

Free Trade Agreements in the Americas: Worth the Investment?

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Nations that negotiate new trade agreements with the United States hope that such deals will attract foreign investment. This is certainly what Peruvians, Colombians and Panamanians are hoping for as an outcome of agreements currently in the pipeline for US Congressional approval.

The promise of investment is that it will translate into stable jobs, technology transfer and economic growth. However, new research suggests that signing a trade agreement with the United States may not bring the desired investment, and if it does, economic growth does not necessarily follow.

Critics argue that the investment chapters in these trade deals restrict the ability of signatory countries to require that foreign firms adhere to performance requirements, such as technology transfer and local content requirements.

Traditionally, nations have instituted performance measures to spur broad economic growth by creating links between foreign firms and the domestic economy. Indeed, China has become a master in using such tools over the past fifteen years. Although allowed under the World Trade Organisation, these development tools would be prohibited under bilateral and or regional free trade agreements (FTAs) with the United States.

These pacts also have a another little secret that is *not* allowed under the WTO: they leave open the possibility that ad hoc investment tribunals will interpret social and environmental regulations as ‘indirect expropriation’. Under such interpretations, multinational firms themselves (as opposed to states filing on their behalf as required by WTO rules) can sue for massive compensation from foreign governments. For example, the US firm Occidental Petroleum in 2004 took advantage of a US-Ecuador investment treaty to challenge Ecuador’s decision to cancel tax rebates and was awarded US\$71 million.

Proponents of these deals argue that agreeing to such measures is the price that developing countries must pay for receiving more investment. The problem is that even in the event that the investment does materi-

alise, US FTA partners may have traded away the tools that countries such as China have used to make foreign investment work for economic growth and poverty alleviation.

The World Bank’s 2005 *Global Economic Prospects* report warned that trade and investment agreements by themselves would not necessarily translate into new foreign investment. This conclusion was based on a study the Bank commissioned on the experience of twenty developing countries between 1980 and 2000 in order to determine whether bilateral FTAs that provide assurances to foreign investors do indeed attract investors.

More recent studies have similar findings for Latin America. Articles in the peer reviewed journals *Latin American Research Review* and the *Journal of World Investment and Trade* found no independent correlation between foreign trade or investment agreements and increases in foreign investment in the region.

Mexico’s experience with NAFTA, however, is an exception. At least until 2000, Mexico was able to attract unprecedented amounts of foreign investment, which increased more than fivefold and made Mexico the third largest recipient (after Brazil and China) of foreign investment in the developing world.

However, Mexico’s foreign investment has not translated into the promised benefits. Although foreign investment has surged, total investment has lagged at less than 20 percent of GDP (compared to China’s 40 percent) – one of the reasons why the Mexican economy has grown barely over one percent a year in per capita terms since NAFTA’s entry into force in 1995.

New research shows that although Mexico was initially successful in attracting multinational corporations, foreign investments waned in the absence of active government support, as well as China’s increasing competitiveness. Moreover, the foreign investment created an ‘enclave economy’, the benefits of which were confined to an international sector not connected to the wider Mexican economy. In fact, foreign investment put many local firms out of business and transferred only limited amounts of technology.

Conclusion

All this evidence does not in any way suggest that foreign investment or trade agreements are bad things. What it does suggest, however, is that the costs of prohibiting performance requirements and adopting draconian expropriation rules could very well outweigh the benefits of new treaties with such provisions. The experience of China suggests that investment rules should be left as they are under the WTO, which gives nations some flexibility to translate foreign investment into sustainable growth.

From a US perspective, the best trade deal with developing countries is one that helps our trading partners grow their economies. Growth leads to political and macroeconomic stability and (selfishly) to the ability to import more goods. The US Congress and its trading partners should think twice about agreeing to the investment rules in pending agreements.

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