Chapter 9 International rules and standards

9.1 International arrangements affecting the investment climate have a long history. In the 12th century cities in the Northern Europe joined together to form the Hanseatic League to protect commerce, originally along the Kiel "salt road."[1] And customary international law began recognizing limits on the ability of governments to expropriate foreign property at least as early as the 1920s.[2] But the number of international arrangements dealing with investment climate issues has grown dramatically in recent decades. There are more than 2,200 bilateral investment treaties, 200 regional cooperation arrangements, and 500 multilateral conventions and instruments.[3] They cover most areas of the investment climate—from investment protection, bribery, and trade, to corporate governance, taxation, and environmental and labor regulation. How might these arrangements help governments improve the investment climates of their societies?

9.2 Arrangements that reduce regulatory barriers to international trade and investment can improve investment climates in obvious ways—by expanding market size, reducing costs, and enhancing competition (chapter 5). Regional cooperation arrangements can be especially important for smaller economies (chapter 3). This chapter looks at the potential advantages and tradeoffs associated with international agreements dealing with investment climate issues. The focus is on three areas:

- Reducing risks for firms by enhancing the credibility of government policies.
- Reducing costs in international transactions.
- Dealing with international spillovers that might otherwise undermine the investment climate.

9.3 When considering the impact of particular arrangements in these areas, the details of specific rules or norms obviously matter. But so do the compliance mechanisms associated with the norm, and the scope of participation in the arrangement (box 9.1).

Box 9.1 Evaluating international rules, norms, and standards

The role and impact of any particular international rule, norm, or standard depends on the mechanism for securing compliance and the scope of participation in the arrangement.

Compliance mechanisms. At one end of the spectrum, norms may be expressed as formal treaty obligations, and violating them may expose defaulting governments to sanctions of various kinds. In some cases the arrangement includes detailed mechanisms for dealing with allegations of noncompliance (WTO Dispute Panels). At the other end of the spectrum, norms may be no more than a statement of common aspiration, influencing governments mainly through reputation effects (APEC). In between is a rich menu of hybrid approaches that seek to leverage the reputation concerns of governments. For example, the OECD Guidelines for Multinational Enterprises involve no formal obligations but contain a mechanism for reporting allegations of noncompliance. The OECD Corporate Governance Principles go further by providing a mechanism for governments to voluntarily have their compliance assessed by an independent third party. The New Partnership for Africa's Development (NEPAD) establishes a mechanism for participating states to submit to "peer review" by other participants (box 9.3).

Scope of participation. Some arrangements are bilateral—such as the more than 2,200 bilateral investment treaties concluded since 1959. Others are regional—examples include the EU, NAFTA, MERCOSUR, APEC, and NEPAD. Yet others are multilateral, and so could have global adherence—examples include various UN-sponsored arrangements and the WTO. While arrangements with a smaller number of parties usually are easier to negotiate and accommodate the preferences of the participants, the limited participation also limits the impact.

Enhancing credibility

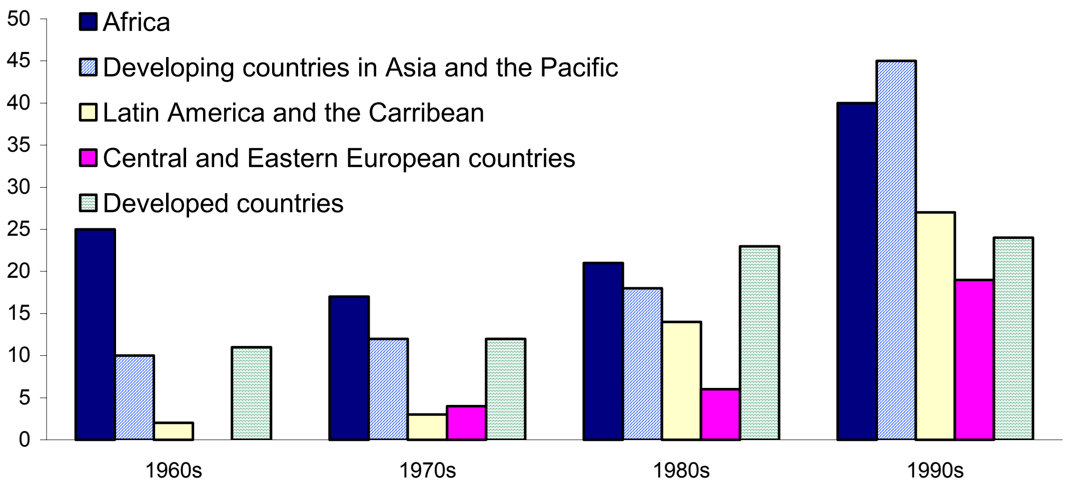
9.4 As emphasized in chapter 2, the impact of particular government policies in supporting productive investment is ultimately determined by their credibility—can firms rely on those policies with confidence when making their investment decisions?[4] Governments can enhance the credibility of their policy commitments through local laws and institutions, enshrining key protections in constitutions and creating independent judiciaries (chapter 4). But when those institutions are at early stages of development their impact on credibility may be weak, increasing uncertainty and risk for firms. Entering international agreements on particular issues provides a mechanism for governments to "tie their hands" and, by increasing the costs of reneging on commitments, enhance their credibility. International commitments can also influence domestic policy debates on reform issues.[5]

9.5 But there are tradeoffs between commitment and flexibility. Entering a binding international commitment on an issue, by design, inhibits domestic policy flexibility in that area. Few governments today claim the right to expropriate private property without compensation, so commitments on this subject have become fairly straightforward. But the prudence of entering binding commitments on many other policy issues needs to be considered case by case. Reflecting this, international instruments provide a menu of approaches to calibrate the form and extent of commitment to the relevant policy issue. Traditional approaches focused on government-to-government treaty obligations, but two other models are playing an increasing role in investment climate issues. The first offers a lower commitment and rests more on leveraging governments' concerns about their reputations. The second provides a stronger commitment by allowing private firms to pursue claims against the government directly—through binding international arbitration.

Traditional government-to-government treaty obligations

9.6 Traditional approaches involve governments entering reciprocal commitments, with default by one party creating the possibility of sanctions. For example, bilateral investment treaties include commitments not to expropriate property without compensation, prohibit discrimination between investors, and provide a range of other obligations that can be enforced by recourse to binding international arbitration (figure 9.1 and box 9.2). The WTO provides a mechanism for governments to "bind" trade tariffs at particular levels, with any subsequent increase accompanied by compensation. Dispute settlement mechanisms under the WTO facilitate enforcement of obligations and so enhance the credibility of government trade policy commitments.

Figure 9.1 Bilateral investment treaties have proliferated in recent years



Source: UNCTAD (2000), number of new BITs concluded during each decade.

Box 9.2 Bilateral investment treaties—enhancing credibility one bit at a time

The first bilateral investment treaty (BIT) dates from 1959 (Germany-Pakistan), and the number has since proliferated. By the end of 2002 BITs covered around 22 percent of the stock of foreign direct investment in developing countries.

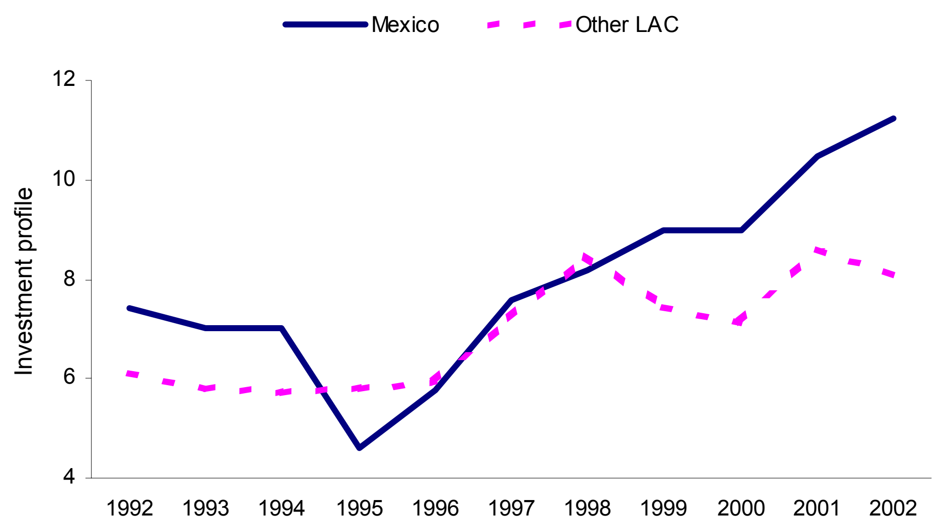
At the center of most BITs are obligations not to expropriate property without compensation. They also typically include provisions governing the repatriation of profits and the transfer of funds; standards of non-discrimination on admission, establishment, and post-establishment phases of investment; and broader undertakings to provide equitable treatment. They also usually provide mechanisms for settling disputes between the contracting states and between an investor of one state and the government of the host state.

Assurances of this kind can contribute to the investment climate of the host country, and there is evidence that investors rely on those assurances. But empirical studies have not found a strong link between the conclusion of a BIT and subsequent investment inflows. Three factors may be at work. First, as highlighted in chapter 2, firms make their investment decisions based on an assessment of the opportunity as a package, and treaty protections alone may not be enough to outweigh the impact of other features. Second, the negotiation of BITs is often driven by governments seeking to foster stronger bilateral ties, rather than immediate interest from investors. To the extent this is so, there need be no direct connection between signing a treaty and subsequent investment activity. Third, there is evidence that many investors are not aware that a BIT is in place at the time of considering an investment, and indeed may remain oblivious until some issue arises when its provisions may be relevant. It so, promoting wider understanding of the existence and role of BITs may enhance investor responses.

Sources: Dolzer and Stevens (1995), World Bank (2003), Hallward-Driemeier (2003), UNCTAD (2003), UNCTAD (1998).

9.7 Joining a regional economic cooperation arrangement can improve the investment climate of a participating state by expanding its market size. But it can also do more. For example, in return for access to a fairly liberal internal market, the European Union requires members to comply with a range of policy requirements. The prize of access to a larger market provides incentives for governments to improve their policies to meet EU requirements, and the desire to remain in good standing encourages governments to sustain those policies.[6] Participation can thus enhance the credibility of policies once integrated into the *aquis communitaire*. Similar factors can be seen at work as NAFTA opens to new members[7] (figure 9.2).

Figure 9.2 NAFTA and government credibility: Mexico's experience



Note: Mexico is compared with an average of 18 other Latin American countries. The NAFTA agreement between Canada, Mexico, and the United States went to force in 1994. Investment profile index is an assessment of factors affecting risk to investment, including contract viability/expropriation, profits repatriation, and payment delays. It does not include risks to investment related to other factors. Maximum value of this index is 12, which corresponds to the highest government credibility.

Source: Calculations based on the International Country Risk Guide database.

9.8 The impact of an international treaty on each party's policy credibility will depend on the specific provisions of the agreement—and on the parties' incentives to enforce the agreement. Agreements between parties that demand high levels of compliance from each other will have a bigger impact on credibility than agreements involving those with lower expectations.

Arrangements with voluntary compliance mechanisms

9.9 Given the tradeoffs between commitment and flexibility, some governments prefer entering arrangements that do not involve binding treaty obligations. These arrangements may nevertheless enhance credibility if they leverage government interest in improving or preserving their reputations. For example, the OECD Corporate Governance Principles do not impose binding obligations—governments can ignore them with impunity. But they include a mechanism that allows governments to submit their domestic laws and policies to scrutiny by an independent third party. Governments interested in signaling to investors that they apply high regulatory standards in this area have incentives to submit their policies to scrutiny—and to attain high standards. Countries including Brazil, Georgia, India, the Philippines, Poland, and Turkey have subjected their policies to such assessments.[8] A similar model is being adopted by the New Partnership for Africa's Development (box 9.3).

Box 9.3 NEPAD and its peer review mechanism

As part of an effort to improve the quality of governance in Africa, the New Partnership for Africa's Development (NEPAD), was created in 2001 by regional governments. It puts enhancing government credibility front and center. An African Peer Review Mechanism is the core instrument.

NEPAD includes principles to improve political governance and economic reform—and to promote competition, trade, investment, macroeconomic and political stability, and sustainable development. The peer review mechanism enhances transparency and accountability of participating governments. Each participating country submits to peer review and ongoing monitoring. The country is evaluated on economic and political grounds according to a set of standards that includes democracy and political governance, economic governance and management, corporate governance, and socio-economic development. The review is to be undertaken by experts appointed by an independent panel, with the results made public.

Source: Funke and Nsouli (2003), NEPAD official documents.

9.10 As with arrangements resting on more tangible sanctions, the attitudes of other participants toward compliance make a difference—low standards of compliance will lower the impact on credibility. Arrangements that maintain high membership standards will thus deliver stronger benefits than more permissive schemes. When compliance depends on reputation alone, the transparency and integrity of the monitoring mechanism is critical to success.

Arrangements permitting private firms to have direct recourse to governments

9.11 Traditionally the remedy for foreign investors who believed they had been harmed by an action of the host government was to sue the government before local courts. But investors often felt this was inadequate, with concerns that the local court might be biased in favor of the host government or otherwise not provide an effective remedy. The immediate response was for investors to enlist the support of the home government to pursue their interests through diplomatic channels. But this also had its limitations and weaknesses. The fate of the investor's claim often depended on the state of diplomatic and political relations between the two governments. In some cases claims might have been ignored. In others what was essentially a commercial dispute became politicized, sometimes culminating in interminable negotiations[9]—and sometimes in the use of armed force.[10]

9.12 To help remedy these problems, the International Center for the Settlement of Investment Disputes (ICSID) was established by international convention in 1966. It has since been ratified by 140 countries. Under ICSID, firms from one member state can pursue their investment disputes against other member states through binding international arbitration, without the need to involve their home government. And the governments can pursue investors directly as well. The parties are responsible for appointing the arbitrators and abiding by the decision. Typically the investor and the host state each choose an arbitrator and the parties have to agree on a third arbitrator. Sitting in a neutral venue, the arbitrators hear evidence and render an award. ICSID provides the procedural rules and a small secretariat to support the arbitrators and the parties.[11]

9.13 ICSID's jurisdiction rests on the consent of the parties, often given through clauses inserted in investment contracts case by case. In the 1990s it became common for bilateral investment treaties (BITs) to include provisions for governments to give their prior consent to ICSID jurisdiction, thus eliminating the need for case-by-case agreement by governments. Similar provisions are included in NAFTA. This has expanded access to ICSID jurisdiction, and the volume of cases submitted to ICSID has grown strongly in recent years—more than half the 129 cases it has registered since its inception were filed in the last five years.[12]

9.14 The use of BITs and other agreements that include prior government consent to ICSID jurisdiction creates a new source of discipline on host governments—and a powerful tool to enhance the credibility of their contractual and policy commitments. Governments and firms can both benefit. Governments benefit from access to a commitment device that can address concerns from investors, and thus help them attract more investment at lower costs, and reduce the risk of any later dispute becoming politicized. Firms benefit from reduced risks and a more reliable mechanism for protecting their rights if the relationship with the host government deteriorates. While ICSID is designed to encourage foreign investment, domestic firms also benefit from the halo effect provided by stronger constraints on arbitrary government action. Despite these advantages, the new system of investor-state dispute settlement does raise two main issues.

9.15 First, while the prohibition against expropriation without compensation reflected in BITs and other agreements is now widely accepted, there is a degree of uncertainty over how prohibitions against "indirect" expropriation, and non-discrimination guarantees, might be applied to certain host government regulatory actions. It is clear that some governments have used arbitrary regulatory or taxation behavior to achieve a result equivalent to expropriation, and most observers agree that such behavior should be caught by the prohibition. But there is concern that the provisions might be interpreted to restrict legitimate regulatory action by host governments, or that firms might use the threat of such claims to induce a "regulatory chill." So far arbitration panels have tended to interpret the provisions cautiously. And panels can deter frivolous claims by the threat of sanctions.[13] As with any new international norms, the scope of interpretation can expect to be settled over time through the accumulation of case law.

9.16 Second, the fact that some recent disputes have involved sensitive matters—including the cancellation of a private water concessions in Latin America and the application of environmental regulations under NAFTA—has raised concerns about the perceived legitimacy of the international investor-state dispute settlement system. Arbitration panels evolved from commercial and diplomatic practice where it was customary for proceedings to be confidential. While ICSID has always promoted transparency, efforts are under way to further increase the opportunities for public participation (box 9.4).

Box 9.4 The evolving system of investor-state dispute settlement

The recent rise in the number of investment disputes brought before ICSID arbitration panels has put investor-state arbitration in the spotlight.

Arbitration proceedings were traditionally confidential, but ICSID's rules require making a dispute public and encourage parties to publish information about the dispute and its outcome. Concerns about the perceived legitimacy of international arbitration between investors and states are also leading to procedures that more closely resemble those of judicial proceedings. For example, in a recent case brought against the United States under NAFTA, the parties agreed to use an *amicus curiae* (friend of the court) procedure allowing non-disputing parties to make submissions to the arbitration panel. The U.S. government has also modified its model BIT agreement, incorporating provisions for greater transparency in new agreements. The Chile-US Free Trade Agreement contains a requirement that arbitration panels conduct the hearings open to the public, and disclose key documents.

The legitimacy of investor-state arbitration also depends on the perceived fairness of the results. The state party prevailed in half of the 24 disputes that went to final award between 1987 and 2003.

Cases brought to ICSID, 1987-2003	Under NAFTA	Under BITs
Cases registered	10	87
Cases concluded (including settlement) by February 2003	6	31
Final awards rendered	6	18
Investor prevailed in	2	10
State prevailed	4	8
Average duration (from constitution of tribunal or ad hoc committee), months	29.5	28.2

Source: ICSID website; World Bank staff; official texts of the mentioned agreements.

Reducing costs

9.17 In the normal course of events, each country or jurisdiction tends to develop its own rules and standards on particular issues to reflect local conditions and preferences. This adaptation is an important part of ensuring a good "institutional fit"—and one reason to be cautious in uncritically transplanting regulatory systems from other countries (chapter 5). A mixture of adaptation and experimentation can also lead to the discovery of new and better ways of achieving particular policy goals. A degree of institutional competition between jurisdictions can also encourage government to attain higher standards.[14]

9.18 But divergent approaches to some regulatory issues can increase the costs of international trade and investment transactions. If goods or services need to meet different standards in every country, customization can drive up the costs of production and distribution. Diverse approaches can also increase the costs firms face when evaluating alternative investment locations, perhaps deterring them from pursuing investments in countries with unfamiliar arrangements. Beyond reducing transaction costs, international standards may also facilitate domestic policy reform when local interest groups have divergent preferences.[15] They also help to signal the application of high standards to firms, consumers, and other groups.

9.19 The tensions between local customization and international harmonization play out in proposals to develop common international standards on a wide range of issues relevant to the investment climate. Efforts to develop uniform standards to facilitate international commerce have long been a focus of private bodies such as the International Chamber of Commerce.[16] Complementary efforts at the intergovernmental level include those of the United Nations Commission on International Trade Law[17] (UNCITRAL) and a variety of other international agencies. In Francophone Africa, for example, harmonization of business law is being facilitated by the Organisation pour l'Harmonisation en Afrique du Droit des Affaires (OHADA, see box 9.5). The possible areas for cooperative action range from developing a common set of international rules on contract law to harmonizing international accounting standards.[18] Clearly, the costs and benefits of each approach need to be considered case by case.

Box 9.5 Harmonizing business law in Africa—OHADA

The Organisation pour l'Harmonisation en Afrique du Droit des Affaires (OHADA), established in 1993, promotes the harmonization of business law in Africa. It has 16 member governments: Benin, Burkina Faso, Cameroon, Central African Republic, Comoros, Congo, Ivory Coast, Gabon, Guinea, Guinea-Bissau, Equatorial Guinea, Mali, Niger, Senegal, Chad and Togo.

Under OHADA the texts of "Uniform Acts" are endorsed by a Council of Ministers and then made directly applicable in each member country. So far, the harmonization process has resulted in Uniform Acts in six areas: general commercial law, companies, securities, debt recovery, bankruptcy and insolvency, and arbitration.

The OHADA Treaty also establishes a Common Court or Justice and Arbitration, which acts an advisory body to the Council of Ministers, serves as an appeal body to foster common interpretations of the Uniform Acts, and supports the conduct of commercial dispute settlement.

Source: Ba (2000), OHADA official documents.

9.20 To be effective, common international standards do not always require binding treaty obligations. Countries or even firms can voluntarily adopt common norms, with the incentives to comply driven by reputation. Some international agencies have also developed "Model Laws" to encourage convergence on common approaches, but leaving countries the freedom to adapt to local priorities—the UNCITRAL model law on international commercial arbitration, for example, has been adopted by more than 35 jurisdictions.

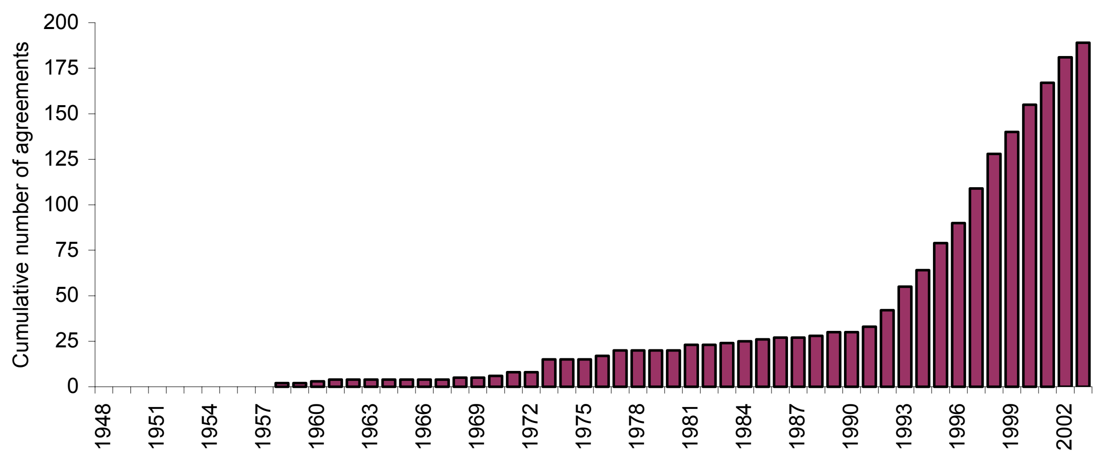
9.21 There can also be alternative strategies for the same end. For example, rather than adopting identical rules in each jurisdiction, participating governments may agree, in mutual recognition schemes, to accept in their jurisdiction goods or services that meet the regulatory requirements of another participating jurisdiction. This has done much to facilitate commerce within the European Union, for example, and between the European Union and some nonmember states. Similar approaches could have wide application across a range of investment climate issues.

9.22 A more ambitious form of harmonization is to agree not only on common rules, but also to delegate responsibility for administering them to a common regulatory body.

This presents opportunities for greater consistency in interpretation, reduced administrative costs, and possibly enhanced credibility for participating governments. In practice, supranational regulatory bodies are more often proposed than implemented, in part because of concerns over national sovereignty. But there are exceptions. The Eastern Caribbean Telecommunications Authority regulates telecommunications in five small countries in the Caribbean. And OHADA has a common court to foster consistent interpretations of harmonized business laws. Progress usually requires a high level of trust between participating governments—and an effective governance framework.

9.23 The advantages and disadvantages of harmonization proposals also depend on the scope of countries participating in the arrangement. Multilateral approaches offer the largest benefit, but increase the challenge of developing approaches that will meet the interests of all participating governments. And they can involve protracted negotiations. Reflecting these tradeoffs, the number of regional economic cooperation arrangements has shot up in recent years (figure 9.3).

Figure 9.3 Regional economic cooperation agreements shot up in the 1990s



Note: Agreements reported to the World Trade Organization.

Source: WTO website.

9.24 For the liberalization of trade and investment, there is an ongoing debate over whether regional arrangements are building blocks or stumbling blocks toward a liberal multilateral system.[19] Proposals that focus on the harmonization of standards tend to pose fewer concerns of this kind, although there can be other tradeoffs. For example, harmonizing standards at the regional level can reduce transaction costs for intraregional investment, but harmonizing standards with major capital exporters outside the region might offer even greater benefits. In practice, international trade and investment transactions are subject to a mix of domestic, bilateral, regional and multilateral norms, creating a complex maze for firms to navigate.

Addressing international spillovers

9.25 Many existing and proposed international arrangements seek to address international spillovers of some kind—where actions in one country can have affects on others.

9.26 The clearest cases involve environmental protection. For example, emissions or effluents from industries in one country may harm the environment in other countries. When this is so, international cooperation may be needed to mitigate the negative externality and achieve an efficient outcome. Indeed, there has been a growing volume of international rules on various matters affecting the environment since the 1970s.[20] But not all environmental issues have an international dimension and thus warrant international attention. For example, when the adverse effects of pollution are contained within a country's borders, the case for overriding the sovereignty of that government is weak.[21]

9.27 Outside environmental protection, there are also many areas where the argument for international cooperation is strong. This is the case with international efforts to combat corruption (box 9.6). But when international spillovers are less tangible, the case for international cooperation can be more complex. Take competition policy. There is growing understanding of the importance of adopting cooperative approaches to the investigation and prosecution of international cartels, which can impose large costs on countries. In the 1990s about 40 international cartels were prosecuted in the EU and US alone. The average international price increases due to those cartels are estimated to have been around 20-40 percent. It was also found that many of these cartels specifically targeted developing countries without appropriate national legislation in place. The imports of 12 cartelized products by developing countries in 2000 alone exceeded $10 billion. In particular, a vitamins cartel, that operated for 10 years during the 1990s imposed costs of $3 billion on consumers in developing countries.[22] Although argument for action is strong, there is room for debate about the best form of action: should it be limited to coordination between national agencies, or multilateral agreement on competition policy is required?[23]

Box 9.6 International cooperation to combat corruption

National anti-bribery laws are at least as old as the Law of Moses, which dates from the 9th century BC. The first attempt to address bribery on an international level came in the 1976 OECD Guidelines for Multinational Enterprises. This foreshadowed the most significant step to date, the ratification of a multilateral convention committing parties to make the bribery of a foreign official by one of its citizens a criminal offense.

The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions was signed in 1997 by all 30 OECD member countries and 5 non-member countries (Argentina, Brazil, Bulgaria, Chile and Slovenia), and went into force in 1999. The Convention provides guidelines and a monitoring mechanism to improve domestic anti-bribery laws and outlines areas where coordinated action to reduce corruption should be taken. To ensure the parties live up to their agreement, the Convention establishes procedures to monitor compliance. Transparency International complements official monitoring with a series of public reports on each country's progress in stemming the bribery of foreign officials.

An even more ambitious effort to foster international cooperation is the United Nations Convention against Corruption signed in 2003 by 106 countries and entering into force in 2005. It stems from two previous UN arrangements—the UN Declaration against Corruption and Bribery in International Commercial Transactions, and the UN Convention on Transnational Organized Crime—and complements the OECD Convention. It addresses cross-border issues associated with asset recovery, freezing of accounts and seizure of foreign property of corrupt officials.

Source: Official texts of Conventions, Transparency International (2004), Braithwaite and Drahos (2000).

9.28 Proposals to develop new international rules to address issues associated with competition for investment are even more problematic. Competition between governments to attract or retain investment has led to concerns that there may be a "race to the bottom" in tax rates, environmental regulation, or other matters. As discussed in chapter 5, however, the theoretical support for such races is mixed, and so far the dire predictions of some commentators do not seem to be taking place. But the concern illustrates some of the tensions and practical challenges for international cooperation on matters where countries can have divergent interests.

9.29 Take tax levels. Countries that prefer high tax rates may be motivated by slowing the movement of firms to countries that prefer lower taxes—but the latter countries have limited incentives to cooperate. Such differences in perspective have stymied progress in reaching agreement on these matters even between countries at similar levels of development, such as the European Union.[24] And the prospects of achieving a truly global accord on minimum tax rates that incorporates countries with even more divergent perspectives seems at best a distant prospect.

9.30 When these differences exist, the challenge extends beyond the feasibility of negotiating an agreement. The enforcement challenges can be formidable, particularly in countries with widespread informality. And even if uniform international tax rates could be agreed on, and enforced, countries could simply shift competition to other dimensions of their investment climate policies, such as providing infrastructure or enforcing a host of other regulations.[25] Indeed, given the breadth of policy areas that influence the investment decisions of firms, efforts to contain competition would need to cover a vast field—leaving little scope for sovereign states to reflect different social preferences or levels of development. Without evidence that such competition is leading to real welfare losses, the case for intruding on the prerogatives of national governments seems weak.

9.31 An alternative is to reinforce the reputation concerns of firms. As discussed in chapter 2, a growing number of initiatives aim to address concerns associated with international economic integration by targeting firms directly, rather than governments. And many of these initiatives also emanate from the nongovernmental sector (box 9.7).

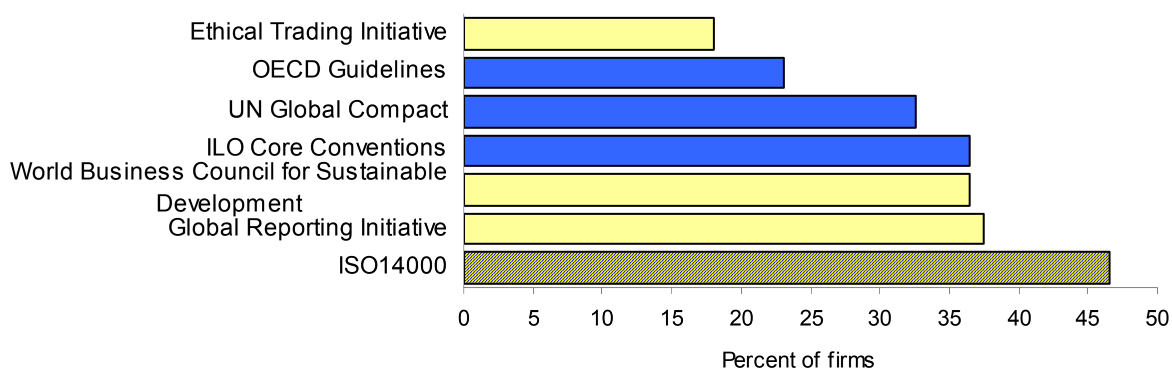
Box 9.7 Privatizing international cooperation

Efforts to promote international cooperation on matters related to the investment climate are not limited to arrangements between governments. There has been a growing trend to develop international norms applicable to firms directly, without the intermediation of states. And particularly for corporate social responsibility, many initiatives emanate from the nongovernmental sector.

These codes of corporate conduct outline basic principles of behavior for firms, including matters of corruption and respect for environmental and labor norms. Not legally binding, the codes typically depend on the reputation concerns of major firms that operate in more than one country, with compliance often reinforced through third-party inspection and transparency arrangements. Examples of such initiatives include the Global Reporting Initiative, the CERES Principles, UN Global Compact, The Equator Principles, the Publish What You Pay Initiative, and Transparency International Business Principles for Countering Bribery.

These mechanisms may help firms adopting high standards to signal their compliance to burnish their reputations, thus complementing national laws and policies. But the proliferation of new codes and arrangements can create confusion about acceptable standards. And since these initiatives affect mainly multinational firms that have an interest in enhancing or maintaining their international reputations, they may have less impact on the behavior of other firms. But a recent survey showed that many firms take standards of corporate social responsibility into account when making location and production decisions—and suggests that those emanating from the nongovernmental sector often were more influential than those developed by international agencies.

Box figure Standards are influencing business



Note: Percentage of firms that indicated standards as influencing their business. Standards emanating from inter-governmental initiatives are in blue, and by non-governmental organizations are in yellow. The International Organization for Standardization (ISO) is a nongovernmental organization, but it takes a special position between private and public sectors.

Source: Jorgensen and others (2003), Smith and Feldman (2003), UNCTAD (2001), Bhagwati (2004), Berman and Webb (2003).

The future

9.32 International rules and standards can be expected to do more in shaping investment climates as the intensity of interactions between governments and cross-border trade and investment expand. But as this brief survey highlighted, progress in that direction will need to grapple with several general tradeoffs.

9.33 Measures to enhance the credibility of government commitments can be especially important for countries with domestic institutions at an early stage of development. Stronger commitment devices offer greater benefits, but they also involve forfeiting more policy autonomy—and so need to be considered carefully. And to be sustainable, measures that curb domestic policy autonomy must also be accepted as legitimate, spotlighting efforts to enhance transparency.

9.34 Measures to reduce costs through harmonization offer many benefits, but involve three tensions. There is tension between harmonization and customization—taking local priorities and capacities into account. There is tension between harmonization and competition—where some degree of competition between standards can be an important part of the learning process. And there is tension between harmonization with neighbors and harmonization with major markets or sources of capital. The tradeoffs need to be considered case by case.

9.35 Measures to address international spillovers also need to reflect the divergent perspectives between countries at different levels of development. Care needs to be taken to ensure not to curtail the policy space of emerging nations without clear justification. At a minimum, the voices of developing countries need to be heard when framing these initiatives.

9.36 Developing countries can thus take advantage of the emerging network of international rules and standards to improve their investment climates—by enhancing their credibility, reducing costs, and addressing other matters of shared concern. But proposals need to be evaluated case by case. Uniform global rules may be appropriate for some matters, but differences in priorities and capabilities need to be reflected in others (box 9.8). And while well-conceived international rules and standards can be an important complement to domestic laws and policies, they cannot substitute for the development of local institutions.

Box 9.8 A multilateral agreement on investment?

Proposals to develop a multilateral treaty on investment have a long history. The first attempt was in 1929 at the Paris Conference on the Treatment of Foreigners. The experiment was repeated again in the 1948 Havana Charter. In 1959 two private initiatives were combined as the Abs-Shawcross Draft Convention on Investment Abroad. In 1967 the OECD produced a Draft Convention on the Protection of Foreign Property. In 1995-98 the OECD attempted to develop a Multilateral Agreement on Investment. In each case the proposal failed to find sufficient support. And investment issues have been proposed for inclusion during the Doha Round of the WTO launched in 2001. Are such attempts futile?

Looking back, each proposal had its own features and encountered different obstacles. But there are basic challenges in constructing an agreement that includes investment protection provisions (along the lines of BITs) and market opening provisions that meet the interests of capital exporters and importers and that reflect the interests of both developed and developing countries.

For a developing country, a multilateral agreement that provides high standards of protection for investment should have many attractions as a tool to reinforce the credibility of government policies. But recent experience under NAFTA suggests that proposals in this area need to place special emphasis on dealing with the interactions between prohibitions on indirect expropriation and domestic regulation—and on enhancing the transparency and perceived legitimacy of investor-state dispute settlement mechanisms. The treatment of restrictions on foreign capital flows may also be subject to debate (chapter 3). In principle it should be possible to fashion an agreement that accommodated these interests. But the same agreement would need to meet the interests of developed countries, which will typically place greater emphasis on market opening measures, including those between themselves.

While a broad negotiating forum provides opportunities to trade concessions across a range of subject areas, it can also involve complex negotiations that can easily be derailed. Another option could be to develop or expand regional agreements with effective investment provisions. NAFTA provides a possible example. But this approach offers little help to low income countries in other regions, which would stand to gain the most from effective commitment devices. And creating a regional investment agreement covering Africa alone would likely offer only limited benefits.

Source: Ferrarini (forthcoming), Henderson (2003), World Bank (2004), Parra (2000), Warner (2000).

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Endnotes

[1] Braithwaite and Drahos (2000), Dollinger (1970).
[2] For example, the Permanent Court of International Court of Justice ruled that compensation was payable for the expropriation by Poland of private property belonging to a German firm in the *Chorzow Factory Case* in 1928. The court stated that " there can be no doubt that the expropriation . . . is a derogation from the rules generally applied in regard to the treatment of foreigners and the principle of respect for vested rights" and that "reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed."
[3] According to the United Nations Secretary General, and description of the UN Treaty Collection, containing the list of treaties deposited with the UN SG, at http://untreaty.un.org/.
[4] In particular, government policies are subject to a time inconsistency problem, see Kydland and Prescott (1977).
[5] Putnam (1988), Ederington (2001), Staiger and Tabellini (1999), Conconi and Perroni (2003).
[6] See Berglof and Roland (2000).
[7] Lederman, Maloney, and Serven (2003).
[8] The World Bank assists its client countries in the assessment of their corporate governance institutional frameworks and practices by preparing country corporate governance assessments using the OECD Principles as a benchmark. These assessments have been carried out under the auspices of the joint World Bank-IMF initiatives on the Financial Sector Assessment Program and the Reports on the Observance of Standards and Codes (ROSC).
[9] Kronfol (1972) cites efforts to gain compensation for the nationalization of the Suez Canal company.
[10] Shihata (1986) cites the example of the "Jecker" claim, when an investment dispute was used by France for armed conflict in Mexico in 1861-1862.
[11] More information on ICSID can be found on its website (http://www.worldbank.org/icsid/). ICSID Review-Foreign Investment Law Journal published by the Johns Hopkins University Press, keeps an update on the current state of affairs in the international investment arbitration. See also Shihata (1986).
[12] ICSID (2003).
[13] Recent cases have been based on interpretations of NAFTA, rather than BITs, although similar issues can arise. Some of the leading cases are the Metalclad case (a Canadian company pursuing a claim against the Mexican government); The S.D.Myers case (a US company pursuing a claim against the Canadian government); and the Marvin Feldman case (a US investor pursuing a claim against the Mexican government). The cases are discussed in UNCTAD (2003) and Hallward-Driemeier (2003). For those considered under ICSID jurisdiction, see also http://www.worldbank.org/icsid/cases/awards.htm.
[14] Weingast (1995).
[15] Putnam (1988), see also Maggi and Rodriguez-Clare (1998).
[16] The International Chamber of Commerce dates from 1919, and has been involved in promoting harmonization of various contractual terms to facilitate international trade. See http://www.iccwbo.org/.
[17] UNCITRAL is a subsidiary body of the General Assembly of the United Nations, and was established in 1966 with the general mandate to further the progressive harmonization and unification of the law of international trade. UNCITRAL has since prepared a wide range of conventions, model laws and other instruments dealing with the substantive law that governs trade transactions or other aspects of business law having an impact on international trade. See http://www.uncitral.org/.
[18] See 1980 UN Convention on Contracts for the International Sale of Goods. UNCITRAL has also sponsored the Model Law on International Commercial Arbitration that has been adopted by 46 jurisdictions.
[19] Hoekman and et al. (2004); Schiff and Winters (2003); Bhagwati (2002).
[20] Concerns about environment have been expressed since at least the sixth century BC when Solon the Law-giver in Greece proposed to ban agriculture on the steep slopes to prevent soil erosion (Braithwaite and Drahos (2000)). Multilateral arrangements on environmental issues date from the 1972 UN Stockholm Conference.
[21] Siebert (2002).
[22] World Bank (2003), WTO (2003), Clarke and Evenett (2002).
[23] Hoekman and Mavroidis (2002), Clarke and Evenett (forthcoming).

[24] The tax harmonization debate in the EU has been ongoing for many years, without producing any policy results. Analytical work also suggest that the benefits from tax coordination in the EU may be negligible, see Mendoza and Tesar (2003).

[25] For example, although the national government in Brazil prohibited the states from exempting enterprises from the value-added tax, states were able to get around this using various mechanisms include lending enterprises amounts equal to the tax they owed on highly subsidized terms, see Tendler (2000).