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Inter-Relationship between Trade and Investment: Strengthening Policy Coherence

Discussion Paper for the G20
Prepared by the WTO, UNCTAD, OECD and World Bank

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(The views expressed in this paper do not necessarily represent those of G20 members.)

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1 INTRODUCTION

1.1. G20 members recognize that trade and foreign investment are key drivers of global economic integration, growth and prosperity. Yet these drivers have slowed in recent years with worrying repercussions for the global economy as a whole and developing countries in particular. 2015 was the fourth year in a row that global trade volumes grew by less than 3%—barely at the rate of GDP growth—while foreign direct investment (FDI) flows over this period have yet to attain their pre-crisis levels. This report—prepared for both the trade and the investment streams of the G20 Trade and Investment Working Group—explores how trade and investment flows are becoming increasingly interlinked and mutually reinforcing. It examines how national trade and investment measures—and international trade and investment regimes—interact, and where policy coherence could be strengthened. The objective is to provide a factual and "joined up" picture of the fast-evolving global trade and investment landscape so that G20 policy makers can assess the options for strengthening policy cooperation in this critical area in order to boost trade and investment growth.

1.2. In the early 1990s, the world economy entered a phase of rapid integration, growth and development—or 'globalization'—driven in large part by fast-expanding and mutually reinforcing trade and investment flows. With the opening up of key developing and transition economies, the spread of global value chains (GVCs), and the negotiation of new trade opening and investment protection agreements—all underpinned by major advances in transport, communications, and information technologies—global trade grew twice as fast as global output between 1990 and 2008, the year before the "Great Recession"—increasing trade's share of world GDP to over 30%—while FDI grew almost seven fold—raising the global stock of FDI to 24% of GDP. Not only did trade and investment expand over this period, but their coverage dramatically widened as well. Since 1990, developing countries share of world merchandise exports has increased from 33% to 43% in 2008, while their share of inward FDI flows has grown from 17% to close to 40%.[1] Even more strikingly, developing countries have emerged as important outward investors—accounting for 35% of worldwide FDI outflows in 2014, compared to just 8% in 2000. The result was a virtuous circle: the expansion of FDI fuelled trade growth—as affiliates of multinational enterprises (MNEs) increasingly exchanged components and services in joined-up production networks—while trade growth in turn fuelled further FDI expansion.

1.3. But while trade and investment flows have become increasingly integrated, interdependent, and 'globalized', the international rules and regulations underpinning them remain fragmented—comprised of a complex web of bilateral, regional and multilateral agreements—some centred on trade, others on investment, still others combining trade and investment provisions—that intersect and overlap at multiple levels. Although these agreements are broadly complementary—in that their basic aim is to promote greater economic openness, cooperation, and certainty[2]—there are invariably inconsistencies in their application, as well as gaps in their coverage. The issue of whether the existing architecture adequately reflects the reality of a world economy increasingly interconnected by global productions networks and borderless digital trade—where businesses see trade and investment as two sides of the same strategy for producing and distributing goods and services across multiple foreign markets—is worth examining. In fact, a number of countries and regional groups are in the process of revising and updating their international trade and

[1] Two key—and related—drivers of this trend were the rapid economic growth of China and the commodity price boom which supported the integration of many resource-based developing economies.

[2] The core functions of the WTO include lowering trade barriers and creating a more predictable and transparent trading environment. Regional trade agreements generally also have the same goals. Most international investment agreements are focused mainly on the protection of foreign investment, although a small but growing number also include pre-establishment commitments, extending national treatment and MFN treatment to the "establishment, acquisition and expansion" of investments (see below).

investment relations—including by negotiating Regional Trade and Investment Agreements (RTIAs)[3] that seek to address these new coherence and coordination issues within a common legal framework. Examining these issues is especially important as G20 policy-makers look for ways to address the structural, as well as the cyclical, causes of the simultaneous global slowdown of trade, investment and growth since 2010.

2 THE EVOLVING TRADE-INVESTMENT NEXUS

2.1. The relationship between trade and investment in the real economy is rapidly evolving, as a result of technological developments, economic liberalization, and new ways of organizing production and distribution. Although trade and investment have always been interlinked—since both are concerned with the efficient international allocation of economic resources (goods, services, and capital)—three related developments in the global economy—the spread of GVCs and NEMs, the growth of services, and the rise of digital trade or 'e-commerce'—are reinforcing their complementary relationship and, in certain respects, blurring the lines between them.

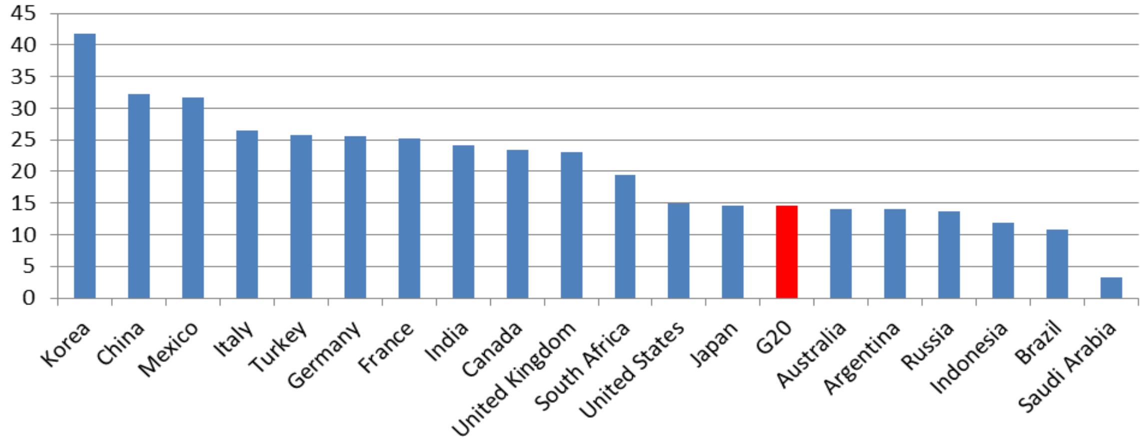
2.1.1 The continuing evolution of global value chains

2.2. A key driver of the growing interdependence of trade and investment is the globalization of production organized around GVCs. In the post-war decades, trade and FDI were often regarded as substitutes, not complements. Faced with relatively higher trade barriers and costs, many MNEs used FDI, rather than exports, to access markets—establishing foreign subsidiaries behind tariff walls that produced goods or services mainly for domestic consumption. But in today's more open and interconnected world economy, MNEs increasingly use trade and investment as complementary strategies to create what are in effect 'world factories'—locating design, manufacturing, assembly and other stages of the production process in the most cost-efficient or skills-rich locations around the world. These value chains vary depending on what, where and how they produce. Some focus on mass-market consumer products, others on capital goods, still others on services, agricultural, and natural resources products. GVCs also continue to evolve as more efficient suppliers arise, new technologies open up, underlying economic conditions change, or consumer tastes shift. All rely on increasingly sophisticated, seamless, and flexible trade and investment networks that allow a wide range of geographically dispersed firms and service providers to deliver "just-in-time" output, at required specifications, in a tightly sequenced and coordinated way. It is estimated that upwards of 80% of global trade now takes place within the international production networks of MNEs. A number of G20 economies—both developed and developing—are highly integrated in GVCs. The share of foreign valued added in Korea's exports, for example, is over 40%, while for Mexico it is over 30% (figure 1).

[3] In this paper, the term Regional Trade and Investment Agreement (RTIA) will be used instead of Regional Trade Agreement (RTA) when the agreement includes a separate and comprehensive investment chapter alongside chapters on goods and services trade and intellectual property.

Figure 1: G20 economies have varying degrees of backward integration in GVCs

Share of foreign value added in gross exports 2011, in %



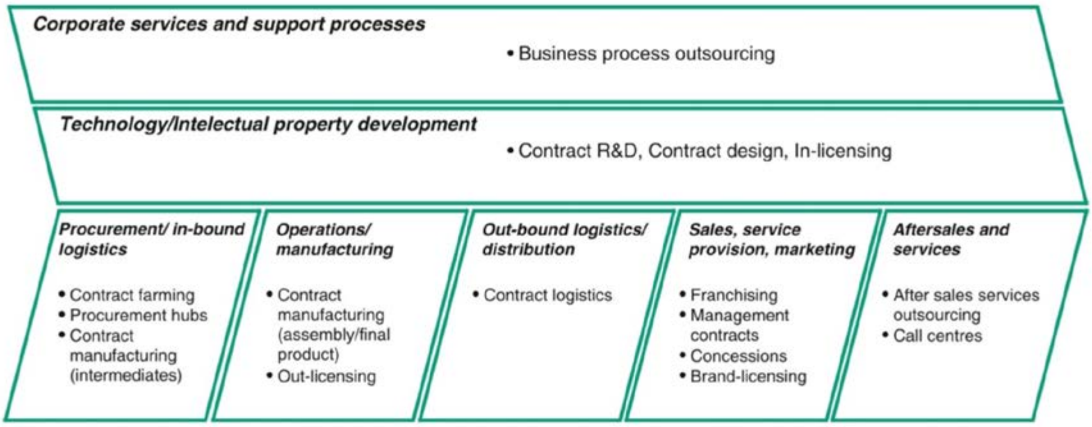
Notes: The average G20 share of foreign value added in gross exports is weighted by total value added exports in each G20 country. The EU is not included in this figure.

Source: OECD (2016), OECD-WTO Trade in Value Added Database.

2.1.2 The growing importance of non-equity modes of international production

2.3. One important way that GVCs are evolving—and their networks are becoming more complex—concerns how MNEs coordinate the activities of host country firms. Today contractual relationships, minority equity relationships, and other non-equity-based business relationships have come to fore as important building blocks of GVCs. Non-equity modes (NEMs) of international production are also influencing trade flows in GVCs through non-traditional coordination mechanisms, which are neither arm's-length nor intra-firm, but contract-based (see figure 2). Cross-border NEM activity is increasingly significant worldwide and particularly important in developing countries (figure 3). NEMs employ an estimated 18–20 million workers in developing countries. Their value added represents up to 15 per cent of GDP in some economies; and their exports account for 70–80% of global exports in several industries. NEMs support long-term industrial development by building productive capacity, including through technology dissemination, domestic enterprise development, and by providing access to GVCs. At the same, employment in NEMs can be highly cyclical and easily displaced, and the value-added contribution can appear low if assessed in terms of value captured out of the total GVC. Although these non-equity relationships are an increasingly important 'glue' binding many global production networks together, they are governed more by industry- and firm-level standards than by explicit national or international policy-based rules.

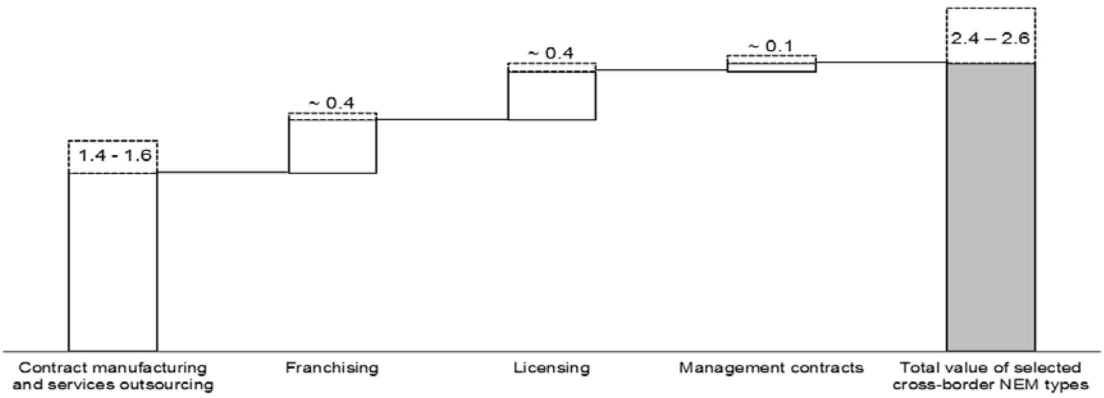
Figure 2: Selected NEM-types along the value chain



Source: © UNCTAD, WIR11, based on Porter's classic value chain representation (Porter, 1965).

Figure 3: Estimated world-wide sales

Selected NEM types, 2014 ($trillions)



Source: © UNCTAD, updated from *WIR11*, p. 132. Note: For estimation methods and sources, see *WIR11*

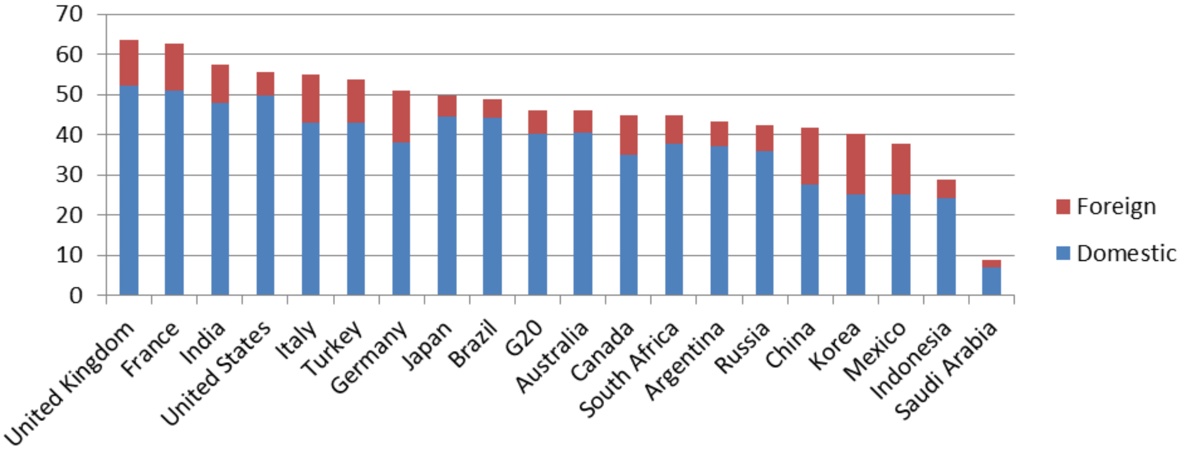
2.1.3 Growing importance of services

2.4. The growing importance of services—and not just as globally traded products but also as key enablers of global production—is further sharpening the interdependence between trade and investment. 'Backbone' services such as transport, telecommunications, and informatics make GVCs possible, while R&D, design, consulting, and other services contribute to firm-level productivity and innovation at every stage in value chains. In G20 economies, services are now responsible for upwards of half of the value added in gross exports (figure 4). Because many services are delivered through a commercial presence in foreign markets—as well across borders electronically—multinational service suppliers, like multinational goods producers, have developed complex regional and global business strategies that rely on the seamless integration of trade and investment. Global financial institutions, for example, combine centralized services delivered across digital networks—such as money transfers—with localized services delivered through country-based branches—such as insurance. Search companies, to take another example, merge their globalized and localized services even more seamlessly by transforming personal and geographically-specific information into global data products. The WTO estimates that some 55%

of global service industries involve some form of commercial presence in overseas markets. Meanwhile, two-thirds of global FDI stock is now concentrated in services industries.

Figure 4: Services inputs play an important role in G20 exports

Share of services value added in gross exports, foreign and domestic, 2011



Source: OECD (2016), OECD-WTO Trade in Value Added Database.

2.1.4 Rise of digital trade

2.5. The rapid rise the digital economy—including e-commerce—is further blurring the lines between trade and investment. New digital technologies are not only transforming the way goods and services are produced and exchanged globally, but also the nature of the products themselves. Digital products—from downloadable films and music, to software programmes and information media—often defy easy categorization as goods, services, or intellectual property. For example, 3-D printing illustrates a bend of these three elements. Moreover, many of these current technologies will continue to transform products, processes, and the organization of economic activities in unforeseen ways. The very nature of digital products and their delivery method—together with the inherently global nature of the digital economy—poses new challenges for national and international regulations that treat trade and investment as distinct and separate economic activities.

3 THE GROWING INTERACTION OF NATIONAL TRADE AND INVESTMENT MEASURES

3.1. In today's interconnected world economy—where trade and foreign investment are increasingly complements, not substitutes—the benefits of national policy coherence (and the costs of incoherence) are rising. Global production networks require more integrated trade and investment regimes if they are to maximize the benefits of economies of scale and comparative advantage. At the same time, MNEs have more scope to choose where—and for how long— they will locate the various stages of their production process.[4] In order to be part of these networks—and to benefit from the accompanying trade and FDI flows—countries need to put mutually supportive trade and investment policies in place. Incoherent policies weaken their effectiveness and can ultimately be self-defeating. Avoiding inconsistent investment and trade policies requires paying close attention to those policy instruments that simultaneously affect investment and trade - i.e. (i) trade measures affecting investment and (ii) investment measures affecting trade.

[4] While the two 'ends' of most manufacturing-based global values chains are somewhat fixed—tied at the beginning to specific primary resources sources, and at the end to specific consumer markets—the various stages in between can increasingly be shifted to a growing number of potential locations around the planet.

3.2. Trade measures affecting investment involve a variety of measures, such as those impacting market access conditions, market access development preferences, and export promotion devices, among others (table 1).

Table 1: Potential investment effects of trade policy measures

Trade policy measure	Potential investment-related effect (illustrative)
• Import tariffs, tariff escalation • Non-tariff measures: regulatory standards (e.g. technical barriers to trade and the application of sanitary and phytosanitary measures)	• effect on export-oriented investment in operations that rely on imported content that is subject to the measure • effect on market-seeking or import substitution investment (barrier-hopping)
• Trade facilitation (applying to both imports and exports) • Export promotion (e.g. export finance, credit guarantees, trade fairs)	• effect on export-oriented investment by reducing the cost of multiple border crossings on both the import and export sides and through expedited exports (of particular relevance in time-sensitive GVCs) • effect on market-seeking investment that benefits from facilitated (and cheaper) imports
• Preferential or free trade agreements (including rules of origin and sector-specific agreements)	• effect on investment that benefits from easier (and cheaper) trade between member countries, strengthening regional value chains • effect on market-seeking investment through economies of scale from serving a bigger market • Consolidation effect on investment (primarily through mergers and acquisitions) as a result of reconfiguration of GVCs in member countries • effect on investment sourcing of inputs
• Market access development preferences (e.g. GSP, EBA, AGOA)	• effect on foreign investment in preference-recipient countries targeting exports to preference-giving countries
• Trade remedies (e.g. anti-dumping, safeguards and countervailing duties)	• effect on export-oriented investment in the country affected by the measure (and on existing export-oriented investors who made investment decisions prior to the measure's enactment)

Source: © UNCTAD, adapted from WIR13.

3.3. Broadly speaking, more open and predictable trade policies can boost foreign investment and strengthen the positive relationship between trade and investment. In contrast, high tariffs, inefficient customs procedures, or other trade barriers—not to mention weak trade infrastructure—can often discourage trade-oriented investment and hurt a country's competitiveness by restricting access to imports of the intermediate goods and services that firms increasingly need in order to export. Another critically important factor influencing foreign investment inflows is the degree of certainty or risk over the time horizon of the proposed investment. While many policy and economic factors impact investment decisions, the structure and stability of trade policies—both of host countries and of potential foreign markets—can be important influences on the willingness of MNEs to seek customers in foreign markets, locate production processes in host countries, or separate the production process into stages located in different host countries.

3.4. Investment measures affecting trade comprise a wide variety of policy instruments that apply to the activities of foreign investors in the host country. Broadly, they include entry and establishment rules (such as screening measures, licensing requirements and procedures, foreign equity limitations), trade-related operational measures, production requirements and knowledge-related requirements, as well as promotion and facilitation measures (table 2). Such measures are particularly relevant in the case of services trade as they apply to the establishment of commercial entities (subsidiaries and branches) for the purpose of supplying a service under mode 3 (see below). Many such investment measures are to be found in WTO Members schedules of commitments under GATS.

Table 2: Potential trade effects of investment policy measures

Investment policy measure	Potential trade-related effects (illustrative)
• Investment promotion, in particular for export-oriented FDI, including financial incentives, fiscal incentives; other incentives (e.g. subsidized infrastructure, market preferences, and regulatory concessions in special economic zones (SPZs))	• effect on exports, possibly with higher imported content, and at risk of distortive effects • effect on export competitiveness where they result in an increase in costs of production once incentives are phased out
• Investment facilitation (e.g. reduced registration and licensing procedures, access to land)	• effect on exports, possibly with higher imported content, where facilitation helps attract export-oriented (i.e. efficiency-seeking) investment
• Entry and establishment restrictions	• effect on exports where restrictions discourage export-oriented investment • effect on export competitiveness where restrictions discourage investors that produce critical inputs (intermediates) used by other firms (domestic or foreign) in the country for exports
• Joint venture requirements	• effect on export competitiveness in the absence of a competent local joint venture partner • long-run effect on export competitiveness of domestic firms and on domestic value added
• Export performance requirements • Trade balancing requirements*	• immediate effect on exports, possibly with higher imported content, but with a risk of distortive effects • effect on exports where requirements discourage export-oriented investors (or increase costs of production)
• Local employment requirements and restrictions on hiring key foreign personnel • Training, transfer of technology and R&D requirements • WTO TRIMs: Local content requirements*	• long-run effects on export competitiveness of domestic firms, domestic value added and upgrading potential • effect on exports where requirements discourage export-oriented investors • effect on export competitiveness where requirements result in an increase in costs of production

Source: © UNCTAD, adapted from WIR13.

3.5. Similarly, secure national investment frameworks are increasingly important factors determining the extent to which countries can take part in MNE-driven global production and distribution networks and benefit from intra-corporate trade and technology transfers. This is especially true of FDI in services sectors—such as logistics, informatics, and financial services—that are increasingly indispensable to global trade and production networks. Conversely, FDI restrictions in industries where foreign capital or skills are needed for the development of productive capacity can hinder a country's access to global markets through GVCs and, hence, value added exports. This also hinges on the adequate protection of technology and other intellectual property rights.

3.6. Given the close link between trade and investment, choices taken in international trade arrangements may indirectly impact on domestic investment policies, and vice versa. Thus, when adopting trade (or investment) measures, policymakers cannot limit themselves to verifying that such measures are in accordance with international trade (or investment) law. To be on the safe side, they also need to check whether trade measures could potentially be inconsistent with international investment agreement disciplines, and investment-related measures found in WTO les or regional trade agreements. Otherwise, there is a risk that countries' trade policies will be challenged under investment agreements, and that some aspects of their investment policies will be scrutinized under WTO or RTAs (see below). Taking commitments through international trade and investment agreements can help to support economic reform at the country level—which can be important to increasing countries' integration into the global economy.

4 THE INTERACTION OF INTERNATIONAL TRADE AND INVESTMENT REGIMES

4.1. Since the 1980s, there has been a widespread trend toward liberalization of national policies and regulations relating to trade and foreign investment, especially in developing and transition economies. International agreements have played an important part in both advancing and reinforcing this trend, facilitating the reciprocal reduction of barriers, encouraging the greater compatibility and even harmonization of regulations, and providing greater transparency, predictability and security in global trade and investment relations—all of which has served to underpin the ongoing globalization of production and distribution. Despite the close relationship between trade and investment in the global economy, there is no single multilateral regime dealing comprehensively with both issues.[5] The original GATT dealt largely with trade in goods, although the WTO—through the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and Trade Related Investment Measures (TRIMs) Agreement, as well as through the plurilateral Government Procurement Agreement (GPA)—included important provisions regarding the treatment of foreign companies, assets, and investment measures. In addition, countries have negotiated over 2,920 bilateral investment treaties (BITs) —that deal exclusively with foreign investment issues—and roughly 270 RTAs (economic partnership agreements, bilateral free trade agreements, or regional trade agreements)—that deal with both trade and investment issues.

4.1.1 How trade agreements impact investment

4.2. The global trading system is comprised of the WTO and several hundred preferential trade agreements (including Generalized System of Preference schemes and bilateral and regional trade agreements).[6] As of March 2016, 270 regional agreements had been notified to the WTO of which roughly 80% are bilateral agreements and 20% are plurilateral agreements, involving several parties. No longer strictly "regional" in scope, some 53% of these notified agreements are now considered to be "cross-regional", while 43% are intra-regional. To the extent that these agreements encourage trade-oriented investment by opening up markets and securing trade relations (through tariff "bindings" and rules limiting trade discrimination and other distorting policies), then all have an investment dimension.[7] This "market access" aspect of attracting foreign investment inflows is important not only for countries that lack a large domestic market, but increasingly for all countries as more and more MNEs "think globally" and see even large markets as potential export bases for their global production and distribution networks. In addition to their broad impact on FDI flows, many trade agreements—including the WTO—also have specific disciplines which indirectly or directly pertain to investment measures.[8]

4.1.2 Investment-related measures in the WTO

4.3. Although the WTO does not include a specific legal framework regulating foreign investment, a number of its provisions apply to investment measures. The WTO's Agreement on Subsidies and Countervailing Measures (ASCM) does not address investment measures directly, but its disciplines

[5] The close relationship between trade and investment has long been recognized. One of the intentions when drafting the charter of the International Trade Organization (ITO) in the late 1940s was for rules on investment (and competition policy) to exist alongside those for trade in goods. However, when countries failed to ratify the ITO, it fell to the more limited GATT—which only included the trade provisions of the ITO charter—to administer multilateral trade relations until the creation of the WTO in 1995. The question of bringing investment rules into the multilateral trading system was revisited several times, including during the 1955 GATT review conference which produced a "Resolution on International Investment for Economic Development" which highlighted the importance of providing security for existing and future investment, the avoidance of double taxation, and facilities for the transfer of earnings of foreign investment. It urged GATT contracting parties, upon the request of any contracting party, to enter into consultation or participate in negotiations directed to the conclusion of bilateral and multilateral agreements related to these matters.

[6] According to WTO rules, members may enter into a preferential trade agreement with other WTO members either concerning trade in goods (GATT Article XXIV), or trade in services (GATS Article V), or both. It is also possible for developing countries to form preferential agreements under a separate legal instrument – the 'Enabling Clause'.

[7] Many countries enter into multilateral and regional trade agreements for investment, as well as trade, reasons. China's 2001 accession to the WTO, for example, was widely credited with increasing inward FDI because MNEs now had more secure access both to export markets and to imports of needed components, services, and resources. Similarly, the 2013 WTO Trade Facilitation Agreement—by streamlining and harmonizing customs procedures—should make countries more attractive to trade-oriented FDI and better equipped to participate in GVCs.

[8] It should also be noted that the WTO recognizes the importance of environmental and sustainable development objectives, as well as economic goals—and in doing so reaffirms Members' right to regulate in accordance with their exiting international rights and obligations. This "right to regulate" is also explicitly recognized in the preamble to the GATS.

on trade-distorting subsides can and do cover various types of investment incentives. Financial incentives (such as government grants and subsidized credits) and fiscal incentives (such as tax credits) would generally fall under the definition of a subsidy. So too would certain kinds of indirect investments incentives (such as the provision of land or infrastructure at less than market prices). To the extent that investment incentives are specific to certain enterprises or industries (within the meaning of Article 2), they are subject to the substantive disciplines of the agreement. Nevertheless, the agreements disciplines are focused on the adverse effects of subsidies for trade in good, not subsidies for trade in services—and not subsidies for investment per se, thus limiting its potential applicability to investment incentives.

4.4. Likewise, while the WTO's TRIMs Agreement does not discipline the treatment of investment directly, it aims to facilitate "investment across international frontiers" by clarifying that certain types of investment measures are inconsistent with GATT Articles III (national treatment) and XI (quantitative restrictions) and by requiring that all inconsistent TRIMs be removed within a certain period of time. The trade-oriented nature of the Agreement means that its obligations are much narrower in reach than the disciplines on performance requirements found in recent regional trade agreements. Another limiting feature of the TRIMS Agreement is that it applies to measures involving the discriminatory treatment of imported or exported goods, not to measures involving services trade—and more broadly, not to measures concerned with the treatment of foreign investors or foreign investment.

4.5. The WTO's GATS is different in that it applies directly to certain investment measures. Recognizing that exporting services to a foreign market often involves establishing a commercial presence—i.e., an investment—in that market, the GATS defines four "modes" of supplying services, one of which is the supply "by a services supplier of one Member through commercial presence in the territory of another Member". The concept of "commercial presence" is defined broadly, covering any type of business and professional establishment. In other words, under the GATS, foreign investment is identified as a form of trade and is subject to the disciplines of the Agreement. When Members make commitments on market access under mode 3, they commit to open a certain sector to foreign investment, and thus to allow at least some foreign participation in that sector. Commitments under mode 3 (like other modes) are set out in a "positive list" of specific commitments, to which a "negative list" of limits on market access and national treatment may apply. In addition, Most-Favoured-Nation Treatment (MFN) is a general obligation applying to all service sectors and all members.[9]

4.6. The GATS is not an investment agreement in the sense of most IIAs; its focus is on the ability to supply a service, and one of its essential features is that the establishment of a commercial presence in a host country is to be "for the purpose of supplying a service". Thus, while the concept of commercial presence provides for rights of market access (or pre-establishment treatment), it does not necessarily provide clear rules on the treatment or protection of foreign investors once in a market (or post-establishment treatment). In addition, GATS disciplines obviously only relate to investment in the services sector; there are no equivalent rules in the GATT covering investment in the goods sector .

4.7. Two more WTO Agreements also involve investment-related disciplines. The Agreement on TRIPS contains provisions on minimum standards for the protection of intellectual property, domestic enforcement procedures, and international dispute settlement which are relevant to the foreign investment. That there is a link between foreign investment and the protection of intellectual property is underscored by the fact that most IIAs include "intellectual property" in their definitions of investment. Whereas the GATS addresses "market access" issues for investors but not necessarily "protection", the TRIPS Agreement does the reverse—it addresses "protection" but not "market access". Moreover, its disciplines cover just one aspect of foreign investment, intellectual property. Then there is the WTO's GPA which contains disciplines for public procurement of goods and services. The GPA prohibits discriminatory measures against foreign products and foreign suppliers, including locally established suppliers on the basis of their degree of foreign affiliation or ownership. Since the GPA is one of just two plurilateral—or limited membership—agreements in the WTO, its rights and obligations apply only to signatories to the Agreement.

[9] Members have a one-off possibility of taking certain exemptions from MFN treatment obligations either at the time of the entry into force of the GATS or at the date of their accession to the WTO.

4.8. Thus while a number of WTO provisions directly or indirectly pertain to investment, current disciplines are somewhat piecemeal and disjointed—reflecting the evolution of the system in response to specific trade-related objectives or concerns—and fall short of modern investment agreements when it comes to comprehensively regulating foreign investment. Moreover, the objectives underlying trade and investment regimes, while complementary, can differ in certain respects. While the former is aimed largely at liberalizing trade, the latter were initially concerned mainly with protecting investors' rights.

a. The investment implications of recent WTO disputes

4.9. Just as WTO rules have a direct or indirect impact on investment, so too do WTO disputes. Most—if not all—WTO disputes aimed at upholding commitments and disciplines will have an investment dimension, and governments' interests in such disputes are often driven by investment, as well as trade, concerns. The WTO dispute settlement system—whose efficiency and legitimacy is widely acknowledged—allows for state-to-state dispute resolution with the goal of bringing trade policies into line with existing rules. As part of its institutionalized system for resolving disputes, the WTO also has a permanent Appellate Body which ensures consistent interpretations of WTO rules and thus reinforces the predictability of the multilateral trading system as a whole. Unlike the investor-state dispute settlement mechanisms (ISDS) embodied in most international investment agreements, the WTO does not offer an avenue for individual investors to seek financial compensation for alleged violations of their rights.

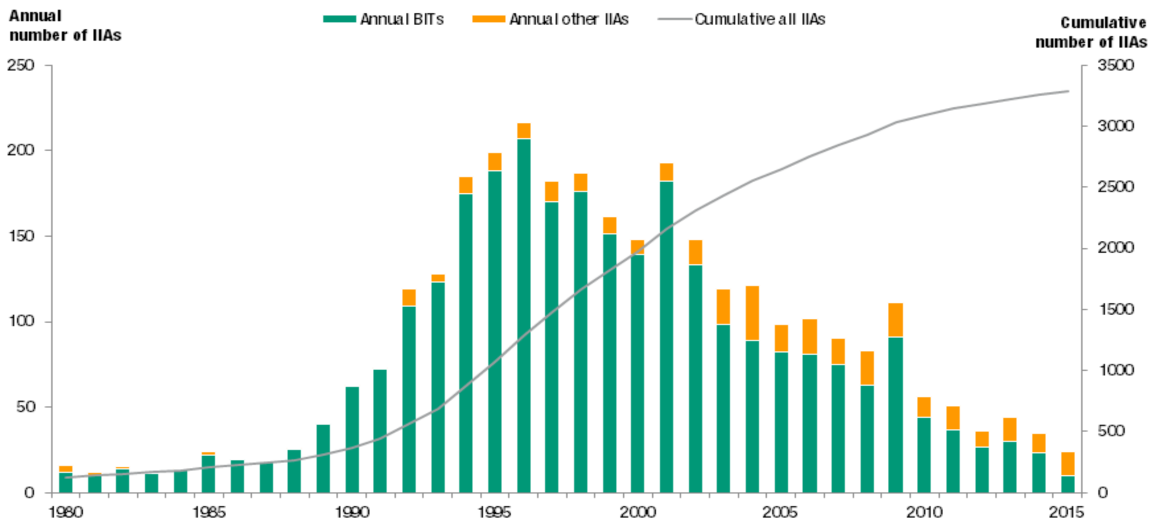
4.10. Although the vast majority of the 500 WTO dispute settlement cases since 1995 have dealt with trade issues, a number disputes have also involved investment measures directly. On several occasions, WTO panels and the Appellate Body have ruled against investment incentives (in the forms of subsidies or tax benefits) that were conditional upon some type of local content requirement. In the 1997 *Indonesia—National Car* case, for example, the United States, Japan, and the European Union (EU) challenged tax benefits provided through Indonesia's national car programme as inconsistent with the TRIMs Agreement and the ASCM. In the 2012 *Canada—Renewable Energy/Feed-In Tariff Program* case, the Appellate Body concluded that the Province of Ontario's Feed-in-Tariff programme included local content requirements inconsistent with the TRIMS Agreement and with Article III:4 of the GATT. In the 2016 *India—Solar Cells* case, a WTO panel found that the requirements contained in the initial phases of India's National Solar Mission investment programme were inconsistent with the TRIMs Agreement and with Article III:4 of the GATT because they imposed domestic content requirements on solar power developers selling electricity to the Indian government.

4.11. Investment incentives in national investment programmes' have also been challenged under the ACSM. This was the case in the 1997 *Canada/Brazil Aircraft* disputes as well as in the ongoing *Boeing/Airbus Aircraft* disputes. In the current *US-Tax Incentives* dispute (an offshoot of the Boeing case), the EU claims that certain conditions of the Aerospace Investment Program in the State of Washington constitute prohibited subsidies inconsistent with the ASCM. Finally, in the current dispute on *Brazil—Taxation,* Japan and the EU are challenging advantageous taxation treatment provided by Brazil to investors in the automotive, electronics, and technology sectors as prohibited subsidies under the ASCM, the TRIMS Agreement, and several articles of the GATT.

4.1.3 How investment agreements impact trade

4.12. By the end of 2015, countries had concluded more than 3,280 IIAs (over 2,920 bilateral investment treaties (BITs) and close to 360 "other IIAs" (i.e. economic partnership agreements, free trade agreements or RTIAs)) (figure 5). BITs and "other IIAs" with substantive investment provisions (excluding framework agreements with a general reference to investment) are largely similar in their structure and content, but vary in the drafting of provisions and therefore can involve different legal implications.

Figure 5: Trends in IIAs signed, 1980-2015



Source: © UNCTAD, IIA Navigator.

4.13. Traditionally, countries have concluded IIAs with a view to attracting FDI and/or ensuring protection for their outward investment. As a general rule, BITs (and some "other IIAs") clauses therefore focus on investors and their investments, and do not directly cover trade matters. However, to the extent that they can help attract export-oriented investment—and that the attracted investment generates imports or, more broadly, is engaged in GVCs—IIAs may potentially increase international trade.

4.14. Typical IIA standards of treatment include clauses on national treatment, MFN treatment, fair and equitable treatment (FET), protection against expropriation without compensation, and transfer of funds. Most IIAs prohibit discrimination in respect of all economic activities associated with an investment, including arguably its trade operations (in the absence of treaty wording indicating otherwise). In addition, most IIAs provide for investor-State dispute settlement (ISDS), i.e. States, through their advance consent, give investors the possibility to submit a claim to international arbitration. Hence, IIAs may result in trade issues being adjudicated by investment arbitration tribunals.

4.15. A small but growing number of IIAs include pre-establishment commitments, extending national treatment and MFN treatment to the "establishment, acquisition and expansion" of investments. By the end of 2014, countries had concluded 228 pre-establishment IIAs (125 “other IIAs” and 103 BITs), overall accounting for about 7 per cent of existing IIAs (see below).

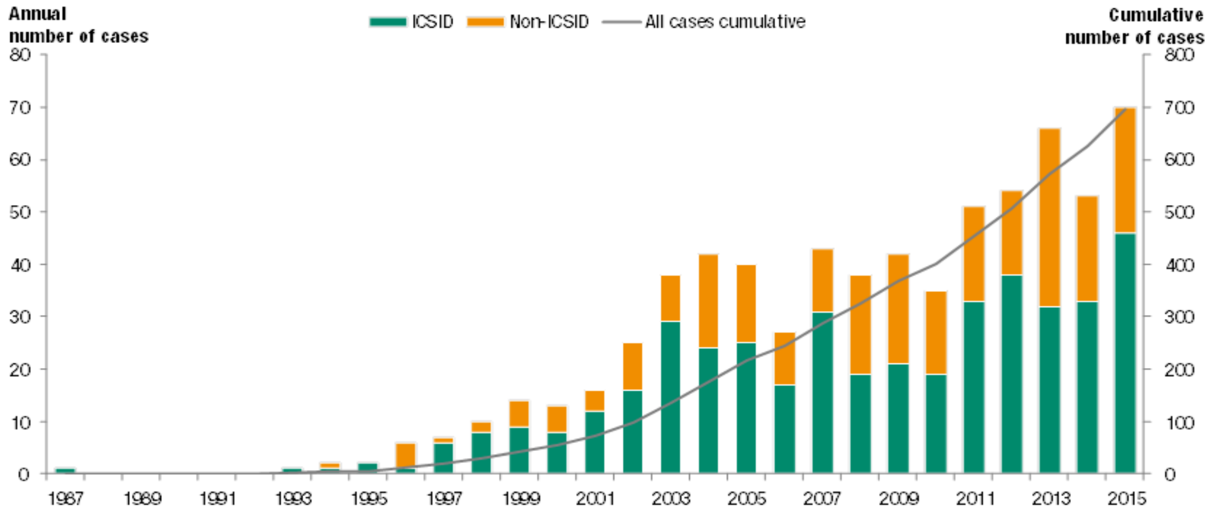
4.16. Some IIAs also set rules directly related to international trade, notably through the prohibition of performance requirements (PRs). Such IIAs preclude States from using certain trade-related investment measures, e.g. local content requirements for investments operating in the goods sector in accordance with the WTO TRIMS Agreements. Some IIAs prohibit PRs going beyond the TRIMs Agreement (TRIMs+), e.g. prohibiting requirements to transfer technology, to achieve a certain level of research and development operations, or to employ a certain percentage of local personnel.

4.17. In addition to trade-related clauses in BITs, many of the "other international investment agreements" (including in particular RTIAs) include a wealth of rules specifically focusing on trade (see below).

b. Trade implications of recent investment arbitration

4.18. As of January 2016, the total number of publicly known investor-State dispute settlement (ISDS) cases against host countries pursuant to IIAs reached nearly 700 (figure 6). The number of cases filed in 2015 reached a record high of 70.

Figure 6: Known ISDS cases, annual and cumulative, 1987-2015



Source: © UNCTAD, ISDS Navigator.

4.19. The increase in the number of ISDS cases in recent years, together with heightened public attention on ISDS issues, has resulted in some questioning whether the existing ISDS regime continues to be as effective as it could be, or whether it should be reformed, with some countries having proposed innovative ways to deal with this issue. However, others consider that the current ISDS system is generally sound and that improvements should concentrate on better treaty drafting, increasing governmental capacity to prevent disputes and defend cases, or expanding the pool of arbitrators. It is also important to note that important reform efforts to improve transparency of ISDS have been carried out at UNCITRAL and ICSID, but further action is required to achieve real results in practice across many treaties.

4.20. In ISDS cases, the most common form of remedy for breaches is monetary compensation (damages). Non-pecuniary remedies (e.g. restitution of property) are less common. Orders to revoke, annul or amend certain legislative, administrative or judicial act seem to be rare or non-existent. In that sense, remedies under ISDS are rather retrospective, while WTO remedies are prospective, e.g. requiring the withdrawal of a measure found incompatible (see above).

4.21. At first glance, ISDS cases do not have a direct impact on international trade. Considering past cases, the "international trade implications" of ISDS cases appear limited to individual companies or producers, and do not seem to be of "systemic" importance. ISDS cases may have indirect implications for international trade flows, under different scenarios.

a. The measures/actions challenged by the claimant have trade implications (e.g. limitations on the export or import of certain goods or commodities; cancellation of export or import licenses for individual producers; regulation of trademarks, patents or other intellectual property; increase of taxes/customs/duties; removal or refusal of exemptions from taxes/customs/duties).

b. The claimant's investment belongs to an economic sector with particular relevance for trade (e.g. transportation; mining; electricity supply).

4.22. Another scenario is the potential use of trade remedies to enforce ISDS arbitral awards. Finally, it could be speculated that an ISDS case or a number of ISDS cases could potentially lead to lower trade flows, but no empirical evidence (or anecdotal evidence) seems to exist to support this.

4.23. Beyond their implications for international trade flows, ISDS can have implications for the relationship between investment and trade rules, and the cross-fertilization between them. For example:

a. A claimant alleges breaches of obligations under a trade-related agreement (e.g. WTO TRIPS) alongside breaches of IIA provisions, or invokes a trade agreement (e.g. WTO GATS) as basis for a tribunal's jurisdiction in an ISDS case. An example of a dispute involving both alleged investment and trade violations is the recent Australia-Tobacco Plain Packaging case, aspects of which have been brought before investment arbitration as well as the WTO dispute settlement system;

b. The ISDS tribunal draws ideas and interpretative approaches from WTO case law. Given that both WTO and IIAs include parallel obligations, investment tribunals have considered WTO case law in some of their rulings. For example, in the NAFTA cases S.D. Myers Inc. v. Canada and Pope and Talbot v. Canada the investment tribunal examined WTO case law for the purpose of interpreting the national treatment obligation due to investors under the NAFTA;

c. Similar factual backgrounds are brought to trade and investment litigation at the same time ("parallel proceedings"). This has occurred, for example, in the softwood lumber and soft drinks disputes where similar or related aspects of the same case were brought before both the WTO dispute settlement system and investment arbitration.

4.24. This can lead to trade issues being considered by investment tribunals and vice versa, raising questions about the coherence of outcomes.

4.25. All of these scenarios can point to increasing cross-fertilization of trade and investment norms in ISDS proceedings.

4.1.4 Regional Trade and Investment Agreements

4.26. Regional trade and investment agreements have become an increasingly important feature of trade and investment relations. Regional agreements formed before the 1990s typically focused on trade in goods and took the form of free-trade areas or (to a lesser extent) customs unions, involving mainly tariff liberalisation. Since the creation of the WTO—which extended rules to trade in services and intellectual property rights—and the NAFTA—which also extended rules explicitly to investment—new regional agreements have also increasingly tended to cover these subjects as well, which revolve chiefly around the regulatory issues involved in "deeper integration". The number of regional agreements—or Regional Trade and Investment Agreements (RTIAs), as they are increasingly termed— containing a specific chapter on investment provisions has grown from less than 5% in 2000 to around half of all notified regional agreements today.

4.27. While these agreements can differ in terms of the way—and degree to which—they treat investment rules, the more advanced RTIAs share certain common features. They typically separate the chapter on cross border trade in services from the investment chapter (which now covers mode 3). Significantly, this investment chapter combines comprehensive "market access" (or pre-establishment) commitments with traditional "investment protection" (or post-establishment) obligations.[10] In the NAFTA-inspired agreements, non-discrimination (national and

[10] By comparison, the majority of BITs focus on the protection of established investors, extending national treatment only at the post-entry, not the pre-entry, stage (the notable exceptions are BITs negotiated by the United States, Canada and several other countries which provide for national treatment at the pre-entry stage as well).

MFN treatment), prohibition of performance requirements and restrictions on senior management and boards of directors are usually granted for all sectors except as indicated in two "negative lists" of non-conforming measures, one for current measures in place and another for future measures which can be imposed at the discretion of the parties in the future. Other agreements use a GATS-inspired "positive list" approach—or a hybrid approach using elements of both negative and positive lists—to set out general obligations and specific commitments. In all three models, the rules usually apply to a broad definition of covered investments (enterprises, shares, loans, licences, and intellectual property rights) and to all sectors (the primary sector, manufacturing and services). The use of ISDS mechanisms is also quite widespread in RTIAs. ISDS mechanisms either use established rules under international arbitration bodies such as UNCITRAL or ICSID or include mechanisms in the RTIA itself. As part of their recent RTIA negotiations, some countries have proposed establishing a permanent tribunal and appellate mechanism to resolve international investment disputes.[11]

4.28. A common feature of RTIAs is the more holistic, seamless way they address a set of issues associated with today's increasingly integrated and globalized system of production and distribution within the same agreement. Apart from including trade and investment provisions, modern RTIAs also address a range of related disciplines aimed at improving the overall business environment, including separate chapters on intellectual property rights, competition policy, regulatory transparency, rules against corruption and bribery, as well chapters on the environment, labour standards, and corporate responsibility. Some RTIAs also introduce disciplines on e-commerce, state-owned enterprises, small and medium-sized enterprises, regulatory co-operation, data protection, and consumer protection (Table 3).

Table 3: Disciplines Relevant to Investment in RTIAs

WTO-plus/-beyond areas	Selected Issues in RTIAs
Transparency	Commitment to ensure advance notice/publication and public comment process open to foreign parties (government and private sector) before introducing new regulations
Regulatory coherence	Commitment to maintain or establish a national, inter-ministerial co-ordination body to ensure coherence in regulatory measures; commitment to conduct regulatory impact assessments for regulatory measures exceeding a threshold of economic impact
Anti-corruption	Obligations to penalise corruption and bribery, apply sanctions to public and private entities, and provide for whistle-blower protection
Competition policy	Maintenance of measures to proscribe anti-competitive business conduct; harmonisation of competition laws; establishment or maintenance of an independent competition authority
State-owned enterprises	Establishment or maintenance of an independent competition authority; non-discrimination regarding production and marketing condition; provision of information; affirmation of Art XVII GATT provision
Innovation	Participation in framework programmes; promotion of technology transfers
Intellectual property rights (IPRs)	Harmonisation of standards; enforcement; national treatment, most-favoured nation treatment Accession to international treaties not referenced in the TRIPs (Agreement on Trade-Related Aspects of Intellectual Property Rights) Agreement
Data protection	Exchange of information and experts; joint projects
Research and technology	Joint research projects; exchange of researchers; development of public-private partnership
Education and training	Measures to improve the general level of education
Movement of capital	Liberalisation of capital movement; prohibition of new restrictions
Labour market regulations	Regulation of the national labour market; affirmation of International Labour Organization (ILO) commitments; enforcement
Social security matters	Co-ordination of social security systems; non-discrimination regarding working conditions
Movement of people	Facilitation of movement of people
SMEs	Technical assistance; facilitation of the access to finance

[11] In the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU, the parties have recently agreed to "pursue with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes".

Environment	Development of environmental standards; enforcement of national environmental laws; establishment of sanctions for violation of environmental laws; publication of laws and regulations; co-operation on climate change

Source: OECD

Note: This table is illustrative, and does not provide a comprehensive picture of all issues addressed in RTAs. The scope of the issues varies across RTAs. It is meant to illustrate the range of disciplines outside the investment and services chapters that affect the decisions of investors.

5 HARNESSING TRADE AND INVESTMENT FOR DEVELOPMENT

5.1. Harnessing the sustainable development benefits from trade and investment, and their growing interrelationship, for developing countries requires pro-active policies and a structured approach that includes (i) embedding trade and investment policies in overall development strategies and industrial development policies, (ii) addressing the growing interlinkages between trade and investment through coherent policy design to foster integration into GVCs, services trade, e-commerce and NEMs, (iii) enabling trade and investment growth by creating and maintaining a conducive investment and trade environment, and by providing supportive infrastructure, and (iv) building productive capacities in local firms. Mitigating the potential risks calls for (v) a strong environmental, social and governance framework, and identifying (vi) synergies between the two policy areas and in relevant institutions (Table 4).

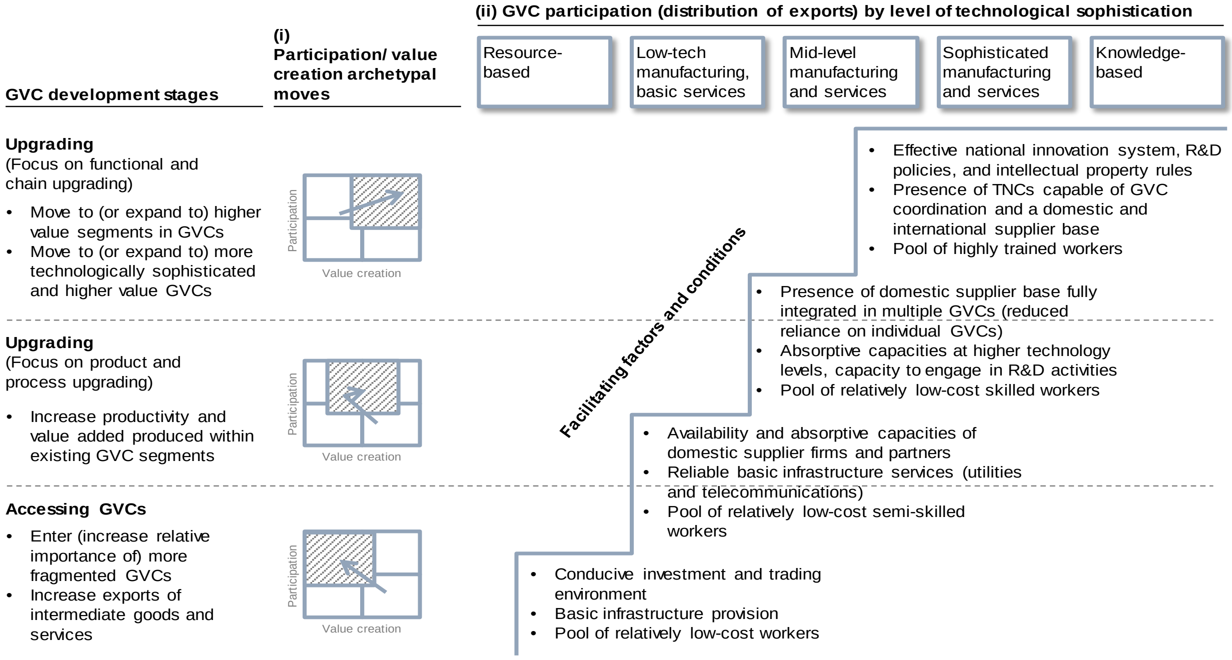
Table 4: Building a policy framework for trade, investment and development

Key elements	Principal policy actions
Embedding trade and investment in development strategy	• Incorporating trade and investment policy in industrial development policies • Setting policy objectives along GVC development paths
Enabling participation in GVCs, services trade, e-commerce and NEMs	• Creating and maintaining a conducive environment for trade and investment • Putting in place the infrastructural prerequisites for GVC participation
Building domestic productive capacity	• Supporting enterprise development and enhancing the bargaining power of local firms • Strengthening skills of the workforce
Providing a strong environmental, social and governance framework	• Minimizing risks associated with GVC participation through regulation, public and private standards • Supporting local enterprise in complying with international standards
Synergizing trade and investment policies and institutions	• Ensuring coherence between trade and investment policies • Synergizing trade and investment promotion and facilitation • Creating Regional Industrial Development Compacts

Source: © UNCTAD.

5.2. For policymakers, a starting point for the incorporation of trade and investment policies in development strategies is an understanding of where their countries and their industrial structures stand in relation to GVCs, services trade, e-commerce and NEM participation. That should underpin an evaluation of realistic development paths, exploiting both participation in GVCs and upgrading opportunities. (Figure 7 depicts the factors and conditions for GVC participation.)

Figure 7: Factors and conditions that facilitate climbing the GVC development ladder



Source: © UNCTAD.

5.3. Based on such strategic assessment, a national policy mix needs to be developed to better harness the sustainable development benefits from trade and investment with the specific country/economy situation in mind. International trade and investment policies are also important: they can support sustainable development strategies through the provision of enabling factors (e.g., standards) and create the international enabling environment that allows beneficial integration into the global economy. The latter does not come naturally, but requires careful calibration. International organizations have a key role to play in both dimensions.

6 CONCLUSION

6.1. Trade and investment are increasingly complementary, interdependent and intertwined in today's global economy— driven by the spread of global supply chains, the expansion of services trade, and the rise of digital commerce. As their production and distribution networks become more integrated and global, MNEs want international trade and investment rules that are more integrated and global too. Not only do fragmented or inconsistent rules increase transaction costs and add to uncertainty for investors and businesses, but when trade, services and investment flows are increasingly interdependent, policy obstacles in one area risks becoming obstacles across all other areas as well. This pressure for greater coherence in trade and investment rules is part of a broader trend that has seen the need for greater international cooperation and coherence across a range of different policy areas. This is not limited to economic policies and includes, for example, environmental, social, sustainable development, and corporate responsibility areas as well. Meanwhile, many developing countries, as well as developed, have a growing stake in revising and updating the current global trade and investment architecture as their shares of world trade increase, as they become major outward investors, as well as FDI recipients, and as they emerge as increasingly key partners in today's globalized economic networks.

6.2. But the emergence of globally integrated trade and investment flows has not been matched by a globally integrated system of trade and investment rules. Instead, today's international trade and investment regime is characterized by 'patchwork quilt' of bilateral, regional and multilateral agreements— some centred on trade, others on investment, still others that combine trade and investment rules but only as regional undertakings, thus excluding key economies. While all these agreements are broadly aimed at opening up and securing trade and investment flows, their fragmented nature can inadvertently result in policy inconsistencies, gaps, and conflicts, while posing new challenges for dispute settlement when conflicts are addressed across multiple agreements with differing rules. What is ultimately missing is a multilateral solution that would complement and underpin existing bilateral and regional approaches, while addressing outstanding policy gaps and systemic weaknesses.

6.3. This study's examination of the inter-relationship between trade and investment raises a number of policy questions for the G20 to consider, with a view to deciding which of these questions could be pursued by the Trade and Investment Working Group. These include, among others:

- How to strengthen synergies—and avoid incoherence—between trade and investment at the national and international level in the future? Where do the main policy barriers, inconsistencies, or gaps lie?

- What are "best practices" in terms of avoiding policy contradiction that can create unnecessary costs and confusion for traders, investors and governments?

- What is the likely impact of the new generation of RTIAs, what lessons do they offer for future trade and investment rule-making, and how to ensure that they complement and build upon the multilateral trading system?

- How to integrate policies related to NEMs into the overall trade and investment policy framework, and fill some policy gaps in NEMs?
- How to best assist countries—especially developing ones—to achieve greater coherence in their national and international approaches to trade and investment policy, and to benefit more from globalized production networks, services trade, and digital commerce?

- What are the main forces—economic, technological, demographic—that will likely influence trade and investment trends over the coming years?

- What role can businesses play in building more responsible and sustainable cross border production and distribution networks?

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