



Negotiating Group on the Multilateral Agreement on Investment (MAI)

INVESTMENT INCENTIVES

(Note by the Chairman)

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1. Investment incentives (IIs) are commonly used by governments to promote economic growth and employment by stimulating investment and the upgrading of skills. They may be used to attract investment funds from abroad, to encourage the transfer of technology, or to influence investment decisions in favour of specific industries or localities.
2. IIs may take various forms. They may be provided to firms through grants and subsidies. They may involve tax advantages or tax reductions, the availability of infrastructure facilities or R&D capability. They may be associated with the allocation of government contracts, government concessions or other regulatory advantages.
3. Foreign firms may or may not have access to IIs on the same terms and conditions than those that apply to domestic firms. When they do not, their competitive position may be negatively affected. Such measures run counter to the national treatment principle.
4. Different issues arise when IIs are aimed specifically at attracting foreign investors, which can result in more favourable treatment than given to domestic firms. Such use of IIs can lead to competitive bidding among governments, which is not only costly to those governments, but which may also lead to rent-seeking behaviour by investors. The result is a distortion of investment flows between countries and a misallocation of resources.
5. If, as is widely believed, the competition for investment funds has become harsher in recent years there may well be greater urgency for developing international disciplines on IIs.

I. International disciplines

6. The two major international agreements providing for National treatment and Non-Discrimination/MFN with respect to IIs are the *National Treatment Instrument (NTI)* of the OECD Declaration on International Investment and Multinational Enterprises and the *Energy Charter Treaty (ECT)*.
7. Under the *NTI*, IIs including subsidies and grants, shall be accorded to established foreign-controlled enterprises in no less favourable terms than those which apply to domestic enterprises in like circumstances. While this obligation is not legally binding, exceptions to national treatment must be notified and are subject to peer reviews to promote their elimination. The *ECT* contains the same liberalisation principle but it is legally binding and does not allow for exceptions. The National Treatment and MFN obligations of NAFTA do not apply to subsidies or grants and the Agreement provides for broad exclusions with respect to taxation.
8. Other provisions of legally-binding nature are more circumscribed. They concern primarily IIs which imposes performance requirements (e.g. the TRIMS Agreement, the ECT, and the investment chapter of NAFTA) and even so they have a number of limitations [see the Chairman's note DAFPE/MAI(96)4]. The WTO and NAFTA disciplines on subsidies and government procurement focus on the export or purchase of goods (and services under NAFTA), but their application to IIs only covers the cases when IIs produce the undesirable effects proscribed by these disciplines.

9. Finally, the *OECD International Investment Incentives and Disincentives Instrument (IIDI)* and the *ECT* contain provisions which address the effects of IIs on international competition¹. The *IIDI* recognises the need to give due weight to the interests of countries affected by IIs. It provides that IIs be made as transparent as possible so that their importance and purpose can be ascertained and that information on them be readily available. It contains consultation procedures enabling a Member affected by an II in another Member to bring the matter to the Organisation so that it could explore possible solutions and make appropriate recommendations. The *ECT* contains a general undertaking by parties to work towards the alleviation of market distortions and barriers to competition (which may include IIs) but this provision is cast in terms of the implementation of competition rules.

II. The MAI

10. Taking into account the provisions in other international agreements (including the WTO) and other disciplines contemplated for the MAI, the Agreement could include a number of disciplines on IIs.

11. First, in the absence of any specific provision, national treatment, non-discrimination/MFN, standstill and roll-back would apply to IIs and these obligations would be subject to the dispute settlement provisions of the Agreement.

12. Second, for IIs granted to domestic and foreign investors alike, the MAI could provide for increased transparency of IIs which create significant distortions in production and trade activities between countries. The MAI could also go a step further by attempting to limit competition in the provision of these IIs. This could be achieved in various ways ranging from prohibition of certain types of IIs (by sectors, economic activities...), or limitations, to peer reviews and consultations procedures, in a "Parties Group" leading to recommendations to the Contracting Parties concerned.

13. Delegations are invited to answer the following questions:

- a) *Should IIs be subject to the obligations of national treatment, non-discrimination/MFN, standstill and roll-back?*
- b) *Should the MAI contain provisions to increase the transparency of investment incentives which may have a significant effect on the location of production and trade even if they are applied in a manner consistent with national treatment and MFN ?*
- c) *Should the MAI contain additional disciplines on these IIs, for example by prohibiting the use of certain investment incentives or putting limitations on them? If so, which types of incentives/activities/sectors ?*
- d) *At a minimum, should the MAI provide for transparency, peer reviews, consultation procedures ?*

¹ The EC has comprehensive disciplines on aid to industries to ensure a proper functioning of the internal market. These disciplines may go beyond what could be achieved under the MAI.