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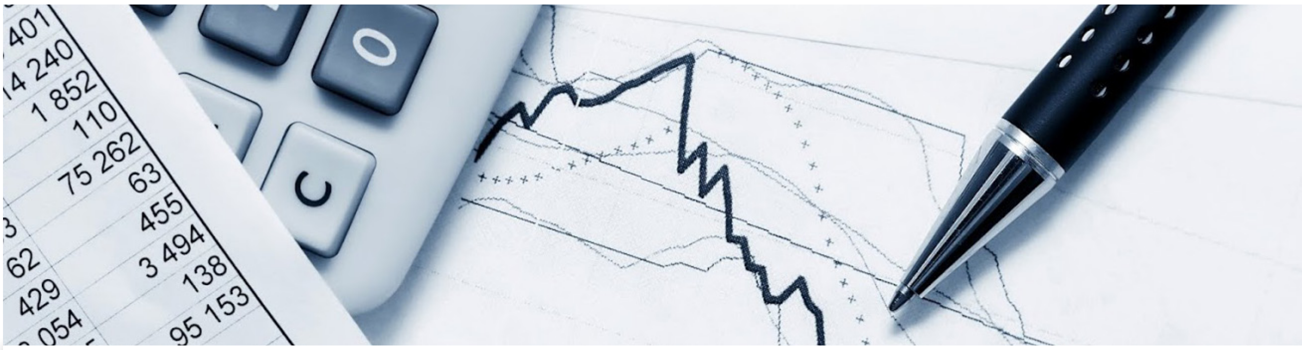

Investment and Trade Regimes Conjoined: Economic Facts and Regulatory Frameworks

Gary Hufbauer and Tyler Moran

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ABSTRACT

Recent research suggests that trade and investment are closely linked as two-way economic complements. Trade liberalization facilitates investment, but even complete trade openness will not overcome an investment environment that is otherwise unfavourable. Countries must do more to attract multinational corporations and global value chains. They need to limit the burdens placed on firms through taxation and regulation, while maintaining the revenue and policy space needed for good governance. The investment chapter in the North American Free Trade Agreement (NAFTA) announced a new era. Subsequent US FTAs elaborated upon the NAFTA template. For example, the Singapore FTA held state-owned enterprises to higher standards in terms of open procurement, transparent accounts, and independent regulation. Intellectual property rights chapters were more precise. Investor-state dispute settlement (ISDS) provisions were refined to ensure that normal environmental, health or safety regulations could not create a claim for investor compensation. However, the World Trade Organization (WTO) lingers far behind FTAs, bilateral investment treaties and double taxation treaties in addressing the nexus between investment and trade. Another weakness is that the WTO only allows member states to bring disputes, even though the overwhelming majority of cases entail state practices that arguably harm private firms. In other words, state-to-state dispute resolution is the WTO norm, unlike ISDS resolution under bilateral treaties and FTAs. As progress at the multilateral level slowed, more limited arrangements have played a larger role in setting the rules for international trade. Even if future WTO rounds become much more productive, it is likely that the next steps on some of these issues will take place outside the WTO. But rules established elsewhere can serve as baselines for future multilateral agreements.

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LIST OF ABBREVIATIONS

ASCM	Agreement on Subsidies and Countervailing Measures
BEPS	Base Erosion and Profit Shifting
BITs	bilateral investment treaties
DTTs	double taxation treaties
EU	European Union
FDI	foreign direct investment
FTAs	free trade agreements
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GPA	Agreement on Government Procurement
GVCs	global value chains
ICSID	International Center for the Settlement of Investment Disputes
IFA	Investment Facilitation Agreement
IPR	intellectual property rights
ISDS	investor-state dispute settlement
ITO	International Trade Organization
LCRs	local content requirements
MFN	most favoured nation
MNC	multinational corporation
NAFTA	North American Free Trade Agreement
NAICS	North American Industry Classification System
OECD	Organisation for Economic Co-operation and Development
R&D	research and development
RCEP	Regional Comprehensive Economic Partnership
ROOs	rules of origin
RTAs	regional trade agreements
SMEs	small and medium enterprises
SOEs	state-owned enterprises
TFA	Trade Facilitation Agreement
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
TRIMS	Agreement on Trade-Related Investment Measures
UNCITRAL	United Nations Commission on International Trade Law
US	United States
WTO	World Trade Organization

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THE OLD VIEW: INVESTMENT AND TRADE DISCONNECTED OR SUBSTITUTES

Following World War II, trade and investment were seen as disconnected modes of international commerce, or as substitutes for each other, or in the case of natural resources, as exploitation of poor countries to serve the raw material needs of rich nations. Drawing on these views, the Havana Conference, which concluded in April 1948, drafted a charter for the International Trade Organization (ITO), wrapping up work that had been started in London and New York. Chapter IV of the Havana Charter, titled Commercial Policy, essentially comprised the General Agreement on Tariffs and Trade (GATT). However, the GATT had already entered into force by a Protocol of Provisional Application effective in January 1948. Chapter V of the Havana Charter, titled Restrictive Business Practices, was designed to discipline the multinational corporations (MNCs) of that era.

The United States (US) Congress objected to Chapter V as well as other parts of the Havana Charter, excepting Chapter IV, and the ITO quietly died, survived only by the GATT. Thus, from the beginning of the post-war era, trade and investment were subject to distinct policy regimes—the GATT for trade, an assortment of bilateral treaties (precursors to today's bilateral investment treaties, or BITs) for investor protection, and bilateral double taxation treaties (DTTs) to delineate the primary and secondary taxing rights of signatory states.

Academic commentators in the 1960s and 1970s generally assumed that trade and investment did indeed occupy separate realms, illustrated by Jackson (1967) and Dam (1977) on trade, and Dunning (1977) on investment. In a pioneering article, however, Vernon (1966) married trade and investment for high-technology products. The US Treasury Department commissioned Hufbauer and Adler (1968) to analyze the extent of substitution between trade and investment in the midst of the dollar stress that characterized the mid-1960s. Later Horst (1971) elegantly analyzed the tariff and tax regimes that would prompt a MNC to produce abroad or export. Most of these analyses assumed that firms engaging in outward direct investment would do so at the expense of exports. In US policy battles, this view reached its apex in the debate over the Burke-Hartke bill (1971), which would have imposed severe tax penalties on US firms investing abroad.[1]

Political economy theorists might suppose that it would be only natural for countries to welcome inward investment, and oppose outward investment, on the argument that inward investment creates jobs, whereas outward investment destroys jobs by replacing exports with production abroad. Indeed, that was the inspiration for the Burke-Hartke bill. However, this sentiment is remarkable for its absence since the World War II. Moreover, as we discuss, research suggests that outward investment and exports are far more often complements than substitutes.

THE NEW VIEW: INVESTMENT AND TRADE AS COMPLEMENTS

Recent research suggests that trade and investment are closely linked as two-way economic complements, especially in manufacturing and services foreign direct investment (FDI). In these sectors, trade and investment are two sides of the same coin. Only for natural resources does the old view of foreign investment as a precursor to one-way exports seem broadly applicable.

Typically, in manufacturing and services, the foreign affiliate relies heavily on the headquarters operations of the parent company, especially for research and development (R&D), finance, and distribution. Over time, the MNC will locate different parts of the production process in different countries through direct investment in affiliates abroad, but there is no set formula for determining which pieces of the production process will be located in a given country. Instead, the firm's locational decisions will depend on the product, the country characteristics, and the transport and communication costs of integration. Ideally the result is an efficient value chain, taking advantage of the strengths of each country.

The strongest and most obvious link is with R&D operations. MNCs based in highly advanced countries often outsource production, but product design and research will generally occur at home, even if the purpose is to serve foreign markets. The link between R&D and outward investment is well supported. Chen and Yang (2013) find a strong positive link between firm-level outward FDI and R&D expenditures, most notably in industries with a major R&D focus. Hufbauer et al. (2013) and Damijan and Decramer (2014) find similar results for US and Slovenian firms respectively.

1 For a brief description of the tax provisions in Burke-Hartke, see Hufbauer (1992).

It is true, however, that outward investment can substitute for exports of comparable products. As suspected by economists of previous decades, it is hard to see why firms would ship a product across international borders when they could just as easily make it close to the ultimate buyer. However, an affiliate's reliance on the parent firm often extends to intermediate inputs and other essential ingredients. Foreign affiliates generally do not look to re-invent the wheel when making serious investments in physical capital and human talent abroad. Instead, drawing on patents, trade secrets, skilled personnel, and inputs from the parent firm, affiliates generally seek the lowest cost solution to whatever items they choose to produce abroad.

To confirm the basics of the trade-investment relationship, we examined US international trade and investment patterns with a simple econometric exercise. The sum of US merchandise imports and exports between 1999 and 2013 were disaggregated by partner country and matched with corresponding annual North American Industry Classification System (NAICS) data on outward FDI flows, as well as the gross domestic product (GDP) of the partner country, and the distance between the US and the partner country. The regression included dummy variables specific to each sector and partner to control for category-specific factors that might influence both trade and investment. All variables were taken in logs, so the coefficients can be understood as referring to a percent change in total trade following a 1 percent increase in the independent variable. The results are presented in Table 1.

The first row indicates that outward FDI flows are significantly and positively linked with US trade, controlling for other factors. Specifically, a 1 percent increase in outward FDI in a given sector is associated with a 0.14 percent increase in trade with the partner country in that sector. Overall, the model has an R-squared value of 0.98, suggesting that our independent variables and dummies explain nearly all of the variation in US trade patterns.

The positive connection between national outward FDI flows and two-way merchandise trade, reflected in Table 1, goes part way to refute the old and still common argument that outward FDI substitutes for trade links between the US and its partner countries. A much stronger refutation is advanced by Hufbauer et al. (2013), who showed, through firm-level analysis, that US exports are strongly and positively linked to outward FDI. The authors also showed that, at a firm level, US investment, US employment, and US R&D are also positively linked to US outward FDI.

RISE OF GLOBAL VALUE CHAINS

Richard Baldwin (2011) crystallized the distinction between "20th century trade" and "21st century trade." The first, 20th century trade, as taught in textbooks and largely practiced through the 1970s, followed the slogan "make it here and sell it there." The second, 21st century trade, largely under the auspices of MNCs (which conduct around 80 percent of global commerce), follows the slogan "make it here and there and sell it everywhere."

The rise of global value chains (GVCs) reflects the huge growth in global trade and the even more dramatic growth in FDI stocks. Between 1970 and 2013, the ratio of exports (goods and services) to global GDP rose from 14 percent to 29 percent. In the same period, the ratio of FDI stocks to global GDP rose from 6 percent to 34 percent.

Equally important, over this period, the composition of FDI stocks shifted first from natural resources to manufacturing and then largely in favour of services, as shown in Table 2. The evolving pattern of FDI corresponds to the needs of GVCs.

The GVC phenomenon has several implications:

- The old idea of import substitution as a path to prosperity, which fell out of fashion 30 years ago, is now even more out of fashion. No country can expect to spark development by erecting a high tariff wall because by doing so it will deprive its own firms of needed inputs at

TABLE 1:

US Outward Investment and Trade

Note: A t score of roughly 1.97 implies significance at the 5% confidence level. The regression also included country- and sector-specific dummies, not shown.

	Coef.	t
Log (FDI outflow)	0.14	9.55
Log (GDP)	0.84	17.56
Log (distance)	-1.12	-14.74
Constant	5.63	5.93

TABLE 2:

Global Outward FDI Stock, by Industry

Note: 1966 figures refer to US outward FDI.
Source: Lipsey (1992); 1990 and 2012 figures are world outward FDI from UNCTAD (2014).

	1966	1990	2012
Agriculture, fishing	1%	0%	0%
Mining and Oil	29%	9%	8%
Manufacturing	42%	44%	19%
Services	29%	47%	69%

reasonable prices; and no country can prosper by closing its door to MNCs because that will deprive it of frontier technology.

- In designing their commercial affairs, countries need to think about policy bundles: tariffs, non-tariff barriers, corporate taxation, infrastructure (ports and airports), labour training, product standards, and investment incentives. The name of the game is to woo and retain important segments of the GVC.

- Bargaining between countries and between countries and MNCs still has a role, but a far more subtle role than slogans such as "exports are good, imports are doubtful," "indigenous innovation," "Buy America," or "local ownership."

"Traditional" agreements that reduce tariffs and slash other "at the border" barriers to trade can be hugely effective in boosting consumer choice and purchasing power, but unlocking the big gains to output arises from quantum leaps in investment and embodied technology. Trade liberalization facilitates investment, but even complete trade openness will not overcome an investment environment that is otherwise unfavorable. BITs and free trade agreements (FTAs) can go some distance towards assuring foreign firms that rules on investment and trade flows will not be suddenly reversed with a change in government. Non-discrimination, fair and equitable treatment, and maximum tariffs can be established by international agreements. But to attract MNCs and GVCs, countries must do more. They need to limit the burdens placed on firms through taxation and regulation, while maintaining the revenue and policy space needed for good governance. In many countries, such self-imposed limits run against the populist grain.

These considerations imply that diminishing returns to trade liberalization set in when investment policy is held constant. Existing trade schemes, from the bilateral to the global level, have recognized the link between trade and investment for decades, seeking to improve policies in both areas at once. Disciplines on performance requirements in regional trade agreements (RTAs), World Trade Organization (WTO) agreements on investment policy, and investor protection rules have generally accompanied major trade liberalization initiatives in recent decades. Even so, important issues are not adequately addressed by existing practice.

REGULATORY QUESTIONS RAISED BY THE INVESTMENT/TRADE NEXUS

The investment/trade nexus raises international regulatory issues, either because national policies may conflict with one another or because cooperation may further the interests of both countries, perhaps at the expense of MNCs. The leading issues are as follows.

- To what extent and how should de jure or de facto investment incentives be disciplined? Bear in mind that firms rarely have an interest in complaining, even when their rivals are subsidized, and note that the distinction in the WTO Subsidies Agreement between export subsidies and domestic subsidies for traded goods does not readily carry over to investment incentives.[2] Under current rules, countries are free to subsidize firms that choose to locate within their territory, provided that the subsidies do not require a certain level of export sales, or a certain amount of local procurement, or take the form of relaxed labor or environmental standards.

- To what extent do local content requirements (LCRs) distort the location of factories or business establishments (for example, localization requirements for servers), and should LCRs be disciplined by trade and investment agreements? As explained in Hufbauer et al. (2013), gaps in WTO rules set forth in the Agreement on Government Procurement (GPA), the Agreement on Trade-Related Investment Measures (TRIMS), and the Agreement on Subsidies and Countervailing Measures (ASCM) allow ample room for countries to impose LCRs.

- To what extent do rules of origin in RTAs hinder GVCs, and how can these effects be mitigated?

- Should all countries be required to impose a minimum rate of corporate taxation and define the corporate tax base in a like manner, so as to deter MNCs shifting profits? If so, what penalties and incentives should be devised to reach this goal? The Organisation for Economic Co-operation and Development (OECD) has launched a project on Base Erosion and Profit Shifting (BEPS), but it remains to be seen whether countries are

2 It is claimed, for example, that US states provide approximately US$70 billion annually to business firms through various incentives and subsidies (Dolan 2015). None of this is challenged in the WTO.

willing to adopt common rules and forgo the use of tax incentives to attract investment.

- Should all countries be required to enforce minimum standards for patents, copyrights, trademarks, and trade secrets? Again, by what means? The WTO has the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and some FTAs have TRIPS-plus provisions, but enforcement commitments are often weak.

- Should state-owned enterprises (SOEs) that engage in foreign commerce, or purchase substantial amounts of inputs, be held to enumerated standards for accounting, procurement, and general transparency? Bear in mind that enumerated standards might be more demanding than the commercial practices of private MNCs.

- Finally, should dispute settlement systems for investment and trade be harmonized either to the state-to-state model customarily applied in the trade realm, or the investor-state dispute settlement (ISDS) model now the norm in the investment realm?

REGULATORY ANSWERS TO THE INVESTMENT/ TRADE NEXUS

PROTECTION AGAINST UNCOMPENSATED EXPROPRIATION

Long before anyone thought about the connection between investment and trade, both home and host states paid attention to direct investment. Populist sentiment ran strong in the mid-20th century, particularly in Mexico, Chile, and other Latin American nations, fomenting a wave of uncompensated expropriation that engulfed plantation, oil, and mineral properties. The modern era of BITs, commencing with the German-Pakistan pact of 1959, was the home country response to post-World War II expropriations. The standards established by BITs called for "prompt, adequate and effective" compensation, "fair and equitable treatment," and impartial arbitration. The International Center for the Settlement of Investment Disputes (ICSID) was established in 1966 and housed in the World Bank to provide arbitration services.

The global count of BITs now exceeds 2,200. For those signed between 1959 and 1990 (some 400), investor protection of land, buildings, and equipment was the name of the game. After 1990, the game evolved in several ways.

EARLY EVOLUTION OF INVESTMENT RULES

The investment chapter in the North American Free Trade Agreement (NAFTA) announced a new era. The fact that investment issues were addressed in a massive trade agreement, rather than a separate BIT, signalled mutual recognition by the US and Mexico that investment and trade were interdependent. For its part, Mexico was anxious to attract FDI as a means of creating jobs and promoting exports. The US insisted that American firms would enjoy both national treatment and most-favoured nation (MFN) treatment, and that Mexico would not use investment incentives as a carrot for performance requirements (LCRs or export targets). To enforce the investment provisions, ISDS was established on the same lines as in the BITs of prior decades. Minimum standards for intellectual property rights (IPR) were the subject of a separate chapter, and Pemex, Mexico's giant SOE, was compelled to open some of its procurement after 2014.

CONTENTIOUS ROLE OF ISDS

Among NAFTA opponents and other sceptics, ISDS is a sore point. Their objections are based on hypothetical scenarios that have not been evidenced by past arbitration decisions. Opponents have three legitimate criticisms, but none is valid as a reason for jettisoning ISDS.[3] One criticism objects to the fact that briefs are not customarily disclosed and proceedings are private, even though arbitration awards are usually published. The Mauritius Convention partly addresses this complaint by extending the United Nations Commission on International Trade Law (UNCITRAL) transparency rules to all ISDS proceedings under agreements between states that have accepted the convention. However, the convention is still new and has not yet been ratified by any party, but it has been signed by 11 states.[4]

A second criticism objects to the absence of appellate review of arbitration awards. This complaint might be addressed in the future if a court system is devised to replace or oversee the existing arbitration system that decides ISDS cases.

3 In most BITs, ISDS only enforces investment protection (for example, compensation for expropriation, fair and equitable treatment), not the liberalization of investment flows, which remains a matter of state-to-state resolution (see, for example, the Comprehensive Economic and Trade Agreement between Europe and Canada, which draws a clear line between the two).

4 The convention is available at https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXII-3&chapter=22&lang=en.

A third criticism relates to the use of "private judges", namely arbitrators, appointed unilaterally by each party in ISDS cases, rather than a "neutral" court. Answering this criticism, Germany and France have proposed the creation of an international court to hear ISDS cases, somewhat akin to the WTO Appellate Body.[5] It remains to be seen whether this proposal gains wide acceptance.

An additional criticism, which has served as a rallying point for ISDS opponents but is far from persuasive, contends that ISDS allows MNCs to undermine public health, safety, and environmental regulations. This objection has already been answered in US BITs and FTAs by language that excludes proper and non-discriminatory regulations from challenge in ISDS cases. Other countries are free to follow the US example.

That said, it is worth rehearsing the reasons for ISDS as an alternative to resolution solely through national courts. First, corruption and bias have been known to plague national courts, particularly when judges are poorly trained and poorly paid. Second, national jurisprudence on investor rights may have very different precedents than those established by international law, as established by custom and BITs. National courts may find it difficult to ignore national precedents and only apply international law. Third, the procedures of national courts may disadvantage foreign plaintiffs, and the speed of resolution may be slow.

RECENT EVOLUTION OF INVESTMENT RULES

Subsequent US FTAs elaborated on the NAFTA template. For example, the Singapore FTA held SOEs to higher standards in terms of open procurement, transparent accounts, and independent regulation. IPR chapters were more precise as to minimum levels of protection for patents, copyrights, trademarks, and trade secrets. ISDS provisions were refined to ensure that normal environmental, health, or safety regulations could not create a claim for investor compensation.

It remains to be disclosed how the text of the Trans-Pacific Partnership (TPP) deals with these issues. Pending its release, our guess is that the TPP text will mirror the highest investment, IPR, and SOE provisions found in recent US FTAs, for example the Singapore, Peru and Korea FTAs. At this juncture, it seems unlikely that the Transatlantic Trade and Investment Partnership (TTIP) or the Regional Comprehensive Economic Partnership (RCEP) will advance on the TPP on these issues. In fact, ISDS provisions could be weakened in the TTIP, given Germany's surprising insistence on a "Calvo clause,"[6] and the allergy of Indonesia, India, and some other RCEP parties to independent arbitration.

Meanwhile, the US enlarged the investment provisions in its 2004 and 2012 Model BITs, though the 2004 model has been accepted only by Uruguay and Rwanda and the 2012 model has not so far been accepted by any negotiating partner (though it serves as the basis for US talks with China).[7] Among other features, the US Model BIT insists on ISDS for IPR and loans connected to FDI, pre-establishment rights for US firms to enjoy national treatment when they explore investment opportunities, and a well-defined short negative list of activities that are off-limits to foreign investment.

ALOOF POSITION OF TAX RULES

The network of bilateral DTTs, now numbering more than 2,500, has remained aloof from bilateral FTAs, mega-regional trade pacts, and from the network of BITs. But DTTs, which assign primary and secondary taxing rights to signatory states with respect to natural persons and business entities, cannot be separated from trade flows. The calculation of business profits arising in a country depends on transfer prices for GVC transactions between related firms of an MNC, and on the location of IPR. Not surprisingly, MNCs do their best to situate profits in countries that impose low business taxes, especially low corporate profit taxes. The same is true of highly paid individuals, such as sports stars and movie actors who sell their intangible services to a world market. To combat these tendencies, the OECD has launched a project titled BEPS, but despite political denunciation of leading MNCs (such as Apple, Starbucks, and Pfizer), the practical results remain to be seen. However, to defuse public criticism, some multinationals, such as Amazon and Starbucks, have "voluntarily" decided to pay more taxes.

WTO BRINGING UP THE REAR

The WTO lingers far behind FTAs, BITs, and DTTs in addressing the nexus between investment and trade. WTO rules were written in 1995 at Marrakesh, some 20 years ago. Much has happened in the business world since then—computers and the internet have revolutionized communications and the workplace; services trade has flourished abetted by FDI; GVCs have come to epitomize 21st century commerce; and SOEs have established a presence internationally, beyond their domestic markets. The ASCM, TRIMs, TRIPs, and Article XVII on state trading all remain frozen as written two decades ago (or earlier).

5 Press report, http://www.euractiv.com/sections/eu-priorities-2020/matthias-fekl-eu-should-have-its-own-arbitration-court-315073.

6 Espoused by Carlos Calvo, an Argentine jurist, in 1868, a "Calvo clause" in an agreement between a foreign investor and a state essentially asserts that "aliens are not entitled to rights and privileges not accorded to nationals, and that, therefore, they may seek redress for grievances only before local authorities."

7 "Toward a US-China Investment Treaty," Feb 2015, http://www.iie.com/publications/briefings/piieb15-1.pdf.

Another weakness is that the WTO (like the GATT before it) only allows member states to bring disputes, even though the overwhelming majority of cases entail state practices that arguably harm private firms. In other words, state-to-state dispute resolution is the WTO norm, unlike ISDS resolution under BITs and FTAs. Some WTO Members have incorporated WTO agreements into their national laws in a manner that allows foreign private firms to bring cases in national courts, for example Latin American and African countries, but not large countries such as the European Union (EU), the US, Canada, or China. These highly distinct resolution paths have important consequences.

- WTO agreements are a dead letter for many private firms, especially small and medium enterprises (SMEs). Such firms lack the clout to persuade their governments to mount WTO cases, given the limited legal resources available to trade ministers and conflicting diplomatic priorities.

- The WTO dispute system has the advantage of published decisions (though not briefs) and an appellate body to review panel decisions. It has the disadvantage that the customary remedy is a “cease and desist” order to the offending government. No penalty is paid for past injury to private firms, and countermeasures—not compensation—are the only penalty for future failure to correct an offending practice.

- Faced with these differences, when an alternative is possible, private firms often prefer to bring an ISDS case under a BIT or an FTA rather than a trade case under the WTO. The same is true in an FTA framework—if a case can be packaged as an investment dispute, private firms usually prefer that route to resolution under another FTA chapter.[8]

CONCLUSIONS AND RECOMMENDATIONS

The WTO lags far behind the norms set by BITs, FTAs, and mega-regionals in terms of rules to accommodate and discipline the close relationship between trade and investment. The GVC world does not get much help from the current array of WTO rules—centred as they are on merchandise trade, with just a nod to services. Nor do WTO disciplines do much to curb the mischief that can arise when individual countries collude with MNCs or SOEs to attract desirable segments of the global value chain, using subsidies and other inducements.

With these observations in mind, we offer the following recommendations for the agenda of the December 2015 WTO Ministerial meeting:

- Rapidly implement the Trade Facilitation Agreement (TFA), the best thing the WTO has done for GVCs in recent memory. Only six WTO members have ratified the agreement thus far, well short of the 107 needed for implementation.[9] It seems unlikely that ratification will be achieved by the time the Tenth WTO Ministerial Conference is held in Nairobi in December 2015.

- Consider launching negotiations for a plurilateral Investment Facilitation Agreement (IFA) that would supplement (not supersede) provisions in BITs and bilateral FTAs. Among other subjects, the IFA would address minimum standards for IPR, pre-establishment, national treatment, and compensation for expropriations.

- Consider updating GATT Article XVII to set minimum standards for SOEs covering, among other subjects, transparency, subsidies, and procurement.

- Consider updating the ASCM to make it easier to challenge investment incentives, even when they have no de jure focus on exports. In addition, fashion meaningful penalties for failure to report federal and sub-federal subsidies and incentives in a timely manner.

- Consider reforming the WTO dispute settlement mechanism in two radical ways—(1) move the ICSID into the WTO with transparency provisions and create an appellate mechanism for reviewing arbitration panel decisions; and (2) allow firms to bring trade disputes against WTO members under the dispute settlement mechanism., However, this avenue would not be available against Members that allow disputes with their own government practices to be decided by national courts applying WTO rules.

As progress at the multilateral level slowed, more limited arrangements have played a larger role in setting the rules for international trade. Even if future WTO rounds become much more productive, it’s likely that the next steps on some of these issues will take place outside the WTO. But rules established elsewhere can serve as baselines for future multilateral agreements.

8 Companies that are interested in cash payment for past harm usually find that ISDS is the best vehicle. But companies or countries that seek legislative changes, not just in one country but as a precedent for the world, may find that WTO dispute settlement is a better alternative.

9 Japan ratified it on 1 June 2015, joining Hong Kong, Singapore, the US, Mauritius, and Malaysia.

INVESTMENT INCENTIVES

Whether or not investment incentives play a major role in a firm's investment decisions is not completely settled, but recent analysis seems to suggest that the impact is limited at best. However, many policymakers around the world continue to compete with one another by offering ever greater giveaways to potential investors. Broadly speaking, the effectiveness of these incentives is beside the point, as they are still undesirable from a global perspective. If they are generally effective, then they represent "beggar thy neighbor" policies that reduce global welfare by distorting the location of investment. If they are generally ineffective, then incentives effectively transfer wealth from the host country to a foreign MNC—hardly a desirable policy objective.

Regardless, countries that engage in investment incentives seem to believe they work and are not eager to part with them. Ultimately, this played a major role in the demise of the OECD's Multilateral Investment Agreement. Such opposition might be overcome—countries identified as tax havens (such as Luxembourg and Switzerland) were not enthusiastic about the BEPS project, which is nevertheless underway. But it is far from clear that major industrialized countries will coalesce around disciplines on investment incentives in the same way that they have for tightening tax rules. Regional agreements that cover countries that compete with one another for investment might make appropriate groups for limiting incentives if no appetite for a global push can be found.

Bilateral agreements are probably not suitable for addressing these incentives, since it's not clear how incentives could be disciplined on a "preferential" basis. Parties might agree not to offer incentives to firms domiciled in a partner country, but the greater issue is competition for FDI from large "source" countries, such as the US, the EU, Japan, and China.

RULES OF ORIGIN

Regional agreements require rules of origin (ROOs) to ward off trade deflection. Moreover, "regional content requirements" are less disruptive than national content requirements. Nevertheless, ROOs should be as liberal as politically possible.

At the very least, regional agreements should apply cumulative ROOs wherever possible. In other words, value added from intermediates originating from another FTA partner should count towards a product's content from a partner country. This approach, common in EU agreements, benefits value chains across the entirety of a country's FTA network, rather than splitting the network into individual free trade blocks.

More ambitious ROOs would disregard foreign intermediate inputs that would have faced zero tariffs if imported directly. For example, if a Mexican product was produced using intermediate inputs from Brazil, only the value of Brazilian products that faced non-zero US tariffs would factor into the qualifying value content calculation. ROOs following this scheme would still serve their nominal purpose since trade deflection is not a concern for imports that are tariff free.

REFORMS TO DISPUTE SETTLEMENT

The increasing interdependence of trade and investment should encourage policymakers to consider both regimes simultaneously. Regional agreements have long linked commitments that facilitate trade with provisions that facilitate investment. The WTO's present capacity for this sort of integration is limited, but integrating the ICSID into the WTO would make a positive contribution. The ICSID's greatest weaknesses, as mentioned, relate to limited transparency and lack of appellate review. Transparency has been improved in the "new" 2006 ICSID rules as well as through the Mauritius Convention, which countries can join, while appellate review could happen along the lines of the European proposal for the TTIP and might be introduced into the ICSID system (Joubin-Bret 2015). Existing dispute settlement provisions in the WTO, however, are better for features and cover a much larger number of countries. But changing both the ICSID and the WTO would be quite difficult.

As another suggestion, solely requiring changes in WTO procedures, a window could be opened for private parties to bring disputes to the WTO's dispute settlement system. A pilot mechanism might be tried out in a WTO plurilateral agreement, for example the GPA or TRIMS. The new mechanism could require that disputes first play out in national courts, provided a party instructed its courts to issue judgments based on the plurilateral agreement in question. The plurilateral agreement could, in turn, allow a state to refer a case to the WTO dispute settlement body if the national court manifestly fails to apply the terms of the plurilateral agreement. While more burdensome than an ISDS arbitration from the perspective of a private party, this approach would represent a significant improvement over the state-to-state dispute settlement mechanism that is now the WTO norm.

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