

WHY DID "MAI" FAIL: THE REASONS FOR THE FAILURE

Av. Vasfi Cem ERTUTKUN*

I. Introduction

"To succeed in today's markets, a company cannot hope to sit back home in Dubuque making widgets and then export the finished goods to buyers abroad. Either through affiliates or joint venture partners you need to be there, on the ground with local facilities. To gain a foothold in an overseas market, you need to invest"¹. The need for investment has been so obvious in last years in the world trade. Growing size of the international investments on the international trade with that obligation led to think the Organisation for Economic Co-Operation and Development (OECD), which is an important institution for the world trade and has the biggest investor states in the world as members², for a Multilateral Agreement on Investment (MAI). The philosophy of the MAI was to create a favorable environment for investment through a set of rules to ensure fair and non-discriminatory treatment of foreign investors, promote access to investment opportunities, protect existing investment and provide a reliable framework for the settlement of investment disputes³.

* İstanbul Üniversitesi Hukuk Fakültesi, University Of Kent L.L.m. in International Commercial Law.

¹ CANNER S. J., (1998), *The Multilateral Agreement On Investment*, Cornell International Law Journal, v. 31, p. 658.

² PICCIOTTO S., (1998), *Linkages In International Investment Regulation: The Antinomies Of The Draft Multilateral Agreement On Investment*, University Of Pennsylvania Journal Of International Economic Law, v. 19, p. 744.

³ GEIGER R., (2002), *Regulatory Expropriations in International Law: Les-*

An intensive preparatory work had started at the beginning of 1990s and the OECD started the negotiations⁴. According to ministerial mandate given in 1995, the agreement was to be concluded by 1997, however the process had run into political difficulties and in "April 1998, the OECD Council of Ministers decided to suspend the negotiations for a six-month period of assessment and further consultation between the negotiating parties and with interested parts of their societies. When the delegations were about to reconvene, in October 1998, the walkout by France abruptly ended the process, and the Secretary General's report to 1999 Ministerial Council stated laconically that negotiations are no longer taking place"⁵.

This was a failure for a unique draft. Very few international negotiations started as much optimism and ended in such a complete breakdown as did the MAI⁶.

Therefore, the main argument of this paper is that, even though the MAI failed, it left behind numerous proposals and provided a reference for any future attempt to construct a multilateral agreement on investments.

To justify this argument, this study will explore the reasons of the failure of such a draft and will try to asset some lessons from that failure. In order to do so, it will first start with the section which will try to make clear the main reasons that led the MAI fail. It will first explore the negotiating environment problems and after that it will go on with the problems in the draft text itself. In the third subtitle, this essay will try to find out the lessons that should be taken from the MAI by working on those problems. Finally, the last part will try to find out the spirit of the failure and conclude the essay.

sons from the Multilateral Agreements on Investment, New York University Environmental Law Journal, v. 11, p. 94.

⁴ GEIGER, (dn. 3), 94.

⁵ GEIGER, (dn. 3), 94.

⁶ GEIGER, (dn. 3), 94.

II. What did lead the Mai to fail?

There were several reasons of the failure. First, there was an argument about the center of the negotiation. It was argued either OECD or WTO should be the center of the negotiations of the MAI. The argument ended up in the favour of the OECD. According to Muchlinski, "this may be explained by the fact that there would have been only limited backing for similar regulations in the WTO"⁷. Another perspective is given by Picciotto for the OECD to be the center of the MAI negotiations. According to him, "The fact that the vast majority of foreign direct investments (FDI) are still amongst OECD countries (%85 of outflows and %65 of inflows) was argued to support the choice of the OECD as negotiating forum"⁸. Thus, since the biggest slice of the FDI is amongst the OECD countries and since there is a lack of the backing for multilateral agreements in the WTO, the platform was the OECD for the negotiating of the MAI.

However, since being a "think tank" of the rich countries, the OECD should not have been the center for the negotiations. One of the major pillars of the MAI was to be a broad multilateral framework of rules for investor protection⁹. In order to be broad, the MAI proposed to let the non-member states and especially the developing countries to be signatory as well. Thus, it can be told that and OECD was a wrong decision for centering the negotiations for the MAI which is draft aimed to be an international and multilateral "constitution" for the FDI. Moreover, OECD was a think tank of the OECD countries¹⁰ and was not suitable for being a negotiating surface for an international constitution. Crane expresses that point in a similar point of view as well. According to him:

"If approved, the MAI will establish broad investment rules that will allow foreign investors to better predict investment conditions in signa-

⁷ MUCHLINSKI P., (2000), *The Rise And Fall Of The Multilateral Agreement On Investment: Where Now?*, 34 International Lawyer, p. 1039.

⁸ PICCIOTTO, (dn. 2), 744.

⁹ CANNER, (dn. 1), 657.

¹⁰ CRANE W., (1998), *Corporations Swallowing Nations: The OECD and the Multilateral Agreement on Investment*, Colorado Journal of International Environmental Law and Policy, v.9, pp 433-434.

*tory nations. The agreement may also be a means for the investors to avoid wasting time coming to grips with local conditions. It is much easier to invest knowing that the rules are the same every where. This result may conflict with some of the OECD's goals, including its objective to provide its 29 member countries with a forum in which governments can compare their experiences, discuss the problems they share and seek solutions can than be applied within their own national context"*¹¹

Therefore, a constitution like the MAI should not have been negotiated by the think tank of rich countries of the OECD, but it should have been done by more international forum. Thus, aiming to be a constitution of the FDI and being made by an institution like OECD, -an institution which had different aims and which was a think tank of some rich countries- was one of the reasons that led the MAI fail.

Besides, a draft which tries to be a constitution for international investment akin to the MAI should have been more negotiated with developing countries. Developing nations have had no voice in MAI negotiations and corporate interest groups have had a strong voice¹². Developing countries had to be in the negotiation phase since they are the market of the most foreign investments. Therefore, this was a reason to make MAI fail as well.

What is more, there were the resistance and the hospitality of non-governmental organisations (NGO) whilst the negotiating phase¹³. "The public and interested NGOs were being excluded from the process notwithstanding the fact that the process had been publicly announced in 1995. The initial lack of attention to public opinion, and to the views of civil society, created an air hostility to the project that made it hard to justify it on political level"¹⁴. Therefore, this lack was a reason for the MAI to fail as well. Moreover, "In August 1997 the Consolidated Negotiating Text of the MAI, which had been circulated to members of the Negotiating Group by their Chairman, and which had the status

11 CRANE, (dn. 10), 441.

12 CRANE, (dn. 10), 436.

13 MUCHLINSKI, (dn. 7), 1039-1040.

14 MUCHLINSKI, (dn. 7), 1040.

of a restricted internal document, was leaked by posting on the Internet"¹⁵. Being open to everyone and being known by everyone day by day led the draft and the negotiation to become a political material for the politicians and this made a stress on them. Thus, that was another reason for the MAI to fail.

Beside the negotiating environment obstacles, there were problems which made MAI closer to fail in the content itself. First of those problems is the ambiguousness of the definitions of the investment and the investor. The definition of the investor and the investment was

*"investor" included not only nationals but also permanent residents, as well as legal persons or other entities constituted or organised under the applicable law of a Contracting Party. "Investment" was defined in terms of "every kind of asset owned or controlled, directly or indirectly, by an investor ..." followed by an illustrative, though not exclusive, list that covered both equity-based and contractual assets. These included, inter-alia, construction contracts, loans, claims to money or performance, intellectual property rights, concessions, licences, and property-related contractual rights such as leases or mortgages"*¹⁶.

This definition is an asset-based definition and despite the fact that it is useful to circumscribe the property rights of the investors, which need to be protected once the investment has been made, it is confusing when applied to the pre-establishment case¹⁷. This broad definition was not acceptable by developing countries. They have traditionally insisted on the right to regulate forms of investment less permanent than FDI¹⁸. It was undeniably potential financial problem for future and in view of the fact that, behaving reluctant and abstaining for the draft of the MAI was not an abnormal attitude for the developing countries. Furthermore, a draft like the MAI, which aimed to be

¹⁵ HENDERSON D., (1999), *the MAI Affair: A Story and Its Lessons*, The Royal Institute of International Affairs, London, p.41.

¹⁶ MUCHLINSKI, (dn. 7), 1040-1041.

¹⁷ GEIGER, (dn. 3), 102.

¹⁸ KURTZ J., (2002), *A General Investment Agreement In The WTO? Lessons from Chapter 11 of the NAFTA and the OECD Multilateral Agreement on Investment*, University of Pennsylvania Journal of International Economic Law, v. 23, p. 763.

an international constitution of the FDI, was not supposed to work without the support and participation of the developing countries and thus it failed.

Another reason for MAI to fail was the pre-entry protection. Like North American Free Trade Agreement (NAFTA), the MAI aimed to liberalise restrictions imposed on investors by preventing member states from discriminating between foreign and domestic investors¹⁹. MAI adopted a top-down approach and extended the rights of entry and establishment. A top-down approach is "the obligations apply to all sectors and categories of measures not specifically covered by country exceptions"²⁰.

It was not acceptable without significant exceptions. According to Muchlinski:

*"Many restrictions on the rights of foreign investors may be regarded as entirely legitimate; the most obvious examples being restrictions based on public health, order, morals, or strategic and defense grounds. Indeed, the draft MAI contained provisions embodying such general exceptions. In addition, it gave contracting states the right to enter country-specific exceptions. Numerous country-specific exceptions were put forward by states, resulting in what some have called a "Swiss cheese" agreement, with more "holes" than the negotiators originally expected"*²¹

There was a little attempt for creating a guide to solve this problem²². Moreover, the top-down structure of the MAI was particularly problematic with regards to the rights of entry provided under the agreement. Given the often sensitive political grounds for restricting entry, the top-down approach forces contracting parties to be overly cautious and lodge extensive exceptions to liberalization commitments. With this complexity it was very hard to make the MAI work in a proper way to resolve and create rules in an international way about investments and this was one of the problems that let MAI to fail.

¹⁹ KURTZ, (dn. 18), 763.

²⁰ GEIGER R., (1998), *Direct Investment: Towards a Multilateral Agreement on Investment*, Cornell International Law Journal, v. 31, p. 470.

²¹ MUCHLINSKI, (dn. 7), 1042.

²² MUCHLINSKI, (dn. 7), 1043.

Another issue to handle to find out the reasons of the fail of the MAI is the non-discrimination concern. The most controversial issue was the extension of the non-discrimination standard to rights of entry and establishment²³. "There was no clarity about the answers of the factual situations in which the standard applied or the technique of comparison should be adopted in order to determine when foreign investors or their investments were being discriminated against"²⁴.

Moreover, the non-discrimination article was deceptive. Picciotto states two reasons for being deceptive:

"First, it does not require the same or comparable treatment for foreign investors, but establishes a minimum of "no less favourable" treatment. Thus, it does not prohibit advantageous treatment of foreign investors in relation to nationals. In this respect it follows the precedent set by the BIT model and favoured by developed, capital-exporting countries, rather than the strict National Treatment standard originally put forward in the Calvo clause and advocated by developing countries... Second ...it is a major gain for international investors, since state sovereignty has generally been recognised as entailing the right to decide whether, and on what terms, to admit foreign investment".²⁵

If the states can not entail when and how they admit the foreign investments it may cause an offence of the state's sovereignty and while trying to be non-discriminative, creating a sovereignty problem was a weakness of such an agreement. Thus, the non-discrimination issue, particularly with the unclearness in determining when foreign investors or their investments were being discriminated and the issue on creating sovereignty problem, was one of the reasons that made MAI to fail.

Provision on expropriation was another difficulty for the MAI draft. MAI draft contained strong provisions requiring host states to compensate investors in the event of expropriation of their investment. Expropriations covered by these provisions were both direct and indirect. Indirect expropriation was covering governmental measures ha-

²³ MUCHLINSKI, (dn. 7), 1043.

²⁴ MUCHLINSKI, (dn. 7), 1043-1044.

²⁵ PICCIOTTO, (dn. 2), 750-751.

ving an equivalent effect to the direct expropriation²⁶. This approach could cause significant problems for countries with strong regulatory regimes as any act of regulation that limits the capacity of an investment to make profits could be seen as an indirect taking of property²⁷. Moreover, this approach was not supported by some NGOs when they explore some of the important cases about the NAFTA, for the reason that the MAI and the NAFTA regulate expropriation very similarly. The Ethyl case led them to think that property rights of individuals could be given precedence over the right of society to regulate for environmental purposes. "More generally, NGOs argued that this provision could be interpreted to mean that any regulation that had the effect of limiting the profit-making capacity of an investment could be challenged as an act of indirect expropriation and they also argued that such an interpretation would effectively nullify many regulatory acts of Governments"²⁸. Thus, the part about the provision on expropriation was an obstacle for the MAI draft. Moreover, according to Crane, the MAI expropriation provisions reduce the ability of the signatory nations to protect natural resources from abuses by foreign investors²⁹. The MAI gave an investor the power to file a claim against a country that has allegedly expropriated property from the investor without providing adequate and timely compensation³⁰. Even if there was a very little possibility for the foreign investors to abuse those natural resources, being rejected by the signatories, and being a reason for the fail of the MAI was not a surprising result for that provisions.

Dispute settlement provisions were among the most controversial aspects of the MAI. The MAI Negotiating Text included clauses on the settlement of investment disputes that provided for consultations, conciliation and State-to-State and investor-to-State means of dispute

26 KURTZ, (dn. 18), 766.

27 MUCHLINSKI, (dn. 7), 1045.

28 UNCTAD, (1999), *United Nations Conference on Trade and Development, the lessons from MAI, UNCTAD Series on Issues in International Investment Agreements*, <http://www.unctad.org/en/docs//psiteiitm22.en.pdf> (12.04.2003), p.18.

29 CRANE, (dn. 10), 446.

30 CRANE, (dn. 10), 446.

resolution, the latter allowing for the possibility that such disputes could be submitted to third-party international arbitration³¹. Investor-to-state resolution gave the ability to the investor to take the dispute to the courts when ever he or she wants except the case of resolving the dispute by negotiations. That situation gave the investor very powerful position in negotiating phase. Resolving the dispute for states became more difficult since the investor had the power to bring it to the appropriate courts. Muchlinski also supports that argument. According to him, "failing to settle the dispute by negotiation or consultation, the investor would be free to choose to submit it for resolution to any competent courts or administrative authorities of the Contracting Party to the dispute"³². The deliberate omission from the MAI of signatory plaintiff rights against investors could therefore prevent a country from enforcing its environmental, human rights, or other national laws against foreign investors and could, therefore, allow multinational investors to avoid conforming to national or local environmental regulations³³. In deed the MAI article about the dispute settlement was maybe about to harm the sovereignty of states instead of creating an international rule of investment. If provisions on dispute settlements are thought with the provisions on expropriation, some problems about sovereignty can rise up since they are blocking the national legislation procedure of the signatories. Dispute settlement problematic was argued a lot but could not be solved and took its place on the list of the reasons made MAI fail.

If the problems are generally revised, some main problems that go in front can be realized. First problem is the political interest conflicts. No signatory nation wanted something against itself or they were not moderate, as Muchlinski expressed they thought this negotiating environment and the draft as "a zero-sum game"³⁴. Second, there were problems about the content. There were no clarity about some definitions or they were so broad. Third the draft was not broad enough as desired. In this context, there were problems about the developing countries. Those problems and conflicts has started from choosing the

31 UNCTAD, (dn. 28), 19.

32 MUCHLINSKI, (dn. 7), 1045.

33 CRANE, (dn. 10), 444.

34 MUCHLINSKI, (dn. 7), 1051.

negotiation table and ended with the failure of the MAI. However, this failure was a good lesson for the nations in order to help to prepare an agreement which can meet the needs in future.

III. What is learnt from the Mai? What are the affects of the Mai for future multilateral investment agreements?

First thing that the MAI taught is to find a more suitable negotiating phase. There were problems as told above about the OECD, the negotiator, and those problems led the draft to fail. Beside the problems that are mentioned above, there were more claims about the OECD. According to Crane:

*“a further concern...is that the US Council For International Business (UCSIB) ‘has been on the inside track [of the MAI negotiations] right from the very beginning’... as a major lobbyist for US business positions on the national and international levels, the council explicitly states its partisanship to corporate America and its linkage to the OECD”*³⁵

The possible results of the MAI were likely to be in conflict with the objectives of pro-MAI lobbying groups such as the USCIB³⁶. This kind of lobbying groups can easily attract the political decisions, and therefore they should be out of the negotiation as much as it is possible. Since US is the most powerful state in OECD, those lobbying groups attracted the draft greatly. In order to disable them and to prepare an agreement draft, which can be fairer and meet the requirements, the negotiation should be more international. It should not be a “local” or less international institution which has some very powerful and very weak countries in the decision process. Moreover, as mentioned above, a multilateral agreement for FDI should be done by more international and broad negotiating. There is a need for a broader multilateral framework for the regulation of international investment³⁷. Thus,

³⁵ CRANE, (dn. 10), 435.

³⁶ CRANE, (dn. 10), 442.

³⁷ PICCIOTTO S., (1999), *Lessons of the MAI: Towards a New Regulatory Framework for International Investment*, *Commentary*, 1999-1, Law, Social Justice and Global Development, <http://elj.warwick.ac.uk/global/issue/1999-1/lessonsmai/> (11.04.2003),, p.2.

the need for fairer and more international table for negotiation is the first lesson from the MAI.

The second thing to do about the negotiations is amplify the role of the developing countries in the negotiating environment. The developing countries were not only discarded from the negotiation, but also led to be scared from the results of such an agreement since the negotiations were behind of the closed doors and with the lobbying activities that are mentioned above. Moreover, drafts like the MAI cannot be successful, if they are not negotiated with the developing states. Not to do so seem to be unrealistic, since such drafts regulate the foreign direct investment, which are heavily concentrated within the developing world³⁸. This means owner of the FDI, the developed countries, did not negotiate with its market and led it to be abstainer. The developing countries, logically, would be abstainer about such an agreement. Naturally, such a draft, which did not represent enough the developing countries and included some possible harmful parts for them, was not supposed to be the most popular one. "Any future multilateral initiative must be made more representative in terms of the participating countries. The active involvement of developing countries and countries in transition is essential"³⁹. Thus, the future draft should pay more attention to the developing countries.

Another issue that a future draft should mind is being a mixture which is composed of some full liberalisation and some full protectionism but not a zero-sum game which either full liberalisation or full protectionism has to win⁴⁰. Moreover, the MAI failure makes it even clearer than before that agreeing on rules for cross-border investment remains a highly complex and contentious undertaking, especially when a large number of diverse and geographically scattered countries are involved and if the initial goals prove to be over-ambitious⁴¹.

A future draft should try to be clearer. Particularly, it should be clearer about the definitions of the investor and investment, since this

³⁸ KURTZ, (dn. 18), 717.

³⁹ MUCHLINSKI, (dn. 7), 1050.

⁴⁰ MUCHLINSKI, (DN. 7), 1051.

⁴¹ HENDERSON, (dn.15),76.

ambiguity in the MAI draft resulted at the end by the unwillingness of the developing countries, which are required more in negotiating, and it was a very big potential to cause financial problems for the future. Moreover, there is an uncertainty on the definition of the non-discrimination issue as well. A future draft should describe non-discrimination more understandable, particularly in the issue of answering the question "when foreign investors or their investments were being discriminated" and it should try more to not to create a sovereignty issue as expressed above. In addition, a forthcoming draft should not cause the problems about the provisions on expropriation since it was one of the most reacted points by the NGOs and as seen the NGOs changed the future of the MAI draft.

Furthermore, the foregoing draft on international investments should try harder on the dispute settlements. According to Muchlinski the dispute settlement process should operate within the limits of international law, which should check against host countries by investors, according to recent developments in arbitral jurisprudence⁴². Moreover, the dispute settlement should be very clear about the issue on not harming the states' sovereignty. Last but not least, in a future draft, dispute settlement should have to take account of the legitimate interest of the host state in regulating the activities of the foreign investors⁴³.

Another lesson can be taken from the MAI draft is to learn how the balance should be obtained between the institutions that the draft has. This point is expressed by Muchlinski. According to him the future draft should

"Balance between the protection of the investors and the interests of countries, especially developing countries. Such future rules must avoid falling into pitfall of the MAI, which recognised only the 'legal symmetry' of the contracting parties, thereby assuming that all countries were formally equal under the law of the agreement. However, with the active participation of developing countries, such "legal symmetry" cannot co-exist with the reality of 'economic asymmetry' without exposing developing countries to the risk of damaging competition from, often

⁴² MUCHLINSKI, (dn. 7), 1051.

⁴³ MUCHLINSKI, (dn. 7), 1052.

stronger, foreign investors, including MNEs. Thus, the very structure, content, and organisation of the agreement should aim at minimizing 'economic asymmetry' through provisions that ensure respect for the legitimate development needs of countries. This may require the introduction of transitional provisions, commitments to cooperation, and technical assistance provisions"⁴⁴.

Therefore this balance is very important and should be minded by all the future drafts.

IV. THE SPIRIT OF THE FAILURE AND CONCLUSION

All in all, there was something wrong led the MAI to fail in the end. An 'ideal' is an agreement very like the MAI but some revisions should have been done⁴⁵. The first thing that has gone wrong was the negotiating stage. The second was the content of the MAI. A more clear draft in content was missing. A future draft should try to be clearer especially about the definitions of the investor and investment, the non-discrimination issue and the provisions on expropriation issue. A future draft should be more concentrated on the dispute settlement and solve the problems that were raised by the top-down approach. It is clear that OECD has tried to create a constitution of international investments. However, it was not broad enough. The developing countries, which are the market of the international investment, were lacking. The MAI did not care enough about developing countries. It forced the developing countries to take a train, which they do not know where it was going⁴⁶. Nevertheless; in this point the MAI creates its paradox. The more a draft tries to be broad, the more problems arise to solve and it seems that MAI was drowned in that paradoxically vortex. In addition, there were suspicion on either MAI was a constitution for FDI or was it the legal coercion to protect the developed countries' investors while they invest on developing countries. Moreover,

44 MUCHLINSKI, (dn. 7), 1051.

45 PICCIOTTO, (dn. 37), 1.

46 ZAHRAN M., (1998), *MAI-type investment model criticized at NGO-Ambassadors meeting*, TWN-Third World Economics No. 187/188, 16 June-15 July 1998, <http://www.twinside.org.sg/title/model-cn.htm> (09.04.2003).

the draft showed us for the next "MAI", the negotiator countries should not be playing a zero-sum game but they should be more concessional. This will help to prove that they are not creating the agreement for the developed rich countries but for the regulation of international investments and decrease the NGOs' and the civil societies' critics. Consequently, it is very clear the future negotiation of multilateral rules on investment, which will try to regulate the international investment, has to solve the problems with the lessons which are learned from the MAI. Only after that, it can be told the MAI failed but not for nothing, but for giving lessons to the future of the international investment.