CREDIT Research Paper

No. 00/2

Investment and Competition Policy in Developing Countries: Implications of and for the WTO

by

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Acknowledgements
This paper was prepared for the *DESG Annual Conference 2000*, University of Nottingham, 27-29 March 2000. The author is grateful to the European Commission (DG1) for commissioning the study on *Sustainability Impact Assessment of Negotiating Issues in a New WTO Round* (undertaken by CREDIT in conjunction with IDPM and EIAC, University of Manchester). This paper is based on work undertaken as part of that study. The views expressed here are those of the author alone and should not be attributed to any other party.

March 2000

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Abstract
This paper evaluates the impact on developing countries of the prohibition of trade related investment measures (TRIMs). The economic impact of implementing the TRIMs Agreement in GATT 1994, and more generally of liberalising investment measures, is likely to be negative and significant for developing countries. Overall, the impact is likely to be significantly adverse. Competition measures would be required in any new round of trade negotiations under the WTO to mitigate these adverse impacts, and the implied impact of competition measures is significantly positive. However, multilateral competition policy would be difficult to agree and implement and the paper considers alternative strategies that developing countries could adopt. The optimal strategy proposed is that governments should adopt measures to promote competition – between local firms and between multinationals investing in the economy.

Outline

I INTRODUCTION

The purpose of this paper is to argue that from the perspective of developing countries in the context of investment and competition policy the status quo (i.e. the TRIMS Agreement in GATT 1994) is unsatisfactory. As a new round of negotiations is required to link competition and investment policies (and rules), and as these are central to relations between host governments and multinationals investing in the country, the status quo has adverse implications for developing countries. Given the importance of multinationals as dominating world trade and being major investors in developing countries, further developments in investment policy/rules within the WTO are likely. Consequently, it is timely to appraise the current situation from the perspective of developing countries.

Some 15 measures for potential trade reform can form a basis for negotiations in a New Round of multilateral trade liberalisation. The measures or issues range from liberalisation of trade in agricultural products, to global investment and competition rules, to protection of intellectual property rights and imposition of labour standards. We will confine attention to the sub-set of issues with implications for investment and competition policy, specifically trade related investment measures (TRIMs) but potentially encompassing trade-related aspects of intellectual property rights (TRIPs) and labour standards. In particular, we are concerned with measures inherent in the WTO (specifically in the Uruguay Round Agreement embodied in GATT 1994) that have implications for relations between host governments and multinationals.

The TRIMs Agreement (GATT 1994) imposed new prohibitions on the use of TRIMs, and developing countries had five years to dismantle prohibited TRIMs (seven years for the poorest countries). These prohibitions fail to address one of the major motivations behind the use of TRIMs - the desire to counter *perceived or actual* restrictive business practices (RBPs) on the part of multinationals. The received neo-classical economic wisdom is that TRIMs distort trade flows and are therefore inconsistent with the principles of the WTO. It has been recognised (e.g. Greenaway, 1992) that TRIMs can be used by hosts in bargaining with multinational enterprises (MNEs): foreign direct investment (FDI) will only take place if the MNE perceives a gain, likewise the host wants to ensure that it derives benefits from the investment. The total gain can be viewed as the rents from the FDI activity. The MNEs utilise their market power to appropriate most of the rents to themselves; hosts respond with TRIMs and other investment requirements to capture rent for the host country. In this view, TRIMs are a countervailing power. This approach highlights the implicit bargaining over the allocation of gains from FDI. GATT 1994 prohibits TRIMs to the extent that they are trade-distorting, but embodies no response to the potential trade-distorting activities of MNEs.

Foreign direct investment is becoming an increasingly important source of external capital for developing countries. Total FDI (in nominal terms) is estimated to have increased from $25 billion in 1990 to $110 billion in 1996. Although this represents a decline from 55 to 43 per cent of total private capital flows, FDI in 1990 was equivalent to less than half the value of aid whereas in 1996 it was more than twice the value of aid flows (World Bank, 1997). Flows of FDI are very unevenly distributed; the share going to sub-Saharan Africa (SSA) fell from about four per cent to two per cent between 1990 and 1996, whereas the share going to East Asia rose from about 25 to over 50 per cent (World Bank, 1997). The most dramatic growth has been to China; other low-income countries account for about seven per cent of the total in 1996.

The fact that few low-income countries attract a significant share of FDI is unsurprising, but does not mean that FDI is not itself important for low-income countries. The major factors (other than natural resources) determining how much FDI flows to particular countries is size and growth of the market. Trade and tax policies, political stability, property rights etc. are important, but not generally the most important factors (unless the disincentive effects are very high). Investment incentives offered by governments are unlikely to be so important, except perhaps at the margin. In this sense, TRIMs would not have been important factors in determining investment decisions. More generally, one would not expect investment measures to discourage FDI, unless they were very restrictive. The motivation for companies in seeking the prohibition of TRIMs was that such measures reduce their profits.

It follows that the abolition of TRIMs reduces host government bargaining power and reduces the potential gains from FDI for the host economy. As FDI becomes more important, as is likely to be the case, the potential loss of ‘rents’ or reduction of benefits to the host does represent a cost to developing countries. This potential cost is greater for countries such as India and China that attract large inflows of FDI, but is real for all developing countries. The purpose of this paper is to elaborate on what forms that cost may take and consider the options available to developing countries.

Section 2 reviews the motivation and effects of TRIMs. Specifically, we outline how TRIMs can be used to increase the benefits of FDI for host countries, thus pointing to potential costs of their removal. Section 3 sets out a general approach to identifying (rather than quantifying) the impact of the removal of TRIMs. Section 4 then turns to alternative scenarios for the development of investment and competition rules within a new round of WTO negotiations, identifying the implications for developing countries. Section 5 concludes and considers some policies that could ‘replace’ TRIMs.

2 Investment Measures

Trade related investment measures (TRIMs) refer to restrictions attached by host states to the activities of multinational enterprises (MNEs) that have invested in the host. They are termed investment measures because they relate to MNEs that have engaged in foreign direct investment (FDI), i.e. that are undertaking production activities in the host (the discussion could be extended to investment in services). They are trade related because the activities of the MNE impact on trade flows, in one or more of three essential ways. The MNE may be potentially able to export, and the TRIM may relate to export requirements (e.g. stipulating a share or value of output to be exported). Alternatively, the MNE may be producing import-competing goods, and the TRIM may restrict such competition (e.g. limiting the share or value of output that can compete with imports). Finally, the MNE may import inputs that are available locally, and the TRIM may require some minimum amount of inputs be purchased from local producers (such as local content requirements). A TRIM, therefore, affects trade flows, the level of imports and/or exports. It follows that the removal of a TRIM can affect trade flows, and such removal is the intention of the TRIMs Agreement in the Uruguay Round Agreement. Any future Round of global trade talks is likely to contain further measures to liberalise investment.

The underlying context is that FDI establishes a relationship between the MNE and the host state, and both parties to the relationship will wish to maximise the gains to them from the investment. The view implicit in the TRIMs Agreement is that TRIMs are a measure adopted by hosts to restrict trade (by restricting the actions of MNEs), although hosts may take they the view that they are really only trying to restrict the activities of MNEs (implying that such activities are trade-distorting). In practice, the host's bargaining instrument (TRIMs) is restricted to a greater extent than is the MNE's behaviour, so that hosts may feel unfairly treated. One possible avenue of removing this bias is to ensure that the WTO addresses investment measures in general and associated restrictive business practices (RBPs), an intention enshrined in the Uruguay Round and in Article IX of the TRIMs Agreement (Morrissey and Rai, 1995, provide a detailed discussion).

There are a number of reasons why MNEs will expect to gain rents from FDI. The most important among these are firm-specific benefits, such as access to a specific technology; location-specific benefits, such as a host country with natural resources; and gains from internalisation, related to vertical and horizontal integration (Dunning, 1981). The MNE can choose whether to produce the good itself (FDI), implying strong benefits of internalisation, or get a local firm to produce it (through licensing or joint ventures, for example).[1] The firm will only choose FDI, even in the presence of TRIMs, if the benefits from keeping production within the firm exceed those from allowing external production.

The host state is usually keen to encourage FDI as a source of potential benefits. Table 1 identifies a number of benefits hosts may anticipate from FDI, and links these to TRIMs and RBPs, confining attention to those with the most obvious trade effects. First, MNEs can contribute to local economic activity by purchasing inputs from local suppliers and creating demand for local firms. In practice these local linkages are not very strong; only MNEs producing for the local market are likely to use local sources (Casson and Pearce, 1987:126). Second, if MNEs produce for export, or for import-substitution (provided they do not displace local import-competing industries), their presence may improve the balance of payments. This requires that MNEs save more in foreign exchange than they cost through increased demand for imports (this is the essence of trade balancing

1 For convenience of exposition we are using a strict definition of FDI to refer to internalised production. Thus, licensing and joint ventures are not included in this definition of FDI. In practice, investment by MNEs is increasingly in the form of some venture with local firms, or buying a share in privatised firms. While the distinction may not be important in economic terms, it is important in the context of international public law. For example, a joint venture increase the potential benefits to the host without recourse to TRIMs or, more generally, with recourse to regulating MNEs. We return to this point in Section 5.

requirements). Again, the evidence is not encouraging: MNEs do not appear to have a better export performance than indigenous firms although they do tend to import more (Casson and Pearce, 1987:125). We do not consider potential benefits of FDI for employment and technology transfer as these are not directly trade related, although the former are clearly relevant to issues concerning Labour Standards.

Table 1 Benefits of FDI, RBPs, and the Effects of TRIMs

Benefits of FDI	*TRIMs*	*Potential RBPs*	*Effect*
1. Provide local linkages:			
demand for inputs	<u>import restrictions</u>	import from parent	imports
(local suppliers)	<u>local content</u>	market allocation	local output
2. Assist balance of payments:			
reduce imports	<u>import restrictions</u>	import from parent	imports
	<u>domestic sales</u>	market allocation	imports
(domestic inputs)	<u>local content</u>	compete locally	local output
	manufacturing requirements		local output
exports	market reserve	limit exports	exports
	<u>export requirements</u>	market allocation	exports
trade values	trade balancing	transfer pricing	revenue
	foreign exchange	transfer pricing	prices

Notes: Table should *not* be read across as one-to-one correspondence: a given TRIM can relate to a number of RBPs and there are a number of RBPs that can limit the benefits of FDI to host countries. Those TRIMs which are illegal *per se* under the TRIMs Agreement of GATT 1994 are underlined. The final column identifies the variable that the change in which is an indicator of the effect of removing the TRIM.

Source: Adapted from Morrissey and Rai (1995, Table 1).

If a host perceives the benefits as less than anticipated, it may suspect that the MNE is engaging in restrictive practices, whose fundamental nature is anti-competitive.

Commonly cited examples include transfer pricing, price fixing and market allocation agreements (which imply that the volumes and values of imports and exports desired by the MNE are not those desired by the host), and tied selling, whereby the parent limits with whom the subsidiary can deal. A more general point is that even in the absence of demonstrable RBPs, the close relationship between parent and subsidiary may distort the trade flows of the subsidiary. Although internalisation may not be essential, it increases the ability of MNEs to restrict the behaviour of subsidiaries. Hosts may have a legitimate fear that such practices can be used to increase the share of rents from FDI appropriated by MNEs. The way of dealing with this fear is not to deny it, effectively the approach of the TRIMs Agreement, but to acknowledge and evaluate whether it is true.

Broadly speaking, FDI has not yielded the benefits anticipated by hosts in terms of technology transfer, local linkages or having a net positive impact on the balance of payments. There are a range of MNE practices, restrictive or not, that reduce the benefits of FDI to hosts, as indicated in Table 1. Thus, the hosts impose restrictions on the activities of MNEs so as to capture more of the benefits. The most prevalent of such TRIMs are local content requirements, import restrictions and export requirements.

Local content requirements stipulate that a minimum share of inputs be obtained from local sources; ‘laws of similars’ are often used to define appropriate local inputs. Import and foreign exchange restrictions have the same effect as both limit the amount of inputs that can be imported. The trade effect is to reduce imports (that are displaced by local supplies); this distorts the flow of international trade in the inputs concerned (and is thus GATT-inconsistent). As such TRIMs reduce imports they also contribute to increasing potential balance of payments benefits from FDI. Export requirements are aimed to increase the proportion of output exported. TRIMs designed to reduce competition with domestic producers, that may be import-substituting, have the same effect. These include manufacturing requirements, market reserve and domestic sales limitations on what can be sold on the local market. Some TRIMs aim to ensure that MNEs, on balance, do not import more in value than they export; trade or foreign exchange balancing are examples.

Clearly, TRIMs do impact on trade flows; that is the intention (shown in the effects column of Table 1). By identifying RBPs in Table 1 we hope to demonstrate that they too can have similar effects on trade flows. Various market allocation arrangements can direct subsidiaries (not) to sell to specific markets (local or export), or import from producers (parent or other subsidiary). This will alter trade flows from what would otherwise have occurred. Transfer pricing may not affect the volume of trade, but will influence values at which intra-MNE transactions are recorded. The intention may be to engineer profits in a subsidiary facing the lowest profits tax rate, or to avoid tariffs or export taxes. More generally, the effect may be to alter prices, and increase competitiveness, in specific markets. All can impact on trade flows.

The host state, in a sense anticipating RBPs, imposes TRIMs with the intention of increasing its share of the gains from FDI. It should be acknowledged that TRIMs are a blunt instrument in this regard, may serve other less defensible purposes (and could encourage corrupt behaviour by either party), and may distort or discourage investment. TRIMs, as instruments of policy, can be viewed as part of a package with investment incentives but motivated by RBPs. Most importantly, both TRIMs and RBPs have potentially similar effects on trade flows. Within the WTO they are not considered as a package, and the TRIMs Agreement does not deal directly with RBPs. Future developments of investment rules should recognise this ‘package’ nature.

3 Identifying the Impact of Removing TRIMs

In establishing the implications for developing countries of the removal of TRIMs, it would be helpful to start with a list of the various TRIMs in force providing an indication of the effects they have had. However, such information is not generally available (there are no inventories of TRIMs in place and their probable effects for any country). We will proceed by assuming that specific TRIMs were in place, and that they have had the trade-distorting effect implied by the restriction. For simplicity, we consider three broad types of TRIMs. First, export requirements that are intended to increase the value, from the host perspective, of exports (perhaps with the objective of reducing a balance of payments deficit). Second, with a related intention, are restrictions on imports. Such export and import restrictions could be achieved in a variety of ways (stipulating market shares, trade values or trade balancing). Third, are local content requirements that have associated aims of restricting imports and increasing local production (or at least local sales).

The removal of a TRIM is a regulatory measure, or more strictly the prohibition of a regulatory measure. One cannot typically observe any direct economic impact, and cannot even be sure that there is a direct economic impact. However, on the assumption that the TRIM had effects when in place, one can infer the impact of negating such effects by assessing the likely impact of reforms against a set of established (impact) indicators. This ‘Evaluation against Indicators Method’ begins by identifying the affected products or sectors, affected being defined according to likely price and quantity (trade or production, in both cases) effects. The overall aim is to identify production effects resulting from impacts on the composition of a country’s imports and exports. Resulting impacts on the composition of production will have effects on employment and wages. Subsequent effects on incomes will lead to social impacts: the distribution of (household) income effects will influence changes in relative poverty and welfare indicators. Furthermore, depending on the nature of production effects, impacts on environmental indicators are likely (for a more general discussion of ‘impact assessment see the website listed in the references). The steps in the analysis are:

- Identify commodities and/or sectors that are likely to be directly affected by the reform measure(s) in question.
- In the case of regulatory measures identify the range of incentive effects. The resulting impacts on prices and trade/production quantities of commodity prices will affect the related sector(s).
- For each sector affected, identify the likely impacts on a range of indicators – economic, social and environment.
- Considering each indicator, evaluate how the effects on various sectors may interact.
- One can then attempt a summation over all sectors for each indicator, identify important interaction effects, and evaluate the overall impact on the economy.

A specific merit of this method is that the data requirements for a rough preliminary assessment are relatively light (the more comprehensive the desired assessment, the greater the data requirements). To evaluate or quantify economic impacts one requires detail on the structure of trade, production, employment and incomes. Similarly, to evaluate social and environmental impacts one requires details on initial values of the indicators. To assess whether a reform is likely to have a significant impact, however, one only needs to be able to make a relative judgement of the importance of the affected sectors.

We consider three liberalisation scenarios under a new round. No liberalisation of investment represents implementation of the current TRIMs Agreement. Although this requires the elimination of TRIMs, it does so by prohibiting TRIMs using an illustrative list; any on the list are illegal *per se*, but any not on the list are not illegal *per se* (although they could be demonstrated to be illegal within the spirit of the Agreement). Thus, the Agreement does not clearly prohibit all TRIMs (Morrissey and Rai, 1995). Under the <u>no liberalisation</u> scenario, therefore, some TRIMs may be retained. The current situation is not entirely satisfactory, although it is difficult to establish the sustainability impact. However the Agreement, as it is biased towards the interests of MNEs rather than those of host countries, restricts the ability of hosts to constrain the activities of MNEs. This may have undesirable social impacts (in terms of labour standards) and environmental impacts (such as excessive pollution). No liberalisation implies adverse sustainability impact.

The problem with the Agreement is that it fails to resolve the inherent conflict between allowing host governments to apply appropriate restrictions on the behaviour of MNEs, whilst ensuring that such restrictions do not discriminate against MNEs (relative to domestic firms) and do not distort trade. Our scenario for <u>full liberalisation</u> would be one that resolves this conflict, and requires investment measures to ensure regulations are not trade distorting, and competition rules to ensure hosts can regulate MNEs and domestic firms. General statements on the sustainability impact of full liberalisation of this form (incorporating two separate but related trade measures) are difficult. The overall effect should be positive as effective competition policy implies that hosts would have the ability to mitigate adverse economic, social and environmental effects of firm (MNE or local) behaviour. In this sense we can argue that full 'liberalisation' of investment *and* competition measures would have a positive and significant sustainability impact.

The <u>third scenario is an intermediate one</u>, assuming significant 'liberalisation' of investment measures (along the lines of the failed MAI) but no complementary competition measures. We consider this scenario below and show that the sustainability impact would be adverse. By implication, the sustainability impact of implementing competition measures would be positive, as these would mitigate the adverse impacts of investment measures only. Consequently, we do not need to address in detail the impact for competition measures; it is implied by mitigation of the effects outlined below. Thus, our scenario is one where investment measures restrict the regulatory ability of host governments *vis a vis* multinationals, and implicitly restricts their ability to regulate firm behaviour and implement effective competition policy.

4 Impact Assessment of Investment Measures

The assessment below (Table 2) is applicable, in general, to any case where a developed country is the home and a developing country the host. Most FDI, however, is between developed countries. Here the situation is different, as developed countries tend to have effective domestic competition policies and can regulate the activities of host MNEs (treating them in the same way as domestic firms). This again highlights the importance of complementary competition measures.

We consider first the situation in the host country. The removal of a TRIM is a regulatory measure, or more strictly the prohibition of a regulatory measure. One cannot typically observe any direct economic impact, and cannot even be sure that there is a direct economic impact. However, on the assumption that the TRIM had effects when in place, one can infer the impact of negating such effects. Table 2 summarises, against astandard list of economic impact indicators how removal of the three 'TRIM-types' may impact on the economy.

The important feature of TRIMs is that the initial impact is on the source of quantities produced or traded rather then the price, thus production or trade effects are indirect. Obviously, the effects identified in Table 2 will only be observed if MNEs are both engaged in production and initially subject to TRIMs. In any developing country that is a significant recipient of FDI and restricts the behaviour of MNEs so as to increase the benefits to the host economy (i.e. in a manner equivalent to TRIMs), these conditions are likely to hold. We should note that 'large' recipients, such as India and China, may currently achieve these restrictions through policies not prohibited *per se* by the TRIMs Agreement. Often, the same objectives (restrictions) can be achieved by joint venture requirements, or variants thereof. It is reasonable to assume that further liberalisation of investment measures would prohibit all such restrictive requirements. Hence, although we couch our discussion in terms of TRIMs, being the most discussed form of investment restriction in the literature, our coverage should be interpreted in a broader light. We take the view that liberalisation of investment measures under a new round will involve the prohibition of any restrictions on foreign investors that have the effect of constraining trade. It is worth commenting at this point that the MAI aspired to much more as it was not limited to measures that had trade effects, but more generally to any constraints on FDI. The WTO must limit its concern to requirements that constrain trade.

Table 2 Economic Impacts of Removing TRIMs

	Import Restrictions	Export Requirements	Local content
Exports (value)	n/a	-ve	n/a
Imports (value)	+	n/a	+
Trade balance	-ve	-ve	-ve
Domestic linkages	-ve	?	-ve
Local production	-ve	?	-ve
Local employment	-ve	?	-ve
Incomes	-ve	?	-ve
Poverty	+?	?	+?
Overall effect	-ve	?-ve	-ve
Significance	Yes	Yes	Yes

Notes: Indicators are mostly self-explanatory. Codes given refer to the aggregate impact; n/a mean not applicable. Domestic linkages refer to intermediate inputs purchased from the local market. The codes are:

\+ is positive, an increase in the value of the indicator for affected groups.
-ve is negative, a decrease in the value of the indicator.
? implies one cannot be sure of the net impact, as effects are in opposing directions and/or impact may depend on the ability of producers to respond to price changes.

The impacts, from the perspective of the host country, are adverse. This is clear in respect of eliminating import or local content requirements as both imply an increase in imports and deterioration of the trade balance (in the latter case it is assumed that imports from associated MNE sources displace domestically produced inputs). In both cases local production would fall, as would local employment and incomes, therefore poverty may increase. The effect of eliminating export requirements is more ambiguous. Clearly MNE exports fall, with an adverse impact on the trade balance, but production for the domestic market may increase and compensate. Thus, effects on output, employment, incomes and poverty are unsigned in Table 2.

The overall significant and adverse sustainability impact must result if the purpose of the TRIMs was to increase the benefits from FDI for the host economy. If however the TRIMs were truly distortionary, such that they encouraged or supported inefficiency in resource allocation (by, for example, protecting inefficient local producers), there may be long-run (dynamic) efficiency gains to be reaped by the host. If the restrictions imposed by TRIMs were inefficient, ‘their elimination should be beneficial’ (Srinivasan, 1998: 53) in the sense of promoting efficiency and attracting investment. To hold this view it would be necessary to demonstrate that the TRIMs were indeed distortionary (and we are unaware of any studies that have done this). The conclusion must be that the economic impact of the removal of investment restrictions will be adverse for the host.

The impact on the home country is far more difficult to identify, never mind to sign according to indicators, hence a summary such as Table 2 is not attempted. Some comments are in order. Measures that lead to an increase in imports (that have an unambiguously adverse impact on hosts) benefit only the source of the additional imports, the exporter (that is probably a division of the MNE). These benefits are essentially internal to the MNE, and may be sourced from anywhere (possibly without any tangible benefits for the country where production is based). Eliminating export requirements can potentially benefit competing exporters, but this could also be internalised within the MNE (and there is no reason to assume that the home country benefits). The only potential benefit to the home country is repatriation of increased profits by the MNE. This is unlikely to be significant. In a more competitive global environment with fewer restrictions on the activities of MNEs in host countries, it is probable that MNEs would locate more of their production overseas. This implies an adverse impact on home countries also.

The sustainability impact of liberalising investment measures is likely to be negative for both the home and host countries of MNEs, but only for host (developing) countries is it likely to be significant. The discussion so far has concentrated on economic impacts. If the ability of hosts to regulate MNEs is reduced, as it would be under liberalisation of investment measures, anticipated social and environmental impacts would be adverse. Overall, the sustainability impact is likely to be significantly adverse. Competition measures would be required to mitigate these adverse impacts, and the implied sustainability impact of competition measures is significantly positive.

5 Conclusion

There are a number of steps that should be taken if one wishes to assess the implications of the abolition of TRIMs. First, one needs an inventory of the TRIMs in place; from this one can establish the implied impact of removing such measures. Second, one needs to identify the FDI policies and economic performance, especially in terms of impact on host, of any MNEs that have had TRIMs imposed on them. We are not aware of any evidence on which to undertake such an evaluation Third, one needs some indication of the effects of restrictive business practices employed by MNEs, and an assessment of how this affects the allocation of benefits from FDI. This has implications for any regulatory measures that should be introduced regarding investment or competition policy. Then one can apply the impact assessment approaches as outlined in this paper. We have been constrained to discuss the impact of restricting investment measures in a very broad manner. Nevertheless, it is most likely that the impact on developing countries will be adverse (and the method provided could be applied to specific countries of detailed information were available).

The emphasis for linking competition with investment policy within the WTO will depend on one's position. Multinationals desire as few restrictions on investment and competition as possible. Although firms do not have a direct place in trade negotiations, they influence the stance adopted by their home countries (the developed countries). Governments of developed countries, depending on their domestic competition policy, will have their own perspective on investment and competition measures. This will be close but not identical to that of multinationals. Developing countries are likely to hold a different position. The status quo does little to protect their position, and it is they who would benefit most from multilateral rules on competition policy.

Enshrined in the TRIMs Agreement is the intention that a future round of WTO negotiations should reassess the Agreement. Unfortunately, the WTO is not suitably placed to address competition policy. ‘The WTO is a system which deals almost exclusively with the actions of national governments whereas competition policy deals primarily with private actions’ (Lloyd, 1998: 1143). As MNEs are private agents the WTO does not have provisions to impose penalties or restrictions on their behaviour. It follows that a multilateral agreement on competition policy, a set of rules binding on all signatories (that would be governments), is not a feasible aim (Lloyd, 1998). However, multinational law, a set of non-binding rules and principles, is feasible and could build on UNCTAD’s codes of conduct for multinational (Morrissey and Rai, 1995).

The principal problem facing developing countries is that their legal systems, in particular their capacity to implement competition policy and regulate MNEs without TRIMs, are limited. Measures to strengthen their capacity to implement effective domestic competition policy are essential (Lloyd, 1998; Morrissey and Rai, 1995). In the interim, as TRIMs are prohibited, what can they do? The approach to FDI adopted by China and India, amongst other developing countries, may offer the best solution. If developing countries want to increase the benefits to the host economy of investment by multinationals, it may be best to require that investment is in conjunction with local partners. Proposing joint ventures and equity stakes as alternatives to FDI (as defined strictly above) will secure greater benefits for the local economy. Alone, this does not ensure the benefits extend beyond the local partners. The general principle is that government should promote domestic competition.

It is in the interests of host governments to promote competition between MNEs, as a component of promoting local competition. It is not desirable to allow a multinational, even in a joint venture, to have a local monopoly. Within the WTO, governments that argue they are trying to promote competition will be in a stronger position than those that try to restrict behaviour through regulations, especially if such restrictions can be shown to have trade effects. The current situation on investment measures in the WTO does restrict the actions of governments, but only insofar as government actions distort trade. A government measure that promotes competition cannot readily be argued to be trade distorting. Furthermore, a government measure that promotes competition can be at least as effective in mitigating restrictive business practices as any performance requirements.

An appropriate first step of developing country governments in establishing domestic competition policy is to establish domestic competition. This would be consistent with the economic policies promoted by the World Bank and other donors, and recipients could aim to exploit the support of donors. Governments will need support because MNEs do try to gain a monopoly position if they can (if they do, one should not be surprised when they exploit it to their own advantage). Developing countries need to resist this more actively, and transparently, than has been the case in the past. In attracting foreign involvement, the principle should be to ensure many firms are operating in the local market. These may be all foreign, but it is even better is MNEs have local partners. There will be resistance to competition from local firms and MNEs who have actual or potential monopoly positions, and perhaps from politicians who gain from restricted competition. Nevertheless, promoting competition can increase the benefits to the local economy and may be the most effective instrument in mitigating the power of multinationals.

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