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ON INTERNATIONAL INVESTMENT

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FOR FOREIGN DIRECT INVESTMENT IN THE 21<sup>ST</sup> CENTURY*

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TECHNICAL ASSISTANCE AND CAPACITY BUILDING  
RELATED TO FOREIGN DIRECT INVESTMENT

*Communication from the European Community  
and its Member States to the World Trade Organisation*

# **WORLD TRADE ORGANIZATION**

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**Working Group on the Relationship  
between Trade and Investment**

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## **COMMUNICATION FROM THE EUROPEAN COMMUNITY AND ITS MEMBER STATES**

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### **TECHNICAL ASSISTANCE AND CAPACITY BUILDING RELATED TO FOREIGN DIRECT INVESTMENT**

#### **Introduction**

1. International Investment rules at bilateral, regional and multilateral level can play a key role for the purpose of improving the legal environment for FDI world-wide, as a complement to domestic reforms. It is widely acknowledged, however, that investment rules alone are not enough to ensure that all countries attract a greater proportion of the increasing flows of FDI. The main determinants of international investment flows in a given country are market size and structure, macroeconomic and political stability, level of infrastructure, labour skills, etc.

2. At the same time, it is also clear that the enabling environment for FDI is crucial to attract foreign investors or at least to avoid discouraging them. In our view, an improved legal framework should be developed together with accompanying measures aimed at creating a supportive business framework, which would maximise the potential that countries have for attracting FDI. This enabling environment for FDI should include, beyond the legal framework, good governance, effective justice systems, respect for the rule of law, etc. The benefits of a sound enabling environment are widespread. Not only does it make a country more attractive to FDI inflows, but also helps it to absorb the flows in a more productive way, for example through the efficiencies of better governance. It can also help reduce capital flight and encourage greater domestic investment. In this context it will be crucial to identify what appropriate assistance could be envisaged to ensure that developing countries exploit their full potential by attracting more capital flows and consequently, increase their economic growth.

3. As a first step, developing countries could receive assistance on two fronts: on the one hand, assistance should aim at identifying the key requirements for increasing their attractiveness as investment locations and the key bottlenecks that frustrate domestic policies to this end. On this basis, assistance could then be directed at building capacity to: (1) regulate the domestic markets in order to attract investment; (2) identify and deal with obstacles to ordinary market functioning, e.g., competition policy. On the other hand, developing countries should receive assistance to negotiate effectively international investment rules and to transpose the results of negotiations into domestic laws and regulations.

4. This paper attempts to identify possible fields for technical assistance in the context of the possible future negotiations of international investment rules. The paper also refers to some of the existing technical assistance instruments provided by the European Community as well as by international organisations.

5. This submission does not propose to reach conclusions on these issues. Rather, its objective is to open a debate among Members on:

- a) whether the existing instruments are adequate;
- b) whether they should be revised to take into account specific needs and objectives that are not fully taken into account yet;
- c) whether notable gaps exist in the field of technical assistance and Capacity building related to investment, and how they could be filled.

6. Thus, the paper is articulated into 2 main sections. The first section looks at the wider issue of capacity building in the general context of sustainable development of Developing countries, and gives some suggestions on how the WTO and its Members could contribute to improve the coherence of the existing Technical assistance/Capacity building initiatives related to trade and investment. The second part deals with the immediate needs of a developing country wishing to negotiate international investment rules, in terms of both identifying and defending its interests in such a negotiation and then transposing the results of the negotiations into domestic laws and regulations.

7. This paper does not deal with the bigger issue of actually increasing and improving the capacity building element of development assistance. This is an issue that goes well beyond the mandate and the ability of the Working Group.

### ***1. Building capacity to attract, absorb and benefit from FDI – Defining needs and identifying gaps in current assistance programmes***

8. As mentioned above, the main challenge relates to improving the overall capacity of many developing countries to attract a higher share of FDI flows and to absorb inflows in a manner conducive to its smooth and sustainable economic development. This is a medium to long-term issue, which needs co-ordinated and coherent support by international institutions and individual developed country donors also in order to maximise the benefits for those developing countries undertaking efforts on their own in this regard. Clearly, all efforts in this area should be fully consistent and developed within the context of the World Bank/UN global strategy on sustainable development and poverty eradication.

9. The WTO and its Members, however, could kick-start a process of coherence in the area of investment by providing developing WTO Members with resources to (a) identify the priorities for action; (b) catalogue the technical assistance and capacity building initiatives already under way; (c) identify gaps in the overall assistance being provided; (d) ensure greater coherence of the action of international

institutions and individual donors; (e) identify the “capacity bottlenecks” that limit the ability of developing countries to attract, absorb and benefit from FDI; (f) better target international assistance to this end. WTO Members should consider to what extent existing instruments such as for instance the Integrated Framework for LDCs or JITAP could be used for this purpose.

10. This would help developing countries to better target their request for assistance and greatly improve the effectiveness of the assistance itself. It remains clear that there is *no single model of technical assistance* that all countries should follow. The technical assistance programmes have to be targeted at the specific priorities and needs to be identified by individual or groups of developing countries that would allow them to effectively implement as well as benefit from multilateral investment rules.

11. Multilateral investment rules are designed to underpin domestic investment regimes and to reassure foreign investors that, whatever the rules of a potential host country look like, they will always comply with certain basic principles. The resulting greater legal certainty would produce greater propensity to invest abroad and greater FDI flows overall and would also minimise the risk of capital flights. Moreover, a large number of potential host countries, especially among developing countries, suffer from a “perception gap”, whereas they are perceived by foreign investors as posing a much greater risk that the reality would justify. This multilateral underpinning of domestic investment rules would go a long way towards bridging that gap.

12. Nevertheless, even once issues of (real or perceived) legal (un)certainty have been totally or partially laid to rest, the fact remains that many developing countries have a limited capacity, because of their physical or geographical situation, or precisely because of their undeveloped economy, to attract a growing share of FDI, absorb it into their economic fabric, and in the end fully benefit from it. The fact that neither multilateral rules nor the WTO as an organisation can solve this problem does not mean that they cannot play a positive role towards finding solutions.

13. The areas for improvement are many: for instance, better market opportunities (including through regional integration); a functioning legal system; establishment and enforcement of fair competition rules to curb abuses by foreign and domestic firms; development of better banking and financial structures, including better lending facilities for local entrepreneurs; domestic laws and regulations clarifying investors’ responsibilities; improved governance, etc. Efforts by developing countries to achieve improvements in these areas could be supported through coherent and co-ordinated programmes by international institutions (World Bank, IMF, UNDP, etc.), regional institutions and individual donors. The need for co-ordination and participation of many donors in this area is particularly acute.

14. By now the EU and its Member States have gained considerable experience with financial and technical assistance in developing and transition countries. EU programmes are currently being provided to numerous partner countries, including those of Central and Eastern Europe, Russia and the CIS, several countries in the Mediterranean, Latin America, ACP countries etc. Some of these programmes cover technical assistance designed to strengthen public administration, harmonise standards or reform legal systems.

15. In the context of foreign investment, such assistance – as will be provided for example by PROINVEST<sup>1</sup> – is intended to focus on private sector development, on support of investment promotion agencies as well as on legal and financial sector weaknesses in order to reduce non-commercial risk and to increase investors’ confidence to engage in these markets. To foster development it is thereby crucial to

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1. The **overall objective** of the programme is to increase investment (domestic, cross-border, and foreign) in the ACP regions leading to economic growth, job creation and the strengthening of the private sector, thus contributing to economic integration within these Regions and their incorporation in the world economy.

create a virtuous cycle of finance, investment and growth. *Adherence to the rule of law, nationally and internationally, and local capacity building* in this respect deserve special attention in (future) EU assistance programmes.

## **2. *The negotiation of international investment rules and their transposition into domestic laws and regulations***

16. Besides the longer term issue relating to the capacity of a developing country to attract a significant share of FDI flows and to absorb inflows in a manner conducive to its smooth and sustainable economic development, the WTO and its Members could start considering what could be done in the short to medium term.

17. In particular, should investment negotiations be launched, WTO Members would be faced with the need to identify and analyse their domestic laws and regulations that would be relevant to the operations of foreign investors and that could be affected by multilateral rules. This issue would be relevant to both the negotiation and the implementation phase of investment rules.

18. This analysis assumes that, in an investment agreement, WTO Members would negotiate obligations in three main areas:

- a) Transparency;
- b) Non-discrimination (both MFN and National Treatment);
- c) Market Access.

19. Technical assistance needs in these areas will be briefly examined in turn. In general, however, an important element to improve developing WTO Members' "negotiating capacity" would be their ability to identify domestic laws and regulations that may need to be preserved, in order to pursue developmental objectives, through, for instance, MFN exemptions, National Treatment exceptions, no or limited commitments on access, etc.

20. Thus, enabling developing WTO Members to recruit and train staff for this work and/or (perhaps on a transitional basis) to use external specialised human resources (e.g. teams of lawyers and economists) could go a long way towards improving their ability to negotiate investment rules compatible with their level of development, as well as to enable them to transpose these rules in their domestic legal order.

- a) Transparency (and dissemination of information)

21. The transparency of the domestic investment regime is crucial to attract foreign investors in any given country. The question of identifying the domestic laws and regulations that are of most immediate interest to prospective investors and especially the dissemination of this information, should be an important element of investment promotion.

22. It is objectively difficult for any country to identify and list all the domestic laws and regulations that may be relevant to the operation of foreign investors (or of domestic investors too, for that matter). These laws and regulations are usually scattered in different legislative and regulatory texts (even where some of them are collected in an "investment code") and are the responsibility of different branches of government or, in many countries, of independent agencies or sub-national governments. A developing country will need help in financing and training the human resources to comb through such domestic laws

and regulations, and to devise suitable, effective and non-cumbersome procedures to comply with any multilateral transparency and notification requirements.

23. The World Bank (MIGA,<sup>2</sup> FIAS<sup>3</sup>), for instance, has instruments aimed at improving dissemination of information and investment promotion. In the Asia-Europe Meeting (ASEM) context, partners have also created a website (the Virtual Information Exchange) which provides information on the investment regime in each of the ASEM partners and on the implementation of the ASEM Investment Promotion Action Plan (IPAP), including a list of most effective measures to attract FDI.<sup>4</sup> WTO Members should try to make the most of these instruments and share information in order to identify best practices for investment promotion and dissemination of information.

24. Technical assistance for the specific goal of improving transparency could build on existing projects and offer officials and investment promotion agencies from Developing Countries support in terms of know-how as regards (i) identification of national legislation concerning investment, (ii) dissemination of information, and (iii) strengthening the capacity to upgrade regulatory frameworks and to maintain this upgrading. In this context, the existing activities of the World Association of Investment Promotion Agencies (WAIPA) could also be very useful.<sup>5</sup>

#### b) Non-discrimination

25. Non-discrimination provisions are likely to take the form of both MFN and National Treatment obligations. Whatever negotiating format is chosen, neither of these obligations is likely to be an absolute one, realistically speaking. There will be exceptions or exemptions from these obligations in one form or another. A WTO Member, therefore, will have to identify the areas and analyse the reasons for which it needs to preserve flexibility when deciding whether or not to grant MFN or NT treatment to foreign investors. For instance, GATS today contains a list of MFN exemptions. If a similar mechanism were to be used in an investment agreement, a WTO Member would need to decide which exemptions it wishes to maintain.

26. Again, the problem developing WTO Members face here is one of having sufficient resources to carry out this identification exercise. This identification would also be the obvious basis for the implementation of MFN and National Treatment provisions in the domestic legal system after conclusion of the negotiations.

27. Technical assistance for policymakers and their officials could concentrate on (i) the identification and analysis of host countries' relevant legislation, and (ii) the analysis of the cost and benefits of excluding certain areas from MFN/NT provisions.

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2. The MIGA Agency, part of the World Bank group, aims at encouraging foreign investment by providing viable alternatives in investment insurance against non-commercial risks in developing countries thereby creating investment opportunities in those countries. MIGA is also involved in programs, dissemination of information on investment opportunities, and technical assistance that enhances national investment promotion capabilities.

3. The Foreign Investment Advisory Service (FIAS) helps developing and transition country governments design initiatives to attract foreign direct investment. FIAS advises on laws, policies, incentives, institutions, and strategies. It helps countries increase the amount of investment they receive--and the benefits this investment produces.

4. See more information on [http://europa.eu.int/comm/external\\_relations/asem\\_ipap\\_vie/intro/prog\\_report\\_en.htm](http://europa.eu.int/comm/external_relations/asem_ipap_vie/intro/prog_report_en.htm).

5. <http://www.waipa.org>

c) Market Access

28. This assumes that the preferred option to deal with access of foreign investors is that of voluntary commitment, sector by sector, by each WTO Member. In this case too, a WTO Member needs to make a cost-benefit analysis as part of the negotiation process. Some WTO Members may need to identify the sectors where opening to foreign investors would be problematic for their developmental objectives and where they wish, therefore, to maintain restrictions to access. The same analysis would then be the basis for dismantling, in the implementation phase, those restrictions that the Member has chosen not to maintain.

29. Technical assistance for policymakers in this area could focus on: (i) the economic analysis of removing or maintaining restrictions to entry in a given sector; (ii) programmes aimed at facilitating the transposition of international rules into domestic legislation.

30. Good examples in the area of technical assistance for the negotiation of investment rules already exist. UNCTAD is running a multi-donor project aimed at assisting developing country governments in the negotiation of international investment agreements.