

Comments from the Editor



Tamir Agmon,
Editor

International business is about cross border movements of factors of production. In today's world it is common to discuss the role of human capital in the development of international business in high-tech industries like information, microelectronics and communication. Human capital plays an important role in earlier periods as well. The article by Florin Aftalion, on the contribution of Jewish immigrants from Russia to the US in the 19th century, highlights the way by which a competitive advantage in key industries like apparel was built by a specific historical and social situation that expressed itself in creating a two generations advantage based on human capital. This specific human capital in the US was created by the will of many individuals to better their life and to generate a basis for their sons and daughters to improve their chances through education. The political and socio-economic developments in Eastern Europe in general and in Russia in particular pushed many Jews to look for a place in which they can live peacefully without the extreme economic, social, and political discrimination that they experienced in Russia at the time. The US of the early 19th century provides such a place. The combination of the economic and social situation in the US at the time, new technology, and the individual human capital and the social and organizational capital that the new immigrants brought with them created a basis for competitive advantage for many new firms and even industries in the US. Moreover, the rapid changes in the lot of many Jewish immigrants of the first generation and their preferences with regard to investment in education for the second generation created a stock of highly skilled human capital in the US that played an important role in creating the competitive advantage of many US based multinational enterprises that

composed much of the international business in the second half of the 20th century.

The article by Professor Aftalion, a part of an on-going research, is another example of the many faces of International Business. As was demonstrated in other articles in AIB Insights in the last two years there is much to learn about international business from history. International business is better understood as a complete human system. As such articles like the one by Aftalion contribute to a deeper and more complete understanding of this system.

The study by Aftalion is presented here as an example of the interface between the needs of individuals, the immigrants, in a crisis situation and the opportunities in a different system, the target country, that provides a solution for those in need. The article by Professor Gugler focuses on the evolvement of the system once the changes have taken place. The article by Gugler is another expression of the tension between the national state and its interests and the multinational enterprise (MNE) as an organization that crosses national borders and creates a possible conflict between its interests and the interests of some, or the entire national states in which the MNE operates.

Gugler discusses two processes. The first is the attempt for global and/or regional coordination by national states and international and regional agencies. This effort results in a number of international agreements, regional agreements, and bilateral agreements that govern many aspects of the operations of multinational enterprises. The second process is the internalization of movements of factors of production within the MNE (This is one of the conceptual bases for the existence of the MNE in the first place). As Gugler demon-

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strates the first process is often inconsistent and confusing in itself. As this process is politically driven by political organizations it is often in disagreement with the internalization process which is a result of value maximization by economic agents.

The article by Gugler, like the article by Professor Kobrin in the last issue of *AIB Insights* is an example for the ever existing tension between the national and the global elements in international business. Gugler ends his article with a plea to continue the efforts to resolve the tension. It may be so that this tension as well as the process to resolve it is inherent to the nature of international business.

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*We look forward to your
comments and submissions.*



Florian Aftalion

Professor Emeritus at ESSEC

The First Russian Jews in America

Since the destruction of the second Temple, Jews have been wandering around Europe and the Middle East, chased from towns or countries and finding only temporary refuge under some Kings or Sultans who needed their expertise as merchants and money lenders. The better known of these sad episodes is the expulsion of some one hundred thousand Jews from Spain (and shortly afterwards from Portugal) and the resettlement of many of them in Turkey. The migration of Jews from the German Holy Empire to Poland is another one. However, the most massive and spectacular movement of a Jewish population in history occurred in the thirty-three years preceding World War I. In that time span two million Jews immigrated to the United States coming mainly from Russia¹ but also from neighboring Rumania and Galicia.

The assassination of Tsar Alexander II in 1881 was followed by a series of pogroms spreading killings and destructions from the southern Ukraine to the Baltic sea. When they finally ceased, the new Tsar Alexander III, a fierce anti-Semite, in order to accommodate what he perceived as a popular sentiment, announced a series of ukases further restricting Jewish presence in big cities² and imposing quotas in higher education and in the professions. For many Jews the dream of becoming good Russian citizens suddenly evaporated. Their only hope now was emigration. But where should they go?

In 1881, when the first Russian Jews fled in a panic, Palestine was not an option yet. America, on the other hand, was the country where Jews had been free to wor-

ship since before the Revolution. It was a land where they had equal rights and many opportunities. Legends of Jews who had stroked it rich were told in the *shtetlach*. It was a long journey to America but the recent replacement of sailing vessels by steamers had made it possible. The time of the Atlantic crossing had been cut from three months to less than two weeks. Traveling in steerage, extremely uncomfortable, had also made such crossings affordable.

Arriving in the United States was one thing. But what sort of a living could a poor almost illiterate Yiddish speaking Jew make there? Some of the intellectuals in the Jewish enlightenment movement believed that going back to tilling the earth would bring an end to their suffering. Attempts to organize Jewish agricultural communities in Argentina³ or in the United States by young idealists failed miserably⁴. From a long run perspective this was fortunate. In the century to come the American rural population was to decrease from some 40% of total population to around 2%. In the Diaspora, Jews had lost all talent as peasants but had developed other skills as artisans or tradesmen (and also as scholars to be discussed later).

In the second half of the 19th century, the sewing machine had started a Revolution in the way clothes were produced and people were dressed. Lower and middle class men and women who heretofore had worn second hand used clothes were now offered affordable ready-made new ones. In New York, they were produced in sweatshops where 70 hours weeks were not uncommon. New immigrants

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worked for contractors, themselves Jews, who received bundles of cut cloth from merchants or manufacturers and had them transformed into finished garments by toilers, paid piece-meal. The division of labor which prevailed in this type of structure allowed the employment of workers of various skills. In the garment industry one could stitch, trim, make button holes, iron, etc. Besides, language was not a problem as everybody spoke Yiddish and the sanctity of the Sabbath was preserved.

Immigrants lived in overcrowded tenements. When they went to work during day-time, they rented their bunks to some even poorer bachelor who toiled at night. Pay was miserable but the work in a fast expanding industry, itself part of a prosperous economy, was plentiful. Most of these wretched immigrants managed to save enough to bring wives, children and parents from the Old Country. Some saved even a little more and could ascent professionally from

worker to contractor and then to small manufacturer. As garment manufacturing became New York's most important industry, bigger factories appeared. Most of their owners were Jews. In these factories, there was more air to breath than in the sweatshops and workers earned fixed wages. As employment in the needle trade increased—textile firms employed 312 245 men and women in 1913⁵—labor became organized and could successfully strike for the betterment of their working condition.

The textile industry was not the only providing jobs in New York and in other big cities. Construction was another one. And then there were all the self-employed people often running small shops. They were cigar manufacturers, haberdashers, painters, carpenters, tinsmiths or butchers.

When setting foot in the United States, most Jews settled in the immediate proximity of their point of entry. Most of the time this

was New York but Boston and Philadelphia were also major arrival ports for European immigrants. These cities became the home of important communities as well as Chicago and some other cities. More adventurous Jews tried their luck further inland and could be found scattered all over the United States. Very often they started as peddlers and upgraded their businesses to dry goods stores.

Although at that time Government didn't provide any welfare or medical aid, Jews could benefit from the charity of their, by now Americanized, coreligionists. These were mainly German Jews who had immigrated earlier in the 19th century and by now had achieved middle class status or even better. Some like the Guggenheim, the Straus or the Schiff were among America's wealthiest citizens. At first these upper class Jews felt threatened and shocked by the rude manners and dirty appearance of the jargon (Yiddish) speaking Russian immigrants. Would they not ignite anti-Semitism? But following a long tradition of helping out their brethren in need⁶ they quickly organized and financed philanthropic institutions to give relief to the poor, grant loans, operate vocational training schools, send nurses and social workers to care for the sick and maladjusted, etc. Child care being particularly important to Jews, they financed an Orphan Asylum and sponsored the Mount Sinai Hospital.

America was the end of the line. There was no other place to go. Therefore, Russian Jews had to become good citizens in their new country. With this purpose in mind, most of them were ready to abandon some of their ancestral ways. They shaved their beards, started eating forbidden foods and worked on Saturdays. They also send their kids to public schools where tuition was free, education good and sports—not a very Jewish activity at the time—part of the curriculum.

The fortunes of the Ashkenazim (Jews from Eastern and Central Europe) improved quite rapidly. In New York they started moving uptown into more comfortable premises. When new subway lines and bridges across the East River were constructed, many of them could afford moving to the Bronx and to Brooklyn, at the time developing residential areas.

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Thus, first generation Russian Jews, that of the sweaters and of the peddlers, managed to extricate itself from poverty. But first generation children didn't do very well at school. However, next generation children attended college more frequently than the average Americans. Their academic achievements were amazing. Just consider the Nobel prizes they won⁷: 14 in physics, 9 in chemistry and 19 in physiology and medicine plus some more in literature and economics. The third generation blended into the American population and became their country wealthiest ethnic group. A census taken in 1980 showed that the average Jewish families' income was 1.73 times that of the average American home, the highest of all ethnic groups⁸. And all this in spite of the Big Depression and of discrimination Jews suffered in housing, jobs and education.

How can we account for such achievements?

Nobel Prize winner Gary Becker, himself born to Russian Jewish immigrants, offers the following general explanation⁹:

... economists regard expenditures on education, training, medical care, and so on as investments in human capital. They are called human capital because people cannot be separated from their knowledge, skills, health, or values in the way they can be separated from their financial and physical assets.

Education and training are the most important investments in human capital. Many studies have shown that high school and college education in the United States greatly raise a person's income, even after netting out direct and indirect costs of schooling, and even after adjusting for the fact that people with more education tend to have higher IQs and better-educated and richer parents.

However, human capital is not the only factor explaining a person's income. People without any schooling can and sometimes do get rich. Earnings of a given cohort of University graduates, people with the same education, are generally widely dispersed. Individual differences in intelligence¹⁰ don't seem to be a sufficient explanation. Psychological factors must also be at play like the will to succeed, thriftiness, readiness to work

hard and many more.

For a sociologist like Pierre Bourdieu¹¹ "cultural capital" is supposed to account for the inequality of performance at school of children from different social classes, rich "bourgeois" children being more successful than poor "labor class" ones. But this is obviously not the case of children of Russian Jews, on the contrary: they were among the poorest and also among the more successful. Which discredits Bourdieu's theory.

"Social capital"¹² is another notion supposed to explain economic success of groups in society. Although it has received many definitions, they all stress the degree to which a community or society collaborates and cooperates (through such mechanisms as networks, shared trust, norms and values) to achieve mutual benefits. Trust seems to be a common factor in all these definitions.

For a greater number of first generation immigrants, fortune came thanks to the human capital they had invested in the "needle trades" (many of them were tailors) which was highly valued in a growing economy where demand for clothing was rising rapidly. Social capital, resulting from the fact that the clothing industry was almost entirely Jewish, enhanced the dividends of the human capital element. Then, because the organization of this new industry was such that small firms could be started with small amounts of capital, many Russian Jews became entrepreneurs. They were able to accumulate initial investment money by being frugal and thrifty. Life in Russia had accustomed them to extreme poverty. Putting pennies or dollars aside still left them enough money to lead lives which were no worse than what they had known in Russia.

However, human and social capital cannot account for Russian Jews' drive to get an education nor for the highly above average wealth they acquired in several economic

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production and distribution sectors. Some common characteristics, not included in the definitions of human, cultural or social capital must have been at play.

For many generations Russian Jews had lived in urban environments where economic progress could be achieved by bettering one's craftsmanship and accumulating human capital. In pre-industrial Russia many Jews were artisans. They could start as apprentices and, some day, own a shop or a store. Their behavior can be contrasted with that of immigrants from rural areas of Europe (Italy, for instance) who were used to think that, as crops depend on weather, their success in life depends on luck and little on factors they could control. Past urban experience explains, at least in part, why the descendants of Russian Jews had more years of schooling than other white Americans and, accordingly, obtained higher earnings¹³.

But why were they so outstandingly successful in academia and in the professions?

In the Old country where religion played a predominant part in a Jew's life, learned people were held in high esteem. The persistence of this attitude gave Russian Jews an added incentive to have their children earn the highest possible degrees and join the professions or become academics. It can also be argued that the study of the Talmud improved problem solving abilities, not only in Talmud students but also in their whole social group in which they diffused their way of reasoning. Acquired and family transmitted psychological traits such as these can explain success in academia and the professions. There are also more controversial hereditary theories of Ashkenazim intelligence of which the most recent relates it to genetic diseases¹⁴.

Economists, especially those of the "Austrian School¹⁵", stress the role played by entrepreneurs in "discovering" new markets and new opportunities. From this point of view, Russian Jews have been very successful but their achievements, although widely reported, have not been analyzed and related to their past experience.

In Russia, many Jews lacked permanent residence and lasting jobs. In order to make a living they had to be on the lookout for some deal they could be part of, some transaction for

which they could act as intermediaries, some temporary work for which they could get paid. In a stagnant economy and given all the discriminations they were subjected to, such opportunities were difficult to find. In America, things were different. The economy prospered, almost nothing was forbidden, no paperwork was needed to start a business, and there were no taxes to be paid. Although bigotry excluded Jews from certain jobs, opportunities were aplenty in new, unprotected markets which Russian Jews discovered and developed.

Take the case of Samuel Zemurray. He arrived in the United States in 1892 at age 15. A few years later, after working at several low-paying jobs he found himself a longshoreman in Mobile, Alabama. After noticing that ripe bananas were thrown away in the harbor he decided to collect them and rush them to grocers. He expanded his system by buying carloads of "ripes" at bottom low prices and shipping them to small town stores by railway while informing his customers of the exact delivery time. His next step was to move to New Orleans and expand his network. At that point Zemurray had become a millionaire. After a few more years of selling "ripes", he bought land in Honduras, and developed banana plantations there. Then he sold his very successful business to the United Fruit Company for shares of stock and became its biggest shareholder and finally its President.

Zemurray found a way to make money out of junk. This was not uncommon for Russian Jews. In the Old Country poverty had led them to deal with waste nobody else wanted to touch. In America they started businesses, among other things, in scrap metals which they melted before reselling them very profitably to big steal companies. They also dealt successfully in scrap non ferrous metals, rubber, paper and cotton which became their exclusive areas.

Consider also the film industry. Eastern European Jews didn't invent the movies but they created Hollywood. Cinema, as a technique, was invented by Edison and improved by the Lumière brothers in France. At the beginning of the century, short films about ten minutes long were shown in *nickelodeons*, most of the time former stores. Their popular success was enormous especially in the Lower

East End. Although Jews were running nickelodeons the production and distribution of films was trusted by gentiles, protected by Edison patents.

Carl Laemmle, although born in Germany, had arrived in the United States at the time of the big wave of Russian immigrants. After trying different jobs, he was doing well managing an apparel store. But sensing the future of the film industry he opened two nickelodeons before starting his own production firm (using French manufactured equipment). The movies Trust tried to have the law close his bootlegging business. Its effort proved unsuccessful. Laemmle had opened a new field of burgeoning opportunities to his fellow enterprising Jews.

Among these, the better known figures are: an upholsterer and blacksmith (Adolph Zukor), a hawk of soda pop, sandwiches and chimney black (William Fox), a former trapper from North Dakota (Morris Kohn), a furrier (Markus Loew), a worker in a glove factory, later road salesman, (Samuel Goldwyn), a vaudeville actor (Jesse Lasky), a junk peddler (Lazar Mayer), a whole family of junk

dealers (the Warner brothers). Their legacy is the Hollywood Studios—Universal Studios, Twenty Century Fox, Metro Goldwyn Mayer, Columbia Pictures, Warner Brothers—and the thousand of films for which they have become famous¹⁶.

Economic and social success of a group of immigrants can be explained by the combination of their own attributes and the conditions they find in the host country. In the case of the Russian Jews the chemistry of their encounter with America was indeed extremely favorable. Many of them arrived in an expanding free economy endowed with a particular form of human capital at a time when it was in high demand. They had also brought with them a strong drive for learning, the understanding of the usefulness of investing in human capital, readiness to work hard, thriftiness and at least for some of them, a remarkable talent for discovering new business opportunities. All these characteristics had been acquired through the hardships they had suffered in Tsarist Russia and were put to good economic use in the United States.

Footnotes

¹ At the time Poland and Lithuania were part of the Tsarist Empire.

² Jews were already obliged to dwell inside the Pale of Settlement.

³ By the French philanthropist Baron Moritz de Hirsch.

⁴ Kibbutzim were a much later endeavour.

⁵ *Encyclopedia Judaica*.

⁶ In the Roman Empire days, they would pay ransoms to free Jews captured as slaves.

⁷ Not counting Jews of German origin or Jews who immigrated to the United States after World War I.

⁸ Thomas Sowell, *Ethnic America, A History*, Basic Books, 1987.

⁹ Gary S. Becker, *Human Capital*, University of Chicago Press, 1964; Gary S. Becker, *The Concise Encyclopedia of Economics*, www.econlib.net.

¹⁰ Controversially measured by one's IQ.

¹¹ Pierre Bourdieu and Jean-Claude Passeron, *Cultural Reproduction and Social Reproduction*, 1973 ; Pierre Bourdieu, *The Forms of Capital*, 1986.

¹² Robert D. Putnam, *Bowling Alone: The Collapse and Revival of American Community*, Simon & Schuster, 2000.

¹³ Barry R. Chiswick, The Skills and Economic Status of American Jewry: Trends over the Last Half-Century, *Journal of Labor Economics*, 1993.

¹⁴ Gregory Cochran and Henry Harpending, Natural History of Ashkenazi Intelligence, to be published in *The Journal of Biomedical Science*, 2006.

¹⁵ See for instance Israël M. Kirzner, *Competition and Entrepreneurship*, University of Chicago Press, 1973.

¹⁶ Neal Gabler, *An Empire of Their Own: How the Jews Invented Hollywood*, Anchor, 1989.



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Towards a coherent multilateral framework on FDI

International investment is the driver of globalisation (OECD, 2005, p.1). Investment flows have tripled within 10 years and foreign capital stocks are now twice the size of global GDP. International investment agreements, instruments of co-operation for the promotion, protection and liberalisation of foreign investment, have all increased in the last decade. More than 2,300 Bilateral Investment Treaties (BITs) and about 150 trade and economic integration agreements comprising substantive investment provisions have been concluded in this period. Another 60 or so agreements are currently under negotiation. The legal framework of investment agreements has also evolved significantly and the growing package of jurisprudence raises new questions about interpretation and implementation for governments and investors in both developed and developing countries. The number of international investment disputes arising from investment agreements has increased sharply. Likewise, the cases brought to dispute settlement have become increasingly complex, creating various interpretations of their provisions and generating huge debates among governments, academics and practitioners (OECD, 2005). This contribution seeks to analyse these issues in three ways. The first section of the analysis will take stock of the current situation. The second part examines the various multilateral initiatives undertaken in the field of international investment. Finally, an exploration of some possible next steps is undertaken in the third section of this paper as a means of contemplating a more coherent international normative framework governing FDI.

The current international framework on international investments

Comprehensive multilateral rules governing international economics are currently limited to trade issues. Even though the WTO agreements contain major loopholes, multilateral rules on trade constitutes a broad umbrella of rights and obligation under which regional, plurilateral and bilateral agreements as well as national laws all regulate trade issues. Although FDI has increased significantly over the last two decades, outpacing the already significant expansion of trade during the same period (UNCTAD, 2005, p. 14.), the current international legal framework for foreign direct investment (FDI) is highly fragmented. The current framework consists of a wide variety of national and international rules and principles that differ in form, strength, and coverage. The result is an increasingly complex international setting for international investment in which governments must ensure consistency between differing sets of obligations.

The sources of international law are international treaties, custom, general principles of law, and national law (Article 38 (1) of the Statute of the International Court of Justice). Customary international law treats FDI as a matter of national law in accordance with the principle of national sovereignty. Conversely, it is recognized that each State has an interest in the proper treatment of its nationals and their property abroad. A State may therefore invoke the rules concerning the responsibility of States for injuries to aliens and their property that have occurred in violation of customary international law (principle of nationality).

Although national laws and policies still constitute the most concrete and detailed part of the legal framework of FDI, the current system has become increasingly dependent upon international treaties. The attempt to create a multilateral organisational framework for FDI in the Havana Charter failed to enter into force in 1948, with the result that the legal situation since then has become a patchwork of bilateral, regional, plurilateral and multilateral treaties. The early 1960s witnessed the early process of negotiating bilateral investment promotion and protection agreements (BITs) between countries. The proliferation of these agreements set up two competing themes within international investment rules, notably that though an increasing number of developing countries were willing to subscribe to basic standards for investment protection and treatment, they were unwilling to do so at the multilateral level. BITs have since become the core of the current framework for FDI. More than 2,300 bilateral agreements have been concluded since the early 1960s, most of them in the 1990s.

Regional and plurilateral agreements are also popular means of formalising international rules on investment. Regional and plurilateral agreements comprise, by definition, a limited number of countries. Among OECD Members, for example, two Liberalisation Codes cover capital movements and current invisible operations respectively. Their degree of integration and cooperation differs depending upon the treaty and the member states. The European Union (EU) model is the most integrated of these regional agreements and is characterised by the strong impact it has on FDI among member countries and investment in and from third countries. Other regional integration agreements involve lower degrees of integration than that displayed by the EU, nonetheless have a noticeable effect upon FDI regulation. NAFTA is a good example of such an agreement. Although NAFTA is formally neither a “free trade zone” nor a common market or economic union, the agreement does pertain to FDI. Another example is the recently negotiated Framework Agreement on the ASEAN investment area, which focuses exclusively upon FDI. This agreement seeks to promote the liberalization of investment regu-

lations in the region by enhancing cooperation between countries in the Asia-Pacific.

The policy space left behind by the failure of a multilateral set of rules on investment has been filled to some extent by international organizations and institutions. As stated by UNCTAD, “with respect to FDI, no comprehensive global international convention dealing with FDI exists, and various efforts in this direction, in the past as well as more recently, have met with no success” (UNCTAD, 2004, p. 17). Among the relevant multilateral agencies in existence, several deal with issues that are important for FDI, such as the Agreement of the International Monetary Fund and the GATT. The international organizations created as part of these agreements, e. g. the World Trade Organization (WTO), the World Intellectual Property Organization (WIPO), constitute the sole international institutional structure that is indirectly or directly relevant to FDI. Other multilateral agreements, although they may not address the FDI process in its entirety, nonetheless pertain to important aspects of it (e. g. the Convention on the Settlement of Investment Disputes between States and Nationals of other States.) A draft Code of Conduct on transnational companies (TNCs) has been developed by the UN. Finally, several WTO agreements are related to foreign investment issues such as the GATS, the TRIMs and the TRIPs.

The initiatives taken towards a multilateral investment agreement

An important advantage of bilateral investment treaties and regional agreements, is that they can be tailored to the specific circumstances of the parties concerned, such as development issues. However, as the number of bilateral investment treaties and regional agreements continue to expand, different standards and disciplines are beginning to be exerted

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over foreign investments. This might create confusion for MNEs operating on a global scale (WTO, 1998, p.47). A comprehensive set of consistent multilateral rules on foreign investment could allow for a stable, transparent and consistent environment for firms operating internationally, whatever their ownership structure or place of incorporation. The global application of broadly the same investment disciplines would remove the complexity arising for investors from the existing framework of bilateral and regional investment treaties and agreements and thus facilitate compliance. Furthermore, a multilateral set of rules on investment would enhance the predictability of the legal and regulatory environment in host economies.

Over the past 20 years, three attempts to negotiate binding multilateral rules for investment have failed: in the United Nations, in the Organisation for Economic Cooperation and Development (OECD) and in the World Trade Organisation (WTO). The two main important and recent initiatives are those undertaken within the WTO and within the OECD. These two latter initiatives will be dealt with below.

Ministers from WTO member countries decided at the 1996 Singapore Ministerial Conference to set up three working groups: on trade and investment, on competition and investment and on transparency in government procurement. Those three issues were included on the Doha Agenda. The mandate for these working groups was to prepare the basis for negotiations on these three issues after the 2003 Cancun Ministerial Conference. However, on August 2004, it was agreed to drop those three issues from the Doha agenda. The Working Group on Trade and Investment did not formulate a draft agenda - which was not an obligation under its mandate - but it did create a forum in which were collated numerous analyses of the relations between trade and investment alongside country experiences regarding national investment policies, the existing international instruments regarding trade and investment, and so on. Important concerns were also raised during the OECD negotiation on the Multilateral Investment Agreement (MIA). Discussions there dwelt upon the problem of a loss of freedom to regulate the entry of FDI that may have been

implied by formal provisions dealing with the liberalisation of investment rules.

In May 1995, the OECD Council decided to start negotiations aimed at reaching a Multilateral Agreement on Investment (MAI), which would provide a broad multilateral framework for international investment with strict standards for the liberalization of investment regimes and investment protection and would also include an effective dispute settlement mechanism. It was agreed that the MAI would be a free-standing international treaty open to all OECD Members and the EU and to accession by non-OECD Member countries. The negotiations failed in April 1998.

Following the failure to install a multilateral framework on foreign investment within the OECD as well as within the WTO, opinions diverge as to whether approaches to regulate FDI through multilateral regulations should continue. These failures should not be read as a signal to abandon the search for multilateral rules. These failures may rather be considered an indication of the importance of multilateral regulations on investment and of the fact that governments have not yet identified an appropriate negotiating agenda (Mann and al., 2005, p. viii).

Indeed, the increasing importance of FDI makes the current legal situation unsatisfactory. A comprehensive multilateral legal framework for FDI would help to reduce transaction costs and thereby enhance the economic benefits of FDI. At the turn of the century a renewed impetus to create such a framework has begun to gain momentum. "Although the MAI itself is dead, this agenda is still alive, if not necessary well." (Graham, 2000, p. 14).

Key issues for achieving a coherent international framework on foreign investment

As stated by Dunning, "multi-lateral action may still be necessary and may still be addressed to regulating MNE activity. However, today, its main thrust is to ensure that the global economic order works so as to ensure that MNEs and other cross-border actors optimize their contribution to the capabilities and competitiveness of Nation States" (Dunning, 2003, p. 587). A multilateral framework on foreign investment

should lead to a more coherent international framework on foreign investments. However, to achieve this goal, key controversies should be carefully addressed in order to find a consensus on a multilateral framework on FDI. Among the key issues to tackle in such an agreement should be the degree of liberalisation of rules governing the entry of foreign investment, the treatment in force in the post-establishment phase, the macroeconomic effects of FDI, the environmental concerns as well as the protection of social right and human rights (Cosbey, 2005, Mann and al., 2005).

Liberalisation, in the context of FDI, involves the diminution of restrictions on the entry of foreign companies (UNCTAD, 2004, p.24). Today, screening of investments is still common although it tends not to be strict and demanding. It may be assumed that such screening is subject to considerable influence by political pressure groups. Such restrictive, and thereby market-distorting, governmental measures need to be removed. The catchphrase here should be fair competition in contestable markets. However, developing countries in particular may prefer to retain screening powers in order to protect infant industries. Of the two basic model BITs, only the treatment provisions of the “North American model” BIT apply to the pre-establishment phase, while the “European model” merely covers investment post establishment. The choice of one of these two rival models in a multilateral framework will generate a lot of debate. The existence of two competing models may prolong negotiations about a possible future framework.

A second principal category of issues concerns “investment protection”. Positive standards of treatment, particularly directed at the elimination of discrimination against foreign investors, are common. In certain treaties the standards of treatment are also applied to the pre-entry phase. The most common standards of treatment are the “most-favoured-nation” (MFN) standard, the national treatment standard and the standard of “fair and equitable” treatment. In the case of developing countries the question that arises is whether they can preserve sufficient policy space to promote their development. Therefore, most provisions allow for exceptions (e. g. referring to public order and health). As the extent of these exceptions

and their impact are subject to interpretation, a substantial amount of uncertainty remains both for the investor and for the host State. This often results in unwieldy agreements in which the exceptions complicate the application. Another topic steeped in controversy is the amount of compensation due for breach of the provisions of the agreement. Opinions range from full compensation (including future profits) to no compensation at all. Several BITs contain references to adequate compensation. All these issues give rise to scores of legal problems that may lead to disputes. Investor-State dispute settlement methods are hence necessary to translate the standards into action.

The potential costs of adhering to an investment agreement for host States are a limitation of their sovereignty and the risk of financial crises. In order to protect investors, many BITs enlarge the notion of “expropriation” to cover so-called “regulatory takings”. All government measures that are seriously detrimental to an investor’s interests or affect foreign investors in a disproportionate way entail compensation. Obviously, this raises the risk of unduly limiting generally acknowledged regulatory powers of the host State. For example, the French considered the MAI an unacceptable threat to national sovereignty. The MAI was designed as a pure investor-protection instrument and was therefore considered an anachronism which failed to reflect the recent transformation in political discourse. This discourse did not challenge the importance of free private enterprise as such but rather its legitimacy as a potential violator of human rights, an abuser of market power, a corruptor and a polluter. Civil society stressed the need for standards for TNC conduct and criticised the MAI for the imbalance between investor rights and obligations. It has been argued that foreign investors could secure additional property rights which would be more substantial than many host States had anticipated (Hallward-Driemeier, 2003, p. 4). This could lead to problems of moral hazard and adverse selection as these provisions could be used as an insurance against “normal” business risks.

Another point of controversy concerns the macroeconomic aspects of FDI. Capital account liberalisation was initially thought to lead to the efficient allocation of savings in the global

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economy and to allow citizens to diversify their portfolios. However, according to authors such as Singh (2003), this liberalisation has instead led to an increase in economic and financial crises, with subsequent implications for economic meltdown. Although FDI is generally regarded to be much more stable, this view seems to be contradicted by empirical evidence. The opponents of full liberalisation argue that FDI entails considerable foreign exchange liabilities and may lead to a liquidity crisis especially in the case of developing countries. Therefore, the government must screen the amount and timing of inward FDI (Singh, 2003, p.208). It is important to keep in mind that financial crises are sometimes brought about within the context of sound economic fundamentals due to a process of self-fulfilling expectations. Constraints on capital movements might channel the conduct of investors into a more development-friendly direction. Considering these risks it seems that further evidence on the causal link between financial liberalisation, banking crises and currency crises is necessary. Otherwise, the economic and social costs of

financial crises may end up surpassing the potential benefits of liberalisation.

The debates regarding the MAI have pinpointed several issues which would play an important role within a multilateral framework on foreign investment. These include the “development” dimension of such an agreement, environmental concerns, as well as social and human rights. Initiatives have recently been undertaken under the auspice of the UN as well, by some research institutes in order to address those issues within the framework of a multilateral agreement on investment. Given the complexity of all the dimensions to take into account, the progress toward a less fragmented framework will need further analyses. Studies on the key dimensions of rules governing foreign investments should be designed to promote both the firms’ efficiency and the economic development and competitiveness of host and home countries. Furthermore, the challenge is not only to “open” the framework to new issues but also to consider it in a dynamic perspective. As stated by Dunning, the interaction between governments and MNEs is a dynamic and iterative process (Dunning, 1993, p. 547).

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Footnotes

- ¹ Prof. Philippe Gugler, Department of Economics, University of Fribourg (CH). The author would like to thank Mr. Serge Brunner, Research Assistant, for his significant help in this contribution. This contribution is part of a research project supported by the NCCR project “International Trade Regulation: From Fragmentation to Coherence” at the World Trade Institute in Berne, Switzerland.