EPAs and investment

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Strengthening Africa in Word Trade

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Summary

The European Commission (EC) is trying to make African, Caribbean and Pacific (ACP) countries sign up to economic partnership agreements (EPAs) that would set rules for the way in which they can select and regulate foreign investors.

One objective of these rules-based agreements is to help developing countries attract more investment. To date they have failed to do this. Developing countries also often find that foreign investment carries potential costs and its much-publicised benefits are not automatic. Traditional agreements have hindered, rather than helped, them to manage this impact. The case of the Caribbean tourist sector shows how traditional rules-based agreements can limit the ways in which a country manages foreign investment to fit its own development strategy while avoiding potential pitfalls. The case also shows the real danger that the EC's approach poses to important regional strategies, which are especially important in the ACP context.

The Cotonou Partnership Agreement (CPA) and the ACP negotiators themselves suggest an alternative agenda that focuses on: capacity building and development assistance for local institutions and local businesses; support to regional processes; and improved investment promotion schemes. The case of the Kenyan horticulture sector shows that these elements are more likely to attract new investment – both domestic and foreign – and allow ACP countries to better reap its benefits.

Faced with strong advocacy on investment by the EC and an unequal negotiating process, and in light of the real dangers and missed opportunities of adopting the wrong approach, we recommend that:

1. The EC must improve the process surrounding investment talks to ensure that there is no ambiguity around agreement to discuss investment and to ensure that ACP countries are not forced into rules-based agreements that are potentially detrimental to their development objectives. To do this, the EC should remove the imperative to negotiate on investment, leaving this initiative squarely and solely with the ACP countries. The EC should also be ready to discuss investment cooperation agreements – under the ambit of the CPA and outside EPAs – with ACP states and regional bodies that do not want rules-based agreements.

2. If countries wish to discuss investment rules, these should not be of the traditional investor protection variety, but should:
   - have an explicit over-arching development objective
   - have greater balance in the rights and obligations of all parties
   - have stronger investment promotion provisions
   - not excessively limit the ACP states' policy options to manage investment.

3. The EC should abandon its rigid approach to rules-based agreements, and take other constructive actions to positively contribute to enabling development through investment in ACP countries.

Introduction

‘On the issues of investment policy, competition policy and government procurement, we reiterate the concerns we have raised at the World Trade Organisation. We reaffirm that these issues be kept outside the ambit of economic partnership agreements.’
Nairobi declaration on economic partnership agreements
African Union Conference of Ministers of Trade, 12-14 April 2006, Nairobi

‘There can be no surprise that I fundamentally disagree with subordinating EPA progress to progress in the WTO. Why? Fundamentally because investment, government procurement and trade facilitation are all essential subjects for development.’
Karl Falkenberg, EC chief EPA negotiator[1]

The EC's determination to secure WTO rules on how countries manage investment, government procurement, competition and trade facilitation (the Singapore issues)[2] – in the face of opposition from developing countries – was in large part blamed for the breakdown of WTO talks at the Cancún Ministerial in 2003. Now investment looks set once again to be a negotiation battlefield between the EC and some of the world's poorest countries.

In 2003, developing countries succeeded in stopping talks on the issues, which would have constrained their choices in crucial policy areas for managing their domestic economies. In their submission to the WTO[3], African countries warned of the serious implications the issues have for their economies, the complexity of their relationship to trade and the lack of consensus on how they should be handled in trade agreements. Developing countries’ lack of resources to meaningfully negotiate further justified their call to remove the issues from the agenda. The relevance of these arguments has not diminished since 2003.

There is evidence that many of the same countries that stood up to EC pressure in Cancún now face a more unequal battle in EPA talks on the same issues. The EC has clearly stated that since these issues are no longer on the table at the WTO, they ‘will continue to pursue discussions on investment and competition in other international fora... The EC’s objective is to persuade countries, especially developing countries, of the value of these rules for their growth and development.’[4] In regional negotiations with the EU, the political leverage of ACP regions and individual countries is reduced, and the prospect of development assistance makes it harder to resist agreement.[5] Problems relating to negotiating capacity are compounded as EPA negotiations run concurrently with WTO talks.[6]

‘We are worried by this backdoor approach. Where is the convergence between the WTO level and the EU approach in the EPAs?’
Zambian trade minister, Dipak Patel, speaking on the Singapore issues
Dar-es-Salaam, 20 January 2005[7]

This unequal power relationship in EPA talks already appears to be leading to imbalanced outcomes, as the Singapore issues continue to form the major part of all the region's negotiating roadmaps, despite ACP ministers' repeatedly stated reluctance to negotiate on the issues. For example, four of the five working groups established for phase one of the west Africa regional talks deal with the Singapore issues – two of them exclusively. Only the fifth working group – on productive sectors

– was proposed by the west African negotiators themselves. The EC resisted the establishment of this fifth group, which as a result did not start work until December 2005. By contrast, investment – under the influence of the EC – has received increasing attention throughout phase one. In the latter half of 2005, all negotiating bodies – the technical support committee, regional negotiating committee (technical and senior officials levels), ministerial coordinating committee and chief negotiators – have addressed the subject on the EC's initiative. In phase two, the same priorities look set to dominate, as the group established to produce the EPA text is dealing with market access and trade-related issues only. ACP concerns relating to productive sectors are dealt with in another body, and will therefore be sidelined from the main agreement.

As well as advocating for inclusion of the Singapore issues in the talks, the EC is also pushing for them to be handled in a way that suits them, ignoring ACP proposals. In the Caribbean region, negotiators presented the EC with a clear agenda on investment, which included:

- the EU incentivising European investment in the region
- support for regional integration – for example, by financing a regional association of investment promotion authorities
- flexibility to target EU investment in strategically useful areas
- prioritising local and regional investors over European ones
- providing safeguards to prevent balance of payments difficulties due to outflows of profits or capital by investors.

Many of these proposals are off the table in negotiations, as the EC has consistently refused to discuss development assistance in this context. The EC has no competence on investment promotion, which means that the only proposals left for debate in EPA talks are those relating to regional flexibility. The EC's response has been: 'It would be easier for the EU if more countries could be less concerned about highly structured regimes with distinct arrangements for third parties [ie European investors]. EU industry is clear that they don't have time to understand the complexity of such an investment regime. CARICOM should look for the simplest way to establish an investment regime.'[8]

ACP and EU civil society have called on European member states to revise the EC's negotiating mandate on EPAs and remove the imperative to negotiate the Singapore issues, placing the initiative squarely with ACP negotiators. This demand was based on concerns that differences in negotiating capacities would result in a lopsided agenda and inequitable outcomes in EPAs, but also a recognition of concerns that such agreements are of dubious development value. They would require resource-intensive regulatory changes to implement, and would risk reducing ACP governments' scope to select and manage investment in line with their own development objectives. Although some EU member states – including the UK – supported this position, the EC's reaction has been strongly defensive of their advocacy for agreement on these issues, and the chief negotiator, Karl Falkenberg, has since reiterated that the EC would insist on these issues forming part of any EPA.[9]

What the EC says about investment in EPAs

In the face of opposition from NGOs, ACP and its own member states, the EC has resorted to a legalistic and paternalistic 'development' justification of its pursuit of issues such as investment in EPA talks. This section examines their main arguments.

EC argument: *The Cotonou Agreement already contains provisions relating to investment and mandate to negotiate further. The EC approach is to 'fine tune' provisions that already exist.*

The CPA does not stipulate that an investment agreement should be part of an EPA, nor is there any WTO obligation to include investment provisions in a regional trade agreement. Within CPA, substantive provisions on investment appear only under the heading of financial cooperation, a section that deals mainly with capacity building assistance and financing.

Although the parties agree in the CPA to 'take measures and actions which help to create and maintain a predictable and secure investment climate' and 'enter into negotiations on agreements which will improve such climate', the precise nature of such agreements is not defined. They do not need to form part of a binding trade agreement, nor be of the traditional variety of investor rights and freedoms guaranteed by the state. In fact, the CPA objectives clearly indicate that the overriding emphasis of any agreement must be on the development objectives and priorities of ACP states, with a main focus on support for institutional capacity building, regional integration and the ability of ACP states to attract investment. This would allow a radical departure from the EC's focus on rules-based commitments and a return to the focus on development cooperation and assistance implied in Cotonou.

Finally, circumstances have changed since the CPA was drawn up in 2000. After the Cancun Ministerial stand-off the Singapore Issues, including investment, were formally removed from the negotiating agenda of the WTO Doha round in July 2004. Even the EC's own negotiating directive recognises that negotiations should be adapted to take into account outcomes at the WTO.[10]

EC argument: *It is crucial to attract investment to ACP regions. Today investors avoid Africa, Pacific and Caribbean states; even investors from other ACP states. This has to change and predictable, transparent rules are essential.*
Economic partnership agreements: FAQ
DG Trade website, 28 September 2005, Brussels[11]

The EU and ACP countries agree on the potential value of investment and of sound, well-functioning regulatory regimes for development. What is in dispute is the added value of a rules-based investment agreement between the regions.

Many ACP states already have ongoing domestic reforms relating to their investment regimes. The added value of an ACP-EC agreement could only be the EC's belief that it would ensure implementation and 'locking in' of reforms – thus increasing attractiveness to EU investors – or that it would act as an additional impetus for this reform agenda. This thinking is wrong on both counts.

Agreements that require regulatory changes – such as investment agreements – demand technically trained personnel and significant institutional and financial capacity and carry potentially high costs for governments. While the EU can help address implementation costs to ensure that the benefits of reform are not foregone because of finances, we have to question how useful external pressure is in locking in such reforms, if countries do not have the capacity to implement them. It would be advisable for ACP countries to hesitate before entering into binding agreements that commit them to expensive reforms.

The case studies in this report illustrate the clearest argument against rules-based investment agreements as development tools. They do not help governments to address the poor track record of investment in contributing to development. Rather, they risk acting as a hindrance by constraining a government's ability to regulate investment, without helping them to better enforce standards of investor behaviour.

EC argument: *'None of the regions and no one in Kenya has said that it is not in the interest of Kenya to negotiate on these issues.'*
Karl Falkenberg, Dar-Es-Salam, 19 January 2005

In claiming that the ACP states are willing to negotiate on investment, the EC is deliberately conflating the different aspects of investment cooperation, which are:

- EU financial assistance, capacity building and technical assistance on investment
- measures to promote inward investment into ACP states
- EU support to regional integration processes
- EU-ACP agreements on investment rules.

In the joint draft report on phase one of the 'all ACP-EC' level negotiations, both sides agreed on the importance of trade-related issues and the need to support ACP development of infrastructure and institutions. However, they differed with regards to:

- the scope and coverage of the issues
- the relative importance of the different aspects of investment cooperation to development agreements
- how they interrelate and consequently how they should or should not be prioritised.

They also disagreed on 'the sequencing of EPA negotiations with both WTO negotiations and building of regional capacity in ACP states to deal with trade related subjects.'[12]
The ACP did not want to negotiate the rules aspects of these areas before there was agreement on how they should be treated at the WTO. However, attempts to establish WTO rules have since been abandoned. They also felt that the countries and regions needed to build legal and institutional capacities before considering negotiating rules-based agreements with the EC. The EC, on the other hand, believes that capacity building and agreement of rules could run in parallel. This would force the pace of reform and deny ACP states the opportunity to sequence commitments with building capacity. This runs counter to the advice of the Commission for Africa and commitments by the G8 in Gleneagles to allow countries to 'pace and sequence' their economic reforms in line with their development strategies.

ACP states face other difficulties in negotiating EPAs that help to explain the apparent discrepancy in ACP ministers' statements[13] and the willingness of some regional negotiators to talk about investment. These are:

- the relative newness and undeveloped nature of regional negotiating bodies: these institutions often lack the mechanisms to consult and constantly engage with their member states. This problem is compounded by the rush to meet the 2007 deadline for issues of market access arrangements for trade in goods. This deadline is irrelevant for investment. Even EC officials have expressed concerns at the divorce between the regional negotiators' activities and the level of buy-in of ACP member states, fearing that in some regions they would end up with 'paper EPAs' that nobody implements.
- the lack of information with which to negotiate: the paucity of impact assessment for the liberalisation of trade in goods under EPAs has already been documented[14]; the situation for investment reform or the closely related area of services liberalisation is even worse.

EC argument: *The EC's intentions can only be altruistic: the EU has no commercial interest in ACP markets*

A corollary argument often made by the EC as a justification for including investment in EPAs on development grounds is that they have no self-interest in these talks. The EC's internal strategy documents reveal that this is not the case and that justifying investment agreements on development grounds is in fact self-serving. The EC actively pursues the inclusion of investment provisions within its regional trade agreements (RTAs) to ensure its strategic objectives and maximum economic gains. The EC explicitly recognises that it is in direct competition with trade rivals, such as the US, in negotiating investment agreements to establish strategic relations and to ensure that any regimes in those markets are more compatible with those in operation in its own member states, noting that if countries '...were to align their regulatory practices with those of the United States, this would place the EU at a competitive disadvantage.'[15]

The opportunity and conditions for investment are especially important in the service sector, where consumer and supplier often need to be physically close for trade to occur. The EU's economy is highly dependent on the success of its service suppliers, which contribute 77 per cent of its GDP and employment. In a draft document on improving the EU's external competitiveness, the EC explains how improving conditions for investment brings significant gains for EU companies:

"We need to further strengthen the presence of EU companies in third countries through a permanent establishment. A '"physical"' presence in a foreign country consolidates the image of the firm and that of the country of origin; adds predictability to the flow of trade, not relying on local importers; and facilitates the access of EU companies to more business opportunities. Moreover, the ability to invest freely becomes increasingly important as supply chains become more globalised. Investments need a predictable, transparent, non-discriminatory and secure business climate."

Also as tariffs cease to be a hindrance to EU companies, other barriers to trade and investment become more important:
"'But it is useless to get tariff reductions if the market remains closed… . ..We need to look at the whole operating environment in third countries and reduce the barriers and transaction costs derived from the fragmentation of the productive process.'[16]"

Draft Communication on External Aspects of Competitiveness, Ref.318/06, Brussels, 28 June 2006

Divided interests on international investment rules

Of the Singapore issues, investment[17] is arguably the most controversial. There is a chequered history of attempts to establish multilateral rules on how countries regulate investment, with the earliest efforts dating back to the failed Havana Charter in 1948. In 1998 the Organisation for Economic Cooperation (OECD) hit the headlines after abandoning its multilateral agreement on investment, following protests and formal withdrawal of support by member governments. While multilateral rules on investment exist to a degree at the WTO, their existence is highly controversial, as is their treatment of developing countries.

Countries make commitments under the general agreement on trade in services (GATS) to open up certain service sectors to foreign investors and to set parameters for how these companies will be treated once they are established. The agreement on trade-related investment measures (TRIMS) places restrictions on the kinds of measures governments can take against foreign investors. Notably, countries cannot impose local content requirements, which would allow local companies to benefit from the presence of foreign firms by selling them goods and services. In the current WTO round of talks, developing countries have launched initiatives to ensure that these rules do not undermine their right to regulate inward investment. A coalition of developing countries has called for the removal of the 'necessity test' from the GATS talks, which limits a government's regulatory choices in services sectors. With regard to TRIMS, developing countries are seeking to extend their current exemptions.

Underlying the controversy surrounding international investment rules is the fact that countries have very divided interests. Companies investing overseas are generally based in developed countries, which therefore seek to use investment agreements to protect the rights of their investors, optimise their profitability and increase their opportunities to invest. Within this group, different countries and blocs – notably the EU and US – have different domestic investment regimes, and it is in the interest of investors to encourage other countries to develop systems that are compatible with their own. This has resulted in competition between the EU and the US to introduce favourable regimes through their regional trade agreements.

Investment and development: the case for flexibility

Developing countries want to attract inward investment, and manage such investment through regulation to minimise costs and maximise benefits. The usefulness of binding international rules on investment for developing countries is controversial, as they tend to limit these policy choices and do little to attract new investment.

Investment has the potential to contribute to a country's development by providing:

- a source of capital for cash-strapped governments
- services and infrastructure to fill gaps in the domestic economy, creating new export opportunities
- opportunities for transferring technology, upgrading skills and training the workforce
- jobs and tax revenue
- opportunities for local firms to sell goods and services, learn new techniques and encourage entrepreneurialism.

Standard advice to developing countries from the World Bank, International Monetary

Fund (IMF) and donors has been to pursue liberalisation and deregulation to attract foreign investment. Investment agreements were deemed useful, as they help make these changes ‘predictable and transparent’. This is certainly the EC's thinking behind seeking investment provisions in EPAs. According to the EC’s former director general for trade, Peter Carl, ACP countries ‘badly need inward investment which will only flow in an environment that is stable’. The Singapore issues are therefore ‘important to trade performance and development and we should continue to advocate for them if EPAs are to deliver for development.’

However, foreign direct investment (FDI) does not automatically follow an investment agreement. In 2003, a World Bank study concluded that investment treaties had little impact on investment decisions and warned that these could ‘expose policy makers to potentially large-scale liabilities and curtail the feasibility of different reform options.’[18] Although Africa has joined the rush to sign bilateral investment treaties, levels of FDI there have generally declined. Angola has proved more attractive in per capita terms than Egypt and Nigeria, indicating that there are other pull factors other than a ’predictable and transparent environment’.

In many cases new investment has not necessarily resulted in capital accumulation, growth or economic diversification. ‘Enclave development’ has been a problem in the extractive and tourism sectors, limiting links and benefits to local companies. Governments do not benefit from increases in revenue, as generous incentives and liberal tax regimes mean companies repatriate, rather than reinvest, their profits. Inward investment has also been in the form of takeovers of privatised state assets, mergers and acquisitions rather than ‘green field’ investment in new enterprises.

Benefits from investment are not automatic: they can be undermined and even reversed, depending on the conditions in place and the behaviour of investors[19]. For example, although investment can create good employment opportunities, when it takes the form of a merger or acquisition there may be no new jobs and there may even be job losses. If the benefit of investing in a country is low-cost labour, and adequate, well-enforced regulations are not in place, labour standards can slip even further as countries compete to attract investment.

On the other hand, if a government actively intervenes to manage investment, this can help ensure the transfer of technology, the creation of decent local jobs and linkages with the local economy. It can also prevent too much repatriation of profits, manage competition with local firms, impose export requirements (to diversify exports and protect balance of payments) and ensure maximum income from foreign firms. These policy options have been used successfully in the past, but many are now jeopardised by investment agreements.

Case studies:
Successful use of restrictive investment policies

Pepsi Foods in India

Before it could invest in India, Pepsi Foods Limited was required to enter into a joint venture with local firms (Voltas and Punjab Agro Industries Corporation) and to export at least two billion rupees worth over ten years. Since its business was to import concentrate and bottle drinks locally for sale on the domestic market, Pepsi had to think creatively about how to fulfil this requirement. In 1989 it set up food processing plants in Punjab to export processed tomato products. In order to supply these plants, the company invested in local contract farming, providing training and inputs. The firm brought in specialists and invested in the local university's research and development department to ensure that food safety standards were met and to minimise production costs. This system has since spread to other crops – including potatoes, chillies and basmati rice – and has led to a horticultural boom in Punjab[20].

Car manufacturers in India

When Ford India set up as a joint venture in 1996, it was also required to balance its import and exports. Its solution was to source components locally, launching a joint programme with the Automotive Component Manufacturers Association. The same requirement led to General Motors and Daimler Chrysler developing more linkages with local firms – the latter set up 20 joint ventures for component manufacture, and now exports parts to Germany[21].

Chile

Since the 1980s, Chile has linked its incentive schemes for investors to requirements to use local content and export non-traditional products. This has led to an increase in the number of exporting firms – particularly small and medium-sized enterprises – and a growth in export value of non-traditional manufactures from five per cent in the 1970s to 30 per cent in the 1990s[22].

South-east Asia

Japan, Korea and Taiwan also used restrictive investment policies,[23] which:

- permit investment in certain sectors only
- prohibit more than minority foreign ownership in key sectors
- use progressive local content requirements
- limit the royalties paid by local firms on technology licences of trans-national companies to ensure that local firms benefit from, and are not detrimentally affected by, incoming foreign investment.

The following table gives some illustrative examples of development objectives with respect to foreign investment, policy tools to achieve them and investment agreement provisions that limit their use.

Potential benefit of investment	Corresponding adverse impact	Investment policy tool that helps determine impacts	Potentially constraining investment agreement provision
Source of capital and income for cash-strapped governments	Increased capital outflows through profit and asset repatriation, tax incentives diminish revenue	BOP safeguards, currency restrictions, regional cooperation on incentives	Liberalisation of current and capital payments;national treatment on incentives prevents targeting local firms, MFN/national treatment (NT) for 3rd country constrains regional initiatives
Increased employment	Lay-offs following mergers and acquisitions investments; poor employment conditions	Limits on M&A investments, employment requirements	Lowering of restrictions/ requirements on pre-establishment, bans on performance requirements
Technology transfer	No technology transfer due to enclave development or vertically integrated supply chains	TT or training requirements	NT post-establishment, ban on performance requirements
Linkages with local firms	High import content of goods and services input	Local sourcing requirements, legal entity requirements	Liberalisation of restrictions on establishment, ban on performance requirements, NT post-establishment
Fill gaps in services and infrastructure	Crowding out of local entrepreneurs/ competition with local firms in area of potential	Bans on entry in specific sectors, licensing/ selection procedures	Liberalisation of establishment provisions, especially negative list

The content of investment agreements has been too skewed toward the interests of foreign investors. The interests of local entrepreneurs and the rights of the host government are usually neglected[24]. Although traditional investment agreements give companies rights against the excesses of governments and recourse to dispute settlements if these are not respected, there are no comparable rights for governments. This imbalance already exists in bilateral treaties and has created situations where smaller country governments in particular cannot effectively discipline companies, but risk being sued by them for implementing legitimate regulatory changes. Even the USA has faced these situations.

For example, a group of Canadian cattlemen are seeking US$300 million under the investment provisions of the North American Free Trade Agreement (NAFTA) in compensation for losses incurred when the US halted imports of live cattle from Canada in the interests of public health following discovery of a case of BSE.[25]

Without an explicit, overarching development objective to investment agreements, and with no recognised right to regulate for governments, there is no compulsion for arbitrators to make a judgement based on the balance of public interests versus investors' interests. Nevertheless, this has not dampened the EC's enthusiasm for traditional binding investor protection agreements.

The EC's approach to investment: limiting flexibility

Until now, EU investment provisions in RTAs with developing countries have been extremely limited, but are showing increasing ambition. The latest EU-Chile association agreement is the most far-reaching in both scope and depth.[26] It prevents the Chilean government from imposing entry requirements on EU firms, bans legal entity requirements such as joint ventures, and adopts a 'negative list approach' for market access to outside services[27].

This lack of ambition is mainly a reflection of the division of competence between the EC and its member states on investment, greatly reducing the EC's potential scope of activity. However, this is set to change. The Commission, frustrated at the EU's 'empty' investment agreements compared to the US's NAFTA-style agreements, has recently made proposals the Article 133 Committee (C133) – the body where member states debate the EC's trade policy – to change how it can negotiate investment. In the document presented to C133, the EC calls for an improved mandate in RTAs to improve benefits for EU companies: 'In comparison to NAFTA countries' agreements, EU agreements and achievements in the area of investment lag behind because of their narrow content. As a result, European investors are discriminated vis à vis their foreign competitors and the EU is losing market shares.' [28]

In this document the EC also proposes to establish a 'minimum platform' for investment provisions in RTAs that incorporates and builds on current practice, encompassing the following principles:

- most-favoured nation treatment (MFN) on pre- and post-establishment rights
- non-discrimination/national treatment
- free flow of payments and investment-related capital movements
- basic principles of investor protection.

As explained below, this agenda has failed to draw lessons from the experience of FDI and investment agreements in developing countries.

MFN Pre-establishment: These relate to conditions of access to markets for EU investors. The EC's stated objective is most-favoured nation treatment: in other words, for EU investors to get the same or equivalent rights to any other country or region that has (or will have) an agreement with the host country or region. This will limit the ability of ACP host countries to select strategic partners, and will make it difficult to assess the impact or policy implications of any future agreements, as the country will also need to factor in the EU. Undertaking such a commitment will most likely reduce a government's ability to selectively liberalise pre-establishment provisions towards the EU to:

- protect infant industries by barring or placing quantitative or legal entity restrictions (such as joint ventures) to certain sectors
- put in place procedures that will vet individual investors to ensure that those selected make the greatest contribution to development.

National treatment/non-discrimination: Once an investor is established within the country, the investment agreement determines the regulation and treatment they are subject to. The EC's stated objective is national treatment, whereby EU firms are treated the same as domestic or regional ones. This will prevent ACP countries from assisting local investors through preferential treatment and from fostering regional integration through favouring regional investors. It will also make it harder for them to use of performance requirements to gain maximum benefits from the presence of foreign investors – through technology transfer and staffing requirements, for example.

Free flow of current payments and investment-related capital movements: This is a common provision in investment agreements and secures the right of investors to repatriate profits and liquidate and repatriate assets. It can have implications for a country's balance of payments and it is therefore essential to put in place safeguards to overcome this. It also facilitates outflows of capital from developing countries, potentially undermining the likelihood of capital accumulation, and discouraging long-term investment. When combined with liberalising financial services, it can affect a country's financial stability; combined with incentives, it can limit financial gains from the presence of foreign investment.

Investor protection: Investment agreements also establish minimum standards of treatment and protection from expropriation by the host government, often backed up by an investor-state dispute settlement. Unfortunately, these rights have been interpreted very broadly by arbitrators and as a result governments have effectively found themselves obliged to compensate investors for instigating policies to limit the social or environmental costs of the same investor's practices. For example, Methanex is currently seeking US$970 million compensation for loss of profits after the state of California banned the use of MTBE – chemicals involved in its methanol production – because they are contaminating the state's drinking water.

Regionalism and EPA investment

A large part of the EC's reasoning and its perceived 'added value' as a partner in EPAs is the focus on regional integration – a particularly important part of ACP strategies on investment. Larger markets help to attract investment, improve financial stability, facilitate infrastructure planning and can help create more dynamic patterns of industrial development. This was an important part of the east Asian development experience, where harmonising regulations at the regional level reduced transaction costs for local business. Coordination policies can also prevent a 'race to the bottom' in incentives and standards in countries competing to attract investors, while regional cooperation can enhance the monitoring of corporate practice and improve enforcement.

While the EC claims to be supporting regional integration through bi-regional agreements, its demand for national treatment does not allow ACP states to favour regional partners over EU companies. This will leave countries with the difficult choice of abandoning regional integration schemes, or adopting the same levels of investment liberalisation with the EU. This could stall, reduce or abandon the benefits discussed above, as it does not allow countries to selectively liberalise to strategic partners first.

At the same time, the EC is seeking to force the pace of ongoing ACP regional integration processes, which still have a long way to go – even in relatively advanced cases like the Caribbean. As the World Bank has observed, international agreements cannot substitute institutional development on investment. It would therefore be more appropriate to provide assistance and support for regional integration, rather than seek to supplant it. The UN Economic Commission for Africa advises regional African groups to learn from the European experience: 'The institutional agenda should avoid being excessively ambitious. Institutional development in the European Union shows that initially focussing on one or two areas (coordination of coal and steel industries, and later, agriculture) led to the European Union's success.'[29] Investment was not a feature of the Treaty of Rome in 1957.[30] In fact, the European experience shows that building regional markets is a lengthy process that requires gradual institutional development and political will.

The complexity of regional configurations on trade arrangements is amplified for investment. Configurations on trade and investment do not always match, and in the case of ACP states, many have bilateral investment treaties with the EU that add an extra layer of complexity when considering the implications of new agreements. The new EU proposal for stronger regional investment provisions in RTAs does not resolve this problem, and the legal complexity of how bilateral investment treaties will relate to a more substantive EU bi-regional agreement is unclear. The consequences of overlapping investment provisions are important. On the one hand, they can make provisions stronger than a country intended, or they can include contradictory provisions that create uncertainty or allow investors to choose, for example, between several dispute settlement routes.

Case study:
Tourism in the Caribbean

Barbados, like most Caribbean countries, sought investment as a key strategy to finance development in the absence of adequate domestic savings. Tourism is one of the main sectors to attract foreign investors, accounting for 77 per cent of all capital investment in Barbados in 1999. Tourism is economically important to many Caribbean countries, contributing an average of 15 per cent of GDP and 16 per cent of employment in the region. These figures are much higher in some countries like Barbados, where the industry produces 52 per cent of GDP and provides 58 per cent of employment.[31] It is the single largest earner of foreign exchange in 16 of the 30 countries in the region.[32]

Although Barbados has an impressive track record in attracting investment in tourism and in the number of visitors to the country, the impacts of the industry and the quality of investment have recently come under scrutiny. Benefits to the local economy are reduced because of revenue lost through incentive regimes and tax evasion; the high import content of goods and services used in the industry; the lack of links to local businesses, especially in all-inclusive resorts and cruise tourism; and damage to the local environment.[33] Working conditions for local people could also be much improved. A high proportion of workers are unskilled and part-time workers and gender inequity is rife. A local MP recently remarked that: 'Barbadians are still the maids, Barbadians are still the gardeners, they are still the domestics, they're still the cooks, still the maintenance people, they are still cleaning the bathroom.'[34]

The EC's own impact assessment study identified the importance of ensuring that the environmental and social impacts of tourism are well-regulated in the Caribbean, and that governments do not continue to lose out on revenue due to tax incentives and profit repatriation. Labour and tax incentives were among the main early strategies used to attract investors to the Caribbean. This led to what the OECD has identified as 'harmful tax competition', whereby governments compete fiercely for foreign investment through tax breaks or a 'race to the bottom' in labour and environment standard 'flexibilities'. As a result, countries damage their own economic and social development prospects. To address this problem through regional cooperation, CARICOM amended made their treaty as follows: 'Member states shall harmonise national incentives to investment in the industrial, agricultural and services sectors' and grants the financial and planning council (COFAP) to formulate proposals for the establishment of regimes that are consistent with international agreements.' By jeopardising regional integration, EPAs could undermine these strategies.

Local governments have also not remained idle in addressing these problems. A number of countries have activities in their development plans to enhance sectoral linkages via agri-tourism initiatives and community tourism. A study by the Caribbean Regional Negotiating Machinery (CRNM) recommended the preservation of some tourism-related activities for regional suppliers of services such as: small hotels of 75 people or less; water sports; tour guides; ground handling; ground and marine transport; entertainment; travel agencies; speciality restaurants; and others.

These policies would allow local firms to develop their competitiveness and benefit from the presence of the large foreign resorts. Investment provisions in EPAs could prevent this strategy from being implemented by insisting on market access for European companies in these sectors, or preventing governments from promoting the use of local businesses by foreign investors.

An alternative ACP agenda for investment in EPAs

Research shows that investment tends to follow growth[35] and not investment agreements. UNCTAD found that factors such as good institutions, sound infrastructure, skilled human resources and goods services (especially financial, transport and public) are key to attracting investment[36]. Therefore, rather than push for a rules-based agreement on investment, the EC would do better to help ACP countries develop such factors. This would encourage more investment and influence the type of impact that investment has on local development, and corresponds more closely to the objectives of the CPA[37] and the ACP negotiating groups.[38] Countries would reap the benefit of investment as the result of a good growth and development strategy (of which investment policy is one part), and not the reverse.

Case study:
Horticulture in Kenya

Research into the Kenyan horticulture sector for this report reveals the importance of developing good local institutions, infrastructure, human resources and services. This sector is often hailed as a success story of FDI in Africa, attracting a large investment component and contributing some US$616 million (around 23 per cent) to the value of Kenya's exports in 2005[39] and around 17 percent of GDP. The sector's commercial success is undisputed. However, this prosperity is largely not benefiting poor Kenyans or the Kenyan economy as a whole.

The state of local institutions and their ability to enforce regulations helps determine the impact of foreign investment. Kenya's National Environment Management Act stipulates that all investment and production must undergo impact assessment, and that companies must follow environmental standards and regulations and take measures to mitigate negative impacts. However, these rules are not properly enforced – for example, chemicals from large-scale horticultural farms are reported to be contaminating local soil and water supplies. Institutions lack the support they need to properly monitor and enforce relevant activity. EC assistance in local institution-building would therefore be of great benefit to ACP states.

Current investment agreements do not contain provisions to curb the excesses of foreign companies. Although matters have improved in some cases, due to the work of initiatives such as the Ethical Trading Initiative (ETI), much remains to be done. The effects on employment of investment in the Kenyan horticulture industry seem to be impressive at first glance – nearly 2 million people are directly and indirectly employed by the flower industry alone. However, this positive impact is diminished by poor working conditions, low wages and gender inequity. Job insecurity is high, with 30 per cent seasonal and casual workers, and women are especially prone to dismissal without warning. Average earnings of farm workers are often insufficient to cover basic family spending on food, water, rent, transport, school fees and medical expenses. Overtime is mandatory and not well compensated.

In a cooperation agreement with ACP states, European countries could commit to making their multinationals respect international labour and environment standards and domestic laws in host countries. They could also undertake to fight corruption and to use the OECD guidelines for multinational enterprises to highlight and address bad behaviour.[40]

Improving infrastructure, services and technological capabilities helps local companies to benefit from linkages with foreign firms. The horticulture sector is structured in three distinct categories: large-, medium- and small-scale producers. The Horticultural Crops Development Association (HCDA) estimates that there are about 50,000 predominantly foreign large- and medium-scale producers and 200,000 local small-scale producers in Kenya. The last group has been in decline over recent years, with their contribution to production shrinking from 70 per cent in 1996 to 30 per cent in 2005.

Most small-scale producers have simply not benefited from the presence of efficient, profitable enterprises in their region or sector, as they are unable to exploit the opportunities presented. Concentration in the food retail market has changed the demands placed on suppliers down the supply chain. Market consolidation and massive buying power have given the supermarkets the upper hand, and they place great demands on producers to conform to high standards (increasingly including private standards to offer access to lucrative niche markets that differentiate them as cleaner or greener than their competitors). Producers also have to offer flexibility and reliability of supply to meet the demands of 'just-in-time' delivery, and accept lower profit margins. A supportive infrastructure and services would help small producers meet the supermarkets' demands.[41] Instead, poor transport, inadequate irrigation and a lack of access to credit forces them to sell to medium-scale producers who act as agents, selling on to larger exporters at a considerable mark-up while abusing their greater bargaining position to dishonour contracts or delay payments.

Technology transfer is another anticipated benefit of FDI that has failed to materialise in the Kenyan horticulture sector, partly because of small producers' capacity problems. The large firms that dominate the sector operate as closed systems and vertically integrated supply chains. Unable to break into this system and become regular suppliers, small firms are not exposed to new technologies, knowledge and practices. Companies also tend to employ expatriate workers in more senior and technical roles, preventing a spillover effect, whereby local workers would learn new skills that they might consequently take to new jobs.

The problems of the Kenyan horticultural sector are similar to those of the Caribbean tourism sector. Local suppliers lose out on business with foreign firms to because of problems with the quality of products and services. But they are not only missing out on contracts: they are also missing essential learning opportunities from exposure to other practices and expertise. Investment in the productive and marketing capacity of small-scale producers, however, would enable them to reap the benefits large exporters have to offer, and could be a feature of investment cooperation agreements under CPA.

Conclusion and recommendations

We believe that the EC should stop advocating for the inclusion of investment in the EPAs for two reasons: the ACP states' unwillingness and limited capacity to negotiate the issue, and the implications it would have on the CPA's goals of sustainable development and poverty eradication.

Despite the rhetoric and undertakings of EU commissioner for trade, Peter Mandelson and the UK government, there is evidence that the EC is pushing its own agenda on the ACP, promoting European interests despite competing interests and opposition from ACP states. While both parties agree on the potential value of investment and the importance of sound regulations and regimes, the EC is pushing for rules-based agreements, while the ACP wants investment promotion, technical assistance and capacity building.

The EC must improve the process surrounding investment talks to ensure that there is no ambiguity around any discussions on investment, and to ensure that ACP countries are not forced into rules-based agreements that are potentially detrimental to their development objectives. This would involve removing the imperative to negotiate on investment, leaving the initiative squarely and solely with the ACP. There is no WTO deadline or CPA compulsion to finalise investment provisions in EPAs, so talks on the issue should only proceed on the instigation of ACP states and regional negotiators. Given the potential costs of any agreements, the lack of evidence on which to base talks, and the limited negotiating capacity of the ACP, any talks must clearly reflect ACP priorities.

Where ACP states and regional bodies invite discussion on investment cooperation, but do not wish to discuss rules-based agreements, the EC must consider discussing cooperation agreements under the ambit of the CPA and outside EPA trade agreements. This avoids conflation of these issues and the difficulties associated with binding rules agreements for the ACP.

This shift in process is important, as the wrong kind of agreement will have serious implications for the ability of ACP states to manage investment as part of their development strategies.

If countries wish to discuss investment rules, then these should not be of the traditional investor protection variety, but should rather have a more developmental approach. This would mean agreements that:

- have an explicit over-arching development objective
- provide a greater balance for the rights and obligations of all parties, including:
    - the host country's right to regulate in order to achieve development objectives, even when these have an adverse impact on investors
    - the EU states' responsibility to ensure that investors respect laws and standards in ACP countries
    - the EU states' obligation to use the OECD guidelines and other mechanisms to highlight and address bad behaviour
- have stronger provision for investment promotion – agreements to date have achieved little in this respect
- do not excessively limit the policy options of ACP states to manage investment, including their ability to prioritise the interests of local and regional investors.

The EC should abandon its rigid approach to rules-based agreements, and make a positive contribution to enabling development through investment in ACP countries by:

- incentivising and actively promoting EU investment in ACP states and regions
- providing assistance and support to regional integration initiatives without seeking equal treatment for EU states and investors, and without forcing the pace of these processes
- providing assistance to develop local institutional capacity, which is key to encouraging and regulating investment
- building skills, infrastructure and key service provision to enable ACP countries to attract investment and facilitate benefits from linkages and technology transfer to local producers and service providers
- undertaking to discipline EU companies operating in ACP markets to ensure respect of international and local regulations and standards on labour and the environment
- using the OECD guidelines to highlight and address bad behaviour.

Glossary

Acronym	Term
ACP	African, Caribbean & Pacific Region
BITS	Bilateral Investment Treaties
BOP	Balance of Payments
CARICOM	The Caribbean Community & Common Market
COFAP	The Council for Finance & Planning
CPA	Cotonou Partnership Agreement
CRNM	Caribbean Regional Negotiating Machinery
DDA	Doha Development Agenda
EC	European Commission
EPA	Economic Partnership Agreements
ETI	Ethical Trading Initiative
EU	European Union
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
HCDA	The Horticultural Crops Development Association
IMF	International Monetary Fund
M&A	Mergers and Acquisitions
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NT	National Treatment
ODI	Overseas Development Institute
RTAs	Regional Trade Agreements
SIA	Sustainability Impact Assessment
SME	Small and Medium Sized Enterprises
TRIMS	Agreement on Trade Related Investment Measures
TT	Technology Transfer
UNCTAD	United Nations Committee on Trade and Development
WTO	*World Trade Organisation*

Endnotes

1 Karl Falkenberg, 'EPA and DDA, parallelism or crossroads?' *Trade Negotiations Insights*, Vol 3/4, July 2004.
2 The Singapore issues are the four trade-related issues added to the WTO's negotiating agenda at the 1996 Singapore ministerial: trade facilitation, competition, investment and government procurement. The inclusion of these issues in trade negotiations has been controversial because, while the issues impact on trade, they are primarily concerned with how a country manages its economy not only through border policies (tariff rates) but also 'behind the border' policies. International rules would not only affect the viability or desirability of trading in and with that market, but would also directly affect the extent to which a government can set conditions for domestic actors.
3 WT/GTC/W510, 14 August 2003
4 EU Directorate General Trade (DG Trade), *Work Programme and Main Issues for the 133 Committee in the Second Half of 2006*, Brussels, 6 July 2006.
5 In fact the EC is refusing to establish a separate EPA adjustment facility, and the tenth European Development Fund (EDF) is instead being earmarked for EPAs. Therefore it is not even the lure of additional funding, but securing scheduled funding that is the motivation.
6 At time of writing, WTO talks have been suspended. The earliest date widely touted for resumption of talks is November 2006, when EPA negotiations will be in full swing. Even during the suspension, countries' negotiators and officials need to continue to prepare positions for resuming WTO talks in order to have the chance of winning an advantage and to avoid falling behind during the hiatus.
7 EC Trade Director 'Stunned' in Dar as African Ministers Oppose Singapore Issues In Epas ... www.twnafrica.org/news_detail.asp?twnID=785 - 32k
8 Confidential note, EU/CARIFORUM technical negotiating meeting, 2005
9 In a recent meeting in west Africa, Dr Falkenberg insisted on an investment agreement that liberalised west Africa's investment regime as part of EPAs, and the importance of creating a 'transparent, predictable and investment-friendly environment' for European investors. 'No EPA without investment rules and full reciprocity, Falkenberg insists'*, Third World Network Africa* (7 April 2006).
10 European Commission, *Directives for the Negotiation of Economic Partnership Agreements with ACP Countries and Regions* (Doc 9930/2) (12 June 2002), Article 6.1.
11 http://ec.europa.eu/comm/trade
12 Joint phase one report paragraph 25, 2003.
13 For example, the ACP Group Declaration on the WTO 5th Ministerial Conference (Brussels, July 2003) the Cairo Declaration (2006), the AU Ministerial Declaration Grande Baie, Mauritius (2003), and the LDC Dhaka Declaration (May 2003).
14 Christian Aid, (April 2005), For Richer or Poorer: Transforming Economic Partnership Agreements between Europe and Africa.
15 European Commission, *Trade Development Strategy for ACP states- towards increased competitiveness* (Brussels, June 1997).
16 European Commission, *Draft Communication on External Aspects of Competitiveness* (Ref 318/06) (Brussels, 28 June 2006).
17 In this report investment generally refers to foreign direct investment: foreign capital invested in the productive assets in a country.
18 Mary Hallward-Driemeier*, Do Bilateral Investment Treaties Attract FDI? Only a. Bit… and They Could Bite,* World Bank (Washington DC, 2003).
19 UNCTAD (2006), Economic Development in Africa: Rethinking the role of FDI, Geneva
20 UNCTAD, *Foreign Direct Investment and Performance requirements: New evidence from selected countries* (Geneva, 2003).
21 Ibid.
22 Ibid.
23 Chang, HJ. and Green, D.*The WTO and Foreign Investment: Don't do as we did, do as we say*, (London, 2003)
24 A. Cosby, Mann, Peterson, von Moltke, *Investment and Sustainable Development,* International Institute for Sustainable Development (2004)
25 (Public Citizen, Table of NAFTA Chapter 11 investor-state cases and claims, February 2005).
26 For a discussion of the evolution of EU investment provisions in RTAs, see S Szepesi, 'Comparing EU free trade agreements: investment', *ECDPM InBrief 6D* (Maastricht, 2004)
27 This means that the government must liberalise all areas for investment in agriculture and manufacturing, except for a limited list of exclusions that it can specify.
28 European Commission, EC Free Trade Areas: An Appraisal, 8 March 1995 (SEC(95)322final).
29 ARIAII, *Rationalizing Regional Economic Communities*, 2006.
30 ODI evidence to Select Committee Hearing on EPAs, April 2005.
31 Te Velde and Nair, *Development Policy Review 2006*, Vol 24(2) pp 437-454.

32 D Meyers, *Caribbean Tourism, Local Sourcing and Enterprises Development*, PPT Working Paper 18, January 2006.
33 EU, *Regional EPAs SIA draft Report: Caribbean*
34 *The Nation* newspaper, 8 February 2006, Barbados
35 William Milberg, *Foreign Direct Investment and Development: Balancing costs and benefits* (1998).
36 UNCTAD (2006), Economic Development in Africa: Rethinking the Role of FDI, Geneva
37 According to the CPA's objectives and principles on economic and trade cooperation (Article 34): 'Economic and trade cooperation shall aim at fostering smooth and gradual integration of the ACP States into the world economy, with due regard for their political choices and development priorities. To this end, economic and trade cooperation shall aim at enhancing the production, supply and trading capacity of the ACP countries as well as their capacity to attract investment. It shall further aim at creating a new trade dynamic between the parties, at strengthening the ACP countries trade and investment policies and at improving the ACP countries' capacity to handle all issues related to trade.'
38 According to the SADC proposed framework for negotiations (43/06ACP, 16 March 2006): 'SADC EPA member states have limited institutional and negotiating capacity, which would be severely strained if these [Singapore] issues were to be negotiated under the EPA. Further, new generation trade issues would pose serious policy challenges as SADC has no common policies in these areas. Negotiating these subjects under such conditions runs the risk of delivering unbalanced outcomes that may be prejudicial to national developmental objectives and to prospects for deeper integration in SADC.
'Nevertheless, SADC EPA member states would be prepared to engage these issues in an appropriate framework. This framework should focus on technical exchange and cooperation where the EU could assist in the development of SADC institutional, policy and legislative infrastructure. This may extend to development of common policies in SADC to foster regional integration.'
39 Central Bureau of Statistics, *Economic Survey 2006*, Kenya Ministry of Planning and National Development.
40 Myriam van der Stichele, *EPA negotiations do not promote the right investment policies in Africa*, SOMO, 12/9/2006, DRAFT.
41 Oli Brown, *Supermarket Buying Power, Global Commodity Chains and Smallholder farmers in the Developing World*, Occasional Paper UNDP Human Development Report Office, 2005.