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BACKGROUND PAPER:
Investment Liberalization
in the EU-ASEAN FTA

A Report for Focus on the Global South

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Foreign direct investment (FDI) flows have seen a constant increase in nominal terms since they were first reported to UNCTAD in 1970, except for two periods when there was a slump in FDI flows: The first was the crisis of the European Exchange Rate Mechanism of 1992 that affected the UK and curtailed European capital movements. The second period was the reduction in EU-US investment flows between 2001-2003, especially of mergers and acquisitions, as a result of the economic downturn stemming from the explosion of the *dotcom* bubble.

The latter slowdown has been overcome with spectacular increases in FDI flows between 2006-2007, from a flow of US\$ 880,808 million in 2005 to US\$ 1,996,514 million in 2007 (in current terms). This huge amount of capital was a great concern for the economies involved, and especially so for the European Union which alone accounted for 57.21% of world FDI outflows in 2007, of which US\$1,142,229, or 98.75% came from the EU15¹. Although it is expected that 2008 will show a fall in FDI due to the present financial (the so-called “subprime” mortgages) crisis², the general upward trend is expected to stay in the mid-term with increases especially in the service sector.³

In 2007, all developing economies together received only US\$ 499,570 million of total FDI flows representing 27.25% of world FDI for that year. While the bulk of investment flows are among developed economies themselves, southern countries are still pressed to open their economies to FDI from northern countries under the assumption that this will provide them with the much-needed funds for their development. The issue of investments has been a contested one in the WTO. In 1998, the Multilateral Agreement on Investment (MAI) was rejected in the Organisation for Economic Cooperation and Development (OECD) with strong campaigning from civil society. Later investment was excluded from negotiations in the World Trade Organisation (WTO) again in 2003 due to strong opposition from developing countries. A Trade Related Investment Measures agreement (TRIMS) however, in place since the Uruguay Round, exists at the WTO. TRIMS includes important commitments such as abolishing performance or local content requirements that governments could impose on potential investors. However Least Developed Countries (LDCs) are exempt from this treaty and thus developed nations are quite unsatisfied with it and have been pushing for measures to deepen investment liberalisation despite the resistance of southern countries. Given the failure to forge a binding multilateral agreement on investments, developed nations are at present more focused than ever on using bilateral and plurilateral negotiations (free trade agreements or economic partnership agreements) to impose on developing countries the

measures that had failed to pass at the multilateral level.

But despite the failure to include an investment as part of a WTO agreement, other indirect means to liberalize the flow of foreign capital into and out of developing countries have been used. In this respect, it is important to note the relation between other areas of multilateral talks and investment flows.

In the case of trade in services, for example, one of the main modes of service trade is through the establishment of the provider in the host country, either by acquiring a local company or creating a new one, or directly by the presence of a "natural person" in the territory of the buyer. Thereby, liberalization of services usually includes a commitment to allow foreign companies to set up office in the country (what, in the General Agreement on Trade in Services, GATS, was considered "mode 3" of the four possible ways of trade in services) and usually also repatriation of profits, which means, in the end, opening the service market to foreign FDI.

At the multilateral level, GATS claims to be a very flexible rule, where countries are allowed to choose which services to liberalise and developing countries are allowed to commit fewer sectors and to a lesser degree. Furthermore, the Hong Kong Ministerial Declaration of WTO exempted LDCs from any commitment in service liberalisation.

Another highly contested area where agreements may affect FDI controls is public procurement regulations. Only an Agreement on Government Procurement (GPA) negotiated during the Tokyo Round exists in the WTO framework, and most developing countries are not part of it. Public procurement is a powerful tool for economic policy and industrial promotion for governments, being a discretionary measure commonly used in economic downturns to boost demand with public expenditure channelled into the economy through local companies. Opening the bids to foreign companies in non-discriminatory conditions would amount to allowing them a considerable investment in the country for many types of public works, in which creation of a company may be necessary. Liberalization of public procurement would also include provisions allowing foreign companies to repatriate the profits made with the project. Were this to happen, it is to be expected that big foreign engineering and consulting companies may displace local firms⁴ in providing the public sector, especially with infrastructure projects.

Intellectual property rights are also important for FDI since industrial property rights enforcement is said to be a precondition for investment decisions made by foreign companies. Actually some bilateral agreements, such as the Bilateral Investment Treaty (BIT) between the Netherlands and Bolivia, define investment also as "rights in the field of intellectual property, technical process and know-how". Similar provisions exist in other free trade agreements (FTAs), such as the one between US and Morocco. On the other hand, the only WTO agreement on trade related intellectual property rights -- known as the TRIPS agreement -- has not yet been fully implemented by many developing countries and LDCs have an exemption period until 2013, when they must assume TRIPS rules.

EU'S Aims in Investment in Bilateral FTAs

What does the EU want?

The EU has, as a general rule, placed most of its efforts to reach agreements that would serve its interests in the multilateral arena. It even maintained a temporary moratorium on bilateral talks, until the failure of the Doha Round of the WTO in Cancun in 2003. Then, it shifted its focus and actively pursued bilateral agreements under the reasoning that in not doing so it would suffer disadvantages with its competitors (namely the US and, to a lesser degree, Japan), which were already ubiquitously signing such agreements at the time. Of the 222 regional trade agreements registered at the WTO and in force at present, more than half include the EU or its members, but most of these are either internal agreements or affect EU neighbouring countries.

In 2006, the European Commission published its Communication *Global Europe: Competing in the World*, where it clearly stated its view: the EU should, in order to promote its interests in the world markets, speed up negotiations for bilateral trade agreements and obtain “WTO-plus” commitments, including the so-called “Singapore Issues” -- investment, competition, government procurement and trade facilitation -- which had already been rejected in Cancun by developing countries.

In fact, *Global Europe* had quite a few references with respect to investment, emphasizing the importance of improving its conditions: “the ability to invest freely in third markets becomes more and more important” or “establishing a 'physical' presence in a foreign country helps EU companies realise business opportunities”. It is clear that EU corporate interests are foremost in the Commission’s agenda, since benefits of FDI liberalisation to any other stakeholders apart from the investing corporations are, at best, disputed. In the *Global Europe* document, FTAs were regarded as helping international trade by building on WTO rules and “preparing the ground for the next level of multilateral liberalization”. The inclusion of the Singapore Issues in bilateral FTAs is seen by the Commission as a means to eventually re-introduce these issues at the multilateral level negotiations. It specifically pointed at investment and government procurement as part of the issues that, remaining outside WTO, should be “addressed through FTAs”.

To start FTA negotiations at the EU level, the European Commission requires a mandate to be approved by the European Council. The Commission on its own does not have the authority to negotiate investment liberalization, since this is considered a faculty of the member states, which reach country-to-country agreements in the matter via bilateral investment treaties (BITs). In fact, the Commission is usually granted a mandate that allows it to negotiate market access but not investment protection, which stays in the sphere of member states.

In recent years, a more aggressive push by the EU to include issues related to investment in its agreements can be perceived from internal EC papers and from the proposals tabled during negotiations.

Engaging with ASEAN

In 2007, a draft mandate was issued by the Commission for Council approval in order to formally start negotiations for a EU-ASEAN FTA. In the “Explanatory Memorandum” of the draft mandate, it already aspired to including investment as part of the negotiations, stating that “FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalisation, including far-reaching liberalisation of services and investment”.

The Commission is here clearly hoping to obtain WTO-plus commitments from ASEAN countries and negotiate better access for its investors in order to be able to obtain a strong foothold in ASEAN and counteract the advantageous position that its competitors are obtaining already in the region (i.e. Japan with its economic partnership agreements, EPAs, with many ASEAN members). This means the Commission will try to obtain non-discrimination rules, in the form of “most favoured nation” commitments, which would provide EU companies with all the benefits other countries may obtain through bilateral agreements with ASEAN.

In May 2006, a report released by a “Vision Group” of officials from every member state of both ASEAN and EU included conclusions from a study commissioned by the joint group on the effects of a FTA, stating that “the bulk of the gains to ASEAN are associated with liberalisation in services”. In the same line, and referring to several studies, the report concluded that further liberalisation of trade in goods, services, and also investment would bring about a “wide range of anticipated positive effects” to both parties. The report goes as far as to assure that an agreement would “boost growth in ASEAN and increase ASEAN's presence in the EU, enhancing inter-regional FDI flows in both directions” and make a case several times for increasing liberalisation and facilitation FDI.

One more report, paid by the Commission Director General on Trade to a Dutch consulting company, ECORYS, is still underway and expected to be finished by June 2009. The second phase of the study includes limited consultation with civil society. A draft of its Global Analysis Report has already been released. According to this report, it is taken for granted that the future FTA will cover also investments, intellectual property rights and government procurement. Again, not surprisingly, the document estimates that the FTA will bring along “positive net income effects for all the economies involved” and even that “the more limited the FTA is in terms of [...] service sectors liberalisation, etc., the smaller the welfare gains are expected to be”. At least in this case, contrary to the “Vision Group” estimations, the results are admitted to benefit the EU more from a liberalisation of services.

What has been Accomplished so Far?

A look at FTAs that the EU has already signed would expose the results it expects to obtain in its ongoing negotiations.

Table 1: Service and capital commitments in selected EU FTAs with developing countries

	EU – CARIFORUM	EU – CHILE	EU – MEXICO	EU – SOUTH AFRICA
SERVICES	GATS plus	GATS plus, great degree of liberalisation	GATS plus, great degree of liberalisation	GATS confirmation. South Africa has opted out of SADC EPA on service liberalisation concerns
MOVEMENT OF CAPITAL	No restrictions in the free movement of capitals relating to direct investments (art. 123). Safeguard measures in case of difficulties for exchange rate or monetary policies allowing to controls with a maximum of six months (art. 124)	No restrictions in the free movement of capitals (art. 165). Safeguard measures in case of exchange rate or monetary policy problems allowing to controls with a one year period that can be extended through reintroduction (art. 166)	Implemented in the “Decision No 2/2001 of the EU-Mexico Joint Council” (2001). Progressive liberalisation with no new restrictions allowed to be imposed after the entry into force of the Decision (art. 29.1) Safeguard measures for exchange rate or monetary policies difficulties (art. 30) with restrictions up to six months (extension possible) and for balance of payment difficulties (art. 31) for limited duration and not beyond necessary to remedy the imbalances.	Free movement of capital and repatriation of benefits for EU companies (art. 33) Safeguard measures in case of “serious balance of payment difficulties” for South Africa, when restrictions on current transactions of limited (though unspecified) duration can be imposed (art. 34)
NOTES	Liberalisation of tourism, important economic sector for the countries, aimed at favouring European vertical tourism providers	The Central Bank of Chile can limit or restrict capital transfers. It can also demand reserves to transactions up to 30% of any investment, credit or deposit, for a maximum of two years (see Annex XIV par.3)	Liberalisation in financial services caused 4 largest Mexican banks are now owned by foreign finance corporations	Vague mention of services in the FTA reflected only as objective for further negotiation

The case of the FTA EU-Chile is an interesting one since this is the most comprehensive agreement signed by the EU so far with a developing country, covering all sectors that are considered Singapore Issues and takes them to a WTO-plus stage of liberalisation.

In this FTA, "establishment of a commercial presence" is explicitly part of the Title III "Trade in Services", where principles of reciprocity and non-discrimination are mentioned, specifying that the provisions affect services provided "through commercial presence in the territory of the other party". This applies to all services, including financial services, even though they are covered in a different chapter of the agreement.

By defining commercial presence, among others, as "the constitution, acquisition or maintenance of a legal person", this chapter is giving *de facto* freedom of investment to companies in this sector. It bans explicitly measures such as limitations of foreign capital in Chilean companies and states national treatment as a principle enforced by the agreement. Furthermore, in the Title of the agreement dealing with establishment, national treatment is guaranteed for actors of any sector from the other Party. As is usually the case in the services sector, it is in the schedules attached to the agreement in annexes where the real impact of the agreement would be found. In this case, the schedules do not provide any differential treatment to Chile in the implementation period for these measures compared to the EU, except for specific fields such as pension plans. Social security is one of the few exemptions. In the Title for government procurement provisions, national treatment and non-discrimination are stated in article 139, with no exceptions or provisions, and the Title for investment flows (called "Capital Account" in the agreement) is brief and direct where, liberalisation of capital flows is only curtailed by a safeguard provision in case of difficulties for monetary policy (see Table 1). However, the Constitutional mandate that empowers the Chilean central bank to implement capital controls is respected in the agreement through its annex XIV, so Chile has kept certain freedom to take such measures.

The latest FTA signed by the EU is the one with the Caribbean countries, grouped in CARIFORUM. This is already a region-to-region bilateral agreement, precedent of what the EU-ASEAN FTA may look like.

In Title II of this agreement, investment and trade in services are already grouped in the same regulatory section, reflecting how the EU actually considers both areas as interlinked. In this chapter, apart from only a few sectors excluded like maritime cabotage, air transport and some related to security (military production), the freedom of establishment is guaranteed for parties to the agreement. This includes EU access to the important tourist market of the Caribbean countries, which was not bound under GATS. Article 68 of Chapter 2 implements the usual national treatment requirement "to commercial presence and investors of the other Party", and with respect to most favoured nation principle, Article 70, paragraph 1.b mandates CARIFORUM to provide EU investors "treatment no less favourable than" that applied to "any major trading economy with whom they conclude an economic integration agreement after the signature of this agreement". This in practice, as we have argued in the case of ASEAN, safeguards the EU's competitiveness against other developed economies (mainly the US) that may engage in bilateral agreements with CARIFORUM. In paragraph 2, the agreement registers a necessary exception to allow regional integration processes (and the CARIFORUM FTA with Dominican Republic) to continue without need to apply their internal agreements to the EU.

As usual in these FTAs, the real outreach of the liberalisation is to be found in the complex "list of

commitments” found in the annexes, where a detailed list of limitations to national treatment and market access allowed under the FTA are presented. However, in the case of banking services, it is noteworthy that no limitations are present for banking activities except a grace period until 2018 given to some countries to fulfil the requirements in the articles. Public monopolies however, are allowed under article 129, paragraph 1, where CARIFOURM states are specifically not prevented from “designating or maintaining public or private monopolies according to their respective laws”.

Title III, which is dedicated to “Current Payments and Capital Movements”, directly ensures that there will be “no restrictions on the free movement of capital relating to direct investments [...] in accordance with the provisions of Title II, and the liquidation and repatriation of these capitals and of any profit stemming there from”, which is self-explanatory. Only one safeguard measures article (art. 166) is included, by which capital controls can be imposed in case the flows “threaten to cause serious difficulties for the operation of monetary policy or exchange rate policy” but for a maximum period of six months.

In intellectual property rights, the provisions merely ratify TRIPS commitments already made by the members, and specifically allow for state promotion of access to medicines, and longer implementation terms for LDCs.

Finally with regards to public procurement, the agreement explicitly bans rules of origin for all the signatory parties. While national treatment is not reflected in this FTA, several clauses deal with non-discrimination “against a supplier established in either party” or, in the case of CARIFORUM, established in any (other) CARIFORUM state. This section, though, has several exceptions like land rent and acquisition, research and development or procurement for international assistance, which make it less strong than the provisions of, for example, the EU-Chile FTA in this aspect.

SOME PREVIOUS EXPERIENCES

There are already examples in previous agreements where investment was included either openly in a specific article or in a subtler manner as a liberalisation of establishment. The effects of these agreements have been already felt and are worth looking at in order to predict the outcomes of European access to developing countries markets via FDI.

One good example is Mexico and its FTA with the EU that kicked off in 2000. In this agreement, services were included and, most remarkably, financial services were opened by the well-known non-discrimination and national treatment clauses. This brought about a great flow of capital from European companies and FDI in Mexico peaked in 2001, but has been volatile and unstable since then (see Table 2). These investment flows have failed to boost growth in the Mexican economy and have been concentrated in the same sectors and regions as before the agreement⁵, contributing very little to development in the country.

Table 2: FDI inflows into Mexico

Year	2000	2001	2002	2003	2004	2005	2006
US\$ billions	17.9	29.4	21.1	15.0	22.5	19.9	19.2

The removal of several regulations on the Mexican financial market included lifting the ban on full foreign ownerships of banks in the country resulting to a deep transformation of Mexico's banking system. A few foreign banks now control the country's financial sector, eliminating the competition that is so dear to the rhetoric of these agreements and causing a drop in lending within the country,

as revealed by IMF documents on the outcome of the treaty⁶. Also UNCTAD reports prove that credit for productive activities has diminished. Medium and small sized businesses in Mexico are suffering from lack of credit as the financial system favours bigger transnational corporations and purely financial activities. Furthermore, foreign banks established in Mexico are now free to repatriate all profits out of the country. Both the NAFTA and Mexico-EU FTA together have brought about an overall increase on profits taken out of Mexico over time⁷.

This, needless to say, has had a strong impact on the local economy. As shown in the IMF study, companies have been unable to stay in business due to the lack of credit leading to a worsening of employment and a downturn in economic activity.

HOW DO ASEAN COUNTRIES FACE THESE NEGOTIATIONS?

While the use of FDI as a development tool has been widely discussed in the academe, there has been no clear agreement on its beneficial effects except for a common understanding that for its benefits to be realized there needs to be a series of other conditions⁸ that would prevent the negative effects on local companies, unable to compete with the powerful TNCs from developed countries. Small business could even disappear, leading to private monopolies or TNC oligopolies and market control, or the loss of foreign currency reserves caused by repatriation of profits. The fact that FDI does not immediately translate into technology transfers is admitted even by the WTO itself⁹.

At an historical level, there is no single "success story" of development with an economy totally open to foreign capitals movement that would support that such measures would benefit ASEAN economies by themselves. Even from the narrow point of view of GDP growth¹⁰, all the newly industrialised countries, including Japan in the post-war period, had some kind of limitation to entry of foreign investors and state control over capital flows. Actually from a long-term historical perspective, industrialised countries have always used such controls in their first stages of take-off¹¹.

ASEAN countries however continue to count on FDIs to provide technology transfers and better training for the labour force. They continue to push for policies and measures that would attract foreign capital to feed their export-oriented economies despite the risks associated with a dependence on foreign capital and increased vulnerability to international downturns like the one taking place in 2008 since the outbreak of the sub-prime crisis. It is so much so, that countries that have not signed bilateral investment treaties with the individual EU member states are actually willing to include investment in the free trade agreement as they expect this would amount to obtaining an investment treaty with all 25 member states at a time, and they believe this would boost business confidence and investment in their economies. Actually, due to the mandate given by the EU members to the Commission, and the internal structure of investment negotiation within the EU, the Commission may negotiate market access in treaties with other countries but not investment protection, which is the prerogative of the individual member states, and so the FTA would never equal to BITs as some expect.

ASEAN countries have diverse but existing degrees of protection for capital flows, and any WTO-plus commitment would require elimination of safeguard measures that are protecting local businesses at the moment. Countries are already relaxing their requirements for FDI and favouring foreign investors in their treatment, for example by eliminating restrictions in foreign ownership of companies, or even introducing incentives to establishment in their territory.

The very different nature of the countries grouped under the ASEAN umbrella makes it especially challenging to establish any general assessment of the effects derived from easing the movement of

FDI in and out the region. Similarly, the different levels of development and economic structure have in fact caused diverging demands from the member countries in negotiating this issues even inside ASEAN. The lack of strong regional institutions at the level of those of the EU has slowed down negotiations and has made concluding an inter-regional agreement a cumbersome task. It is for this reason that the EU has been considering separate negotiations with individual countries it deems ready to sign, with the hope of speeding up the process and leaving the door open for the remaining countries to join later.

FDI flows to ASEAN have been increasing in recent years both at a regional level as well as on individual countries. In 2007, FDI inflows went up by 16% over the previous year, and according to UNCTAD's World Investment Report 2008, “reinvested earnings were particularly strong in the region”.

The diversity of regulations and incentive structures for investment explains the important disparities in investment flows within the region. For example, while in 2007 Singapore received an inflow of US\$ 24,137 million and has already quite an open regime for foreign capital, the next highest destination of FDI, Thailand, had an inflow of only US\$ 9,575 million, less than half Singapore's figure, and has a much more restrictive regulations. Thailand has limitations on foreign ownership of companies, especially restrictions in productive primary and secondary sectors, but also in services, where activities require official approval for foreign full ownership of companies inside the country.

More important are the differences in the amount of FDI stock in the country. Singapore's FDI stock as of 2007 of around US\$ 249,667 million is the highest in ASEAN followed by Thailand, with US\$ 85,749 million stock which is only slightly above one third of Singapore's. The list goes on in a fast diminishing scale.

Looking at regional figures for both EU and ASEAN, FDI inflows to the EU in 2007 amounted to US\$ 804,290 million, while ASEAN received US\$ 60,514 million¹², not even a tenth of the investment flows received by the EU. FDI inflows in ASEAN however amount to 43% of its GDP, higher than the 40.9% in the case of Europe, showing the importance of FDI relative to their size.

It is when we compare the outflow of FDI that the differences become more acute. While ASEAN as a whole cannot be properly accounted for due to lack of data in countries like Lao PDR and Myanmar/Burma, FDI for the rest of the eight ASEAN countries totalled US\$ 33,466 million while the EU had an outflow of US\$ 1,142,229 million. However, when compared to the size of the economies concerned, the EU's outflow of investment is 48.1% of its GDP while in the case of ASEAN the figure is 20.3%.

Thereby it becomes clear whose investment capitals would benefit more from an easing of restriction and regulations under these FTAs. Even when investment liberalisation is not treated separately in the agreement, the conditions imposed through the chapters about trade in services aim at the maximum possible opening for FDI into the countries through freedom of establishment for the services sector. Tackling this sector is of crucial importance for the EU, given that it is the biggest services exporter in the world with 46.01% market share of all service exports¹³ and more than triple the revenues of the US, which is second on the list. FDI in services is concentrated in trade and commerce, finance and real estate. As it was already stated in the EC report *Global Europe: Competing in the World*: “Services are the cornerstone of the EU economy”, “our service industries are world leaders in a range of fields”, and thus, of course “The EU will need to negotiate to liberalise trade in services with key trading partners”.

It is following this declaration of interests that the EU is imposing service liberalisation in all its agreements with southern countries to a further level than GATS and downgrading the preferential treatment that it provided them before.

Such is the case for previous FTAs signed by the EU like the one with CARIFORUM or that of Mexico. In the case of ASEAN, the EU has been reticent in the negotiations to allow for different commitment schedules for each country, and in case of giving in to this demand, it has expressed its intention of signing in return a different list of EU commitments for each of ASEAN members, which would elevate the complexity of the treaty to a new level. Such a position reflects its pursuit of reciprocity in its negotiations with the south, and its disregard for other concerns such as development promotion or preferential treatment based on the situation of the trading partner. This all in accordance with its new approach reflected in Cotonou agreement with ACP countries in 2000, which is supposed to be a step back from the system existing under the earlier Lome convention.

Under GATS, commitments are flexible and depend on each country's schedule, which vary a great deal. Were the EU to respect GATS schedules, the FTA would acquire a great complexity, such as the CARIFOURM annexes where sector-by-sector commitments are presented at individual state level for those sectors liberalised in a “positive list” approach. In the case of ASEAN, disparities in GATS schedules are wide. There are countries like Brunei Darussalam with a great degree of protection of services and no national treatment for foreign companies “except with respect to existing commercial presence”, Myanmar/Burma with almost no commitments, or Thailand and Indonesia, where foreign ownership of joint ventures is limited to 49% of capital as a general rule. On the other end, Singapore, Cambodia and Vietnam are, to a great extent, open for service-providing foreign companies to establish in the country.

Because the right to establishment in services amounts to liberalisation of FDI outside of the investment negotiations, the demand of ASEAN members to deal with this issue in a separate investment chapter becomes a matter of conflict with the negotiators from the Commission. One of the problems that developing countries suffer when engaging in FTA deals is lack of resources that makes it difficult for them to have negotiators present in all tables. In the case of ASEAN, the group does not have an internal decision mechanism with the degree of integration of the EU, and requires constant meetings of its members to agree on the positions to take. Due to this, some of its members face serious difficulties attending and following each working group of the negotiations, which makes it even more difficult to defend positions that will not damage their interests in all fronts. They are even not prepared to foresee the consequences of some of the EU demands in complex areas in which there has been little previous experience of the effects of signing for more liberalisation, such as public procurement.

As for another important mode of entry into a market, mergers and acquisitions, the EU is again responsible for the highest number of transactions with ASEAN, but in this type of capital flows, intra-ASEAN movements are also very important. It is worth noting how ASEAN firms from the economically stronger countries in the region, Singapore and Malaysia, are performing important investments inside ASEAN, especially in infrastructure and construction industries. The impact of these flows on the host economy is considered to be more beneficial than investment from developed countries¹⁴ in terms of technology transfer and job creation. Actually, these flows are part of the regional integration process in South East Asia, supposed to help with economic integration and stability. Opening investment to the EU on equal or similar conditions could threaten the development of these networks if investment and acquisitions by developed countries' transnational

corporations displaced regional investors.

Companies from these dynamic economies of ASEAN are also becoming important investors in other developing countries outside the region, but for this to be possible they will undoubtedly need to be protected from the much more powerful northern TNCs at home.

Liberalising investment and, most importantly, the return of benefits to the companies' home countries can benefit only the EU corporations despite the reciprocity rhetoric, given its high outflow of FDI. It would also reduce the present barriers that keep many local companies in business. Moreover, the growth of many TNCs in new markets is through acquisition of local companies, rather than creation of new entities, thereby providing little development and opening of new sectors and economic activities.

ASEAN companies, with very few possibilities and capacity for investing in such a competitive market as the EU, would rarely benefit from access improvement to the EU economy, and the small amount of FDI flowing out of these countries shows that clearly. At the same time, an inflow of freely moving European TNCs would bring them much bigger and more developed competitors to their own markets with whom they could barely compete. Free repatriation of capital to Europe would undoubtedly extract financial resources from these economies as well, exacerbating the overall loss in self-reliance that can be predicted from this situation.

The case of the financial sector in Mexico illustrates how the entry of TNCs into an economy that lacks the resources to face such competition leads to displacement of the local business and, in further stages, actual lack of service provision to the population. In this case, loans to small and medium size enterprises diminished¹⁵ and small farmers have lost access to credit¹⁶ due to the profit-seeking strategy of the corporations.

Foreign investment in the industrial sector attracted under the EU-Mexico FTA liberalization didn't help the latter's economy either. Many of the companies that settled there established only assembly lines that imported parts and re-exported the products again to the USA or the EU, "and many export industries have weak or non-existent linkages to the rest of the Mexican economy."¹⁷ This tendency, which already exists in some of the ASEAN economies economic structures, would most likely be exacerbated by increasing foreign companies' rights to local establishment, ownership and movement of their capitals.

The definition of FDI is one of the fronts where the FTAs preserve the interests of European TNCs. Capital flows can be of a speculative nature, with some big short term capital movements being able to cause great economic distress, as has been already experienced in several crises such as the one in Mexico in 1994, the Asian crisis of 1997, or Russian in 1998. Giving a broad definition of FDI as most EU FTAs do (usually referred to as any direct investments made in accordance with the laws of the host country, EU-CARIFORUM art. 123, EU-South Africa art. 33.1), including portfolio investment is a way to rule out controls over capital flows. Shares purchases will be considered direct investment, according to the International Monetary Fund (IMF) definition, if they provide 10% of the voting power in the company to the buyer. It is important, though, to look at the safeguard measures that allow for temporary restrictions, always under the assumption of some emergency situation. In any case, use of capital controls as a policy measure becomes banned under normal circumstances and is only allowed in extreme cases, as defined in each agreement. Only in the case of the EU-Chile FTA, the Andean country preserved the right of its central bank to exert control over capital flows as stated by its constitutional law. The agreement allows it to impose restrictions up to

one year which can be renewed indefinitely, but on the other hand established limits to the amount of reserves to be deposited in the central bank as a requirement to capitals moving in or out the country of up to 30% and two years period. These kinds of measures were imposed by the country over the period 1991-1998, when a 30% deposit was required over a period of one year for all incoming capital, with great success in limiting short term flows, currency volatility and contagion of external crises.

As for other existing EU agreements, the case of EU-CARIFORUM agreement, the most recent to be signed by the EU, is revealing. Restrictions on capital flows can only be imposed as “strictly necessary” and for a maximum period of six months (Title III, art. 124.1). In the one signed with South Africa, capital movements related to investments are liberalised (Title 3, section C, article 33) and only “serious balance of payment difficulties” would allow for any kind of controls on foreign capitals, again being “of limited duration” (Title 3, section C, article 34).

The EU-Mexico FTA is vague and its true development lies in the EU-Mexico Joint Council Decision of 2001 which establishes the rules for non-discrimination and national treatment, including a timeline for removing of existing barriers. In additions, it allows for joint committees to be established under the FTA which continue to deepen and widen the reach of the commitments without any public oversight.

Also, as said before, investment treaty negotiations by member states are correlated with EU FTA talks. Mexico is a great example of this (it signed BITs with 12 EU members between 1998 and 2000) and it could explain why Pascal Lamy, EU's trade commissioner, proudly claimed that the FTA had provided Europe with “NAFTA parity”¹⁸, given that most of them include “most favoured nation” clauses that would give the European countries the same rights as the US obtained through NAFTA. This raises the question of the controversial “investor to state” dispute settlement mechanisms as present under North American Free Trade Agreement (NAFTA) and in many of the BITs signed by the EU which gives investors the power to take countries to international arbitration on the basis of treaty violations. These provisions are usually unfavourable to the less powerful partners, which actually have few companies investing in developed countries. Many foreign investors are more than willing to file suit if they cannot reap the profits they expect from their projects. More than 250 investor cases against states have been taken for arbitration at international bodies like the World Bank's International Center for Settlement of Investment Disputes (ICSID). It is yet to see if European companies will make use of such provisions to the same extent as American ones in the case of NAFTA¹⁹. Of the 49 cases filed until October 2007 under the latter's infamous Chapter 11 by companies against signatory states, the US was the only country not losing any case and free of any damage compensation, while Mexico was the country with most cases filed against and had to pay compensations in three of them so far. Meanwhile Canada has lost two cases and has settled another two “out-of-court”.

Although the scarcity of cases presented so far by European investors may point in a different direction, in the case of Chile or Mexico there are already several arbitrations taking place in the ICSID between European companies and the state: three in the case of Chile, all brought to court by Spanish investors, of which one has been dismissed by the arbitrators and two are still under way. Two cases have been filed against Mexico, with the ICSID decision in one of them amounting to a payment by Mexico of US\$5,533,017.12 plus a 6% interest for two years to a Spanish investor for breaching a non-discrimination clause in the Mexico-Spain BIT. Should the EU TNCs follow such a pattern of litigation as in NAFTA, the cost for ASEAN, and especially LDCs within it, could become unbearable.

Already, some of the ten members of ASEAN have BITs with EU members: Indonesia (20), Vietnam (19), Malaysia (16), Philippines (15) or Thailand (13), but it may be expected that pressure will be exerted on smaller countries with few such treaties to open their markets to investment, as is the case of Cambodia (5) or Lao PDR (6). Myanmar/Burma has no BITs with EU members, and also its participation in the FTA is under consideration due to the EU embargo on the basis of its human rights record, but experience suggests that the EU's human rights considerations will prevail over its business interests for long.

In conclusion, the EU is undoubtedly pursuing the maximum investment liberalisation at all costs. The actual measures that some ASEAN countries have taken in the past could hardly fit into many of the FTAs signed to date with other developing countries. For example, the measures which allowed Malaysia to come out successfully of the Asian financial crisis, with capital controls that lasted for one year and tax levies on portfolio capital outflows after this period, would not be possible under an agreement similar to that signed by CARIFORUM or South Africa.

Also, the Thai central bank's imposition of a 30% withholding tax on inward investments to slow speculation on the Thai baht in 2006 would be against provisions such as article 34 of the EU-South Africa FTA or under article 124 of the EU-CARIFORUM FTA, which would only allow such measures for six months while Thailand for two years.

Although ASEAN countries are trying to hold a position in their talks with the EU of not signing any agreement that would require them to change their existing laws, it is unclear whether those countries that agree to a lower standard in their service schedules or in investment and capital controls will find their hands tied when some situation arises that would require them to adopt restrictive policies on such flows.

1 Source: UNCTAD FDIstat

2 “[...] a modest and temporary decline in global FDI inflows is expected in 2008. Global FDI inflows are projected to return to steady growth in 2009-11”, Columbia Program on International Investment and The Economist Intelligence Unit, *World Investment Prospects to 2011*, The Economist Intelligence Unit 2007

3 UNCTAD, *World Investment Prospects 2008-2010*

4 See *World Investment Report 2008*, UNCTAD for potential crowding-out effects of infrastructure investment from TNCs in developing countries

5 R.A. Reveles and M. P. Rocha L., *The EU-Mexico Free Trade Agreement Seven Years On, A warning to the global South*, Transnational Institute, 2007

6 IMF, *Mexico: Financial sector assessment program update / Technical Note / Financing of the private sector*, IMF, Washington DC., 2007

7 World Bank, *Global Development Finance 2008*, World Bank, Washington DC., 2008 cited in Jones T., *Raw Deal: The EU's unfair trade agreements with Mexico and South Africa*, World Development Movement, 2008.

8 UNCTAD, *World Investment Report 2002*

9 Note by the WTO Secretariat, Minutes of the 2001 7-8th March meeting, WGTI/M/14, p.6.

10 See for example: Ajit Singh, *Multilateral Competition Policy and Economic Development*, UNCTAD 2004

11 Chang, Ha-Joon, *Kicking Away the Ladder*, Anthem Press 2002, London

- 12 UNCTAD, *World Investment Report 2008*
- 13 WTO, *World Trade Report 2007*, p. 12
- 14 UNCTAD, *World Investment Report 2006; FDI from Developing and Transition Economies: Implications for Development, Chapter 5.*
- 15 IMF, *Mexico: Financial sector assessment program update -Technical note- Financing for the private sector*, IMF Washington DC. 2007.
- 16 Henriques, G. and Patel, R.. *NAFTA, Corn and Mexico's Agricultural Trade liberalization*, America Program Especial Report, 2004.
- 17 Blecker, R.A., *The North American economies after NAFTA: A critical appraisal*, International Journal of Political economy Vol. 33 No.3., 2003.
- 18 "it provided NAFTA Parity (México gave us more than 90% of what it had given the US, and in some areas more - e.g. such as goods, services and intellectual property)", Lamy Pascal, Commissioner of Trade, Speech /02/189: "Mexico and the EU: Married Partners, Lovers, or Just Good Friends?". European Integration Studies Institute, Instituto Tecnológico Autónomo de México, Mexico city, 2002
- 19 Scott Sinclair, *Trade and Investment Research Project*, Canadian Centre for Policy Alternatives 2007