional, or multilateral.

For competition policy, an agreement would potentially have large benefits if it addressed those restrictions on competition in the global marketplace that most adversely affected developing countries: policy barriers to competition that hurt exporters, private restraints in the form of international cartels, and officially sanctioned private restraints emanating from antitrust exemptions. Much more information is needed in this area on the prevalence and effects of policies that restrict competition. The international community can collaborate with developing countries by providing technical and financial assistance

to foster mutual learning, information exchanges, and cooperation on competition policy.

Notes

1. WTO 2001a, Paragraphs 20 and 23 in the Doha WTO Ministerial Declaration. The need for enhanced technical assistance and capacity building in these areas was also recognized.

2. See Ostry 1997; see also Hart 1996.

3. United States 1998, as cited in Gilpin 2000: 184.

4. See Smythe 1998.

5. South-South FDI is calculated by comparing developing countries' FDI inflows with recorded outflows from other regions. This figure may be more accurate than others because developing countries often underreport FDI outflows. In addition, round tripping of a country's own capital can overestimate the FDI figure (World Bank 2002a).

6. For a cogent description of the predominance of services in the NAFTA reservation lists, see Rugman and Gestrin 1994. See also Gestrin and Rugman 1993.

7. By 2003, all members must have completely phased out performance requirements that were in place at the time of the agreement and that were grandfathered through a notification process. All 27 notifications of policies not consistent with the agreement were from developing countries. Almost half of notified measures related specifically to the automotive sector. Many of these performance requirements have already been phased out during the transition period. Ten countries that requested an extension of the transition were granted an additional four years, to 2003.

8. WTO members are faced with two options. First, they can agree to re-open the agreement, which seems unlikely. Second, they can seek to reduce or elaborate on the length of the Annex Illustrative List. The issue is that, even though both notifications and disputes have, to date, centered primarily on the "illustrated" list (notably on local content and, less so, on trade-balancing requirements), the agreement arguably prohibits a greater range of as-yet unspecified performance requirements. Introducing greater specificity in the language could enlarge the effective coverage of the agreement or confine it to the illustrated list.

9. Within the framework of the ASCM the scope for discipline lies in the challenge of an investment incentive that can be shown to be specific, to be within the meaning of the agreement, and to be contingent on export or on having an "adverse effect" on the trade of another member. The difficulty of such a challenge depends on the specific types of policies that are in question. One of the key factors in determining a subsidy is the "financial contribution" that could cover the range of fiscal and financial incentives that are used by developed and developing countries. These disciplines have yet to be tested. In the case of services, the GATS provides a mandate for developing "necessary multilateral disciplines to avoid such trade-distortive effects." The work has progressed slowly.

10. There is evidence of significant investment diversion away from the Caribbean Basin countries and toward Mexico, but Mexico's adherence to NAFTA has almost certainly been a more important motivating factor than the use of fiscal or financial incentives, which it can generally ill afford.

11. This is not to deny the potential risk of "investment poaching," including within developing countries. Studies have indeed documented the negative welfare implications that derive from incentive packages that merely transfer investment from one location to another without creating new jobs or improving productivity. In the case of Brazil, for instance, the consensus among researchers is that heavily indebted states have granted very large tax breaks to automotive companies to build factories that the companies had intended to build in Brazil anyway (Rodríguez-Pose and Arbix 2001).

12. Producer support estimates are the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers. These numbers are taken from World Bank–IMF 2002.

13. The fact that predation has very little to do with antidumping as it is practiced is perhaps best illustrated by the United States, which has two antidumping statutes. One, the Antidumping Act of 1916, maintains a predation standard for antidumping; the other, the Tariff Act of 1930, as amended, has a price and cost-discrimination standard. Invariably cases invoke the second act and not the first.

14. Epstein and Newfarmer 1980, for example, found that a cartel for heavy industry operated off and on from December 1939 through the mid-1970s, with overcharges of more than 20 percent on sales of steam turbines and other products.

15. WTO members with established competition enforcement seem to insist that a precondition for cooperation is that developing countries adopt legislation and establish enforcement capacity: "[C]ooperation with respect to competition matters [is] only possible when a competition regime [is] already in operation; that is, when there [is] a domestic competition law of some sort and a domestic competition authority existed with sufficient powers to effectively enforce that law . . . . While cooperation could be provided within a voluntary framework of mutual interest, it would not be possible for a developing country to eradicate anti-competitive practices which had an impact on their

markets unless it also developed a national competition law" (WTO 2001c: 27, para. 79).

16. See World Bank 2002c for a fuller discussion of conferences on ocean liners.

17. See WTO 2002.

18. Birdsall and Lawrence (1999) write: "When developing countries enter into modern trade agreements, they often make certain commitments to particular domestic policies—for example, to antitrust or other competition policy. Agreeing to such policies can be in the interests of developing countries (beyond the trade benefits directly obtained) because the commitment can reinforce the internal reform process. Indeed, participation in an international agreement can make feasible internal reforms that are beneficial for the country as a whole [and] that might otherwise be successfully resisted by interest groups."

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