FORSCHUNGS- UND DOKUMENTATIONSZENTRUM CHILE-LATEINAMERIKA gemeinnütziger e.V. FDCL

Production of Dependency
Value Chains – Investment – Patents

Translated by Andrea Carina Ceschi.

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Prologue

A number of recent developments have brought attention back on subjects regarding global production and dependent development. The impact of liberalisation on the industrial development of peripheral economies has increasingly been a controversial issue in bilateral and multilateral free trade negotiations. And more frequently than in former years, governments from Latin America, Africa and Asia have been coordinating attempts to expand their scope of industrial policies, which global value chains and the international trade regime increasingly narrow.

In some cases, these efforts have proved successful: at the World Trade Organisation conference in Cancún in 2003, a broad coalition foiled an attempt by the European Union to negotiate a global investment agreement which would follow the WTO logic of easier market access - hence an agreement formed precisely not to protect the 'infant industries' on the periphery. Likewise, the development countries are taking up positions in the matter of intellectual property rights which are increasingly relevant to modern network production. A group of 14 countries headed by Brazil and Argentina have presented an initiative for a new development agenda at the World Intellectual Property Organisation, WIPO. They are aiming at a development-oriented reform of international standards in intellectual property which would allow for technology and knowledge transfer by restricting the scope of copyrights and patents. After the multilateral level, the struggle for leeway in industrial policies continues in the context of bilateral and interregional liberalisation negotiations. Bilateral trade agreements allow for considerably deeper cuts in national industrial politics than any multilateral framework would ever permit. Thus the current negotiations between the EU and MERCOSUR on an interregional free trade zone include, among other issue, the investment regulations that have, until now, failed in the WTO framework.

Not least, the discussions on industrial development took place against the background of hierarchically structured global value chains - governed by transnational corporations - that shape today's world labour division. Individual countries, above all in Latin America and Asia, managed to become integrated into these networks as subordinate manufacturing localisations, for instance, in the carmaking, electronics or food industries. It is one of the contradictions of globalised production that on the one hand, it constantly triggers important class formation processes and the emergence of independent trade unions, while on the other hand, it sets off mechanisms of dependent development, which generate considerable social disparities at national and international levels. It is becoming increasingly evident that the internal trade regime contributes to maintaining the value hierarchy typical for interconnected production.

The present publication is embedded in the 'Free Trade and Industrial Development' project. With it, the Research and Documentation Centre Chile-Latin America (FDCL in its German acronym) wishes to create a basis for a broad debate among social movements, trade unions and NGOs on the, up till now, neglected issue of industrial development. In view of the formation of an international trade regime that integrates periphery economies into the international production networks in a precarious way, thus also influencing the scope of action of social movements and unions, we believe that it is more urgent than ever to discuss possibilities for participation. Hence, the aim of the project is to bring together analyses and criticisms brought forward by trade unions, social movements and progressive scientists in the EU and Latin America, as well as to improve the capacity for action in this area.

This book brings together three contributions on different aspects of the contradictory field of global production and dependent development.

In his article, **Thomas Fritz** examines to what extent the recently formulated theses on an equalising motion between centre and periphery associated with interconnected production are justified. To this end he describes the attempts, with varying degrees of success, at integrating foreign direct investment into import substitution strategies, the remarkable class formation processes triggered by capital movements, the global industrial restructuring intensified by the monetarist turn in the 1980s, and the extremely unequal value distribution in the production networks. Fritz concludes that global value chains have as yet in no way contributed to equalising the drastic worldwide wealth disparity, which is why workers' protests might continue to take on more militant forms in the periphery regions than in the capitalist centres.

Christian Russau's contribution is based on the assumption that neo-liberal policies seek to weave an increasingly perfect net of international agreements in the three areas of trade, investment and immaterial goods. In the case of investment, this is condensed down to a legally cemented investment regime that considerably narrows the creative scope of states with regards to foreign direct investment. These regimes include on the one hand, bilateral investment agreements, and on the other hand, free trade agreements, such as the one currently being negotiated between the EU and MERCOSUR. Russau argues that the regulation of foreign direct investment as part of an active industrial policy is urgently needed from the development-political aspect, as well as being indispensable from the perspective of democratic sovereignty.

From the Brazilian standpoint, **Cícero Gontijo** discusses the relation between patents and dependent development. To this end, he gives an overview of the historical development of the international immaterial goods right - from the Paris Convention of 1883 to the TRIPS agreement of the WTO. He demonstrates how the patent system has increasingly abandoned the original concept of the Paris Convention - the obligation to completely disclose an invention and recognition of the principle of local production - and how it has been reduced to a mere property protection right. This neo-liberal reform of patent law undermines the efforts of the South towards autonomous industrial development. Gontijo therefore describes alternatives like different ways of compensating inventors, or the current WIPO initiative for a development agenda which could contribute to a patent system that is compatible with development.

Thomas Fritz, Christian Russau | Berlin, October 2005

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Global Production, Polarisation and Protest

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1. Production networks: Polarisation or Convergence ?

'The networking logic of the new global system makes possible to integrate in a network everything that is valuable, while switching off from the network everything that has no value or is devalued (...). So, the world is not divided any longer between North and South but between areas and people who are switched on/off from these networks' (Castells 2000). The binary formula of switching on or off from global networks is gaining more and more credit as a maxim for action. Allegedly, it has the power to determine the distribution of opportunities and wealth. These and similar perceptions result from quite real shifts in global economic integration. Contrary to the era of colonialism and imperialism economic interpenetration does not establish itself merely through the circulation of money and goods, but to a much higher degree through globally interconnected production. The dynamic growth of world trade is associated with structural changes that facilitated a profound restructuring of global manufacturing, particularly after the crisis of the 1970s.

The vertical disintegration of transnational companies is a fundamental characteristic of this restructuring. The spread of new and low-cost transport and communication media offered multinational enterprises unexpected opportunities to dismantle the manufacturing process and to redistribute its constituents among various countries. Since then, manufacturing has increasingly occurred in the framework of global value chains dominated by individual 'lead firms'. And while all those activities no longer considered part of the core business were being outsourced, the necessity emerged to manage these production networks, which were gradually developing sophisticated internal and external power relations. Therefore, global value chains imply power conflicts – both between the countries, regions and companies involved, as well as between capital and labour. Even more: the expansion of transnational companies itself is not only a sign of technological innovation and increased competition, but also of the conflict of classes. Global capital movements are also inevitably a reaction to workers' resistance and attained social rights. At the same time, capital movements stimulate enormous worldwide class formation processes.

The large increase of foreign direct investment (FDI) since the 1980s has been an important driving force behind the deepening of global economic integration. But the currently dominating value chains differ significantly from the foreign investments undertaken by Western companies in the first three postwar decades. Above all, countries of the capitalist periphery only allowed market access under the condition of local manufacturing with a high degree of local content. However, with the change from such domestically orientated import-substitution strategies towards liberalisation and world market integration, these structures were demolished and replaced by hierarchically structured global supply-bases. Still, the high value-adding activities remained concentrated in the industrialised countries.

However, a comparison of the various global production networks shows that today it is not only labour-intensive activities that are being relocated to so-called 'low-wage countries', but increasingly capital-intensive processes as well. In this respect the highly influential thesis of the 'new international division of labour' formulated by Fröbel et al (1977) certainly requires a critical examination. The 'Fröbelians' were convinced that the world market factories they had analysed (above all in the textiles and electronics sectors) would contribute negatively to the current and future development of employment and qualification, to technology transfer, and to foreign-exchange earnings. Nevertheless, today it is evident that more and more capital-, technology- and knowledge-intensive processes are being transferred to the periphery. But still the question remains, whether this development will contribute to economic and technological convergence between North and South as well as diminish the enormous national and international income disparities.

For many this question – if considered at all – already seems to be resolved. For them modern network production is a process that may level the North-South divide and other polarising effects of capitalist expansion. Similar to the view of Castells, Hardt and Negri (2002) believe that the transition from the industrial to an 'informational economy' will lead to de-centralised and 'deterritorialised' production, 'so that it is no longer possible to demarcate large geographical zones as centre and periphery, North and South'. Because of the 'unifying process of capitalist development', centre and periphery 'clearly infuse into one another' (ibid, p. 334f.). In different regions of the world all stages of production can be found next to each other: elements of small farming, partial industrialisation and partial digitalisation: 'the economic stages are thus all present at once, merged into a hybrid, composite economy that varies not in kind but in degree across the globe' (ibid. 289). 'The general equalisation or smoothing of social space' (ibid: 336) does not eliminate social disparities, yet it proves increasingly difficult to define them along a dichotomy of centre and periphery.

Whereas Hardt and Negri explicitly describe capitalist development as a 'unifying' process, and transnational network production as an element in an equalising movement between centre and periphery, this decision also seems to have implicitly been taken in a large part of the literature on global value chains. 'Global value chain research and policy work examine the different ways in which global production and distribution systems are integrated, and the possibilities for firms in developing countries to enhance their position in global markets' (Gereffi et al. 2003). One of the key insights is 'that access to developed country markets has become increasingly dependent on entering into the global production networks of lead firms situated in developed countries' (Humphrey/Schmitz 2001). Accordingly, the analysis of value chains serves to develop policy instruments for industrial upgrading and job creation. Hence, the addressees of this literature mainly consist of 'policy makers at all levels' (Kaplinksy 2004). Value chain research certainly provides valuable insights into the functioning of global production networks, but its epistemological horizon is limited to integration and upgrading in value chains. It almost completely ignores the role of workers. In this type of scientific research, the labour movement and workers' resistance is widely non-existent.

In this paper we will examine the question of whether it is correct to assume that transnationalised production is associated with an equalising movement between centre and periphery. Do global value chains neutralise, reduce or even reverse the effects generally associated with capitalist expansion, i.e. polarisation and generation of inequalities? This leads us to further questions: What were the reasons for the global restructuring of production?

How does it affect the hierarchical structure of the world system and global income disparities? And what is the role of workers' movements in the expansion of capital? Naturally, it cannot be our aim to provide final answers. Rather, we will delineate mechanisms that affect the development of globalised production. To this end, drawing on David Harvey, the subsequent second chapter will describe a few mechanisms of unequal development linked to capitalist accumulation: overproduction, monopolisation and crises. The subsequent third chapter describes more or less successful attempts of integrating foreign direct investment in an import-substituting industrialisation strategy in Africa, Latin America and Asia during the first postwar decades. The fourth chapter provides a few examples of the impressive class formation processes triggered by capital expansion in the periphery which leads us to question the widely accepted thesis of a 'labour aristocracy'. The fifth chapter is dedicated to the radical 'switching crisis' in the US of the 1970s and 80s, caused by the monetaristic change, which gave momentum to the internationalisation of production, altered class relations, intensified differentiation in the periphery, and led to a number of financial crises in the countries concerned. The sixth chapter describes the historical development of the contractual forms typical for modern value chains. It offers a few insights into the automotive and electronics production networks, their internal and external power relations, the global income effects, and the contribution of the modern trading system to the hierarchical structure of global value chains. Finally, the seventh chapter gives a summary of this paper.

2. Accumulation, Monopoly and Crisis

Why do capital movements happen in the first place? And why is the worldwide distribution of capital so unequal? David Harvey (2005: pp. 89f.) explains unequal development with overproduction crises and their always unstable solution in the form of 'spatial-temporal fixes'. Drawing on Marx's accumulation theory[2], he assumes that capitalism tends to constantly generate over-accumulation crises. In such crises surplus capital (in the form of goods, money or productive assets) co-exists with a surplus labour force, and apparently the two cannot be combined in a lucrative way. A possible reaction to these crises is the devaluation of surplus capital. This is illustrated by the devastating global economic crisis of the 1930s, when goods couldn't be exported any more due to the protectionist wave initiated by the US.[3] The consequences were a gigantic destruction of surplus capital,

[2] According to Marxist theory, in addition to the working hours for which they are compensated with their wages, wageworkers do 'surplus labour', generating value which the owners of the means of production appropriate. However, capitalists do not spend all the appropriated surplus value on consumption, instead a part of it is retransformed into capital, i.e. accumulated. The entrepreneurs' renunciation to consume the entire surplus value is not at all voluntary. Rather, capitalist competition forces them to continually expand the capital invested in their enterprises, if they wish to preserve it. This expansion requires the permanent 'accumulation' or 'expanded reproduction' of capital (Marx 1962: 605ff.).

[3] In May 1929, the US Congress, followed by the Senate after the stock exchange crash of 1930, adopted the 'Smoot-Hawley Act', which erected high tariff barriers and made European products, among others,

bankruptcies, and the worldwide rise of unemployment. To prevent similar devaluations one must look for lucrative ways of surplus absorption. 'Spatial-temporal fixes', which bind surplus labour and capital, act as follows: '(a) temporal displacement through investment in long-term capital projects or social expenditures (such as education and research) (...), (b) spatial displacements through opening up new markets, new production capacities and new resource, social and labour possibilities elsewhere, or (c) some combination of (a) and (b)' (ibid: 111). The spatial-temporal fix is a metaphor for always unstable 'solutions to capitalist crises through temporal deferment and geographical expansion' (ibid: 116).

However, the geographic extension cannot be explained by absolute economic imperatives. Thus historically, the refusal of the ruling classes to absorb surpluses through investments or internal redistribution at home played an important role. After attending a meeting of unemployed 1895 in London, the British financier and colonialist Cecil Rhodes put his preferred solution for the social problem as follows: 'My cherished idea is a solution for the social problem, i.e., in order to save the 40,000,000 inhabitants of the United Kingdom from a bloody civil war, we colonial statesmen must acquire new lands to settle the surplus population, to provide new markets for the goods produced in the factories and mines. The Empire, as I have always said, is a bread and butter question. If you want to avoid civil war, you must become imperialists' (cited in Lenin 1975: 88). Thus, internal class conflicts and the unwillingness of ruling classes to absorb overaccumulation through social reform at home are determining factors of spatial expansion.

Geographical expansion requires a physical infrastructure, which in itself leaves spatial traces. Roads, rail tracks, ports, airports, electrical energy grids, water pipes and canals constitute the land-fixed capital. Generally, investors are attracted by locations that promise low costs and high profits. The advantages of individual locations are therefore reflected in a territorial and spatial division of labour, which produces a dynamic of unequal geographic development. The metropolitan areas equipped with the necessary infrastructure do not only absorb foreign capital, but also raw materials, food and the labour force from their *hinterland*, the 'internal colonies'. For a company a wise choice of location can entail a competitive advantage. For individual capitalists locational advantages may be of similar importance as technological advantages (Harvey 2002: 96). Still, the locational advantages may also expire, for instance, when the restless search for absorption opportunities leads to new, superior sites.

But such geographical moves threaten spatially-fixed values, particularly if these haven`t yet been realised. Deprived of the freedom to move, fixed capital is threatened by direct devaluation, for instance, through deflationary recession. This happened 1990 in Japan, when the bursting real estate bubble triggered a deep economic crisis, which is still going on today. But if capital is withdrawn, it leaves behind a trail of devastation and de-industrialisation. Early examples are the silver mining regions of Mexico, Peru or Bolivia, impoverished and abandoned when their markets disappeared; more recently, there are the de-industrialised

unsaleable on the US market. In reaction to this, many other countries imposed retaliatory measures that caused the collapse of the world market (Arrighi 1999).

regions of northern England, the German Ruhr Region, and some of the export processing zones that were abandoned after just a few years.[4]

Depending on the type of surplus, its territorial absorption may take different forms. A surplus of goods can be transferred to foreign markets, provided they possess the means of payment, such as money or commodities. Paying goods with other goods is still common in our times. Especially countries with low foreign exchange reserves may resort to these forms of 'barter' trade. The exchange of Cuban doctors against Venezuelan oil takes place without the intermediation of US dollars. If neither money nor goods are available, credits or aid will lend absorption a helping hand. In the 19th century London banks promoted the sale of British finished products by lending money to the US, Canada, Australia and Argentina. Today, Japanese credits for the US secure the purchase of Japanese products by US consumers. However, transactions of these kinds only offer short-term solutions to overaccumulation: Surplus goods are sent out and after short time money or other goods flow back. In contrast, foreign direct investment (FDI), which initiates new processes of capital accumulation in the receiving countries, allows for longer term absorption. The FDI wave starting in the 1980s can therefore be interpreted as an important element of a crisis-solution strategy.

Since British hegemony in the 19th century this process of territorial expansion has been accompanied by a deepening interpenetration of the trade and banking sectors. In particular, the increasing significance of states as buyers of railroads, ships or weaponry meant that the services of high finance became indispensable. Investment banks issued shares at the London Stock Exchange or offered loans to finance mines, railroads or ports in India, Argentina and Brazil. Towards the end of the 19th century capital export became one of the most important sources of income for the propertied classes investing in shares and loans. Already at that time financial institutions conditioned their loans to the purchase of goods of the creditor country – a praxis known today as 'tied credit'. Extremely close relations between banks, companies and governments supported this mechanism. Lenin (1975: 73) cites a report by the Austrian-Hungarian consul in São Paulo: 'The Brazilian railways are being built chiefly by French, Belgian, British and German capital. In the financial operations connected with the construction of these railways the countries involved stipulate for orders for the necessary railway materials.'

Still, capital export often provoked considerable rivalry among corporations, which reacted by forming cartels. The formation of the international rail cartel may serve as an illustration: 'The first attempt of the British, Belgian and German rail manufacturers to form such a cartel was made as early as 1884, during a severe industrial depression. The manufacturers agreed not to compete with one another in the home markets of the countries involved, and they divided the foreign markets in the following quotas: Great Britain, 66 per cent; Germany, 27 per cent; Belgium, 7 per cent. India was reserved entirely for Great Britain.' (ibid: pp. 81f.).

[4] These processes of decline, which only took place after the affected regions had been integrated into the capitalist world market, served as an important argument of André Gunder Frank's thesis on the 'development of under-development' formulated in the 1960s (Frank 1980).

As will be demonstrated below, in our days it is above all the periphery which suffers the adverse effects of monopolisation and cartelisation.

Further contradictions arise once the newly-opened territories produce their own surpluses. They too will then attempt to absorb theses surpluses through geographical expansion. This was the case in Japan and Germany, where postwar reconstruction was promoted by credits, Marshall Plan aid and direct investments. Yet, in the 1960s both countries' firms became competitors of US corporations, first mainly through exports, and later also through capital export in the form of direct investments, loans and portfolio investments. In the 1980s South Korea, Taiwan and other South-East Asian countries also transformed themselves into significant exporting countries. They fixed their surplus capital in many countries around the world, be it through export, as subcontractors of transnational corporations, or by setting up their own plants. Nonetheless, their spatial-temporal fixes were confronted very soon by strong competition from the current economic expansion of China, which in the wake of the capitalist reforms initiated in 1978 became a gigantic 'sink' of surplus capital. The instability of these fixes is expressed in 'switching-crises', when capital flows are redirected from one place to another because of over-investment in plants, infrastructure, goods, or public spending (Harvey 2005: 121).

Harvey finally introduces a further mechanism, which contradicts the assumption that the permanent generation of capital surpluses will be absorbed by 'constructive' productive investment. This assumption belongs to the official political ideology which seeks to create the illusion that its 'global governance' framework aimes at directing global capital flows into productive, growth promoting and poverty eradicating investments. However, the accumulation process and expanded reproduction have a far more destructive, predatory, fraudulent, violent, and at times even war-mongering side to them. Marx (1962) described these forms only for the transition period from feudalism to capitalism. Recurring to the state, its monopoly on violence and its legal system, 'primitive accumulation' creates the requirements for the new mode of production. It is 'nothing else than the historical process of divorcing the producer from the means of production'. Its methods are 'anything but idyllic' (ibid: 742): the expulsion of the peasant population; the commodification and privatisation of land; the conversion of various forms of property rights (common, collective, state-owned) into exclusive private property rights; the commodification of the labour power; the suppression of traditional forms of production and consumption; colonial and imperial appropriation of assets; the slave trade; monetarised exchange and trade; the modern tax system; national debt; and the very effective credit system.

Drawing on Rosa Luxemburg, Harvey (2005: 140) highlights the lasting significance of primitive accumulation and its 'organic relation' with expanded reproduction. Therefore, he uses the term 'accumulation by dispossession', arguing that since these processes are ongoing it would be inadequate to call them 'original' or 'primitive'. Their significance lies in the fact that to resolve the problem of overaccumulation, capitalism permanently needs a stock of assets that is somehow 'outside' of the system. If such assets, for instance, unused land or new raw materials, are not available, capitalism itself has to produce them. Thus it creates –

in a certain way – its own 'other', a form of 'exterior'. To generate lucrative outflow opportunities for surplus capital, accumulation by disposession therefore sets free a number of assets. The massive privatisations of public services and social systems or the appropriation of genetic resources in the centres of biodiversity through bio-piracy are current examples. However, in regionally limited crises this goal can also be achieved through a controlled devaluation of capital and labour power. The inexorable outcome of the debt crisis of the 1980s and the financial crises of the 1990s were large quantities of devaluated assets. As we shall demonstrate later, these crises provided transnational corporations with lots of opportunities to re-fix their surplus capital. Imperial wars, which lead both to enormous devaluations in the countries destroyed as well as to control over their natural resources, represent the violent peak of accumulation by dispossession.

However, there are risks involved, for instance, when it becomes impossible to regionally contain such crises, when devaluations cross borders or trigger revolts. 'One of the principal objectives of state interventions and international bodies is the effective concertation of devaluations, so that accumulation by dispossession can take place without triggering a generalised collapse' (ibid: 130). The credit system and the manipulation of interest rates are the main mechanisms used by the Group of 7 and the international financial institutions to generate controlled devaluation of assets. We shall later describe this mechanism in the case of the gigantic 'switching crisis' of the 1970s and 80s and the recent financial crises of two countries of the periphery – South Korea and Brazil. The costs of these 'destructive' aspects of accumulation are largely passed along to the periphery. As long as international state and financial institutions manage to regionally limit devaluations and to minimise the risk of 'contagion' of the capitalist centres, accumulation by dispossession remains a fundamental mechanism of unequal development.

3. Imperial Links: the Postwar Boom in Direct Investment

For a deeper understanding of production networks and value chains one has to recur to the common history of foreign direct investment and transnational corporations. Hence, we describe the postwar expansion of direct investment from the centres to the periphery, the fledgling workers' struggles in US industry, and the contradictory attempts to integrate FDI into import-substituting development strategies. The different results of import substitution in Africa, Latin America and Asia are related to the historical and social characteristics of these regions.

Until the 1940s, transnational companies were largely a European phenomenon, closely linked to colonial and imperial expansion. Foreign investments went into securities issued by colonial governments or into mining and railroad shares. In the British, French, Dutch, German and Portuguese colonies small enterprises, small plantations, trading houses and craftsmen shaped the company structure. The economic activity was dominated by the export of raw materials and agricultural produce. Accordingly, the internal markets of the periphery saw no significant development.

As late as 1914, Great Britain was leading as regards foreign direct investment. The British held FDI worth US$ 4 billion. In 1929, the US overtook the UK with an FDI stock of $ 7.5 bn. US companies began to set up foreign subsidiaries in the period between the wars, especially in Europe. Yet US investment increased significantly only after WWII with average growth rates of 10.4% in the period from 1950 to 1960 and 9.3% between 1960 and 1968. While in 1950 US foreign investment amounted to $ 11.8 bn, by 1960 this amount had risen to $ 31.9 bn, reaching $ 64.8 bn by 1968. Regionally, investment was mainly concentrated in Canada, Europe and Latin America, and to a lesser extent in Asia and Africa. Remarkably, as late as 1950 55% of US investment went into peripherical countries. However, by 1968 this share had dropped to 40% (Cardoso 1972).

The increase in US foreign investment was due, among other reasons, to the reconstruction aid for war-damaged Europe (and Japan) provided for under the Marshall Plan. Apart from food aid, the plan contained credits for infrastructure modernisation and individual companies, many of which already under US control. Furthermore, the US also exported to Europe the specific fordist model of mass production and mass consumption. For this purpose the Marshall Plan authority promoted the liberalisation of intra-European trade. The founding in 1952 of the European Coal and Steel Community (ECSC) was an important step in the creation of a larger economic region required for the fordist mass production of cars and other consumer goods. Besides, the Marshall Plan was also embedded in strategies to contain the Soviet Union and the expansion of communism. Trade unions were successfully divided into communist and anti-communist organisations. The rewards for renouncing anti-capitalist policies were the system of collective bargaining and rising incomes. On top of this, the global expansion of the fordist model also required Europe’s consent to the independence of its colonies. Accordingly, the US linked Marshall Plan aid to the precondition that the European states would not suppress liberation movements in the periphery, unless they were pursuing a communist course. However, one of the most important objectives of US postwar activities probably was the integration of the European bourgeoisie into a Transatlantic ‘class alliance’ (Van der Pijl 1998: pp. 118f.).

Gindin and Panitch (2004: 17) describe US foreign direct investment as ‘the crucial factor in cementing the new imperial bond’. Independent of their changing regional distribution, FDI developed a social power that increasingly integrated international and national capital. ‘Their interpenetration made the notion of distinct national bourgeoisies (...) increasingly anachronistic’ (ibid 15). Although in Europe the growth of US investment initially inspired defensive reactions, eventually an interest both in attracting it and responding to the ‘American challenge’ by investing in the US prevailed.[5] Tensions or alliances inside the ruling classes could no longer be analysed in purely national terms. German and Japanese carmakers began to share mutual concerns with their US counterparts, such as over the prices of steel. Neither did they see any problem in using the services of the new world power. ‘When

[5] ‘Le défi américain’ (The American Challenge), which was published in 1967 and became a bestseller, mirrors the *zeitgeist*. The author, Servan-Schreiber, proposed to select 50 to 100 European companies able to stand up to US competition and award them with state subsidies.

instability in Latin America or other foci of unrest put their international investments at risk, they look to the US for protection, instead of their own governments' (ibid: 17).

Further important motives for the increase in foreign investment after WWII were the militant workers' struggles in the strongholds of fordist mass production, particularly in the US car industry in the 1930s and 1940s. After the first successful occupation of a General Motors factory in Flint in 1936/37, which ended with the capitulation of the management, who were forced to sign a contract with United Auto Workers, a wave of strikes brought unionising to the mass production industries of the US. The complex division of labour of fordist mass production, including its assembly-line manufacturing, gave workers significant 'workplace bargaining power'. They were able to effectively bring to a halt large industrial plants' production through selective strikes or sabotage actions. The companies reacted with a threefold strategy: relocating investments from union strongholds to rural areas and abroad, technological and organisational innovation, and promotion of 'responsible' and co-operative union policies, as well as the suppression of 'irresponsible' combative strategies. While after the collapse of the world market in 1930 the international emergency exit was blocked for the companies, after World War II it became viable again. Thanks to the Marshall Plan, the creation of the common market and the re-establishment of currency convertibility in 1958, Western Europe became a favourite target region. Nevertheless, investment in Latin America, South Africa and South East Asia saw a successive increase, too (Silver 2005: 65ff).

3.1. Investment and Import Substitution

The decolonisation of the periphery after WWII opened up further regions to the international expansion of US corporations, followed later by companies from Europe and Japan. In this process peripherical economies sought in various ways – and with varying success – to integrate the inflowing investments into an import-substituting industrialisation strategy. Historically this policy was a reaction to the collapse of the world market in the wake of the 1930s world economic crisis. Among the main elements of import substitution were the relative devaluation of the national currency, tariff increases and non-tariff barriers, an expansive monetary policy, the promotion of the public sector, the expansion of the internal market, as well as a diversification of the economy and an extension of the range of export products. Whereas in a number of Asian states the adaptation of these policy instruments indeed led to some economic successes, in Latin America and particularly in Africa the results were but limited. In addition, in these two regions it became evident that high external tariffs and other protectionist measures would in no way hinder the expansion of transnational corporations. Their preferred method of overcoming such barriers was foreign direct investment. Particularly in Latin America it could be observed that local subsidiaries of transnational corporations erected monopolistic positions behind the tariff barriers of import substitution, thus fighting off any potential newcomers. However, contrary to the conventional wisdom of international development 'experts', the varying level of development in peripherical countries is not just the effect of erroneous national policies. Instead, they are closely linked to their respective colonial and post-colonial legacies.

In the African states, decolonised after WWII, a capital outflow from the sector of small colonial companies and trading houses was accompanied by a capital inflow into mining, manufacturing and export agriculture, which were dominated by oligopolistic firms and corporations. This process changed the pattern of foreign investment: while financial and trade interests, as well as small enterprises, lost significance, manufacturing and vertically integrated transnational corporations in mining and industry became more and more important. The sectorial distribution of foreign investment had three characteristics: 1.) the colonial pattern of investment in the primary sector (agriculture, mining and oil) for exports remained the same. Yet with one important difference: from then on the newly independent states themselves had to invest in the necessary road, railroad and shipping infrastructure, in ports and energy supply – partly internally financed, partly by international aid and private credits. 2.) Industrial investment concentrated either on final assembly of imported parts for export or on import substitution, such as the production of consumer goods. 3.) In contrast, investment in capital goods – especially steel, machinery and the chemical industry – remained weak. Finally, research and development of new technologies was practically absent (cf. Arrighi 1974: pp. 227f.). Although African states received comparatively small investment flows, the manufacturing sector was almost completely foreign owned. An important yet mostly underestimated reason for this development is the colonial legacy of a structural labour shortage due to the export of African slaves, which hampered economic development well into the postwar era. The slave trade led to a low population density, small local markets and a sustained disruption of productive activities. The widely accepted thesis that 'underdeveloped regions are characterised by "unlimited supply of labour" never really applied to Africa, where labour appears to have always been in short supply' (Arrighi 2002: 25). Labour shortage together with foreign ownership of colonial enterprises didn`t allow for the development of local entrepreneurs. This deficit still remained after independence. The poor development of state institutions, combined with an – often rather propagandistic – economic nationalism, deterred small non-African businesses without creating a compensating number of African enterprises.

Although Africa realised some economic success in the era of import substitution, in two aspects there was no basis for integrating direct investment into a long-term viable development strategy: firstly, a lack of effective regulatory capacities on behalf of the state, and secondly, the missing local economic basis to establish links with subsidiaries of TNCs, which could have facilitated technology- and know how-transfer. Not integrating foreign investment into a development strategy perpetuated the dependence on technology imports, which had a negative impact on the trade balance and resulted in increased debts. The internal market remained underdeveloped, and consumption was restricted to small parts of the urban population and the working classes.

In postwar Latin America foreign investment in the manufacturing industry increased steadily compared to investment in the traditional sectors of oil, mining and agriculture: while in 1940 it was just 8%, by 1968 it had climbed to 34%. The share of investment flows into manufacturing was particularly high in the economically more advanced countries of Latin America, where by 1968 it was up to 64% (Argentina), 69% (Brazil) and 68% (Mexico). In Latin America, in contrast with the African countries that only achieved independence in the 20th century, transnational corporations allowed a limited participation of domestic capital. Joint ventures and other forms of mixed ownership, in which local public and private capital was combined with international monopoly capital, were rather frequent, both in manufacturing as well as in mining. Nonetheless, majority ownership and effective control remained mostly in foreign hands. However, with the progressive increase in investment in manufacturing, the importance of the internal markets in these countries grew. Thus, the car factories of General Motors, Ford, and Volkswagen produced not just, but *also* for the Latin American market. Thus foreign investment required a certain degree of prosperity in Latin American locations. But even in these cases the capital-goods industry remained in the centres, thus enabling transnational corporations´ control over capital accumulation in the periphery – above all through their technological lead (Cardoso 1972).

Moreover, it had already become clear by the 1950s and '60s that investment stocks were increasingly rising independently of the foreign capital inflow. Instead, transnational corporations recurred to the internal savings of the affluent middle-classes, and to reinvesting a part of their Latin American profits. In the late 1960s, 60% of new investments came from reinvested profits.[6] Additionally, the subsidiaries repatriated high amounts of profit to their headquarters. Estimates for the postwar period from 1947 to 1967 calculate the relation of capital inflows to repatriated capital in Latin America at 1 to 2.7, i.e., for every inflowing dollar, 2.70 dollars left the region (Dos Santos 1970). The companies circumvented regulatory attempts to cap those outflows and prevent balance-of-payments difficulties by using more subtle forms of profit transfer, such as licence or patent fees. Thus, it is not the subsidiary abroad that pays royalties to the parent company, but its local licensee.

Hence, Latin America was also unsuccessful in integrating foreign direct investment into a sustainable import-substituting development strategy. Yet the reason for this was not only the behaviour of the multinationals, but also the strong influence of big landowners and the urban entrepreneurial classes on the state apparatus. These groups, too, had an interest in protecting the privileges of the existing production and export structures, and in blocking any redistribution policy. 'The powerful landowners and the bourgeois *compradores* influenced the composition and orientation of the bureaucracy, and of official policies (...). Therefore, Latin America did not have the relative autonomy of the state that characterised South-East Asia' (Arceo 2003). Under these circumstances, the Latin American state apparatus didn´t manage to subject the conflicting interests of different capital groups to a coherent industrialisation strategy. Such a strategy was further undermined when military dictators opened the economy to foreign direct investment. On the one hand this perpetuated dependence on technology imports, while on the other hand it led to shrinking export

[6] This pattern persists. Today many multinationals use their cash-flow to finance new investments or re-investments.

revenues due to the worsening terms of trade for traditional agricultural and raw materials exports. The only way to counter the soaring trade deficit was by increasing foreign capital inflows – with the unavoidable consequence of rising debt. Because of the refusal to carry out land reforms and redistribution policies, internal demand rested only on a few sectors of the urban population. Together with the governments' insufficient regulation of foreign investment this meant there were no conditions to advance production to higher levels of value added (ibid).

As already indicated by Arceo, the import substitution era yielded completely different results in Asia – especially in Japan and the South-East Asian countries, but also in India – compared to Africa and Latin America. The East and South-East Asian countries were characterised above all by an extremely restrictive attitude towards foreign direct investment, which they subjected to strict and efficient controls, integrating them into a consequent industrialisation strategy. Foreign investors were, for example, completely barred from certain branches, or only gradually admitted once domestic producers had established a strong market position. In many instances the authorities allowed only minority ownership, while mergers and acquisitions remained completely banned. Establishing cross-holdings prevented hostile takeovers. Joint ventures were favoured, but they remained mostly under majority ownership of locals to secure the transfer of technology and managerial knowledge. The authorities thoroughly examined whether technology was outdated, or whether royalties charged to subsidiaries were overpriced. Furthermore, permitted investments were always adjusted to economic changes. Whereas in the 1960s, South Korea and Taiwan promoted direct investment in labour intensive industries, particularly textiles and electronics, in the 1970s they turned towards more capital-intensive production, partially prohibiting direct investment in labour intensive plants. In addition, governments imposed strict requirements on the use of local content and on minimum exports to alleviate the current account. Hence, Japan, South Korea and Taiwan were among the countries with the lowest dependence on foreign direct investment. 'As a result, as of the mid-1980s, only 5 per cent of TNC subsidiaries in Korea were wholly-owned, whereas the corresponding figures were 50 per cent for Mexico and 60 per cent for Brazil' (Chang/Green 2003: 27).

Further instruments for the promotion of national industries were: governmental investment schemes, fiscal incentives, subsidies for investment and export credits, as well as state guaranties in strategic sectors, which nationalised banks further facilitated. Besides, nationalised enterprises played an important role in manufacturing and in establishing linkages with local industries. The number of state enterprises saw a clear increase precisely in the 1960s. In the context of their active industrial policies governments also encouraged national businesses to imitate foreign-patented manufacturing processes (Rodrik 2001).

However, the circumstances in East and South-East Asia were quite favourable for the development of national industries: a quite advanced state- and nation-building process, an abundant labour force, a tradition of entrepreneurship in many countries, and, not least, the impressive entrepreneurial networks of the Chinese Diaspora. In addition, like Western Europe, East Asia played an important strategic role in the anti-communist containment strategy of postwar USA. Hence, the US granted preferential market access for the exports of their allies Japan, South Korea, and Taiwan, while at the same time tolerating their protectionism, state interventionism, and even the temporary exclusion of US companies. In addition to this, the US granted massive military and economic aid, amounting to $ 13 bn for South Korea and $ 5.6 bn for Taiwan, in the period from 1946 to 1978. While in that period economic aid for South Korea alone amounted to $ 6 bn, the whole of Africa received just $ 6.89 bn, and Latin America $ 14.8 bn. Japan, too, enjoyed in the 20 year period between 1950 and 1970 on average $ 500 million per year in US aid. Only Western Europe received comparable benefits (Arrighi 2002).

4. Capital Export and Class Formation

We will now turn to the impressive class formation processes triggered by the expansion of transnational capital, which the most narratives on direct investment and import substitution tend to ignore. The combative, independent labour movements in the periphery place question marks on the still quite popular thesis of a 'labour aristocracy'.

Whereas in the US, Western Europe, and Japan the postwar generalisation of the fordist economic and social model allowed for – always fragile – social pacts between employers, labour movements and governments, in the periphery this was achieved only to a very limited extent. Western Europe, for instance, experienced a wave of mass strikes in the late 1960s, which resulted in significant concessions from employers: permanent recognition of trade unions, extended co-decision procedures, and the linking of wages to productivity. As part of the tripartite deal typical for Western welfare states, governments committed themselves to full-employment policies, employers committed themselves to passing on part of their profits in the form of wage increases, and unions committed themselves to cooperation and moderate demands. Particularly the rising wages enabled the corporatist integration of the labour movement. The possibility of mass consumption in the West was the decisive precondition for the relative stability of this 'class compromise', which was nevertheless constantly broken, for instance, by the strike waves of the late 1960s and early 1970s.

While the labour movement in the West enjoyed the welfare state and mass consumption, this model was not deemed suitable for the rest of the world. Yet, to prevent the spread of communism, modernisation theory promised that the periphery could close the gap to the 'first world' once it had gone through all the phases of the modernisation process. One of the key figures of this development discourse was the modernisation theorist, and future US security advisor, Walt Rostow, whose book 'The Stages of Economic Growth' published in the 1960s bore the revealing sub-title 'A Non-Communist Manifesto'. According to Rostow, the starting point of any development is underdevelopment, which he understood as the lack of industrialisation. He argued that the development process begins with an initial period, followed by a boom period which leads to a takeoff of self-sustained growth, until the society finally reaches its stage of maturity with mass production and mass consumption. However, since the periphery did not have a Marshall plan to support its takeoff, and since the generalisation of mass consumption remained distant, the US tolerated with gritted teeth the import-substituting policies in the South, as long as the doors were left open to US companies – with a few exceptions, like South Korea. In spite of the economic achievements of import substitution, social contracts like in the West were not viable because of the smaller scope for the redistribution of wealth. Hence, in the periphery this era was more strongly marked by labour protests and repression. Consequently, modernisation theorists like Walt Rostow or Samuel Huntington were among the loudest voices in support of military governments as a means of development, and among the supporters of the US intervention in Vietnam beginning in 1964 (Dos Santos 1997).

The oppressive governments supported by the West, like the authoritarian regime in South Korea, the military dictatorship in Brazil, or the apartheid regime in South Africa, turned these countries into favourite investment destinations of transnational companies from the US, Europe and Japan. But contrary to management expectations, their direct investments inspired the creation of new, combative labour movements, as illustrated by the following examples from South Korea, Brazil and South Africa:

A 'Times' article from 1975 describes the positive investment climate in South Korea under the authoritarian regime of General Park Chung Hee: 'Even if South Korea's workforce of 11 million is a key element in the country's development, it is, at the same time, a potential source of unrest. The salaries are among the lowest in the world, industrial action is prohibited by law, and the unions are but a shadow of their Western counterparts. (...) Strict labour laws enable the government to dissolve any union suspected to pose a public threat. (...) On 27 December 1971, the government issued a number of emergency measures, including the illegality of strikes. From that day, strikes are punishable with imprisonment of up to seven years' (cited in Fröbel et al. 1977: 547).

The establishment of labour-intensive assembly plants, particularly in the clothing and electronics industries, caused strong internal migration in South Korea, with above all young women moving from the countryside to the urban industrial regions. In the mid-1970s, half of the migrants fleeing family and countryside were women aged between 15 and 20. Whilst most of the jobs in the capital-intensive industries were reserved for men, female employment predominated in the precarious, badly paid and unqualified jobs of the first world market factories. Contrary to the stereotype of a 'submissive' and 'willing' workforce, often explained by Confucianism, the Korean female workers spearheaded a protest wave, which started in 1974 and lasted until the late 1970s. The protests set in at a time when such activities encountered fierce repression by the state and the employers. They were concentrated in the labour-intensive industries, and were almost exclusively supported by women, while their male colleagues either remained passive, or collaborated – as members of co-opted, male-led trade unions – in suppressing the rebellious female workers. Some of the strikes initiated by female workers were quite successful, resulting in improved working conditions and the recognition of independent unions. Yet other protests were brutally repressed by security forces. Physical abuse and imprisonment belonged to the common methods of intimidation. In consequence, some resistance activities gained much attention, prompting acts of solidarity in the entire country. Moreover, the protests were not restricted to labour demands, but were highly politicised. Opposing the dictatorship, the female workers also acted as a democracy movement. A fundamental prerequisite of this resistance were the class formation processes among the women migrating to the cities. Many of them lived collectively in hostels or factory dormitories. Devised as a control and cost-reducing instrument, at the same time they prepared a fertile ground for the exchange of working experiences and the expression of mutual solidarity, strengthening the labour migrants for future struggles (Mikyoung 2003).

Female workers also played an important role in the disputes of the following decades, for instance in the 'Big Workers' Struggle' of 1987, which marked the starting point of South Korea's formal democratisation. After the military government had eased the investment regime in heavy industries in the early 1980s, numerous transnational corporations invested in the large state-owned car and electronics companies, above all in the form of minority shareholdings or joint ventures. They, too, expected smooth production and high profits under a repressive labour regime. But the outbreak of militant unrest in 1987 crushed their expectations. Hundreds of thousands of female and male workers took part in strike activities all over the country. Among other demands, they challenged the representational monopoly of the Federation of Korean Trade Unions (FKTU), and demanded the legalisation of independent organisations. In the following years, they founded a confederation of the independent trade unions, which in 1995 was renamed 'Korean Confederation of Trade Unions' (KCTU). In 1999, KCTU represented 573,000 workers, of a total of about 1.5 million officially registered trade union members (Kong 2005).

In Brazil investors had similar experiences. However, after General Castelo Branco's coup in 1964 and the subsequent opening up to foreign direct investment, Brazil seemed an ideal location for direct investment. The president propagated 'interdependence' and 'associated development', and the Foreign Secretary, General Juracy Magalhães, declared: 'what is good for the United States is good for Brazil, too', (cited in Dos Santos 1997: 15). The Brazilian dictatorship also promised far more stable conditions than neighbouring Argentina, which at that time was afflicted with numerous workers' protests that culminated in the so-called *'cordobazo'* of 1969, when a strike in the industrial city of Córdoba culminated in the use of military force against workers (Delich 1974). The Brazilian 'economic miracle' was not only characterised by high growth rates, rising exports and the fight against inflation, but also by terror against critics and opponents, by neglecting rural development in favour of forced industrialisation, and, related to this, migration from the countryside and growing urban unemployment. However, together with the rapidly growing manufacturing industry emerged a new working class and a combative trade union movement that broke with the state-centred corporative system. In Brazil this movement was labelled 'new unionism' (Ribeiro de Oliveira 1987: 43).

At the core of this new movement stood the automotive and metal workers in the industrial region of Greater São Paulo. The movement was born in May 1978 with a strike wave that started in the SAAB Scania car factory of São Bernardo do Campo, and which subsequently spread to Mercedes, Volkswagen, and Chrysler factories. Employers used repressive means to keep unions out of their companies, but like their US colleagues in the 1930s, the Brazilian workers took advantage of fordist mass production for their targeted actions. Confronted with continuous protests, stoppages, sabotage and refused cooperation, by 1982 the automobile multinationals were forced to give in. They had to recognise the new independent unions, signed collective contracts, and agreed to wage increases (Silver 2005: 77). Eventually, from the grassroots mobilisations that had come to light in 1978 emerged both the Workers' Party (Partido dos Trabalhadores – PT), founded in 1980, and CUT, the confederation of independent unions (Central Única dos Trabalhadores), founded in 1983. The current PT President of Brazil, Luis Inácio '*Lula'* da Silva, stems from this new labour movement. During the heated phase of the 1978 fights he was president and influential speaker of the Metal Workers' Union in São Bernardo do Campo. He belonged to the circle of 'new unionism' leaders who defined themselves as a 'combative leadership'. Not least, the grass roots unions born in the late '70s were also important in the fight against the dictatorship, and in reinstalling democracy (Ribeiro de Oliveira 1988).

The South African union movement envisaged a similar development. In the late 1950s and early 1960s there were sudden mass protests against the *apartheid* laws, which were brutally suppressed by the South African government. Thus, it proved to the international investor community that it could ensure political stability, and this was rewarded with a large capital inflow. To a great extent these went into manufacturing. The demand for a semi-skilled workforce exploded, and hence emerged a large sector of Black proletarians. The better paid jobs as skilled workers and employees remained a White privilege. In 1973, after a decade of relative calm, a first strike wave erupted in the factories of Durban, followed by hard repression and the persecution of illegal Black unions. Lay-offs, arrests and banning from the cities belonged to the repressive means. Despite this, the membership of independent organisations rose continuously. Eventually, in 1979, new strikes in the metals and automotive industries forced the government to legalise the Black unions. Yet this didn't contain the workers' protests, on the contrary, a new strike wave shook the country. Like their colleagues in other countries, the South African workers took advantage of their strategic positions in the fordist production process, which they used for selective and very disruptive actions. Eventually, in 1985, more than 400 of the newly founded independent unions unified under the umbrella of COSATU (Congress of South African Trade Unions). Together with the ANC, the organised workers' movement would become the most significant part of the resistance against *apartheid*. COSATU was far better able to defend itself against state persecution than many other groups (Silver 2005: 81).

These examples show that foreign direct investment has constantly triggered – or contributed to – impressive processes of class formation, resistance and unionising. The hope of many investors to find submissive worker masses under repressive regimes remained largely unfulfilled. Moreover, the thesis of a 'labour aristocracy', which still circulates today, proved to be rather difficult to sustain. It sought to explain, in different variants, that workers in the international sectors are ideologically close to the lower middle class because of their 'privileged' position and social status, forming alliances with the national bourgeoisie and transnational capital. Cardoso (1972), for instance, diagnosed a 'split of interests' between the advanced sectors of society interrelated with international capital and the retrograde national sectors. The beneficiaries of foreign interests, he argued, are not only the national bourgeoisie, but also the middle class and the 'employees in the "internationalised" sectors'.[7] Yet, as we saw earlier, the employees of the 'internationalised' sectors constantly initiated protest waves, abandoning the supposed interest alliance with transnational capital. Nor were they only fighting to improve their own situation. Rather, their demands consciously included workers of various categories, companies, and branches, be it higher minimum wages or the legalisation of independent trade unions. Their protests also far exceeded company level. Many of the grassroots unions created in transnational corporations made the fight against oppressive governments one of their principal goals. To achieve this, they formed numerous alliances with resistance groups outside the companies, or they themselves became the organisational nucleus of democracy movements.

5. The Switching Crisis in the 1970s and 1980s

The conditions for the worldwide workers' struggles changed drastically with the phenomenon we shall, like Harvey, call the 'switching crisis' of the 1970s and '80s. To evaluate the unfolding context of these struggles, we shall first outline the background of this crisis and the reactions it provoked. We will then describe, using the examples of South Korea and Brazil, on the one hand, how the subsequent devaluation crises in the periphery promote the accumulation of productive assets, and on the other hand, the profound changes they entail for the struggles of labour movements.

As previously described, contradictions arise when the new territories opened up by capital export begin to generate their own surpluses, which they too seek to absorb through geographical expansion. Such a situation emerged in the mid-1960s, when US corporations were confronted with strong competition from Japanese and West European companies. Pampered by Marshall Plan aid, loans, and direct investment, the 'late industrialisers' not only conquered the North American market, but also many of the export markets of US companies. The combination of an advanced technological and industrial base with a lower wage level gave Japanese and West European companies clear price advantages vis à vis the US manufacturing industry, for instance, in the production of textiles, steel, cars, entertainment goods, machinery and other equipment. The competitive pressures resulting from the export offensive of the newcomers, as well as workers' mobilisations leading to wage increases in the US, Western Europe and the periphery, caused a profit squeeze in the

[7] At that time Arrighi (1974) too brought forward similar arguments, stating that the elite, the sub-elite and the proletarians (excluding migrant workers) were part of Sub-Saharan Africa's 'labour aristocracy'. According to him, they enjoy a relatively high standard of living thanks to multinational corporations, but this fact blocks a more comprehensive development. He maintained that this 'labour aristocracy' would probably oppose any redistribution of wealth, or the 'de-coupling from international capitalism'.

US manufacturing industry combined with growing idle capacities.

In view of insufficient profitability, investment capital flew to the financial markets. Profits accruing from trade and production increasingly went to the unregulated Eurodollar markets (above all the City of London), which leaped upwards particularly in the critical years 1968-73 followed by 20 years of rapid growth. In 1970, the US government reacted to this profitability crisis with an expansionary monetary policy and a drastic devaluation of the Dollar vis-à-vis Deutsch Mark and Yen, hoping to re-establish the country's international competitiveness. Low interest rates provided banks and companies with the necessary liquidity to expand foreign investments and exports. Consequently, the relative revaluation of DM and Yen weakened the competitiveness of German and Japanese exporters. So the problems of overaccumulation and profitability were not solved, but instead the burden had been redistributed between the leading capitalist states (Brenner 2005). The inflationary expansion of the money supply and the lasting dollar weakness gave the Bretton-Woods system of fixed exchange rates its final blow, and in 1973 it was officially buried. Continuing this co-operative system would have implied that the US revaluate the dollar, introduce strict budgetary discipline, and follow a hard economic adjustment process, in other words, exactly the kind of drastic measures the IMF was to impose on debtor countries in the early 1980s. At that time, the US was not willing to subject itself to such a harsh adjustment programme. It went against its interests both in restoring competitiveness through expansionary monetary policy, and in continuing the Vietnam war (Arceo 2002).

However, the continued strategy of global Keynesianism further weakened the US hegemony in the 1970s, marked, inter alia, by the US withdrawal from Vietnam in 1975, rising inflation and shrinking growth, waves of workers' protests in the US, Western Europe, Latin America, and Africa, the imposition by OPEC of drastic oil price hikes, developing countries demanding a new world economic order, and not least, the threat of a demise of the dollar as leading currency due to the high money supply outside the US, above all the Eurodollar markets, which were still swelling thanks to the buoyant oil business. The chairman of the US Central Bank, Paul Volcker, initiated the decisive turn in 1979. In the last year of the Carter presidency, the Federal Reserve restricted the money supply and increased interest rates, thus imposing the monetarist structural adjustment programme for the world economy, continued under President Reagan, which has since found eager followers all over the world. The essential elements of this programme are easy to sum up: tight money supply, high interest rates, a strong dollar, low inflation rates, falling wages, rising profits, lowering capital and income taxes, deregulation of financial markets, trade liberalisation, and not least – contradicting pure monetarism – a gigantic debt financed defence programme. In fact, 'Reagonomics' applied a combination of monetarist orthodoxy with Keynesian 'deficit spending' resulting in rising budget deficits and unprecedented levels of public debt (Brenner 2005).

With the collapse of Bretton Woods and the restrictive monetary policy introduced by Volcker, the governments dismissed the 'New Deal' of the postwar era and unleashed the financial industry: 'Just as the launching of the New Deal and its subsequent globalisation under Roosevelt and Truman were premised on the transfer of control over high finance from private to public hands, so its abandonment under Reagan was premised on the resurgence of private high finance at the commanding heights of the global economy' (Arrighi 1999: 240). The financial industry had certainly already expanded in the post-war years, together with trade and direct investment, yet the 'Volcker shock' gave an important additional push. From being a competitor, the US government turned into a supporter of private high finance. It deregulated the financial market and created positive conditions for financial transactions, similar to those already available in the unregulated Eurodollar markets and tax havens around the world. With this turnaround, the US initiated an aggressive competition for money that led to a gigantic redirection of international capital flows to the United States. In the shortest of periods the country turned from the most important source of liquidity and direct investment into the world's main debtor nation and the largest recipient of foreign capital. It created strong incentives to attract money, thus financing its growing trade and current account deficits.

At the same time, the 'reagonomics' placed their hopes on the 'disciplinary effects' of the financial markets. These were meant to enforce industrial restructuring and a reduction in unproductive overcapacities not undertaken during the Keynesian period, as well as to break the workers' 'wage militancy'. In practice, this was carried out by institutional investors (investment banks, pension funds, insurance companies and highly speculative hedge funds) who – due to the finance-led recovery – owned gigantic and growing fortunes. Yet they did not play the traditional role of bank creditors. Instead, they formulated detailed profit goals the industry had to meet in the future. The goals for 'returns on investment' were increasingly orientated at the profits that could be obtained in financial markets. From the capital perspective, the strategy was quite successful. Financialisation imposed a profound restructuring of US industry, increasing its rentability and profits. This included the closure of inefficient plants, outsourcing, the expansion of global value chains, support for innovative 'start-ups', and the dissemination of new technologies (Gindin/Panitch 2005; Brenner 2005). Besides all this, the monetarist programme also required a drastic modification of class relations. To secure the confidence of institutional investors, inflationary expectations had to be conclusively and convincingly broken. Hence, it was imperative to defeat the working class's aspirations and its demands for higher wages. Reagan's smashing of the air traffic controllers' strike in 1981 was seen as a sign of the new government's determination to take up the fight against organised labour. Paul Volcker called the defeat of the air traffic controllers the 'most important single action of the administration in helping the anti-inflation fight' (cited in Gindin/Panitch 2005: 64).

However, for the countries of the periphery, the capital 'flood' of the 1970s turned into the sudden 'drought' of the 1980s (Arrighi et al. 2002: 32). While in the 1970s the international financial expansion had been linked to high North-South capital flows, in the 1980s there was a particularly sharp decline in private credits, which were now concentrated to a much larger extent in OECD countries.[8] The effects of the financial bleeding of the periphery became evident in 1982, when as a result of rising interest rates, Mexico became the first country to default on its debts, followed by others. The intensified competition for capital, and the redirection of financial flows to the US did not only trigger the debt crisis that persists to the present day. Rather, this turnaround has been responsible for the diverging development in the periphery since the 1980s, i.e. for the noticeable 'bifurcation' between Africa and Latin America, on the one hand, and Asia, on the other hand. The rising capital inflow allowed the US to run large deficits in its balance of trade, and thus the import of those goods, that US companies no longer found profitable to produce. This posed opportunities for those East Asian countries whose historical development, combined with the post-war order, had given them sufficient incubation time for import substitution, and for the development of a competitive export industry. Thus, the Asian 'tigers' could now also follow the Japanese example, servicing the expanding US demand for cheap industrial products. The foreign exchange earnings accruing from their exports reduced the pressure to compete with the US in world financial markets. Moreover, since the East Asian states reinvest their export earnings in the US, the latter secures both access to their fortunes, as well as to their cheap goods, i.e. to the Asian labour force. Countries in Latin America and Africa, which for historical reasons pursued the import substitution strategy with less success, lost ground in the competition for the increased US demand. Deterriorated export conditions combined with insufficient exchange earnings led them into the hopeless position to directly compete with the US in the financial markets.

The postwar development of world merchandise exports (Table 1) clearly shows the shrinking share of Africa and Latin America compared to the South-East Asian 'tigers', and more recently, to China as well. The slight increase of Latin America`s share between 1993 and 2003 (from 4.4 to 5.2%) is due almost entirely to the boom of the *maquila* industry that set in after the NAFTA treaty came into force in 1994. Maquilas account for more than 20% of all Latin American exports.

Table 1	Share in World Merchandise Exports, in %				
	1948	**1953**	**1973**	**1993**	**2003**
North America	27.3	24.2	16.9	16.6	13.7
Western Europe	31.5	34.9	45.4	44.0	43.1
Latin America	12.3	10.5	4.7	4.4	5.2
Mexico	*1.0*	*0.7*	*0.4*	*1.4*	*2.3*
Brazil	*2.0*	*1.8*	*1.1*	*1.1*	*1.0*
Argentina	*2.8*	*1.3*	*0.6*	*0.4*	*0.4*
Asia	13.6	13.1	14.9	26.1	26.1
Japan	*0.4*	*1.5*	*6.4*	*9.9*	*6.5*
China	*0.9*	*1.2*	*1.0*	*2.5*	*6.0*
South East Asia (6 'Tigers')	*3.0*	*2.7*	*3.4*	*9.2*	*9.7*
Africa	7.3	6.5	4.8	2.5	2.4

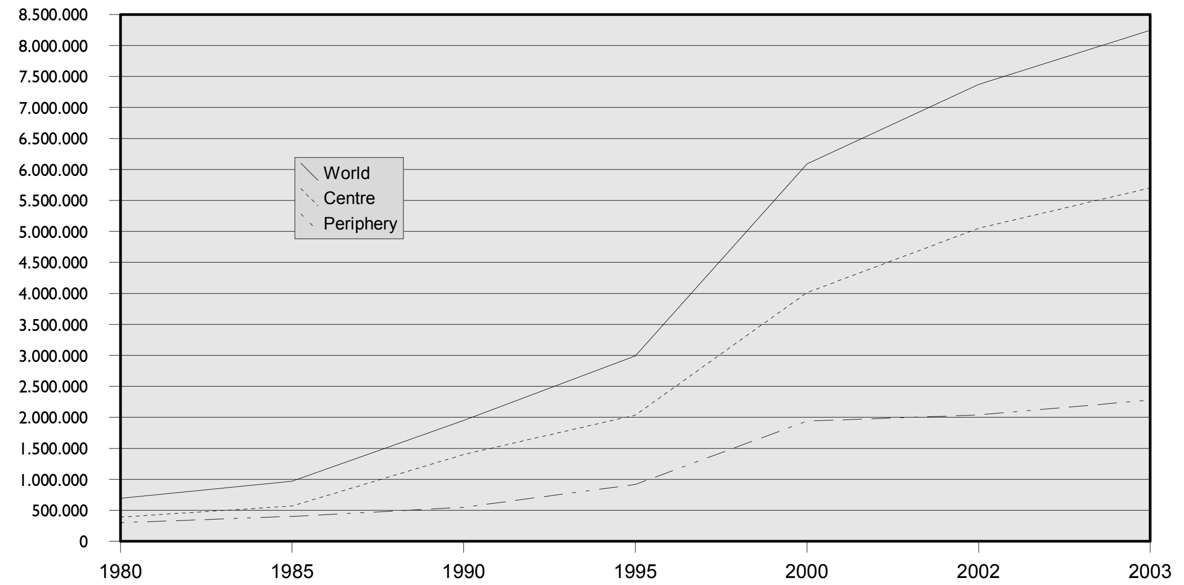
Source: WTO, International Trade Statistics 2004, p. 30

[8] The net capital transfer to developing countries between 1975 and 1982, when the debt crisis erupted, made up 4.91% of the GDP, dropping in the period of 1983-1989 to around 2.87%, and only climbing back to 5% of the GDP in the period 1990-98 (Akyüz/Cornford 1999).

The assumption still defended today by international development agencies, that ‘bad governance’ is responsible for this bifurcation of the periphery, implies that governments could have anticipated the monetarist turnaround in the US, and consequently also the redirection of capital flows, or they could have stopped that turnaround altogether. Both assumptions are equally unrealistic, and can be dismissed as fairy tales of official development discourses.

Under pressure of foreign debt and structural adjustment programmes imposed by the IMF, debtor governments bade farewell to internally orientated import substitution, placing their hopes on an export-oriented integration into the world market. The neo-liberal mix, which the elites of the periphery not only supported but also enforced, consisted of restrictive monetary policy, budget and wage cuts, privatisations and a further opening up to the world market. Trade barriers were lowered, foreign investment attracted and exports promoted – although with varying successes, as we have already seen. Liberalising capital movements proved to be particularly risky, since financialisation led to a significant change in the composition of capital flows. In particular, the share of volatile financial flows, that in case of a crisis could easily be redirected, increased significantly. This became evident in the crises of the 1990s in quite a drastic way. While bank credits had been the main source of finance for development countries in the 1970s, after the outbreak of the debt crisis they shrank to just 16% of their external finance. Moreover, the share of short-term credits increased as well. There was also a sudden rise of the especially volatile portfolio investments (shares, bonds, and other securities) from 3% in the 1980s to 21% in the 1990s. However, the most striking result of liberalisation was that direct investment became the primordial source of financing for peripherical countries. Before the debt crisis they only made up 9% of the net capital inflow, in the 1980s their share went up to 18%, reaching 34% in the 1990s. At the turn of the millennium, they made another leap upward: in 2003, 72% of net capital flows to developing countries consisted of direct investment (Akyüz/Cornford 1999; UNCTAD 2004).

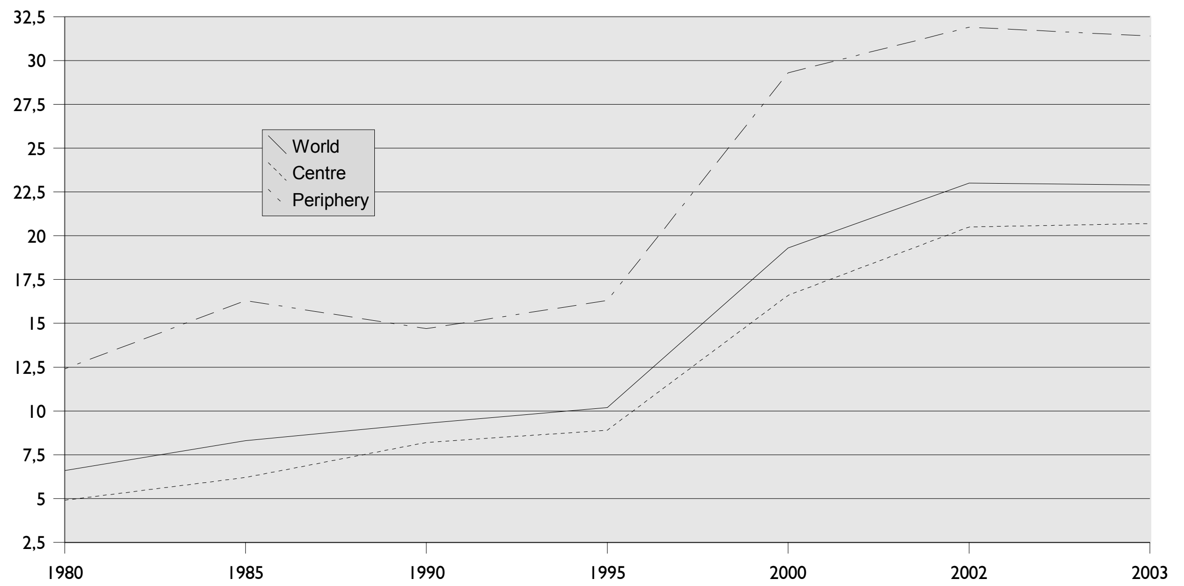
GRAPHIC 1: Foreign Direct Investment Stocks, in Million US $ (inward FDI stocks)
Source: UNCTAD 2004, Annex Table B.3.



However, the high relevance foreign direct investment (FDI) has for transnationalised production is not entirely evident from FDI flows, which fluctuate each year. Instead, FDI stocks accumulated abroad have to be examined. These increased steadily since the monetarist turn, independently of all financial crises. Whereas in 1980 world FDI stocks amounted to $ 700 bn, this sum climbed to $ 8.2 trillion by 2003 (Graphic 1, p. 25).

In this period, invested assets grew much stronger in the capitalist centres than in the periphery. While in 1980 about 56% of FDI stocks were concentrated in the centres, by 2003 this share reached 69%. Hence, the growth in foreign direct investment since the 1980s has not been accompanied by an equalising movement between North and South. On the contrary, the interpenetration of productive assets between the leading industrial countries grew much stronger than between centre and periphery.

Graphic 2: TNC Penetration: Ratio of FDI Stocks to GDP, in %
Source UNCTAD 2004, Annex Table B.6.



Despite this finding, foreign direct investment is highly relevant for many countries of the periphery. One of the instruments to measure dependence on FDI is the TNC penetration, i.e. the ratio between inward FDI stock and the gross domestic product (GDP). On average, TNC penetration rose both in the centres and the periphery, though at a far higher level in the latter. Whereas the TNC penetration in the centres amounted to about 5% in 1980, this figure had risen to more than 20% by 2003, i.e. FDI represented one fifth of GDP. In the periphery, the indicator rose from about 12% in 1980 to 32% by 2003, i.e. FDI represented one third of GDP (Graphic 2). These aggregated figures conceal large differences between individual countries. There are meanwhile a number of states where accumulated FDI stocks represent two thirds of GDP, or even more, like, for example, Chile (65%), Tunisia (66%) Congo (71.3%), Nicaragua (74.7%), Bolivia (78.5%), Gambia (88%), Angola (100%), Chad

(109.3%), Azerbaijan (117%), Equatorial Guinea (127.7%) and Guyana (125.9%).[9]

Undoubtedly, corporate power in these countries is enormous, and since very often only a few companies are involved, the level of monopolisation, too, is quite high.

5.1. Financial Crises and FDI Accumulation

Countries that had fallen into the debt trap after the monetarist turn only obtained 'fresh money' if they complied with structural adjustment and austerity programmes, imposed by the IMF and the World Bank, which included market opening and liberalisation of capital flows. These conditionalities are one of the reasons why the following devaluation crises mainly occurred in the highly indebted developing countries. The principal means used by G7 states and the international financial institutions to generate controlled devaluations are the credit system and the manipulation of interest rates. Nevertheless, the increasingly frequent regional crises that have occurred since the Latin American debt crisis (among others in Mexico 1994, Asia 1997, Russia 1998, Brazil 1999 and Argentina 2001) were barely able to stop the trend towards rising FDI stocks. Often, financial crises acted as catalysts for the accumulation of productive assets. Indebted and devaluated companies provided the ideal opportunity to absorb the surplus capital of transnational corporations. Local companies could be denationalised and merged into the monopoly capital at bargain prices. This became especially evident during the Asian crisis of 1997/98, both in South Korea, one of the countries with the lowest TNC penetration in the world, as well as in Brazil, where the dollar peg was abandoned after several crises.

After the US started a new round of its 'fight against inflation' and raised interest rates in early 1997, thus causing panic and capital flight in South-East Asia, South Korea got into severe debt-servicing difficulties, too. Central bank reserves melted to $ 6 bn, and in the following months the country had to service inter-bank loans worth $ 26 bn. Because of lower interest rates in the international capital market, Korean banks and companies had eagerly borrowed from international commercial banks, mainly short-term credits, which were not renewed in view of the crisis. Fearing that the crisis might affect the international financial system, the IMF intervened with the largest rescue package ever: $ 57 bn. The adjustment programme included requirements such as the restructuring of the business and financial sectors, as well as state authorities, and the liberalisation of the market. All governmental support that might have stopped the bankruptcy of indebted banks and companies was prohibited. Also, labour legislation had to be further 'flexibilised'. Finally, in May 1998, South Korea liberalised all types of mergers and acquisitions (M&A), including hostile takeovers. The government eliminated the cap on foreign ownership in South Korean firms, and liberalised 41 areas hitherto barred to international investors. It also announced that out of 108 state-owned companies, 38 would be completely and 34 partially privatised, with the rest being merged

[9] It comes as no surprise that 'direct investment' in the letterbox companies of unregulated tax havens in some cases exceed the GDP of these countries by several thousand per cent, as is the case with Bermuda (3,051%) or the Cayman Islands (3,157%) (UNCTAD 2004, Annex table B.6.).

and restructured (Chomthongdi 2000). The effect was compelling: by 1998, foreign direct investment had surged to $ 5 bn, and by 1999 to more than $ 9.4 bn, against an average of 1.3 bn in the period 1992-97. Mergers and acquisitions by foreign companies, which were practically nonexistent in South Korea until the mid-1990s, saw a similar leap upwards. While in 1997 they amounted to only $ 800 million, by 1998 they had rocketed to $ 4 bn, declining again only from 2000 onwards (UNCTAD 2004). In view of the sudden rise in foreign ownership, commentators in South Korea and other Asian countries spoke of a 'second Opium War' (Veneroso/Wade 1998: 14).

The crisis clearly weakened the labour movement, not only because of the steep rise in unemployment. Rather, the IMF reforms imposed by Kim Dae-Jung's government against all resistance meant a hard blow, especially regarding the new labour law, which was implemented with only minor amendments. Under Kim's predecessor, Kim Young-Sam, the two union confederations, KFTU and KCTU, had organised mass protests and a general strike against the new law. It undermines the system of unemployment benefits, flexibilises the working week, and facilitates lay-offs and the recruitement of temporary workers. The important labour conflict in the Hyundai motor works of 1998, in which unions shifted to a more defensive line, accepting the management's lay-off plans in exchange for some compensations, was seen as clear evidence of a weakened labour movement (Kong 2005).

Similarly instructive is the example of Brazil under the leadership of Fernando Henrique Cardoso. The introduction of the '*Plano real*' in 1994[10], i.e. the pegging of the *real* to the dollar, contained inflation, but at the same time it also weakened the competitiveness of Brazilian goods, especially industrial products. The trade balance and the current account dropped dramatically, while foreign debt steadily increased (table 2). The situation worsened with every revaluation of the dollar. The first time this happened was in 1994, when the US raised its interest rates from 3 to 6% in one year. While, as a result, the Mexican peso collapsed, Brazil also opted for rising interest rates to counter capital flight and speculation against the *real*: the interest rates rocketed from 42.4 to a sky-high 65.8%. Though this attracted short-term speculative capital, the drastic shortage of money supply undermined all forms of domestic development. A similar episode occurred in 1997, when Brazil was shaken by capital flight and speculation against the *real* after a dramatic increase in US interest rates and the ensuing Asian crisis. Again, the volatile financial flows could only be reverted by drastically increasing the interest rate, this time from 22 to 43%. Nevertheless, Russia's default in August 1998 was the final blow for the '*Plano real*'. Following capital flight and a speculative wave, the Brazilian Central Bank spent a large share of its foreign reserves to defend the *real*. Only an IMF rescue package of $ 41.5 bn was able to postpone the collapse of the Brazilian currency, thus securing Cardoso's second term in office. Since the IMF attached the well-known conditions of interest rate increase and budgetary surplus, the Brazilian economy was strangled even more. Eventually, a coordinated speculative attack against the *real* in January 1999 forced the government to abandon the dollar peg, and the

[10] At that time, Cardoso was still Secretary of Finance.

real was left in free fall. The Central Bank wasted more than $ 50 bn of its foreign reserves in the fruitless attempt to defend the plummeting currency (Rocha 2002).

Table 2	The *Plano Real*, in billion US $				
	Trade balance	Current account	Foreign debt	Net FDI flows	M&A
1994	10.4	-1.7	148.2	-2.5	0.4
1995	-3.4	-17.9	159.2	1.4	1.7
1996	-5.5	-23.1	179.9	7.7	6.5
1997	-8.3	-30.7	199.9	13.7	12.1
1998	-6.5	-33.4	241.6	22.9	29.3
1999	-1.2	-25.4	241.4	23.4	9.3
2000	-0.6	-24.6	236.8	28.5	23.0
2001	2.6	-23.2	210.8	17.4	7.0

Sources: Rocha 2002; Net FDI flows: CEPAL 2005: 92; M&A: UNCTAD 2005: 413

However, during the whole period of the *Plano Real*, and especially in the turbulent crises years from 1997 to 2000, foreign direct investments – supported by Cardoso's radical privatisation programme – experienced strong growth. Thus, between 1996 and 2000, net direct investment grew from $ 7.7 bn to $ 28.5 bn. Mergers and acquisitions (M&A) saw a similarly remarkable growth. Here, the salient change took place between 1999 and 2000. The sudden rise from $ 9.3 bn to 23 bn refers to the devaluation of the *real* since 1999 making the purchase of Brazilian companies cheaper (Table 2). Between 1995 and 1999, transnational corporations were involved in more than 70% of all M&As. High internal interest rates combined with import liberalisation drove many local companies into bankruptcy, or forced them to merge with transnational corporations. As the Brazilian magazine 'Veja' said, 'in the history of capitalism, there are very few examples of such a comprehensive transfer of business control in such a short period' (cited in Rocha 2002: 23).

For the labour movement, the financial instability combined with growing foreign direct investment led to a sharp rise in unemployment. According to official estimates, which systematically underestimate the real rate, it rose from 4.6% in 1995 to 9% by March 2000. Other estimates calculate the unemployment rate in the industrial region of Greater São Paulo at 13.2% as of 1995, rising to 19.3% in 1999 and 20.4% by May 2002. Between 1999 and 2001 alone, real wages dropped by 10%, while absolute poverty increased to 34% of the population, and another 14.5% of the population were condemned to live in relative poverty. This deterioration was 'the direct result of the massacre of small and medium enterprises under the double pressure of high interest rates and drastic liberalisation' (Rocha 2002: 29). Despite the loss of about 20% of industrial jobs under Cardoso's government, grass root unions didn`t suffer an overly strong loss of members. They were even able to raise the membership, particularly of women, and in rural areas (Rodrigues 2005).

6. Global Value Chains

We will now examine the specific mechanisms of unequal development associated with modern value chains and production networks. To do so we shall describe the genesis of the contract types characteristic of modern value chains, followed by a description of production networks in the automotive and electronics industries, their internal and external power relations, and their flexibilised working conditions. We will also outline the effects of growing corporate penetration on the global distribution of wealth, as well as the services provided by the modern trading system to secure the hierarchical structure of global value chains.

Ever since the 1970s profitability crisis of 'fordist mass production', and the start of industrial restructuring in the 1980s, there has been an intense debate on the kind of production model that could replace the ailing fordism. A number of 'post-fordist' models have been discussed: Japanese 'lean production', with flexibilisation of working conditions, team work, 'just-in-time' delivery, and vertical disintegration through outsourcing to subcontractors; the 'flexible specialisation' of comparably small firms, which produce in a craftsman-like, highly modern and flexible way, and are concentrated in industrial districts or 'clusters' like those in northern Italy; and not least the 'new economy', symbolised by the boom of IT and internet companies, whose 'digital production' seemingly doesn`t need traditional industrial work anymore. (Neffa 1999; Zysman 2002). Independently of the above-mentioned fads, global value chains and production networks have become a noticeable characteristic of the new international division of labour. Their rise would have been impossible without the rapid growth of foreign direct investment that set off in the late 1980s, yet they also go beyond the classic FDI links. However, growing FDI stocks have as yet failed to prove the existence of the much-alleged equalising movement between centre and periphery. The question thus arises as to whether global value chains and production networks alter this diagnosis. Are there any signs of change in the 'oligarchic wealth' that results from the disintegration of the production process and its subsequent reintegration in remote parts of the world?

We first have to draw attention to one significant difference between the FDI-led internationalisation of production on the one hand, and value chains and production networks on the other hand. Dieter Ernst (1997) stresses that the modern means of communication and transport facilitate global production strategies that do not necessarily require direct investment. Whereas FDI implies partial or complete ownership and control over a company, the last two decades have seen an increase in cooperation models that do not require transfer of ownership or equity participation, such as licensing agreements, management contracts, contract manufacturing, franchising and strategic alliances. Drawing on UNCTAD, Ernst (1997: 33) proposes a wider definition of international production, whereby 'control over foreign productive assets is typically established through FDI, but can also be exercised through various non-equity forms'. He argues that the predominant focus on FDI is the 'Achilles' heel of research on globalisation', since it is precisely the non-equity links that enable integration of small and medium-size enterprises into international production networks. Small and medium-size enterprises habe become relevant carriers of 'systemic globalisation', since they fill the gaps which large companies can neither detect, nor fill for themselves. At the same time they also act as buffers, and as cheap, flexible, and fast suppliers of a large variety of production inputs.

The emergence of international production networks is illustrated by the disintegration of the large vertically integrated US multinationals of fordist mass production, such as Ford, General Motors, General Electric and IBM. Since the 1980s, these firms have concentrated on their ‘core competencies’ and the highest value-added segments of production (like research & development, design, product strategy or marketing), while reducing direct ownership of ‘non-core functions’ like assembly, services or manufacturing (Gereffi et al. 2003). This also changed the international division of labour. Until the late 1970s, the linkage between the globally dispersed production sites of multinational corporations was typically that of a parent company to its wholly-owned subsidiaries. As a response to pressures from intensified competition and institutional investors, the vertical integration of these locations was deeply restructured. Since then, alternative cooperation forms like long-term contracts, contract manufacturing, strategic alliances or joint ventures, which exist alongside the traditional equity-based linkages, experienced steady growth. Having said that, the worldwide growth of FDI stocks signals that vertical integration does not at all become irrelevant, but alternative cooperation forms arrived on the scene to complement them.

6.1. The Japanese Commodity Periphery

Bunker und Ciccantell (2002) point out that the typical cooperation forms of modern value chains were not developed by US corporations, but by Japanese steel companies, which had already applied them in the postwar decades. The example of the Japanese steel industry is instructive as it illustrates how the intentional creation of dependency and power relations in value chains leads to an extremely unequal cost-benefit distribution between centre and periphery. These power relations do, in fact, reconstruct the hierarchy of the world system. To secure its postwar economic development in a country poor in natural resources, Japan’s steel industry needed a permanent and cheap supply of coal and ores. Assisted by the World Bank and the US, and coordinated by its Ministry of International Trade and Industry MITI, Japan invested large sums improving the transport infrastructure – above all ports, canals and supertankers – to ensure fast and cheap delivery of the necessary raw materials for steel production even from remote regions. At the same time, transport distances were steadily growing. While in the early days coal had been delivered from relatively close countries like Australia, Indonesia, China, Taiwan and the Soviet Union, in time supplies also originated in Canada, South Africa and Brazil, among others. From the early 1960s, Japan began turning into the world’s no. 1 steel producer and exporter. Whereas in 1960 Japanese firms were responsible for 8.8% of the world’s steel exports, by 1976 their share had reached 40.8%.

Due to their correspondingly high demand for coal and iron ore, Japan’s steel companies and government systematically took care of lowering both the costs of raw materials and transport. Before negotiating with coal producers, Japanese steel firms consulted each other. Creating cartels strengthened their position in price negotiations, enabling them to play the coal companies against one another. Their strategy consisted in systematically generating overcapacities in the coal industry, thus lowering the world market price. Hence, the Japanese steel industry preferred to sign contracts with those companies whose governments appeared willing to subsidise coal exports. Thus, the coal companies would put pressure on their governments to promote raw materials exports to Japan. To create incentives for opening up new coal mines, the Japanese offered the prospect of long-term purchasing contracts. Japan's direct investments remained rather low, mainly joint ventures which did not exceed minority ownership. The profitability of these investments played a minor role. It was far more important to generate long-term overcapacities, thus lowering the world market price of coal. This strategy was so successful that the costs of Japanese coal imports were halved between 1959 and 1998. For the coal producing countries on the other hand, the price decline meant falling profits, merciless competitive pressures, and, in many cases, bankruptcy. The resulting restructuring of the coal industry left behind indebted companies, closed mines, and many socially and ecologically devastated regions. This decline was a calculated element of the global value chain of the steel industry: 'At the same time that joint ventures between Japanese steel firms and their Canadian partners have faced repeated crises, the Japanese steel firms have been busy signing new long-term contracts in Australia, South Africa and Indonesia to support the opening of new mines, creating even more excess capacity' (Bunker und Ciccantell 2002: 86).

Japan eventually adopted the same model in Brazil in the late '70s, when, as part of the 'Grande Carajás' project, the world's largest iron-ore mine was opened up. The Carajás region is believed to contain the densest concentration of mineral resources in the world. A year after the failure in 1977 to strike a joint venture with US Steel to develop the mine, the 'Companhia do Vale do Rio Doce' (CVRD) – at that time still state-owned – made a new attempt. After the World Bank had signalled its willingness to provide finance, consultants of JICA (Japanese International Cooperation Agency) wrote a feasability study for an integrated iron ore project in the Carajás region. Their concept was largely accepted when the Brazilian government approved the project in 1980. Such was the influence of the Japanese government on the project that it fit perfectly into Japan's global supply strategy. Promising long-term purchasing contracts Japan persuaded CVRD and the Brazilian government to build an 890km long railway line to the port of São Luis, as well as huge ships, which at that time could only dock in Japan and Rotterdam. The initial arrangement with US Steel would have been much cheaper for Brazil, since smaller vessels could have shipped the ore to the US. Despite all this, the Brazilian government opted for the more expensive concept, and, coinciding with the outbreak of the debt crisis, lots of credits were disbursed – stemming from the World Bank, the European Union, Germany, and Japan – though they covered just a part of the investment costs. And CVRD was really the model child for the Japanese strategy of surplus production. To become integrated into the value chain of Japanese (and European) steel production, CVRD lobbied politicians at federal level, obtaining generous tax exemptions and subsidies for the Carajás project: easy land purchases, cheaper loans, subsidies, credit guarantees, a 10-year waiver of the income tax, as well as a halving of import duties and the value added tax. Integrating the Amazon into the Japanese raw materials periphery meant for Brazil high capital costs, low profits, and an impoverished state (Carvalho 1997).

In the 1980s, the innovations of the Japanese steel industry described above – long-term contracts, joint ventures and other forms of cooperation – became key elements in the global restructuring of US and European corporations, which, in response to their Japanese competitors, disintegrated to create global production networks. Bunker und Ciccantell (2002: 94) conclude that 'this new model of capital accumulation has had very similar impacts on redistributing the costs and benefits of development between centre and periphery for a wide range of global industries'. Therefore, in the subsequent chapters we want to have a look at two other global value chains: those of the automotive and electronics industries.

6.2. The Production Network of the Automotive Industry

The carmaking industry illustrates the shift from vertically integrated production to modern value chains. Particularly in the context of import substitution, many host countries of foreign direct investment – for instance, Brazil, India and South Africa – conditioned market access to local manufacturing and and the use of locally produced inputs. Automotive production developed under strict control of the state. India, for instance, regulated production through a licensing system, which controlled output, models and prices. The government promoted above all lorries, tractors and buses, while the production of cars remained far below demand. Two local companies built most of the vehicles: 'Premier Auto' and 'Hindustan Motors'. Only in the mid-1980s did the government cautiously start to open the Indian market, at first just in the form of joint ventures with foreign companies. Similarly, until the early 1990s Brazil`s automotive regime also promoted local production. Although foreign assemblers like Fiat, Ford, General Motors and Volkswagen were permitted, the parts and components industry that had been emerging since the 1960s was largely owned by local capital. In as late as 1990, imported cars made up less than one per cent of domestic sales, and the import of components covered just 10 per cent of total domestic demand. In 1991/92, India imported just 362 new and second-hand cars, i.e. 0.2% of local production. The import of components equalled 20% of internal production. However, following the forced market openings in the 1990s, these structures underwent a profound change, as the example of Mercedes Benz in Brazil demonstrates (Humphrey 1999).

In the early 1990s, the Brazilian government began liberalising trade for the first time, introducing additional measures to promote foreign direct investment in the mid-1990s. Against this background many companies already active in Brazil expanded their production capacities, and some firms not previously present on the Brazilian market erected new plants, among them Mercedes Benz, Honda, Peugeot, Renault and Toyota. The Mercedes Benz factory was intended to produce 70,000 units of the A-model series. From the start, the corporation used the typical concepts of modern production networks, i.e. 'follow design' and 'follow sourcing'. Mercedes Benz developed the model design in Germany with its major first-tier suppliers. These design standards also apply for the suppliers at the Brazilian location, who may only carry out minor adjustments to local conditions. The supplier network in Brazil consists of about 80 main suppliers and 50 smaller firms. The preferred suppliers are those that already supply Mercedes Benz in Germany, and that also erected plants close to the Brazilian Mercedes factory so they can deliver components 'just in time' for assembly. About 70% of the European suppliers already had subsidiaries in Brazil. Mercedes encouraged suppliers not located in Brazil to also open up operations there. Thus, the principal suppliers have meanwhile become transnational companies that are servicing various carmakers worldwide. When companies already operating as suppliers in Germany cannot deliver a component, Mercedes recurs to other transnational suppliers as its second best option. Only if no transnational company can deliver in Brazil local component manufacturers may become involved. In the hierarchy of the Mercedes production network, Brazilian companies supplied only four components of the A-model series (Humphrey 1999).

A drastic effect of foreign direct investment in the automotive sector was the sale of the major local component manufacturers to transnational corporations. In the context of 'follow sourcing' it became impossible for local manufacturers to survive as independent first-tier suppliers of the automotive industry. Apart from this denationalisation of an entire industry, foreign direct investment was also associated with a sharp increase in component imports. In spite of 'just-in-time' production, not all inputs have to be manufactured in the immediate vicinity of the assembly plants. Within six years of liberalisation, the number of components imports had increased sharply. The European Union, for instance, enjoys a stable trade surplus vis-à-vis Brazil in the segment of auto parts (Fritz 2004).

A further negative consequence Brazil suffers from its subordinate integration into the global production network is the loss of technical qualifications. Research and development, as well as the design of car components remain concentrated in the US, Europe and other industrial districts. As regards employment, due to growing productivity Brazil also experienced significant lay-offs in assembly and component manufacturing, with a particularly high job loss at the management level. Staff in final assembly and the workers of first-tier suppliers may enjoy comparatively good working conditions, but these remain very contradictory: management techniques such as team work, quality circles and 'job enrichment' are neither reflected in remuneration, nor in stability of employment. Quite the contrary: throughout all levels of the production network temporary work increased significantly. Moreover, working conditions at the end of the supply chain are considerably worse, including irregular sweatshops and child labour.

6.3. Contract Manufacturing in the Electronics Industry

The IT and electronics industries underwent a profound transformation towards global production networks, associated above all with contract manufacturing. Corporations from the US, Europe, and Japan – such as Cisco, IBM, Hewlett Packard, Siemens, Ericsson and Sony – largely, or even completely, made the decision to get out of manufacturing and instead focus on the development and marketing of new technologies. These 'non-factory' brand firms outsourced the production of PCs, mobile phones, and other IT devices to contract manufacturers, which, like the first-tier automotive suppliers, also transformed into multinational firms. Hence, the five US companies Solectron, Flextronics, Sanmina DCI, Celestica and Jabil Circuit alone dominate the world market of contract manufacturing. Nevertheless, they remain widely unknown. Their names do not appear on any devices because they produce exclusively for the leading international firms. The 'nameless' contract multinationals produce in Asia, Latin America and Eastern Europe, sometimes employing several thousands of staff, mostly in large factories. They typically crowd into free export zones and other industrial clusters, for instance, in Malaysia (Penang), China (Shanghai, Shenzhen), India (Bangalore), Brazil (Campinas, Manaus), or Mexico (Guadalajara, Monterrey). Similar to the automotive production networks, these industrial districts also became the new locations of contract manufacturers which already had established business relations with the electronics multinationals in their countries of origin. Paradoxically, the disintegration of brand firms leads to the return of vertically integrated fordist mass production in the low-cost locations of the periphery (Sproll 2003). Nonetheless, South-East Asia differs from other contract manufacturing locations in that it developed a veritable domestic electronics industry, alongside Japanese and US corporations. With the exception of the state-owned conglomerates (*chaebols*) in South Korea, these companies were financed to a large extent by the regional Chinese Diaspora. Chinese foreign capital played an important role in developing industrial capacities, not only in the 'Chinese Triangle' (the People's Republic of China, Taiwan and Hong Kong), but also in Singapore, Malaysia, Indonesia and Thailand (Borrus 1997).

Contract manufacturers do increasingly engage in local sourcing, too. Local companies which manage to get listed as certified suppliers of contract manufacturers produce packaging material, plastics and user manuals, or offer services, such as programming or engineering work. The contract manufacturers are thus able to diversify products and services, which they supply simultaneously to many lead firms of the electronics industry. Meanwhile, in addition to component manufacturing and assembly, their 'one-stop-shops' comprise test routines, product re-design, storage, logistics, distribution, customer services and repairs. Nevertheless, the hierarchy of the electronics industry value chain remains unchanged: the brand firms still concentrate their research & development activities in industrialised countries, where they also manufacture strategic components and develop new prototypes. Accordingly, this structure reproduces the unequal distribution of knowledge, engineering capacities and value added. The poles of this 'profit rate hierarchy' are marked by researching centres at one end, and manufacturing peripheries at the other end.

To defend this decoupling of innovation and manufacturing, as well as their own position, brand firms have to prevent their know-how from leaking into the network. Their main defence consists in defining international product standards and technical norms. The research & development departments brood over codes of operating systems, the architecture of integrated circuits, transfer protocols in data nets, and, above all, definitions of interfaces. These are decisive resources for controlling production networks and markets. But they are also the origin of major contradictions. To the extent in which both product and process knowledge are bundled into 'digital packages', before being transferred to the contract manufacturers, the risk of a valuable 'intellectual property' drain increases. Production knowledge can 'be copied, re-engineered, or stolen' (Zysman 2002: 41). The CAD file (computer aided design), without which a contract manufacturer could not produce any electronic element, might contain decisive lead firm knowledge. This is one of the reasons for the globalisation of legal instruments protecting 'intellectual property rights'. Worldwide recognition of patents, copyrights, product standards and technical norms secures the oligarchic structure of modern production networks. Their implementation remains an important responsibility of the state, which is coordinated by international bodies like the World Intellectual Property Organisation (WIPO) and enforced by the World Trade Organisation (WTO).

Technological knowledge is nevertheless being to some extent disseminated in the production networks of the electronics industry. Even some research and development tasks have meanwhile been transferred to 'low-cost locations' with qualified workers. The extent of this dissemination may vary between individual companies and individual locations. At present, the question of which direction the corresponding development might take remains open. Gereffi et al. (2003: 14) point out that IT systems are being developed in two different directions at the same time: on the one hand, towards 'proprietary systems', which are customised to the specific needs of brand firms, and which require a closer collaboration with suppliers but provide more effective intellectual property protection; and on the other hand, towards 'open standards', which facilitate modular network structures and the participation of third parties, but also imply a higher risk of intellectual property leakage.

However, the electronics industry has proved to be highly mobile, so the dream of 'upgrading' might rapidly turn into a nightmare of 'relocation'. This happened to Guadalajara, the Mexican 'Silicon Valley', which since 1997 enjoyed a large inflow of contract manufacturers, thanks to its qualified workforce, technical infrastructure, training centres, and flexibilised labour laws supported by corporatist unions. Some contractors erected plants for over 10,000 employees. Just a few years later, however, the tide turned. The burst of speculative bubbles and the end of the New Economy boom in 2001 generated large overcapacities in the IT sector, resulting in 'downsizing', layoffs, closures and relocations, among other places, also in Guadalajara. Flextronics and other contract manufacturers transferred large production units from Mexico to their Chinese factories. Local politicians remained paralysed in the face of enormous job losses (Sproll 2003).

One of the main contradictions of contract manufacturers is that in spite of being technologically highly modern, their division of labour remains extremely taylorist, with a correspondingly polarised qualification structure. A small group of highly qualified technicians and engineers corresponds with a large mass of poorly qualified and badly paid workers, mostly young women and migrants. Flexible labour relations, i.e. 'hire-and-fire' jobs, absorb the constant abrupt changes in order volumes. In many cases, temporary work agencies are completely in charge of recruiting and administrating the labour force. Yet the extent of precarious working conditions also mirrors the strength of the respective working classes. Mexico, where co-opted unions – closely linked to the old state party PRI – still prevail, and autonomous, combative labour organisations are almost nonexistent, has seen the emergence of a particularly large temporary work market. Temporary employment multinationals like Adecco or Manpower appeared on the market together with contract manufacturers. This was different in Brazil, where labour resistance achieved legal restrictions and collective agreements, which managed to contain the advance of temporary work (ibid).

6.4. Industrialisation and World Income Distribution

At first sight, it seems that the expansion of foreign direct investment and the emergence of transnational value chains indeed bring about industrial convergence between centre and periphery. Arrighi et al. (2002) point out, that developing countries went through a profound structural change. As a consequence, since 1980 developing countries attained a higher degree of industrialisation than the so-called 'industrialised countries'. While in 1960 the manufacturing sector of the developed West contributed 28.9% to the GDP, this share had fallen to 24.5% by 1980, and to a mere 19.8% by 1999. In the periphery, the trend was exactly the opposite. There, the contribution of manufacturing to the GDP climbed from 21.6% in 1960 to 24.3% in 1980, falling slightly to 23.3% in 1999. The UN's Industrial Development Organisation, UNIDO, presented very similar figures: whereas in 'developing countries' the share of GDP in manufacturing climbed from 18% in 1980 to 24% in 2000, in 'industrialised countries' it dropped from 23% to around 20% (UNIDO 2004: 137). In addition, one has to bear in mind that the trend towards 'tertiarising' – i.e. the increasing significance of services – partially hides activities that are also genuinely manufacturing or industrial operations.[11] The 'outsourcing' of hitherto internal operations and 'off-shoring' them to low-cost locations only formally transformed many manufacturing jobs into independent services.

However, the apparent industrial convergence of centre and periphery has been accompanied by a persisting income gap, both between these regions, as well as within developing countries. Arrighi et al. (2002) also compared the GDP per capita of peripherical countries with that of the centres for the period from 1960 to 1998. According to them, during the period from 1960 to 1980, the GDP per capita of the periphery as a proportion of the GDP per capita of the centres fell from a modest 4.5% to 4.3%. And between 1980 and 1998, this proportion increased only marginally from 4.3% to 4.6%. The authors stress that

[11] In the OECD countries, services meanwhile account for 60 to 70% of GDP, while in the developing countries the proportion is estimated at 40% on average. Whereas their increase in the centres is associated with the declining importance of both the primary sector (agriculture and mining) and the secondary sector of manufacturing, their increase in the developing countries occured mainly to the detriment of agriculture and mining, since in these countries the relative weight of manufacturing augmented as well.

the modest decline of inter-country inequality in the 1990s 'is completely due to the rapid economic growth of a single country: China' (ibid: 36).

Kaplinsky (2004) summarises the diagnosis of poverty and inequality:

a) The number of people in absolute poverty (defined by the availability of less than one dollar per day) indeed dropped between 1990 and 2000 from 1.2 to 1.1 billion, but this decline was almost exclusively due to China's growth. Excluding China the number actually rose from 877 to 896 million.
b) Inter-country income inequality grew significantly.
c) Likewise, income inequality increased within most countries; this includes 'successful' developers like China or Chile, 'failing' countries in Sub-Saharan Africa, and most of the wealthy countries, as well (worthy of mention, income disparities grew particularly in the market liberal Anglo-Saxon countries Australia, Great Britain and the USA).

In his analysis, Bornschier (2002) concludes that international income inequalities clearly increased between 1980 and 1997. The per capita income disparities between 103 countries (among them 21 OECD members) grew, measured in real incomes, by 43.3%, and measured in purchasing power parity, by 20.1%.

Acknowledging the persisting income gap between centre and periphery – despite the apparent industrial convergence – points to the conflation of development with industrialisation, widely prevalent in mainstream development theories. It is quite obvious that peripherical societies' attempts to catch up with the centres have as yet failed to translate into a noticeable narrowing of the global income gap. The industrialisation efforts obviously came at high costs, be they social, ecological or economic. We have to recall the enormous costs of fiscal incentives aimed at attracting FDI, the losses incurred due to the intentional creation of high excess capacities in raw materials, the falling commodity prices due to powerful purchasing cartels, the abandoned mines and regions after price declines, the relocations after the burst of speculative bubbles, and not least job losses and impoverishment after 'switching crises'. The impacts of all those mechanisms of unequal development are much worse in the periphery than in highly developed centres. At the same time, the bifurcation within the 'Third World' showed that – for historical reasons – some parts of Asia derived relatively more benefits from industrialisation than many countries in Latin America and Africa. However, not even this apparent 'success' could change the oligarchic global distribution of wealth.

The persisting income disparities are a clear sign of unequal development – and they are precisely a result of integration into the capitalist world economy. Under the given circumstances, the expansion of direct investment and the integration into global value chains will unavoidably produce winners *and* losers. Capitalist production indeed expresses itself as a variety of inequality creating mechanisms. Moreover, a number of empirical studies confirm the strong correlation between TNC penetration and intra- and international inequality. The overview of current research presented by Beer und Boswell (2002: 41) shows that dependence on foreign direct investment 'has been found to be significantly associated with high levels of inequality'. Within countries, a strong dependency on FDI mainly benefits the high-income strata of society, while the low-income majority suffers losses. These mechanisms particularly affect countries with high corporate penetration, i.e. with large FDI stocks in relation to GDP (see above). Beer und Boswell stress that, in principle, this polarising movement also concerns industrialised countries with high FDI growth, for instance, the US and Great Britain.

6.5. The Hierarchy of Value Chains

Nevertheless, not only TNC penetration generates mechanisms of unequal development, value chains do this as well. Their internal and external parameters are set to shield lead companies against potential competitors and provide them with 'rents'.[12] The players inside and outside the production networks partly assist each other in imposing and maintaining the specific hierarchies of the value chains. Lead companies take a range of measures to prevent their rents from eroding early. Doing this, they enjoy the support of an ample network of national and international institutions. But let us first turn to the internal network management.

In the research literature the terms 'chain governance' or 'governance of value chains' are used to describe the efforts to secure the hierarchy of profit rates, typical for value chains (among others Gereffi et al. 2003; Humphrey/Schmitz 2001). Specific 'governance' typologies are developed applying various criteria. The governance of 'buyer-driven' value chains – dominated, e.g., by brand firms from the electronics or textiles industries (Siemens, Nike) or by multinational retailers (Wal Mart, Carrefour) – differs from the governance in 'producer-driven' value chains, for instance, in the automotive industry. According to another typology, inter-firm relationships move between a 'market-based' pole, where changing business partners is relatively inexpensive, and the opposite pole of vertically integrated firms, where changing partners may be quite costly. Humphrey and Schmitz (2001: 10) identify as one major governance trend a high concentration of buyers combined with an increasing number of suppliers: 'a growing number of manufacturers from developing countries takes up contract manufacturing for a decreasing number of buyers'. So what obviously also grows in modern value chains is the monopoly, and thus the accumulation of 'monopoly rents' of lead firms to the detriment of potential competitors and the army of suppliers.

A further governance trend relates to the growing significance of brands. Lead firms spend enormous amounts of money on developing, marketing and protecting their brands, particularly in the consumer goods industry. The annual ranking of the 100 best international brands, published by the consultancy firm 'Interbrand', gives an indication of the relevance of brands (Interbrand 2005). In 2005, the leader was Coca Cola, with a brand value of $ 67.5 billion, followed by Microsoft (59.9bn), IBM (53.3bn), General Electric (46.9bn) and Intel

[12] The concept of 'rents' refers to the advantages that economic players obtain through protection from competition, i.e., when competitors are hindered from entering the market, or the economic players themselves set up barriers that close the market.

(35.5bn). These sums express the net present value of future earnings secured by the brand. US corporations, followed by European and Japanese firms, dominate the list. Only three of the top 100 brands come from the periphery, owned by the South Korean companies Samsung, Hyundai and LG. While these figures clearly exhibit those benefitting most in buyer-driven value chains, brands also stand for certain quality standards that lead firms must secure. They depend on the timely delivery of normed products by their contract manufacturers. Defective products or unforeseen delivery failures threaten the brand value, and accelerate the constant erosion of monopoly rents. So, on the one hand, brand firms have an objective interest in upgrading their contract manufacturers. Yet on the other hand, this conflicts with constant competitive pressures and price wars. To escape the dangerous ‘profit squeeze’, lead firms scout continuously for suppliers who offer ever cheaper labour and production costs. But the ensuing change of partners poses the danger of faltering supply or declining quality, which again would endanger the brand value.

Control may also be exerted through the contract types prevalent in global value chains. Since in many countries of the periphery one single TNC or a de facto cartel offers branded or patented products, the patent-holding multinationals can largely dictate their conditions to the local licensees. By defining production methods, prices, sales regions, and license duration, they manipulate not only the profit rate, but also prevent the leakage of their know-how, that, from the licensees’ perspective, would be a welcome technology transfer. Therefore, the status of manufacturers in the periphery remains that of dependent licensees of knowledge monopolising multinationals. Considering further that 94% of research & development spending, 86% of patent applications, and 97% of licensing fees are concentrated in industrialised countries, it seems more likely that the technological gap will increase, rather than diminish (UNDP 2003: 207, UNIDO 2003: 155). The enormous growth of worldwide licensing fees – they increased at an annual rate of 17% between 1985 and 1998 – highlights the growing relevance of private ‘intellectual property rights’ for modern network capitalism (UNIDO 2003: 38).

6.6. The Globalisation of the State

With the transnationalisation of production emerged the need to also globalise the specific services that states provide for manufacturing. Institutions outside the value chains either had to be created from scratch, or had to be ‘upgraded’ to enforce private property rights and capital mobility, now on a global scale. In addition to the international financial institutions like the World Bank and the IMF, the internationally binding treaties of the World Trade Organisation (WTO), founded in 1995, provide important elements to safeguard globalised production. In a certain way they represent the transnational counterpart of the contractual and property rights guaranteed by capitalist states. The WTO treaties support precisely the lead firms of production networks in maintaining and enforcing their ‘chain governance’, thus contributing to the expansion of global monopolies. This support is especially effective in the periphery, since the WTO’s dispute settlement mechanism permits harsh trade sanctions against 'dissidents', which have a particular severe impact on countries with a narrow export range. However, these globalised state functions will always depend on the capacity of individual states to implement international legislation. Hence, global institutions like the WTO use state apparatuses via the respective governments.

The WTO services for transnational corporations concern both business linkages established through FDI as well as non-equity linkages typical for global value chains. Thus the TRIMS agreement (Trade-Related Investment Measures) imposes considerable obstacles if WTO members wish to link foreign direct investment to joint ventures, technology transfer, local content requirements, or export quotas. In some cases, such requirements are even forbidden. The TRIPS agreement (Trade-Related Intellectual Property Rights) in turn strengthens power relations that rely especially on modern production knowledge. It demands the introduction and harmonisation of intellectual property rights, be they copyrights, brands, industrial designs or patents, which are of particular economic relevance. Since TRIPS refers to the conventions of WIPO, their enforcement was considerably strengthened. Thereby, WTO members committed themselves to certain provisions of the Paris Convention for the Protection of Industrial Property (trademarks and patents), the Berne Convention for the Protection of Literary and Artistic Works, the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations and the Washington Treaty on Intellectual Property in respect of Integrated Circuits. Since 1995, non-compliance with those conventions covered by TRIPS may cause a WTO dispute. Similar relations between WTO treaties and international bodies also exist in other areas relevant for modern value chains, for instance, regarding technical standards (ISO) or food hygiene (Codex Alimentarius Committee of the FAO). Not least, the WTO services agreement GATS will probably also considerably ease the TNCs' burden of global network management. The deregulations negotiated under GATS aim to provide the manufacturing sector with the cheapest possible services, ranging from banking and insurance services, to legal and business consultancies, as well as to industrial infrastructures like telecommunications, energy supply and transport. Considerung the entirety of WTO services for capitalist production, one might wonder why this international body was not named 'World Manufacturing Organisation – WMO'.

Yet equally important for securing the profit-rate hierarchies are the regulatory gaps, which are intentionally left open. For instance, regulatory bodies in industrialised countries notoriously close their eyes to monopolisation, especially if it happens abroad. As has already been demonstrated with the buying cartel of the Japanese steel industry or the concentration of brand firms, modern network production entails a strong tendency towards monopolisation. By controlling both, supply and distribution channels, lead firms can effectively block market access of potential newcomers. Monopolisation is further strengthened by the dominant form of foreign direct investment, i.e. mergers and acquisitions.

The growing integration of manufacturing into global value chains increases even further the impact of national and international cartels, most of which never become public. Periphery economies are particularly vulnerable vis-à-vis price fixing, the allocation of sales regions, or bidder cartels, because their competition authorities are either underfinanced, or simply nonexistent. According to a World Bank study, in 1997 alone developing countries spent $ 81 bn on imports from cartelised firms. Still, this calculation is based only on uncovered cartels. Since a large proportion remains in the dark, the real damage is far higher (Levenstein/Suslow 2001). Since for years the OECD countries refuse to persecute foreign effects of cartels, the situation will remain unchanged. As a rule, antitrust authorities in the centres only deal with domestic effects of anticompetitive behaviour.[13] Although the competition authorities of the US, Europe and Japan do occasionally cooperate to uncover international cartels, developing country authorities are not included in these efforts.[14]

7. Global Manufacturing, Polarisation and Protest

The dynamic transnationalisation of manufacturing, and its restructuring into global value chains, proves to be an ambiguous process. It is one of the contradictions of corporate penetration in the periphery that while on the one hand, it triggers significant class formation processes, on the other hand, it also sets off mechanisms of dependent development which create and perpetuate considerable social inequalities – both at national and international level. Compared to the capitalist centres, the class struggles in the periphery take place against the background of a drastic worldwide income gap, which is not at all equalised by network production – on the contrary, until now it has remained extremely stable. In this respect, the global income gap will probably continue to contribute to more militant forms of workers' protests in the periphery compared to countries where the concentration of wealth allows for a wider redistribution of incomes.

The mechanisms of unequal development go together with both foreign direct investment as well as the new cooperation forms of global value chains. Thus FDI stocks grow much stronger in the centre than in the periphery. The interpenetration of productive assets increases much more between the leading industrial nations than between centre and periphery. Moreover, there are clear signs that the accumulated FDI stocks boost domestic and international income disparities: the stronger the corporate penetration of a national economy, i.e. the share of FDI stocks in relation to GDP, the deeper the internal income gap. This is yet another criterion that applies above all to peripherical economies. Moreover, this

[13] Most OECD members exclude export cartels from the scope of their anti-trust legislation. This is, for instance, the case with Germany's law against anticompetitive behaviour.

[14] A particularly severe case was the infamous vitamin cartel. In 1999, the US Justice Department uncovered a large corporate network, the so-called vitamin cartel, in which pharmaceutical firms from Switzerland, Germany, France, Japan and the US were involved. For nine years, this cartel fixed prices for the worldwide sale of vitamins, which in 1999 amounted to US$ 2 billion. The uncovering of this cartel led to dozens of court cases. Hoffman-LaRoche, for instance, was condemned to pay $ 500 million, one of the highest fines ever in US history. However, although importers and consumers in developing countries were also affected by this cartel the US and European anti-trust authorities did not share their findings with their colleagues in these countries (Levenstein/Suslow 2001).

mechanism seems to be intensifying: while in the 1970s FDI accounted for less than 10% of net capital inflow into developing countries, its current share now exceeds 70% (see above). Thus the polarising effect persists. Expectations that value chains and network production will eventually equalise the differences between centre and periphery also prove too optimistic. Instead, the dominant trend is to internally and externally safeguard the hierarchical structure of value chains with research & development activities concentred in the centres and assembly work in the periphery. This does not exclude the continuing transfer of capital-, technology- and knowledge-intensive processes to peripherical countries. But there is no evidence as yet that these capital movements contribute to technological convergence, or any substantial narrowing of the enormous global income gap. Nor is this conclusion altered by the fact that – for historical reasons – some Asian countries integrated themselves more successfully into global production networks than the vast majority of Latin American and African states. Only the steady growth of China has modified – albeit minimally – the global distribution of wealth. The enormous monopolisation of production and marketing knowledge as well as other forms of 'intellectual property' obstruct any noticeable equalising trend. In this context, the international trade regime, which thanks to the WTO has been transformed into a veritable production regime, plays an increasingly important role. International economic organisations support the lead firms in protecting their privileged positions in the profit-rate hierarchy of global value chains.

To this must be added the always unstable fix of surplus capital, including the destructive aspect of the reproduction process: 'accumulation by dispossession'. A large part of the capitalist devaluation crises have happened in the periphery, especially since the monetarist turn – the *Volcker shock* of high interest rates and short money supply. The adjustment costs are, if possible, passed on to the periphery and the global working class. The G7 and the institutions it controls are firmly determined to preserve this *status quo.* As long as they succeed in geographically restricting the devaluation crises, these will remain a strong mechanism of unequal development. Network production obviously provides no protection against this mechanism. The most devastating crises in the last years happened precisely in those South-East Asian and Latin American countries that had successfully integrated themselves into global value chains. The recurrent pattern of the latest 'shifting crises' may include the flight of speculative capital as well as of some companies, but transnationalised productive assets as a whole continue to grow with stoic calm. Frequently, FDI stocks have increased considerably just after a crisis. At the same time that factories were being devalued and productive assets withdrawn from quite a few regions, the internationalisation of manufacturing continued to expand.

The monetarist programme and the 'disciplinary effect' of financial markets meant a worldwide weakening of the working class. The dogmatic 'fight against inflation', the global industrial restructuring imposed by competitive pressures and financial investors, outsourcing and precarious labour conditions added up to a neo-liberal attack that has deeply changed class relations. However, transnational expansion and the formation of global value chains are not just an effect of technological innovation and intensified competition, but also of the conflict between capital and labour. Global capital movements also react to resistance from labour movements, and to attained social rights, which in turn affect the profitability of firms. Consequently, workers cannot be reduced to mere objects of capital mobility and organisational restructurings – they are instead important players within these processes.

Furthermore, the new technological possibilities for global restructurings do not automatically increase real capital mobility across all industrial branches, nor do they inevitably mean a power shift at the expense of the working class. Internationalisation alone is not a satisfactory sign of any real possibility of relocating productive assets. Capital mobility depends on a variety of factors. It also differs from one branch to the other, and it depends on the position within the hierarchy of a value chain. Nor are global production networks in all cases and at all places accompanied by a weakening of the working class. On the contrary: principally, they may also provide workers with new weapons in their struggles. Transnational corporations may have lots of possibilities to resist strikes and other forms of labour unrest, 'but at the same time, they are vulnerable at many points of their cross-border production chains. (...) Joint cross-border actions by local unions in different countries can cripple even the largest TNCs in their major markets. As the perception of this possibility becomes more widely recognised, the rules of the game will change' (Moody 1997: pp. 63f.).

The possibilities of resistance are favoured by the fact that contract manufacturers and subcontractors often concentrate in certain areas of the host countries. Thanks to their clustering in industrial parks and free export zones, including the return of fordist mass production in the electronics and other industries, they become hot houses of class formation and constant labour struggles. The first strikes for independent unions at contract manufacturers' plants in the special economic zone of the Chinese city Shenzhen prove that there is no place in the world where the international low-wage mafia is safe from resistance.

The high economic significance and immense vulnerability of network production put workers in the international sectors in a particularly strategic position. The thesis that they belong to a 'labour aristocracy' that forms an alliance with transnational capital has proved particularly untenable with respect to the periphery. Again and again, it has been precisely the workers of transnational corporations and contract manufacturers who spearheaded massive protest waves, taking on board the demands of the working class as a whole, and closing alliances with various resistance groups far beyond the factory gate. Today in North America and Europe, a reorientation and extension of union struggles is debated under the keyword of a 'social movement unionism' (Moody 1997). Its roots go back to the combative and independent labour movements in South Africa, Brazil, South Korea and many other countries of the periphery. One of the challenges of emancipatory movements today is to internationalise these approaches along the lines of global value chains. The vulnerability of transnational production networks already increased the 'workplace bargaining power' of workers. Internationalising a 'social movement unionism' would supplement these possibilities with global 'organisational power' and strengthen labour movements as a whole.

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FORSCHUNGS- UND DOKUMENTATIONSZENTRUM CHILE-LATEINAMERIKA gemeinnütziger e.V.

Investment Regimes in the EU-MERCOSUR Negotiations

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Forschungs- und Dokumentationszentrum Chile-Lateinamerika

Project 'Free Trade and Industrial Development'

contents **_page**

1. Imposing International Investment Regimes between the European Union (EU) and the Common Market of the South (MERCOSUR)?

After the 'collapse of Cancún' in September 2003, bilateralism, as represented by free trade agreements (FTAs), preferential-trade agreements (PTAs) and bilateral investment-treaties (BITs), is seen as a logical alternative to the multilateralism of the World Trade Organisation (WTO). There are 282 preferential trade agreements worldwide, 255 of which are *reciprocal* trade agreements, and 27 *non-reciprocal* (i.e. unilaterally granted trade privileges). 192 reciprocal trade agreements are *intra*-regional and 63 *inter*-regional.[1] UNCTAD estimates speak of 2,300 bilateral trade agreements worldwide as of July 2004.

Those who view multilateralism and bilateralism as opposing concepts tend to overlook that rather than exclude each other, they are complementary.[2] The WTO article I GATT from 1947 defines the most-favoured nation principle (MFN), according to which a WTO member state granting trade preferences to another member state has to grant the same preferences to all other WTO member states.[3] However, article XXIV GATT 1947 provides an exception, insofar as theoretically the WTO rules allow regional free trade agreements provided they do not contradict WTO principles. The priority the WTO enjoys in the international trade system determines the rules for the trade-related preferences of bilateralism. In this respect, the apparent absolute opposition of 'multilateralism versus bilateralism' of the free trade agenda is rather a complementary model. Thus, in the bilateral EU-MERCOSUR negotiations, explicit references to the multilateral level of the WTO were made, too - though not formally, but as a political package deal.

This interaction of multilateralism and bilateralism is complemented by the attempt to form the increasingly perfect net of international-treaty regimes in the three sectors (trade, investment, and immaterial goods), determining in this triad the inescapable political rules for the comprehensive and worldwide arrangement of and for the market.

In free trade and bilateral investment agreements, the principles of non-discrimination and national treatment have *priority* over national, regional or local policies. Any trade relevant regulation would previously have had to prove it was the least 'discriminatory'. When it comes to establishing international, market-governed logics of utilisation - on the real floor of a world market fired by competitivity - trade- and investment-relevant policy-making on a communal, regional or federal level represent a threat to neo-liberal market logic: the 'certainty of law' for the neo-liberal market concept might be undermined. Yet from a

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1 State April 2004, see Arashiro, Zuleika / Marin, Cynthia / Chacoff, Alejandro: *Challenges to Multilateralism, The Explosion of PTAs*, (Instituto de Estudos do Comércio e Negociações Internacionais (ICONE)), April 2004.

2 See also Russau, Christian: '*Präferentielle Handelsabkommen und Exporthybris - Multi- und Bilateralismus in der politischen Freihandelsagenda zwischen EU und Brasilien',* in: *FDCL EU - MERCOSUR Bulletin Nr. 2,* 3 September 2004.

3 '[...] any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties', Art.I GATT 1947.

development politics perspective[4] it is particularly urgent to protect the scope for political action, such as the use of 'macro-economic instruments (among others capital-flow controls and protectionist measures)'[5], and it becomes absolutely indispensable from the perspective of the democratic sovereignty of states to be able to make decisions in this policy field.

These insights are the starting point for this analysis of the current negotiations between the European Union (EU) and the Common Market of the South (MERCOSUR), which places emphasis on the issues of foreign 'direct investments' (always implicitly included in the current negotiation round), and explores why a future EU-MERCOSUR agreement on 'foreign investments' threatens to *lever out* the fundamental *condition of the possibility for policy making with respect to foreign direct investments*. The paper examines the regulatory *status quo* for foreign direct investments in the four MERCOSUR member states (Chapter 2), before analysing the negotiation poker between the EU and MERCOSUR in the period between March and October 2004, regarding the negotiation topic 'foreign direct investments'. Chapter 4 complements this by examining the bilateral investment agreements ratified by the MERCOSUR members, and reviews the most recent developments in the special case of bilateral investment treaties signed by Brazil in the 1990s.

2. The Regulatory Status Quo of Foreign Direct Investments in the Four MERCOSUR Member States

The regulatory status of foreign direct investments in the four MERCOSUR member states is not uniform, although it is not only the harmonisation of this specific legal sector[6] that is being discussed as an explicit objective of MERCOSUR (laid down in Chapter 1, article 1 of the Asunción Treaty), but preferably that of as many other sectors as possible.[7]

Article 137 of the constitution of **Paraguay** establishes the regulatory hierarchy of constitution, treaties, international conventions and agreements, in descending order. In the 'investments' sector, bilateral investment agreements[8] that have been ratified by Congress automatically supersede national laws, with the exception of the constitution. In its first three

[4] Relating to the industrialised countries` own past, Ha-Joon Chang pointed out the active role in implementing state-controlled protectionist measures: Chang, Ha-Joon, *Kicking Away the Ladder: Development Strategy in Historical Perspective*, (London, Anthem Press, 2002). See. also Zarksy, Lyuba / Gallagher, Kevin: *Searching for the Holy Grail? Making FDI work for Sustainable Development*, WWF analytical paper, March 2003.

[5] Mahnkopf, Birgit: 'Investition als Intervention: Wie interregionale und bilaterale Investitionsabkommen die Souveränität von Entwicklungsländern beschneiden', in: *IPG* 1/2005, p.129.

[6] See also, among others: 'Gobierno busca generar modelo de tratado de inversiones común para el Mercosur', in: *La República*, 25 June 2005.

[7] Capítulo I: Propósito, Princípios e Instrumentos, Artigo 1: 'O compromisso dos Estados Partes de harmonizar suas legislações, nas áreas pertinentes, para lograr o fortalecimento do processo de integração.', in: *Tratado para a Constituição de um mercado comum entre a República Argentina, a República Federativa do Brasil, a República do Paraguai e a República Oriental do Uruguai*, 26 March 1991.

[8] On bilateral trade agreements, see Chapter 4 of this paper.

articles, Law Nr. 117/91 of 6 December 1991[9] guarantees the general national treatment of foreign investments - subject to legislation to the contrary - as well as the implementation modalities of ratified international treaties.[10]

Uruguay had framework modalities for foreign direct investments under the decrees Nr. 14,179 of 28 March 1974 and Nr. 808/974 of 10 October 1974, until their revocation through Law Nr. 16,906 of 7 January 1998[11], according to which national treatment warrants, amongst others, the explicit exclusion of any conditionals and production requirements, free capital-flow, certainty of the law, and recourse to legal action through an independent arbitration body. [12]

In **Argentina**, Law Nr. 21,382 (Law on Foreign Investments) of 2 September 1993[13] -complemented by the provisions of Decree 1853/93 - grants general national treatment to foreign direct investments. Since Argentina has signed and ratified more than fifty bilateral investment-protection agreements - as a disastrous consequence, Argentina is currently the

[9] 'Ley de inversiones', Nº 117/91 from 6 December1991; in addition, the laws 69/90 and 117/91, and the decrees19/89, 27/90 and 6361/90.

[10] 'Art. 1. - El objeto de la presente Ley es estimular y garantizar en un marco de total igualdad la inversión nacional y extranjera para promover el desarrollo económico y social del Paraguay.

Art. 2o. - El inversionista extranjero y las empresas o sociedades en que éste participe, tendrá las mismas garantías, derechos y obligaciones que las Leyes y Reglamentos otorgan a los inversionistas nacionales, sin otra limitación que las establecidas por Ley.-

Art. 3o. - Las garantías, derechos y obligaciones para la inversión extranjera que el Gobierno del Paraguay haya acordado o acordare con otros Estados u Organismos Internacionales, por instrumentos bilaterales o multilaterales, serán aplicables a la inversión nacional equivalente.', in: Ley de inversiones, Nr. 117/91 from 6 December 1991.

[11] 'Capitulo I: Principios y garantias

Artículo 1º.- (Interés nacional).- Declárase de interés nacional la promoción y protección de las inversiones realizadas por inversores nacionales y extranjeros en el territorio nacional.

Artículo 2º.- (Igualdad).- El régimen de admisión y tratamiento de las inversiones realizadas por inversores extranjeros será el mismo que el que se concede a los inversores nacionales.

Artículo 3º.- (Requisitos).- Las inversiones serán admitidas sin necesidad de autorización previa o registro.

Artículo 4º.- (Tratamiento).- El Estado otorgará un tratamiento justo a las inversiones, comprometiéndose a no perjudicar su instalación, gestión, mantenimiento, uso, goce o disposición a través de medidas injustificadas o discriminatorias.

Artículo 5º.- (Libre transferencia de capitales).- El Estado garantiza la libre transferencia al exterior de capitales y de utilidades, así como de otras sumas vinculadas con la inversión, la que se efectuará en moneda de libre convertibilidad.', in: Ley Nº 16.906, 7 January 1998

[12] See extensively: Torrelli, Milton / Torrelli, Claudia: *Inversión Directa Extranjera en Uruguay: transnacionales europeas y agenda de la sociedad civil de cara a un acuerdo de librecomercio MERCOSUR- Unión Europea,* (Berlin, FDCL-Verlag, 2004), pp.7.

[13] 'Articulo 1 - Los inversores extranjeros que inviertan capitales en el país en cualquiera de las formas establecidas en el Artículo 3 destinados a la promoción de actividades de índole económica, o a la ampliación o perfeccionamiento de las existentes, tendrán los mismos derechos y obligaciones que la Constitución y las leyes acuerdan a los inversores nacionales, sujetos a las disposiciones de la presente ley y de las que se contemplen en regímenes especiales o de promoción.', in: Ley de Inversiones Extranjeras from 2 September 1993.

world leader in both pending complaints, and the absolute value of compensation demands submitted to arbitration tribunals[14]-, the importance of these international treaties in the national legal hierarchy is considerable. In principle, according to section 22 of Article 78 of the Argentinian constitution, international treaties supersede national legislation, provided they have been ratified by Parliament. In the case of contradictory laws, higher laws come before lower laws, newer before older ones, and more specific before more general laws, though ultimately the constitution has to be respected.

The framework provisions for foreign direct investments in **Brazil** are already quite generous: Article 172 of the Brazilian Constitution stipulates that the control of foreign capital investments, promoting reinvestment, and regulating the transfer of capital and profits is the exclusive competence of the legislator, on the grounds of national interest.[15] Furthermore, in Brazil the Law on Foreign Investments of 1962[16] is still valid. According to its Article 2, foreign capital invested in Brazil shall receive the same legal treatment as domestic capital, and any form of discrimination or restriction not explicitly allowed under this law is explicitly forbidden.[17] The modifications of 1964[18] do not concern the principle of national treatment already established in 1962, but only the registration modalities for foreign capital in Brazil and the modalities for the transfer of capital and profits. Compared with many other countries, Brazil guarantees simplified capital and profit transfer. As long as the sums are registered with *SISBACEN* (Central Bank Information System), thus allowing for control by the *Banco Central* of Brazil, there are no conditions for capital and profit transfers at all. Capital transfers in the amount of the original investment are not subject to taxes and can be retransferred abroad without a special permit. Sums exceeding the original investment may also be transferred abroad at any time through *SISBACEN*, and are not subject to any transfer tax other than tax deducted at source (currently 15 percent), that is due anyway. The laws IN Nr. 243 of November 2002 and IN Nr. 321 of April 2003 allow for the control of cross-border financial flows between the foreign mother company and its domestic subsidiary to prevent cross-border profit movements (for instance via tax havens).[19] Declaration of all capital and profit transfers automatically occurs online via *SISBACEN*. Infringements of this simple regulation are only possible by skipping *SISBACEN* registration; in such cases resolution

[14] See extensively in Chapter 4 of this paper.

[15] 'Art. 172. A lei disciplinará, com base no interesse nacional, os investimentos de capital estrangeiro, incentivará os reinvestimentos e regulará a remessa de lucros.', Constitution of the Federal Republic of Brazil 1988.

[16] Foreign Capital Law, Law Nr. 4.131, 3 September 1962.

[17] 'Ao capital estrangeiro que se investir no País, será dispensado tratamento jurídico idêntico ao concedido ao capital nacional em igualdade de condições, sendo vedadas quaisquer discriminações não previstas na presente lei.', Art.2, Law Nr. 4.131, September 3, 1962.

[18] Ammendment to Foreign Capital Law, Law Nr. 4.390, 29 August 1964: the modified articles are: 'artigos 4, 5, 7, 9, 10, 11, o parágrafo único do artigo 25, artigos 28 e 43'.

[19] See: AHK Brasil / Ernst&Young: *So geht's...Besteuerungen von Unternehmen in Brasilien*, 1 Edition 2003, pp.18.

'*Resolução Nº 2883 de 30 de JULHO de 2001*' will apply the penal law criteria for illegal cross-border transfers of foreign capital.[20]

The only legal restriction on the generally free capital and profit transfer to foreign countries comes into play in the case of serious balance-of-payment difficulties. Moreover, this *condition of the possibility* of the state's policy making may only be used in acute cases when safeguard measures for a *post-crisis* stabilisation of the balance of payment would come too late anyway. In spite of this, according to negotiation documents from 2004, the EU wanted to eliminate this last *sheet anchor*, marking every single corresponding restriction Brazil had brought forward in the negotiation documents with the same notorious comment: '*remove*'.

3. Regimes in the EU-MERCOSUR Negotiation Poker: Analysis of the Period from March 2004 to October 2004

After signing an agreement on inter-institutional cooperation in May 1992[21], MERCOSUR and the European Community signed a framework agreement[22] on the start of negotiations on a free trade agreement. In 1997, the EU signed a similar 'fourth-generation' agreement with Mexico, which came into force in October 2000 (also called the 'Global Agreement'); and in February 2003 the association agreement with Chile, signed in November 2002, came into force.

At the summit meeting of EU, Latin American and Caribbean Heads of State and Government in June 1999 in Rio de Janeiro, the EU and MERCOSUR established the negotiation modalities such that since late 1999 both parties have been negotiating at the sessions of the 'Biregional Negotiations Committee' (BNC) on an 'inter-regional association agreement'. The negotiations follow the 'single-undertaking' principle: 'nothing is agreed, before all has been agreed'; they are formally based on the three components of 'cooperation', 'political dialogue' and 'trade issues'.

The EU Commission and the four MERCOSUR governments seem to have come to a relative consensus on the elements 'cooperation' and 'political dialogue', but there is clearly no such understanding as regards the 'trade' sector. MERCOSUR insists (not least due to enormous internal pressure from the well-coordinated agro-business) on improved access to European agricultural markets, in contrast to the market-liberal wish list of the Europeans. The EU requests:

- 'market access', 'investment securities', and legal commitment to 'national treatment' (NT) for the *investment* sectors,

[20] 'Define critérios para a aplicação de penalidades relacionadas ao fluxo de capitais estrangeiros' , Resolução Nº 2883, 30 July 2001.

[21] Acuerdo de cooperación interinstitucional entre el Mercado Comun del Sur y las Comunidades Europeas, Santiago de Chile, 29 May 1992.

[22] Inter-regional Framework Co-operation Agreement, *Official Journal* L 069, 19/03/1996 pp. 0004 - 0022 - L 112 29/04/1999 P. 0066, http://europa.eu.int/comm/external_relations/mercosur/bacground_doc/fca96.htm

- general analogy with the four *GATS modes* (mode 1 *cross-border supply*, mode 2 *consumption abroad*, mode 3 *commercial presence,* mode 4 *presence of natural persons*) for the *services* sector,
- imposition of patents and 'geographic indicators' (GI) (for instance for wine ('Rioja') or cheese ('Parmesan')), etc, for the *Intellectual Property* sector,
- legal mechanisms to guarantee access to the MERCOSUR public-procurement market.[23]

In the negotiation topic 'investments', these international negotiations affect the politically rather relevant issue of the *condition of the possibility* for decision making in the field of industrial policy of the respective countries - on national, regional and local levels. And with respect to this, binding rules consistent with the principles of general national treatment and free capital flow are very high on the EU agenda. International treaties - be they regional free trade agreements like the one currently being negotiated between the EU and MERCOSUR, or bilateral investment-agreements[24] - have legal priority over national, regional or local policies, so that eventually the *condition of the possibility for decision making in the field of industrial policy* might be radically curtailed if the Europeans impose their will.

During the negotiation meetings between May and September 2004, Brazil was ostensibly the most determined of the four MERCOSUR delegations to maintain the *condition of the possibility* of national industrial policies, both in the opinion of the Europeans as well as of MERCOSUR. According to the unequivocal viewpoint of Brazil, it cannot be *automatically subordinated* to international legally-binding treaties. As press reports from the past few months reveal, Argentina has not only been moving towards this position, but in the meantime is obviously planning to make even more vehement use of it than Brazil has.[25]

At this moment, the open points on the EU-MERCOSUR negotiating agenda mainly concern the various negotiation documents (such as 'offers', 'requests', 'minimum requirements', 'side-by-side' and 'consolidated texts') that are relevant for the politically sensitive 'investments' sector. The 'offers' are made up of the horizontal as well as the specific concessions for each investment sector[26] (note that the services sector affects above all the area of policies and law in 'Mode 3 - Commercial Presence'[27]), the 'requests' contain the mutual demands of the negotiating parties, and the 'minimum requirements' contain the minimal pre-condition each party demands from the other to start negotiation talks; the 'side-by-side' and 'consolidated'

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[23] See Russau, Christian: 'Präferentielle Handelsabkommen und Exporthybris - Multi- und Bilateralismus in der politischen Freihandelsagenda zwischen EU und Brasilien', in: *FDCL EU - MERCOSUR Bulletin* Nr.2, 3 September 2004.

[24] See extensively in Chapter 4 of this paper.

[25] See: *Valor Econômico,* 30 August 2005.

[26] 'Horizontal Commitments' 'and 'Specific Commitments'.

[27] For the following see also: Russau, Christian: 'Deregulierung nationaler Märkte durch Regulierung internationaler Handelsregime. EU-MERCOSUR Verhandlungen: EU-Kommission, vertreten durch DG Trade, fordert weiterhin Liberalisierung des brasilianischen Wassermarktes, weitere Zugeständnisse bei Dienstleistungen, Investitionen und Öffentlichem Beschaffungswesen', FDCL, May 29, 2004.

texts are drafts and negotiation documents respectively that both sides have already revised together.

Of the few negotiation documents that have been published or leaked[28], Brazil's offer in the services sector of 30 March 2004[29] still revealed considerable reservations regarding 'investment securities'. 'Brazil's Initial Offer in Services' of 30 March 2004 was as follows:

MERCOSUR-EU | BRAZIL'S INITIAL OFFER IN SERVICES

(Footnote: *Brazil's initial offer is subject to substantial progress in the agriculture negotiations*)

I. HORIZONTAL COMMITMENTS

ALL SECTORS INCLUDED IN THIS SCHEDULE

All modes of supply:

The Brazilian Government reserves its right to suspend temporarily the commitments inscribed in this schedule of specific commitments in one(some) of the sector(s), sub-sector(s) or mode(s) of supply

Measures resulting from decisions adopted for ensuring competition are not to be considered incompatible with the specific commitments inscribed in the Brazilian schedule of specific commitments and therefore cannot be used as a basis for compensation claims for any adverse effects that they may cause to foreign services and/or service suppliers.

ALL SECTORS INCLUDED IN THIS SCHEDULE: LIMITATIONS ON MARKET ACCESS

Mode 1) Cross-border supply: Unbound

Mode 2) Consumption abroad: Unbound

Mode 3) Commercial Presence: In accordance with laws and regulations that rule foreign investments in Brazil, all foreign capital invested in Brazil must be registered with the Central Bank of Brazil to be eligible for remittances. The Central Bank establishes procedures related to the remittances and transfers of funds abroad. Foreign service suppliers wishing to supply a service as a juridical person must be organized as a legal entity foreseen by the Brazilian law, subject to the dispositions of the Brazilian Civil Code ('Código Civil'). Brazilian law establishes for juridical persons a separate existence from the person of its holders, thus granting the juridical person with individual existence. Consequently, a juridical person has full title and responsibility for their patrimonial rights and obligations. An entity earns the condition of private law juridical person when the corresponding incorporation act (By-Laws and/or Articles of Association) is duly filed with the appropriate Entities Public Registry (EPR). It is mandatory that the EPR records contain the following data on the juridical person: i) its denomination, purpose and location of head offices; ii) the description of its management,

[28] The EU Commission in particular has to accept that the accusation of total intransparency is well founded. In October 2004 MERCOSUR published their own offers on the web, an act which was immediately interpreted as a breach of the negotiation rules.

[29] Services - Brazil's initial offer March 30, 2004.

including active and passive, judicial and extra-judicial representation; iii) the process of amendment of the management provisions; iv) the provisions regarding the liability of the officers for its acts; and v) the provisions concerning its termination, including the destination of its assets. Juridical persons referred to as 'sole proprietorship' and 'partnership' are not considered as such under Brazilian law. A joint venture may be accomplished by a capital association through the formation of any type of business organisation as set forth in the Brazilian law (usually a Private Limited Liability Company - 'Limitada' - or a Corporation - 'Sociedade Anônima'). A joint venture may also be carried out through a 'consórcio', which is neither a juridical person nor a form of capital association. A 'consórcio' is used mainly with major contracts for rendering of services. It is a contract between two or more enterprises for a joint accomplishment of one specific undertaking. Each associate in a 'consórcio' maintains its respective organisational structure. Unbound for subsidies.

Mode 4) Presence of Natural Persons: Unbound[30]

At the meeting of the 'XIII MERCOSUR - EUROPEAN UNION Biregional Negotiations Committee' in early May 2004, the European Commission, represented by DG Trade, reacted to this 'Services - Brazil's Initial Offer March 30, 2004' by strongly insisting that Brazil had to make more comprehensive concessions with regards to market access (MA) and national treatment (NT), above all in the first three of the four services sectors ('modes'), in analogy to *GATS*.

Accordingly, on 22 April 2004 the EU asked for a fundamental adjustment in *mode 1* ('cross-border supply') and *mode 2* ('consumption abroad') by the Brazilian delegation[31]: the EU negotiators stated with regret that Brazil had horizontally excluded ('unbound') these sectors in its market access offer for services of 30 March 2004. The Commission declared in April 2004:

> 'The coverage of mode 1 is very limited for this important mode of supply, in particular for Brazil (no commitments) and for Paraguay. It is essential to extend the coverage of mode 1, in particular with regard to: computer-related services; other business services; telecommunications; financial services.'[32]

The sector relevant for investments (mode 3: 'commercial presence') is evident in 'Brazil's initial offer, March 30' on services: maintaining obligatory registration, capital transfer via the Central Bank of Brazil, and, among other conditions, recognising the validity of Brazilian

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[30] Mercosur - European Union - Services. Brazil's Initial Offer, March 30, 2004, p.4; on the legal status of the terms 'none' und 'unbound' see: 'Where there are no limitations on market access or national treatment in a given sector and mode of supply, the entry reads NONE. [...When] a Member wishes to remain free in a given sector and mode of supply to introduce or maintain measures inconsistent with market access or national treatment, the Member has entered in the appropriate space the term UNBOUND.' For a guide to reading the GATS schedules of specific commitments and the list of article II (MFN) exemptions, see: <http://www.wto.org/english/tratop_e/serv_e/guide1_e.htm>.

[31] Minimum requirements for Mercosur offer on Services, 22 April 2004, p.1.

[32] Minimum requirements for Mercosur offer on Services, 22 April 2004, p.1.

legislation, which future provisions in the EU-MERCOSUR-treaty should not undermine. Yet the EU Commission was not satisfied at all with the offer made by Brazil. Up until the present day, Brazil in particular has constantly received separate requests from the EU Commission in the EU-MERCOSUR negotiations. The following is an example from the sector 'financial services':

> 'Brazil: There are minor improvements for Brazil compared to GATS which do not even include the outcome of the 1998 GATS further negotiations. With regard to insurance, two elements must be included in the offer: a) commit with regard to the whole Maritime and Transport (MAT) on mode 1 and 2; 2) commit on re-insurance and retrocession on mode 1, 2 and 3. With regard to banking, the possibility to authorise the establishment of foreign banks on a case by case basis devoids commitments of much of their value and legal certainty, and must be eliminated.'[33]

The EU negotiatiors saw too many 'restrictions' in mode 3 ('commercial presence') of Brazil's offer for the service sector of late March 2004[34], especially from Brazil. The EU does not perceive that these 'restrictions' are very limited in Brazil anyway - no more than the last (post-crisis) 'sheet anchor'. At the centre of the EU critique is the Brazilian reservation, according to which cross-border capital transfer regulations are the competence of its Central Bank, so as to be able to take appropriate measures against an abrupt capital exodus when a crisis threatens the country, as happened in Argentina in late 2001. Nor does the still quite realistic crisis scenario of balance-of-payment risks in a region already weighed down by debt service and interest repayment stop the EU from demanding complete deregulation. The EU Commission remains silent on the remaining space for political action that MERCOSUR governments would still have in a crisis.

The EU Commission was also extremely irritated by the restricted offer the four MERCOSUR member states made for the 'environmental services' sector in April 2004:

> 'Environmental services. The improved offer only includes some limited commitments by Uruguay. There should be comprehensive commitments by all Mercosur countries in all modes of supply.'[35]

In addition to sewage, waste disposal, sanitary installations and plants, 'environmental services' also include the highly sensitive area of 'drinking water', for which the EU wants a cross-border liberalisation, somewhat to the benefit of internationally operating European water companies. Coupled with comprehensive regulations for investments (in which the 'law certainty for investors' acts as exploitation logic implemented through an international treaty), the human right to water as an essential element of life would become completely subject to market logic. Price limits on water imposed by the state in the wake of an acute financial crisis, as for instance in Argentina in 2001, would be forbidden under an international treaty if the EU Commission imposes its demands in the negotiations: liberalised market

[33] Minimum requirements for Mercosur offer on Services, 22 April 2004, p.1.

[34] See Chapter 2 of this paper.

[35] Minimum requirements for Mercosur offer on Services, 22 April 2004, p.1.

access; the principle of national treatment of foreign investors; the elimination of the scope states have to create their own foreign direct investment policies; the inevitable regulations on liberalising profit transfers; etc.

The negotiation documents exchanged at the end of 2004 treated the sensitive area of water only with respect to sewage[36], which at first sight seemed a victory due above all to the persistent efforts of non-governmental organisations, which had been accusing the EU Commission of demanding the unilateral liberalisation of the developing countries' drinking-water supply in the WTO/GATS negotiations. However, a second look reveals a different picture. The Europeans do not demand the liberalisation of water in the chapter on services in the EU-MERCOSUR negotiations; they disguised it rather cleverly in the chapter on investments. And there the concepts regarding the areas of electricity, gas and precisely water supply, too, which the EU negotiators directly dictated into the negotiation document[37], read *in unison* as follows: 'RESERVATION TO BE CLARIFIED AND BETTER DEFINED':

E ELECTRICITY, GAS AND WATER SUPPLY	**Limitations on market access**	**Limitations on national treatment**
40 Electricity, gas, steam and hot water supply 4020 - Manufacture of gas except petroleum gases and derivatives 4030 – Production of steam and hot water	None, except A, B A: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED) B: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED)	None, except A, B A: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED) B: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED)
41 Collection, purification and distribution of water	None, except A, B A: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED) B: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED)	None, except A, B A: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED) B: Unbound (RESERVATION TO BE CLARIFIED AND BETTER DEFINED)[38]

[36] MERCOSURL offer – Services, date unclear.

[37] MERCOSUR-Improved Investment Offer – Sector-Specific Commitments, June 2004.

[38] MERCOSUR-Improved Investment Offer – Sector-Specific Commitments, June 2004

Until now, regarding government procurements, the Commission has not ceased to request 'transparency' and 'market access' regarding public calls-for-tender in the four MERCOSUR countries. The Brazilian negotiators in particular have refused to submit an offer that would exceed 'transparency'. Now transparency in the sense of the EU Commission does not mean 'democratic control of public spending', but transparency in all calls-for-tender, so as to secure new, profitable markets in the interest of European corporations. In May 2004, the EU Commission requested:

> 'The EC indicated which sectors are considered of key interest in an eventual future Mercosur offer. These are procurement by entities operating in the water, transport and energy sectors, indistinctively of their position at central or subcentral level. In general terms, contracts (including public works concessions) related to infrastructure are a priority for the EC.'[39]

Indeed, the EU repeatedly declared (even word-for-word, as in the GATS-2000 Requests directed at 72 states), that it was not 'seeking the dismantling of public policies or the privatisation of state-owned companies'.[40]

However, the pressure for privatisation is a priority in the austerity programmes of the International Monetary Fund and the World Bank, on the one hand; and on the other hand, the above-mentioned appeal to liberalise public procurement just demands consent to an internationally binding legal construction under which public expenditure exceeding a certain sum has to be internationally published, in accordance with 'non-discriminatory rules'. Admittedly, according to the latest negotiation proposals of 2004, bidders from MERCOSUR enjoy a certain preference in the planned free trade agreement between the EU and MERCOSUR. Nevertheless, it remains quite questionable as to how such an obligation to invite for tender all internationally operating suppliers could *not* promote precisely 'the dismantling of public policies or the privatisation of state-owned companies', and, *at the same time,* enable states to continue their autonomous policies of promoting and preferring their regional and local economies vis-à-vis foreign (in the case of the desired agreement: European) competitors?

In the '*investments*' sector, the EU once again highlighted, in its 'Investment-Request'[41] to MERCOSUR of 22 April 2004, that it did not intend any 'dismantling of public policies' or 'privatisation of state-owned companies'[42], though nonetheless, it emphasised its interests:

> 'The EC proposes that Mercosur's initial investment commitments are revised in accordance with this request. The EC is both seeking improved commitments and

[39] Thirteenth Meeting of the MERCOSUR - EUROPEAN UNION Biregional Negotiations Committee, 3 - 7 May 2004, Brussels - Belgium, Final Conclusions, unabridged version

[40] Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR, 22 April 2004.

[41] Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR, 22 April 2004.

[42] Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR, 22 April 2004, p.1.

clarification of existing commitments as set out in this Request. The EC is furthermore looking for a reduction in scheduled limitations whether these are horizontal or sector specific in nature'.[43]

It then highlighted in the access requests in the specific sectors:

'Specific Sectors

[...]

Brazil

Fishing, mining, manufacturing of motor vehicles, electricity, gas and water production are completely unbound.

EC request: to take commitments in these sectors. These are key sectors of interest to European investors.'[44]

It would be difficult to express the EU negotiatiors' goal with respect to the valorisation of central economic sectors in the interest of European capital more unambiguously than with '*these are key sectors of interest to European investors*'.

The BNC met again in May 2004, and in the 'General Conditions for Mercosur´s Offer', MERCOSUR declared its support for a strict positive list for specific offers in the investment sector.

'When no reference is made to one or more MERCOSUR countries for a specific sector or sub-sector, it should be interpreted that that country or countries are not taking any commitments for that specific sector or sub-sector.' [45]

Contrary to this, the EU negotiatiors insisted on eliminating the whole paragraph[46], which would in consequence mean the variant *negative list*.[47]

The MERCOSUR negotiation offer in the 'investment' sector went on to explain:

'Taking into consideration the established principles of the applicable multilateral agreements, the disciplines of the Investment Chapter shall not be interpreted or

[43] Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR, 22 April 2004, p.1.

[44] Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR, 22 April 2004, p.2.

[45] 'The offer of the MERCOSUR countries is presented on a positive list approach, in accordance with what is stated in the methods and modalities document approved at the IXth Meeting of the Biregional Negotiations Committee (CNB).' in: *Biregional Negotiations Committee MERCOSUR - EUROPEAN UNION: Investment - improved MERCOSUR offer*, 21 May 2004, p.1.

[46] *MERCOSUR - EUROPEAN UNION: Investment - improved MERCOSUR offer*, 21 May 2004, p.1

[47] On the structure, function and risks of a negative list in contrast to those of a positive list, see: Russau, Christian: 'Durchsetzung internationaler Handelsregime zwischen der Europäischen Union (EU) und dem Gemeinsamen Markt des Südens (MERCOSUR)? Ausländische Direktinvestitionen als Gegenstand der Freihandelsverhandlungen im Spannungsfeld von Investorenrechten, Entwicklung und Menschenrechten', in: *FDCL: EU-MERCOSUR Bulletin N°1*, January 2004, p.61.

> used as a limitation to the prerogatives of domestic regulation and of the adoption of new regulations in order to attain national policy goals.
>
> Tax legislation and any measures relating to taxes shall not fall within the scope of the regulations contained in the Investment Chapter.'[48]

Again, the EU insisted on the elimination of a whole paragraph, this time with respect to a tax-exemption regulation.[49] The EU also wanted to eliminate the restrictions on investment provisions at federal level, submitted by Argentina and Brazil[50], and the EU Commission manifested its extreme disappointment after the exchange of the 'improved offers' of May 21/22[51], since the MERCOSUR offer in the investment and trade-related policy-making sector still only related to the federal level. The Commission had already deplored this in April:

> 'It is also understood that for the EC it is an important condition that the sub-federal level of government and tax measures are not excluded from the provisions of the agreement and from each Party's schedule of investment commitments.'[52]

The negotiation poker intensified in June 2004: on the MERCOSUR side, the sensitive investment sector, together with services and public procurement, crystallised as the most difficult negotiation topic; on the EU side, it was the agricultural sector. The complete document 'MERCOSUR - Improved Investment Offer – Horizontal Commitments'[53] of June 2004 lists a number of limitations by the four MERCOSUR member states with respect to market access and national treatment, which - according to comments by the EU negotiatiors - have to be *eliminated without replacement*:

- the *condition of the possibility* to take autonomous measures with respect to horizontal market access and national treatment, as well as the introduction of specific investment regimes (above all in Brazil),
- the *condition of the possibility* of performance requirements[54] (Paraguay),
- restrictions on land purchase (Argentina, Paraguay, Brazil),

[48] *Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR*, 22 April 2004, p.2.

[49] *Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR*, 22 April 2004, p.2.

[50] 'Argentina and Brazil, as Federal Republics, and in accordance with their Constitutions, restrict their commitment only to measures corresponding to the federal level of government.' – EU note: 'Eliminate'.

[51] 'Proposta do Mercosul não agrada à UE', in: *Folha de São Paulo,* 25 May 2004.

[52] *Investment. Request from the EC and its Member States (hereinafter the EC) to MERCOSUR*, 22 April 2004, p.2

[53] *MERCOSUR-improved investment offer – Horizontal commitments*, June 2004.

[54] 'Performance Requirements: P: reserves the right to maintain or adopt any measure related to performance requirements in regulations and/or programmes for domestic producers of capital and information technology goods', in: *MERCOSUR-improved investment offer – Horizontal commitments*, June 2004, p.1.

- reserving the capacity to control privatised stock companies and special share arrangements, such as 'golden shares' (Argentina),
- the *condition of the possibility* for subsequent law modifications in the interest of consumer and environmental protection (Uruguay),
- national programmes for domestic producers of any goods[55] (Paraguay),
- the capacity to adopt statistical-control measures with respect to foreign direct investments (Uruguay),
- domestic quota regarding acquisitions by foreign investors (Uruguay, Brazil),
- minimum domestic quota regarding staff and directors in accordance with Brazilian legislation (Brazil),
- requirements and measures regarding technology transfer (Uruguay, Brazil),
- the right to fiscal incentives and other measures and requirements in the interest of national industrial and development policies [56] (Brazil),
- requirements on technology transfer as an inherent element of the contractual clauses concerning the intellectual property rights (Brazil),
- and general demands for autonomous national development policies with the capacity to explicitly exclude the national treatment of foreign investors (Brazil),[57]
- as well as the explicit preferential treatment of small and medium domestic companies according to Brazilian law[58].

To ensure comprehensive protection of their regulation sovereignty on the one hand,[59] as well as for the contractual recognition of the existing asymmetries between MERCOSUR and the EU on the other hand, Brazil, above all, but increasingly Argentina, too[60], is demanding measures and regulations in the industrial policy sector that would also affect foreign direct investments, which it did in the 'side-by-side' text 'investments' of the meeting of May 3-7, 2004:

[55] '[P]rogrammes for domestic producers of any goods', MERCOSUR-improved investment offer – Horizontal commitments, June 2004.

[56] 'Brazil reserves the right to maintain or adopt any measure pertaining to subsidies, incentives, grants, or differentiated financial terms, including subsidized loans, guarantees and insurance by government institutions', in: *MERCOSUR-improved investment offer – Horizontal commitments*, June 2004.

[57] '[R]eserves the right to adopt or maintain any measure that, although denied to foreign investors and their investments, is aimed at developing less privileged regions or at reducing regional inequalities', *MERCOSUR-improved investment offer – Horizontal commitments*, June 2004.

[58] Brazil 'reserves the right to adopt or maintain any measure aimed at according favored treatment to small enterprises incorporated under Brazilian laws that have their headquarters and management in Brazil', *MERCOSUR-improved investment offer – Horizontal commitments,* June 2004.

[59] 'Reserves the right to maintain or adopt any measure related to performance requirements in regulations and/or programmes for domestic producers of capital and information technology goods', *MERCOSUR-improved investment offer - sector-specific commitments,* June 2004.

[60] See: *Valor Económico*, 30 August 2005.

'[R]ecognizing the asymmetries existing with respect to the degree of development of regulations.

[...]

This Chapter does not apply to policies of incentives for technological and industrial development, or to social and environmental policies, at the central, regional or local level'[61],

This stands in contrast to the EU, which at the time preferred to leave a blank space at the same paragraph in its text proposal.[62]

In the 'side-by-side' text 'services' of the meeting of May 3-7, 2004, MERCOSUR had pre-defined:

'This provision shall not restrict the right of parties to regulate and to introduce new regulations in order to meet national policy objectives'[63],

whereas the EU side wished at most to express its 'good faith' 'in order not to undermine the conditions of each Party`s service suppliers'.[64]

The EU and MERCOSUR negotiation delegations met in September 2004 in an attempt to meet the negotiation deadline (on October 31, 2004 due to the EU Commission change). In section II ('Sector Specific Commitments')[65] of its investment sector offer [66] MERCOSUR liberated several investment sectors like '*mining*', '*agriculture*' and '*manufacturing*[67], which had not been comprehensively liberated before: completely in some sub-sectors ('none'), or with limitations in others. However, in section I ('General Conditions'), MERCOSUR redefined as an indispensable condition the possibility for active industrial policy-making:

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[61] XIII BNC/MS-EU/TG-2/33/06.05.04 EU-MERCOSUL 13th round of negotiations, 3-7 May 2004, Investment/establishment chapter (side-by-side text).

[62] XIII BNC/MS-EU/TG-2/33/06.05.04 EU-MERCOSUL 13th round of negotiations, 3-7 May 2004, Investment/establishment chapter (side-by-side text)., p.1.

[63] XIII BNC/MS-EU/TG-2/32/07.05.04 EU-MERCOSUL NEGOTIATIONS, TG 2 – Services consolidated text, p.1.

[64] XIII BNC/MS-EU/TG-2/32/07.05.04 EU-MERCOSUL NEGOTIATIONS, TG 2 – Services consolidated text, p.1.

[65] All offers, including 'public procurement', 'services' and 'goods' (with the comprehensive lists of goods) are on the public website of the Brazilian Foreign Ministry, *Itamaraty*): *Mercosur-European Union - Mercosur's Completed Offer on Investment, 24 September 2004*, pp.13.

[66] *Mercosur-European Union, Mercosur's Completed Offer on Investment,* 24 September 2004, see: Section 1, General Conditions.

[67] Argentina, for instance, reserved the right 'to maintain or adopt any measure related to performance requirements in regulations and/or programmes for domestic producers of capital and information technology goods', and 'to maintain or adopt any measure related to incentives in regulations and/or programmes for domestic producers of capital and information technology goods' in the sector 'Manufacturing', in: *Mercosur-European Union, Mercosur's Completed Offer on Investment*, 24 September 2004, p.13.

> 'This offer is based on the assumption that the flexibilities determined by national laws and regulations are recognized. Thus it shall not be interpreted as a limitation to domestic regulation or to the introduction of new regulations with a view to achieving national policy objectives, in accordance with the main objectives of this agreement.
>
> This offer is also based on the assumption that the Mercosur-EU agreement shall not interfere with existing bilateral agreements relating to taxes and tax measures or with the capacity of Mercosur countries to pursue the objectives of their fiscal policies.'[68]

Shortly before the EU delegation mandate expired on November 1, 2004, the negotiations failed - at least provisionally.

During their meeting in September 2005, the MERCOSUR and EU delegations agreed on a new schedule for two BNC working meetings for late 2005 and early 2006. They also agreed on a ministerial conference in early 2005 in preparation for the summit of Heads of State and Government from Latin America, the Caribbean and Europe in May 2006 in Vienna. After their early September meeting, the parties leaked the information that an agreement had almost been reached in the investment and public procurement sectors, which had until then been quite controversial, whereas services and agriculture still required considerable discussion.[69] In addition to this, there are increasing signs that MERCOSUR might be granted special conditions which would allow its members to implement the reciprocal agreements with some delay - in the sense of a 'temporary special and differential treatment (S&D)'[70], yet not a fundamentally different treatment, adapted to their respective developments.[71]

If this estimation of a 'comprehensive agreement' in the investment and public procurement sectors proves to be correct, the space MERCOSUR has for creative investment policy-making would come to an end very soon, and yet another irreversible step towards the regulation of deregulation would have been taken. This is rather in the interest of transnationally operating corporations, not least European ones.

4. BILATERAL INVESTMENT AGREEMENTS VERSUS DEVELOPMENT PROMOTING POLICY-MAKING

Free trade agreements provide transnational corporations with the legal framework for their global production networking, enabling them to benefit from production-network strategies that exclusively depend on the respective market situations, and restricting state regulations and interventions with a web of international treaties. Traditionally, until well into the 1990s,

[68] Mercosur-European Union - Mercosur's Completed Offer on Investment, 24 September 2004.

[69] 'Áreas como investimentos e compras governamentais (as chamadas concorrências públicas) já estariam com as discussões bastante avançadas', BBC Brasil: see <http://www.bbc.co.uk/portuguese/reporterbbc/story/2005/09/050902_cimentifn.shtml>.

[70] BRIDGES, Weekly Trade News Digest, Vol. 9, Number 29, 7 September 2005.

[71] This was matched by a statement made by Karl Falkenbergs, deputy director-general in the Directorate-General for Trade of the EU Commission, who wants to withdraw the development country status from Brazil (*Valor Econômico*, 28 September 2005).

European foreign investments in MERCOSUR were more interested in the respective domestic markets: European corporations focussed on the domestic markets of Argentina and Brazil[72], but as a consequence of increasingly volatile markets, the transnational companies are increasingly shifting towards a position which is directed at the world market. The globally operating players are concentrating on export production for the world market, taking advantage of the 'comparative cost advantages', while the respective inter-connecting of corporation-controlled global production networks is proclaimed as a maxim.

The 'certainty of the law' that free trade and bilateral investment agreements grant transnational operating corporations for their foreign direct investments - and consequently the legal guarantee for the integration of as many production units as possible, including their suppliers, into the global production network of the transnational corporations - is ultimately secured by the installation of international 'dispute settlement bodies'. The dispute settlement mechanism in regional free trade agreements like the one planned between the EU and MERCOSUR is limited to the complaints that *states* can file against other *states,* whereas in the numerous existing bilateral investment agreements[73], like those between European and MERCOSUR states, *private investors* have the right to file complaints *against states*. Consequently, both types of international agreements in place for the 'investment' sector *secure in an alarmingly efficient way the deregulation of national markets by regulating international investment regimes according to neo-liberal market rules.*[74]

In Latin America, international disputes in the investment sector are not only an intensely discussed issue in the wake of the Argentinian crisis of late 2001, they are a rapidly aggravating, yet widely ignored problem.[75] Argentina in particular, which signed and ratified more than fifty bilateral investment-agreements in the 1990s, had negative experiences with regard to international disputes filed against it at international tribunals on the basis of

[72] 'Brazil and Argentina have long since been a focal point of FDI outside the OECD area by European companies. [...] Traditional FDI patterns were the result of European investors' preference for large and protected markets'. Notably in the automobile and chemical industries, the size and growth of markets provided the major stimulus to FDI in the Mercosur region. Multinational companies used FDI mainly to overcome import barriers', in: Nunnenkamp, Peter: 'Foreign Direct Investment in Mercosur: The Strategies of European Investors', in: Paolo Giordano, Chaire Mercosur de Sciences Po [ed.]: *An Integrated Approach to the European Union - Mercosur Association*, 2002, p.231; see also: Jost, Thomas / Nunnenkamp, Peter: 'Bestimmungsgründe deutscher Direktinvestitionen in Entwicklungs- und Reformländern - Hat sich wirklich etwas verändert?', *Kieler Arbeitspapier Nr.1124*, August 2002.

[73] See also Chapter 4 of this paper. Between 1991 and late 2004, 415 BITs were signed in LatinaAmerica and the Caribbean, see: *Folha de São Paulo*, 1 September 2005.

[74] On the polarity of regulation and deregulation, see: Russau, Christian, 'Durchsetzung internationaler Handelsregime zwischen der Europäischen Union (EU) und dem Gemeinsamen Markt des Südens (MERCOSUR)? Ausländische Direktinvestitionen als Gegenstand der Freihandelsverhandlungen im Spannungsfeld von Investorenrechten, Entwicklung und Menschenrechten', in: *FDCL: EU-MERCOSUR Bulletin* Nr.1, January 2004, p. 86.

[75] See among others: Lagerberg, Gerry: 'Demand for International Arbitration is growing, according to PriceWaterhouseCoopers', 4 March 2004; 'Arbitration: Sign of the times', in: *Legal Week* 13 January 2005; Tawil, Guido Santiago: *Investor-State Arbitration : A hot issue in Latin America*, (Buenos Aires: M.& M.Bomchil, 2002).

bilateral investment treaties,[76] even if, out of thirty-six complaints filed by early 2005[77], four have meanwhile been withdrawn.[78] These pending indemnisation requests against Argentina are also one of the reasons why Argentina is currently engaged in a debate on a fundamental revision of the BITs, including at top governmental levels.[79] Paraguay, with sixteen already ratified bilateral investment treaties,[80] and Uruguay, with twenty-eight[81], have not yet been accused on the basis of their bilateral investment treaties in front of international tribunals. Yet the experiences of Argentina have put at least Uruguay on alert, where since April 2005 the parliament has been engaged in a heated dispute on these BITs, especially regarding the issue of the BITs between Uruguay and the United States signed by the former government under President Batlle.[82] In June 2005, the controversy on this BIT even extended to MERCOSUR, when an unnamed source in the Brazilian Ministry of Foreign Affairs, *Itamaraty*, predicted sanctions against Uruguay, on the grounds that these BITs were incompatible with MERCOSUR treaties.[83]

Brazil for its part is a special case among the four MERCOSUR countries: it is one of the few states without a ratified bilateral investment-treaty (BIT). Although Brazil did sign fourteen BITs in the course of the 1990s (1994-1999),[84] none of them have yet been ratified, and so, at

[76] See also among others: Teitelbaum, Alejandro: *Las demandas de las sociedades transnacionales contra el Estado Argentino ante los tribunales arbitrales del CIADI (1)*, found in: <http://www.argenpress.info/nota.asp?num=018574>; see also: Bissio, Roberto: 'El arbitraje internacional no está por encima de la Constitución', dice el Ministro de Justicia, Red Tercer Mundo, 11 April 2005; also: Verbitsky, Horacio:' Las batallas del tercer año', in:<http://www.pagina12.com.ar>, March 2005; see also: Peterson, Luke Eric, 'ICSID tribunal issues pair of jurisdictional decisions in financial crisis arbitrations', in: I*NVEST-SD: Investment Law and Policy News Bulletin*, 10 June 2005, and: Peterson, Luke Eric, 'Argentine Bondholders girding for multi-billion dollar investment treaty claim', in: *INVEST-SD: Investment Law and Policy News Bulletin*, 10 June 2005.

[77] Peterson, Luke Eric: 'The Global Governance of Foreign Direct Investment: Madly Off in All Directions', in: Friedrich Ebert Stiftung: Dialogue on Globalization. Occasional Papers, Geneva, N° 19, May 2005, p.13.

[78] See AFP, 20 July 2005; Peterson, Luke Eric, 'First domino falls on Argentina as tribunal rules in financial crisis arbitration', in: *INVEST-SD: Investment Law and Policy News Bulletin*, 27 May 2005.

[79] See: *La Nación*, 12 September 2005.

[80] UNCTAD database, <http://www.unctadxi.org/templates/DocSearch.aspx?id=779>

[81] UNCTAD database, <http://www.unctadxi.org/templates/DocSearch.aspx?id=779>, a number of signed but as yet unratified BITs have to be added, see: <http://www.mrree.gub.uy/Tratados/MenuInicial/busqueda/Tema/Tema2.htm>

[82] See among others: Sánchez, Hilda / Orsatti, Alvaro: *Los Tratados de Inversión: hechos y políticas en el Cono Sur*, August 2005; Vis-Dunbar, Damon: 'Uruguayan Senate debates US BIT, looks for common Mercosur posture on BITs', in: *INVEST-SD: Investment Law and Policy News Bulletin*, 22 August 2005; also: *Observador*, 21 September 2005.

[83] '[...] provocar sanciones contra Uruguay, por ejemplo, su exclusión del Mercosur por ser el Tratado incompatible', in: La República: 'El tratado uruguayo con EEUU preocupa en Argentina y Brasil', 12 June 2005.

[84] On the content, structure, system comformity and risks of the Brazilian BITs see extensively: Russau; Christian: 'Durchsetzung internationaler Handelsregime zwischen der Europäischen Union (EU) und dem Gemeinsamen Markt des Südens (MERCOSUR)? Ausländische Direktinvestitionen als Gegenstand der

present, Brazil still has the autonomy to decide on its investment and industrial policies without restrictions from legally binding international treaties. Six of the fourteen signed but unratified BITs have been transferred to the Brazilian lower house of parliament, the *Câmara dos Deputados,* by the government of Fernando Henrique Cardoso (FHC). According to Art. 49 of the Brazilian Constitution[85] the ratification of all international treaties devolves upon the Brazilian parliament - first the Câmara dos Diputados, then the Senate - before the President declares their final ratification.

Between 2000 and 2002, in the course of attempts to ratify the BITs signed between 1994 and 1999 by the Brazilian government, the *Câmara dos Deputados* saw an intense debate in which the opposition insisted on two fundamental arguments against the treaties. In addition to the various constitutional conflicts that would arise from these treaties after their ratification[86], the opposition criticised the latter inherent regulations on international jurisdiction in disputes on foreign direct investments[87]: firstly, the better treatment for foreign investors, since national investors have no access to international courts[88], and secondly, the fact that the 'investor-to-state' complaint right inherent to BITs clashes with the first constitutional principle of Brazil.[89]

As a result, none of these *BITs* were ratified by the *Câmara*, which was due mostly to the continuing refusal of the oppositional *Partido dos Trabalhadores* (PT), so in the course of 2002, long after the Special Parliamentary Report had been compiled[90], the Brazilian President *FHC* withdrew the *BITs* ratification process (under the lamentations of the then Secretary of For-

Freihandelsverhandlungen im Spannungsfeld von Investorenrechten, Entwicklung und Menschenrechten', *FDCL: EU-MERCOSUR Bulletin N°1*, January 2004, pp. 69.

85 'Art. 49. É da competência exclusiva do Congresso Nacional: I - resolver definitivamente sobre tratados, acordos ou atos internacionais [...]',Constitution of the Federal Republic of Brazil 1988.

86 See extensively: Bithiah de Azevedo, Déborah: *Os acordos para a promoção e a proteção recíproca de investimentos assinados pelo Brasil,* Consultoria Legislativa, Câmara dos Deputados, May 2001.

87 See extensively: *Diário da Câmara dos Deputados*fom 13 April 2000, reprinted in: *Diário da Câmara dos Deputados*, August 2003, pp.37782-37809.

88 See also: Russau; Christian: 'Durchsetzung internationaler Handelsregime zwischen der Europäischen Union (EU) und dem Gemeinsamen Markt des Südens (MERCOSUR)? Ausländische Direktinvestitionen als Gegenstand der Freihandelsverhandlungen im Spannungsfeld von Investorenrechten, Entwicklung und Menschenrechten', *FDCL: EU-MERCOSUR Bulletin N°1*, January 2004, p.80.

89 Thus, the MP José Dirceu warned in the *Câmara dos Deputados:* '[...é] necessário considerar que o recurso á arbitragem internacional, na forma proposta pelo Acordo Brasil/Alemanha e pelos demais APPI, fere, a nosso ver, o inciso I do artigo 1° da Constituição Federal, o qual afirma a soberania como um dos fundamentos da República Federativa do Brasil'. *Diário da Câmara dos Deputados* 13 April 2000, reprinted in: *Diário da Câmara dos Deputados*, August 2003, p.37804; see also: 'Art. 1º A República Federativa do Brasil, formada pela união indissolúvel dos Estados e Municípios e do Distrito Federal, constitui-se em Estado Democrático de Direito e tem como fundamentos: I - a soberania; [...], in: Art. 1 Constitution of the Federal Republic of Brazil 1988.

90 The differing opinions of the members of the *Relatório de Grupo de Trabalho* were only published in August 2003 in the *Diário da Câmara dos Deputados*, see *Diário da Câmara dos Deputados* from 13 April 2000, reprinted in: *Diário da Câmara dos Deputados*, August 2003, pp.37782-37809.

eign Affairs)[91] from the *Câmara dos Deputados.*[92]

Partly in response to these experiences, several competing drafts aimed at changing the ratification modalities of international treaties were presented in both houses of the Brazilian Congress (House of Representatives and Senate) in the course of 2004: drafts that aim to restrict the participation margin and ratification modalities of the Brazilian Congress, as well as drafts that aim to widen these capacities.[93] The corresponding parliamentary debates are still in progress.

After the departing government of *FHC* had declared the formal withdrawal of the ratification process from the *Câmara dos Deputados* in late 2002, the political decision-making competence on the modalities of the further proceedings relating to the *BITs* (ratification, modification or refusal) was transferred to the Foreign Trade Chamber (*Câmara de Comércio Exterior*, Camex[94]). For the spring of 2005, the *Camex* commissioned an internal (still unpublished) report from an inter-ministerial committee which gave advice on the declaration of the further proceedings relating to the Brazilian *BITs*.[95] The still unpublished decision[96] is important insofar as with it, Brazil finds itself at the crossroads between *subordination under the neoliberal investment regulatory concept through internationally binding treaties* and *the fundamental right to make autonomous decisions and implement creative investment policies on its own territory.*[97]

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[91] 'Embora o Governo tenha oferecido argumentos para dirimir dúvidas e esclarecer questões levantadas no Congresso, é forçoso constatar que os acordos, por um lado, nunca encontrou o respaldo político necessário para sua aprovação e, por outro, deixaram de refletir as tendências que hoje prevalecem no cenário internacional. É essa a conclusão a que chegamos, meus colegas da Fazenda, do Ministério do Desenvolvimento, Indústria e Comércio Exterior e eu próprio, juntamente com o Presidente do Banco Central, após examinarmos Relatório de Grupo de Trabalho que estabelecemos para debater a matéria. No caso do Acordo firmado com a República Federal da Alemanha, como nos demais, impõe-se nessas condições, a decisão de retirar a Mensagem. Que ora submeto a Vossa Excelência.' Celso Lafer, Records of the 234th Morning Session S 12 December 2002, p.54410.

[92] Ibid pp.54410-54415.

[93] See: Agência Câmara dos Deputados: 'Deputados querem participar mais de acordos internacionais'consolidated - 19/5/2005 0h15; see also the decision of the *Comissão de Constituição e Justiça e de Cidadania* from 9 December 2004, in: Agência Câmara dos Deputados - Event - 9/12/2004 16h15; see also draft legislation PL 4291/04, on conferring more participative powers to the Câmara de Deputados in international agreements, in: Agência Câmara dos Deputados - Order - 4/11/2004 9h20; see also: Agência Câmara dos Deputados - consolidated - 20/9/2004 20h01.

[94] 'A Câmara de Comércio Exterior - Camex, órgão integrante do Conselho de Governo, tem por objetivo a formulação, adoção, implementação e a coordenação de políticas e atividades relativas ao comércio exterior de bens e serviços, incluindo o turismo', found in: <http://www.desenvolvimento.gov.br/sitio/camex/camex/competencia.php On the importance of Camex and various reform proposals see: Ex-embaixador defende maior poder da Camex, in: *Gazeta Mercantil*, 18 August 2005.

[95] See also: 'Camex define destino de acordos bilaterais', in: *Valor Econômico* 18 April 2005, and *Valor Econômico* 9 May 2005.

[96] State mid-August 2005.

5. Conclusions

It is the principal goal of neo-liberal policies to eliminate the *condition of the possibility* for trade-relevant policies, which for instance use active governance elements to promote local or regional development, or capital-flow controls, or other restrictions and conditionings in an acute financial crisis, as a form of political control. The legal foundation of this elimination is provided by bilateral investment treaties on the one hand, and free trade agreements, such as the one currently being negotiated between the EU and MERCOSUR on the other hand. A victory for the EU negotiators in the meanwhile resumed negotiations on an 'inter-regional association treaty' between the EU and MERCOSUR, i.e. the legally binding adoption of the eliminations the EU so vehemently requested in the past,would result in, amongst other effects, [98] one of the two key elements to end the *condition of the possibility of autonomous industrial policies* which the four MERCOSUR countries have to promote region- or sector-specific development by means of economic policy-making. The second element in the web of international investment regime agreements consists of the bilateral investment 'protection' treaties. In the case of MERCOSUR, the position of Brazil concerning the decision on ratification, modification or refusal, or the pending BITs, is pivotal, but the Argentinian discussion on a retrospective modification of existing BITs is equally important. However, if internationally binding treaties eliminate the *condition of the possibility* for political decision-making in the sector of foreign direct investments on national territory, thus imposing the deregulation of domestic markets through the regulation of international investment-regimes[99], the question arises as to which possibilities states may still have to conduct active investment policies to promote social development, on the one hand; and on the other hand, there is a risk of losing democratic control in these political areas, where democratically elected governments cannot exercise any politically relevant influence, since they are restricted by international investment regimes. And this is one of the reasons to oppose not only the free trade agreement between the European Union and MERCOSUR, but also any bilateral investment agreements (existing, planned or in the ratification process).

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[97] See also: Luke Eric Peterson, 'Brazilian government's decision on ratification of BITs looming', in: *INVEST-SD: Investment Law and Policy News Bulletin*, 27 April 2005.

[98] This paper deals exclusively with the questions of 'investments'. For the serious consequences of a potential 'inter-regional association treaty' between MERCOSUR and the EU, see: 'Alianza Social Continental: Movimientos de Mercosur: el acuerdo con UE es nocivo a los pueblos', 3 June 2004, see <http://www.asc-hsa.org/article.php3?id_article=148>; 'Alianza Social Continental: Acordo com UE traria 'ganho social zero'', 15 October 2004, see <http://www.asc-hsa.org/article.php3?id_article=190>; 'Declaración de los movimientos y organizaciones sociales del Mercosur: UE-Mercosur: ganancias para pocos, amenaza para la mayoría', 22 October 2004, see <http://www.bilaterals.org/article.php3?id_article=771>.

[99] See extensively: Russau, Christian, 'Durchsetzung internationaler Handelsregime zwischen der Europäischen Union (EU) und dem Gemeinsamen Markt des Südens (MERCOSUR)? Ausländische Direktinvestitionen als Gegenstand der Freihandelsverhandlungen im Spannungsfeld von Investorenrechten, Entwicklung und Menschenrechten', in: *FDCL: EU-MERCOSUR Bulletin N°1*, January 2004

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Changing the Patent System: From the Paris Convention to the TRIPS Agreement

- The Position of Brazil

By Cícero Gontijo

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contents **_page**

1. FREE TRADE versus MONOPOLIES

At the beginning of the 19th century, Europe saw a serious debate between the monopolists, who were in favour of the patent system, and those in support of free trade, meaning minimal restrictions on the exchange of goods and services. The controversy was so huge that Switzerland and the Netherlands revoked their intellectual property rights; Germany followed in 1869, revoking its law from 1817, which was only reinstalled in 1910. It became evident that a monopoly-based protection system for inventions and a free trade system could not coexist without serious difficulties. They represent antagonistic and conflicting positions because they are pulling in different directions.

Two centuries later, free trade has more supporters than ever before, a phenomenon that has been labelled *globalisation*. The revolution of the information and communication technologies, amplified by pressure from the leading countries, particularly the United States, has forced the other countries to implement changes. They have been forced to open their frontiers, reduce tariffs, accept foreign competitors in their domestic markets and admit a debate on market accessibility (including public acquisitions and uncontrolled financial transfers). This overwhelming movement renders obsolete the import-substitution growth projects and clearly diminishes the sovereignty of each country.

This globalisation should go together with a strong opposition to the intellectual property protection systems; it should dilute the principles and concepts that support the protection of inventions, above all those of foreign nationals, which guarantee monopolies in third-country markets. One would have expected the patent system to come under pressure; and the underlying property theory to have been substituted by compensation theories that admit some type of benefit for the inventor, under the complete exclusion of monopoly grants.

None of this has happened. Not only have free trade and patent protection not been represented as antagonistic movements. On the contrary, they have been presented at the same time and on the same forum (GATT, later converted into WTO). We commented on this amazing contradiction in an article published in March of 1995:

> "It must be remembered that the idea of the TRIPS agreement totally contradicts the other agreements signed in the GATT framework which are directed at eliminating barriers, demolishing monopolies and abolishing the subsidies system - in the spirit of liberalisation advocated by the industrialised countries. The appearance of the TRIPS agreement is a part of the efforts to achieve more rigid norms, impose standardisation and consolidate monopolies. This will have an impact on one of the most valuable economic agents at the end of the millenium: human knowledge. The markets are opened, but, on the other hand, the system in place to produce new technologies is consolidated and strengthened (it is no coincidence that the system concentrates in the countries that demand better protection for the right holders of intellectual property)." *(1.Gontijo, Cícero, "O acordo sobre propriedade intelectual contido no GATT e suas implicações para o Brasil" in: Revista de Informação Legislativa, Senado Federal, January/ March 1995, p. 181).*

The theoretical justification is presented these days as the "Market-Failure" theory, which tries to portray patent-derived monopolies as an exception in the market economy. Recognising that disclosing inventions would give equal conditions to all competitors, while preventing inventors from being compensated for the costs incurred, temporary user-monopolies arise as a solution. This doctrine is explained in Wendy J. Gordon, "*Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors*", 82 Colum. L. Rev. 1600 (1982) and J.H. Reichman, *Charting the Collapse of the Patent-Copyright Dichotomy: Premises for a restructured International Intellectual Property System,* 13 Cardozo Arts & Ent. L.J. 475 (1995).

An ingenious theory, but it does not take into account less rigid means to compensate inventors.

The state can act in two ways to stimulate creation:

a) by socialising the creation costs and risks, the state pays the creator a financial indemnity. The underlying assumption is that the investor will invest in the new creation. The Brazilian law of 1830 provided this form of compensation.

b) by the private appropriation of the results through the legal construction of artificial exclusivity (of which patents are an example). Transferable rights of exclusive use and benefit are thus created.

A third alternative to substitute patents is also being discussed because of its greater flexibility: inventors are granted a non-exclusive right, but they have the right to demand a price for the use of the disclosed information, yet no right to prohibit its use. This includes the "inventor certificates" (used in Mexico and the former Soviet Union for inventions with industrial application) and the "plant breeders' certificates" used by the *International Union for the Protection of New Varieties of Plants* *(UPOV)* that are applied to inventions in the sector of seeds and crops.

This type of inventor compensation that Carlos Correa calls "paying public-domain" deserves a more detailed examination since it may become an interesting alternative to patents, at least for some economic sectors, and for certain countries. (2.Correa, Carlos, in: "Intellectual Property Rights, the WTO and Developing Countries", Malaysia, TWN, 2000, p. 248/251).

1.1.The Paris Convention and the Legislative Freedom of Member States

The Paris Convention, which aimed at harmonising - as far as possible - intellectual property legislation in the different countries has been one of the most successful treaties so far, due both to the impressive number of its members as well as the long time it has existed without substantial change. More than 150 countries have adopted the Paris Convention, which goes back to 1883, when it was signed by eleven members, among them Brazil.

The main reason for this success is that the Convention did not try to level national laws or establish the reciprocity principle for national treatment. On the contrary, it stipulated a vast legislative freedom for each country and only required the equal treatment of nationals and foreigners (national treatment principle). Its other basic principle, priority, was in reaction to a more practical than theoretical question. To prevent elements of a patent application from being irregularly appropriated, and to prevent conflict between two or more inventions concerning the same matter, a priority period was established. This means that applicants who submit an application in one member state have a priority period (currently 12 months) to file an application in other member states. During this period no other application, publication or exploitation of the invention will invalidate their application.

As a result, although it is not mentioned in the original text, the principle of patent independence was established, whereby decisions of a country regarding an application or a patent do not have any impact on the treatment by other member states. These principles - agreed in 1883 - stayed in place for more than a century.

1.2. Compulsory Disclosure and Exploitation of Patents in the Country of Origin

The official text of the Paris Convention stipulated the complete disclosure of inventions, and due to the experience of the leading countries, the effective exploitation of patents. In fact, the English *Statute of Monopolies* only granted patents to inventors who would produce their invention in the country.

The question of effective use had been at the centre of discussions between Austria and the United States at the Vienna Conference (1875). The US demanded that imports should be included as effective use of patented goods.

The Paris Conference (1878), which elaborated the text of the treaty, established that patents could be revoked after a certain period in the absence of local production.

A number of countries, including the United States, England, Germany, Canada, Hungary and Austria were not among the original signatories of the Paris Convention because they objected to the adoption of compulsory local exploitation in the original art. 5:

> "*Importation by the patentee into the country where the patent has been granted of articles manufactured in any of the countries of the Union shall not entail forfeiture of the patent. However, the patentee shall be subject to the obligation to use his patent according to the laws of the country where he imports the patented articles.*"

This definition, which gives member states the right to demand local exploitation of patented articles and processes, is a consequence of the experiences of the leading countries. The legislations of all modern industrialised nations used to contain an obligation of local exploitation, which in the period of their industrialisation was the main objective of the patent system. Patents were granted to develop the exploitation of natural resources and increase the numbers of skilled workers and engineers; the aim was to establish new industries, or new technologies for those already existing. In the United States, a law from 1886 determined that the patents of foreign inventors had to be exploited on US territory. This rule also applied in England, France and Germany. In time, the international trade of these countries increased and they reduced the application of this requirement. However, most countries (except the US) maintained some legal regulation on compulsory local exploitation.

The subsequent revisions of the Paris Convention kept compulsory local exploitation; the text was altered in the sense that the absence of local exploitation is considered a sanctionable infringement by the patentee.

This issue remains the central point of the debate on patentees' duties.

1.3 The Strong Nullity and the Weak Compulsory Licence

The threat arising from patent revocation through exhaustion was the first instrument of 20th century intellectual-property-law to be implemented to enforce the compulsory local exploitation of patents. After the declaration of exhaustion a patent becomes public domain. This permits every person or company to exploit the invention. In these cases, the monopoly is exhausted and any product can compete on the market on equal terms. This corresponds to the situation of countries where the inventor did not patent an invention already patented in the country of origin.

Even before the Paris Convention came into being, legal provisions on nullity due to failing local exploitation existed, among other countries in France, Mexico and Tunisia. When the Convention was signed, it was decided that the import of patented products produced in other member states should not entail the loss of this right. At the same time compulsory local exploitation was confirmed.

Nullity is a powerful legal instrument because it automatically comes into force after the period for local exploitation has ended and the absence of local exploitation has been proved. For this reason it has gradually been substituted in the revisions of the Convention by the compulsory licence.

The compulsory license is one of the instruments the state can use to act on a patent monopoly provided it is in the public interest. It is less drastic than patent revocation through nullity and permits use by others under certain conditions, with a remuneration established by the state. From the legal point of view, the patent monopoly is substituted by the right to receive financial compensation for the use of the invention.

Its first historical appearance was at the Vienna Convention in 1873 for "cases where the public interest made it necessary", and in 1877 it was incorporated into German law. It was not mentioned again until it reappeared in the version of the Hague in 1925, where its goal was to prevent "the abuse that might arise from the practice of the exclusive right conferred by the patent, for instance, by the absence of effective exploitation"; from then on, almost all countries have adapted their laws to incorporate it. In time, it occupied the space that had formerly belonged to revocation through nullity because it was a less drastic measure than the latter.

In contrast to nullity, its practical use is problematic in that it is necessary to find another company of the respective branch willing and capable to produce the product or process without the assistance of the patent-holding company, only equipped with the official authorisation.

The Stockholm Revision (1967) of the Paris Convention brought a modification which made it even more difficult to apply the compulsory licence: it established that the licence should not only be non-exclusive, but that it had to be refused if the holder could justify his inaction with legitimate reasons. The automatic implementation of the instrument disappeared and the rejection by its potential applicants increased.

It is unlikely that a private entrepreneur would have the courage to invest in a factory project to produce an invention under a compulsory licence if there was any doubt that his market would be exclusive, at least for a certain period. A production project requires investment, construction works, buying equipment, hiring staff - all this on the basis of the market that will be served. If the licence is non-exclusive, the holder could decide at any time to produce locally or to grant a voluntary license, which would oblige the compulsory licence holder to compete with other producers. Considering that the patent holder still has the marketing power of his brand it becomes clear that the chances of a non-exclusive compulsory licence are quite slim. Under these circumstances, using the compulsory licence as a means to prevent abuse by patent holders proves totally ineffective. It becomes a blunt knife with the extra disadvantage that the right holders know about it.

Once the compulsory licence had been transformed into a complex and impractical instrument the next step was to find a way to strip the instrument of *nullity* of its efficiency.

The solution came with the text of the Stockholm revision which conditioned the application of nullity to the prior use of the compulsory licence as laid down in art. 5.3:

> "*The nullity or extinction of a patent may not be declared before a period of two years has expired, beginning with the grant of the first compulsory licence*".

The required prior compulsory licence, granted extremely rarely, means that the strong instrument of nullity is practically inapplicable.

1.4. The TRIPS Agreement: Rigid Monopolies in Times of Free Trade

From 1979 the US showed its dissatisfaction about what it saw as insufficient protection for intellectual property. The US tried to transfer the discussions to GATT (General Agreement on Tariffs and Trade) to strengthen protection mechanisms for patent holders' rights. Several countries opposed this move and it was only included into the agenda in 1989, after Brazil and India gave their consent. These countries had insisted that the WIPO (administrator of the Paris Convention) and not GATT was the appropriate forum for the discussion of intellectual property.

The US proposal which was negotiated by GATT was arranged around three topics: the definition of minimum standards (art. 9 - 40), the introduction of implementation mechanisms (art. 41 - 61) for member states (administrative and judicial proceedings) and the creation of a strong international arbitration system (art. 63 and 64). All this was in contrast to what the

Convention had established. Instead of just two basic principles, a large number of concepts and requirements had to be adopted by all members' legislations in a kind of standard law. Rigid rules were imposed as to how the different national administrations and legislations had to act regarding the enforcement of the new intellectual property rules. And finally, a vast and practical dispute-settlement system to avoid any differences arising from industrial property questions remaining unresolved because of questions of national sovereignty.

As could be expected, there was a very strong adverse reaction, especially from the developing countries. The project meant huge changes to the existing laws, all aimed at a higher level of protection for patents and trademarks.

Since it was generally understood that many countries, particularly in the developing world, were not in favour of the new agreement on intellectual property, much effort was necessary to achieve its approval.

> "To advance the negotiations in all the areas of the *Uruguay Round*, the director-general of GATT presented the *Dunkel* text as an essential part of the negotiations. The director-general presented the document as an "all-or-nothing" agreement because he was determined to prevent it from being divided into several parts that the members could vote separately. This requirement proved useful for achieving the TRIPS agreement, since the United States and other industrialised countries could use concessions in the agricultural or textile areas requested by the developing countries to obtain an appropriate TRIPS agreement" *(3. Michael Doane, Georgetown University Law Center, in: "Trips and International Intellectual Property Protection in an age of advancing technology" – American University Journal of International Law and Policy 9 (2), p. 476).*

1.5. The End of Nullity and the Introduction of the Compulsory License

The TRIPS document mentions nullity only once: it defines that judicial review must be available in any decision to revoke or forfeit a patent.

As for the compulsory licence, the term does not even appear in the text; it was replaced by the euphemistic phrase "other use without authorisation of the right holder". Apart from the above-mentioned exceptions in the Stockholm text of the Convention (non-exclusiveness and justification with legitimate reasons), the treaty weakens the instrument to fight abuse even further with additional determinants: it establishes that the proposed user must first have tried to obtain a licence from the right holder; that the use must predominantly supply the domestic market; that the licence has to be revoked when the circumstances under which it was granted cease to exist; and that the right holder has to be appropriately compensated.

As to the right of states to demand the local exploitation of patented products or proceedings, the text is not very clear on this issue. Article 27.1 of TRIPS established a confusing provision that appears to exclude the further use of this alternative:

> "Art. 27.1 - (...) Subject to paragraph 4 of Article 65, paragraph 8 of Article 70 and paragraph 3 of this Article, patents shall be available and patent rights enjoyable without discrimination as to the place of invention, the field of technology and whether products are imported or locally produced".

The first impression may lead to the belief that the requirement of local production has been banned. Some authors believe that the obligation for local exploitation cannot be required any longer from the right holders, and Carlos Correa puts it like this:

> "The compulsory-license granting system of many countries could also be affected by the prohibition to discriminate due to the country of origin (local production or import). The authors of this document wanted to dilute the obligation to exploit the patented inventions, one of the traditional pillars of the patent system". *(10. Correa, Carlos, "Acuerdo Trips" Ciudad Argentina , Buenos. Aires, 1996, p. 136).*

However, there is also a differing interpretation, according to which art. 27.1 refers to a different problem. For Figueira Barbosa:

> "TRIPS certainly stipulates a compulsory license on the grounds of insufficient work, within the principles and limitations of art. 5^{A} of the Paris Convention, even when, in the spirit of 'Paris *plus*', it informs that the license has to aim 'predominantly (at) the supply on the domestic market' (art. 31.f.)" *(4. Barbosa, A.L.F, "Sobre a propriedade do trabalho intelectual", UFRJ Publishing House, 1999, p.189).*

Referring to art. 27.1, Correa states that the text was in reaction to a complaint in the EU preparatory document for the TRIPS negotiations. According to the EU document, the US legislation contained proceedings that discriminated against foreign nationals in legal disputes on the counterfeiture of imported goods. The EU also protested against the preferential treatment of activities on US territory by US legislation, which grants patents to the 'first-to-invent' to the detriment of the 'first-to-file' of European law; this was complemented by restricting the patent validity to US territory. This is what Barbosa says:

> "An interesting part of the document exclusively deals with the discrimination against imported goods. It is divided into two important subjects: (a) discriminating proceedings, and (b) preferential treatment for activities on national territory. There can be no doubt that, on both issues, the complaints pointed mainly at the US (...) The result could not come as a surprise; and article 27 of TRIPS ends with the often quoted and rephrased words: "*...patent rights (shall be) enjoyable without discrimination as to the place of invention (...) and whether products are imported or locally produced.*" (12. Barbosa, A. L.F, op.cit., p. 184).

As two experts on the subject prove, both interpretations are possible.

Add to this that TRIPS seems to deal with this issue in another part; without repeating the Paris Convention texts, TRIPS establishes in art. 2.1:

> "In respect of Parts II, III and IV of this Agreement, Members shall comply with Articles 1 through 12, and Article 19, of the Paris Convention (1967)."

From this we can deduce that the matter referred to the Convention, always in its Stockholm version (1967):

> Art. 5. (2) "Each country of the Union shall have the right to take legislative measures providing for the grant of compulsory licenses to prevent the abuses which might result from the exercise of the exclusive rights conferred by the patent, for example, failure to work."

Based on these arguments, diplomats of the Brazilian Ministry of Foreign Affairs assured the Senate (Upper House) in the course of discussions for the National Congress (Lower House) approval of TRIPs that the failure to work remained an abuse by the right holder. Therefore, this understanding was preserved in the text referring to art. 68 (1), I of the Patent law.

2. THE CONSEQUENCES OF TRIPS ON DEVELOPING COUNTRIES

The standardisation of the different national legislations that results from the ratification of the TRIPS agreement does not take into account the relevant differences between developing and developed countries.

Edith Penrose already drew attention to this in her classic book:

> "Non-industrialised states do not derive any direct benefit from granting patents for inventions that have already been patented and exploited abroad. The only possible economical advantage is that they might provide some kind of incentive for the introduction of foreign technology *(5. Penrose, Edith, in "La economía del sistema internacional de patentes", 1st Spanish version, Siglo XXI, Mexico, 1974, p.200)*.

Extremely few companies have the necessary technological capacity, and the few existing research and development centres in the developing countries focus their efforts on technological adaptation projects. The number of inventions is therefore limited. Global statistics prove that 90% of all patents are registered in the name of persons or companies based in industrialised countries. In the case of Brazil, just 5% of the patent applications belong to Brazilian right holders (10% if registered designs are included). These figures prove that in developing countries, the national systems are designed to serve the rights granted to foreign companies and foreign nationals. This is different from the situation in industrialised countries, where national and foreign companies are on a similar level.

The conclusion is that standardising intellectual property rights at a high level does not benefit the companies in developing countries at all; on the contrary, it stimulates inventions in companies from developed countries, thus freezing and perpetuating the ever-increasing technological gap.

In developing countries, the protection of intellectual property can only be justified by the full disclosure of the patented inventions and if the respective states are entitled to demand the local exploitation of these inventions, which not only means to use the human and natural resources of the respective countries, but also to improve the absorption of advanced technologies.

2.1.Patents as Market Reservation

Without a detailed disclosure of patented technologies and without local exploitation of the inventions, the perverse aspects of the intellectual property protection become evident. For developing countries, the system becomes an obstacle in the advancement of local companies, as well as artificially generating price-rising circumstances for patented products.

It would be less damaging for developing countries if inventors kept the secret of their inventions; better than the current situation in which - shielded by monopolies - they do not locally exploit their inventions and still dominate the markets. If the inventions were kept secret, there would at least exist the chance of finding a technical solution on the basis of trial and error. Under the patent system the monopoly obstructs and slows down the efforts.

> "A monopoly granted either to an individual or to a trading company has the same effect as a secret in trade or manufactures". (6. Adam Smith. *An Inquiry Into The Nature And Causes Of The Wealth Of Nations*)

Market reservation does not only slow down development, it also leads to price rises. Since in developing countries there are fewer competitors, there are many sectors where patented products have little competition and are consequently overpriced.

> "In the case of patents, there is no reduction of a previous liberty (typical of economic monopolies) but the exercise of economical power expressed in the capability to raise prices". *(7. Posner, Richard, in: Antitrust Law, 2nd ed. p.16)*

Interestingly, studies of international bodies confirmed that developing countries have a disadvantage with regards to applying intellectual property protection.

> "In principle, IPRs create market power by limiting static competition in order to promote investments in dynamic competition. In competitive product and innovation markets awarding of IPRs rarely results in sufficient market power to generate significant monopoly behavior. However, in some circumstances a portfolio of patents could generate considerable market power through patent-pooling agreements among horizontal competitors. In countries that do not have a strong tradition of competition and innovation, strengthening IPRs could markedly raise market power and invite its exercise" *(8. Keith E. Maskus, Mohamed Lahonel in "Competition Policy on IPRs in Developing Countries", found in: www.worldbank.org/research/abcde/washington-12/pdf-files/maskus.pdf)*.

Monopolies such as those from IPRs tend to price rises in any country. However, due to the restricted number of competitors, the tendency is higher in developing countries. Furthermore, the tendency is for patent holders to seek similar prices in all their markets. A patented computer chip will cost more or less the same (in US $) in New York and Karachi. Otherwise, traders would buy the chip in Pakistan and resell it in New York. Since people have a much lower income in Pakistan than in New York, the result of the price rise is much more significant for the population of the poor country than for that of the rich country.

2.2 Prices for Products that Cannot be Substituted

The phenomenon of price rises for patented products is even more vicious when there are no similar products. The prices for various mobile phone devices show but a weak influence from the patented model. In addition to not being of imperative necessity, the different models substitute each other at least partially, which reduces the impact of the patent monopoly on the product price. However, when it comes to a really radical invention representing a new product without substitutes, with an inelastic demand, the monopoly enables the right holder to set prices far above the incurred costs. In this case, prices reach the limits of the consumers' paying capacity, sometimes even exceeding it. In a market economy, high prices would attract new investors, which would lead to a reduction in consumer prices. In a patent-monopoly economy, there is no access for other competitors, so prices stay artificially high for the duration of the patent validity.

It is important to note that the studies which support patent systems do not take into account the non-existence of similar products for monopolistic price setting. This phenomenon is confirmed by the specialists' statement submitted to the General Assembly of the United Nations:

> "In particular, it was no longer considered that an exclusive right necessarily conferred market power. Often there were enough substitutes in the market to prevent the intellectual-property holder from actually gaining market power. The availability of substitutes was an empirical question that could only be determined on a case-by-case basis." *Rapport (1998) of the Working Group on the Interaction between Trade and CompetitionPolicy to the General Council*, Wt/Wgtcp2/8, 8 dec 1998.

Some authors stress the absence of studies on the lack of similar products in patent monopolies.

> "For much of this century, courts and federal agencies regarded patents as conferring monopoly power in a relevant market. A 'relevant market' is an antitrust term of art that is used to determine which products compete with one another. Historically, substitute products were not considered in the analysis of whether patents confer monopoly power". (9.Sheila F. Anthony, "Antitrust And Intellectual Property Law: From Adversaries To Partners", *AIPLA Quarterly Journal*, vol.28, nr. 1 p. 1, winter 2000).

2.3 The AIDS Issue. Rejecting the Patent System.

Though the states deal with the question of IPRs, it is the large companies dedicated to research and production which are really interested in standardising, widening and guaranteeing the application of these rights. It is well-known that the semiconductor (integrated circuits topography) and software industries, and - most of all - the pharmaceutical (drugs) industry promoted the huge transformation of replacing the Paris Convention with the TRIPS agreement when the WTO was created.

For the drug-producing industries TRIPS was a huge success. Almost half the states in the world (among them nearly all developing countries) believed that, due to their impact on human life, the state should not grant monopolies on inventions in the pharmaceutical and nutritional sectors.

Countries like Spain and Italy, among other developed countries, only introduced patents for the pharmaceutical sector in the second half of the 20th century. From 1971 to 1996, Brazilian legislation did not permit the patenting of pharmaceutical and nutritional processes and products or chemical products. Since TRIPS came into force, the subject has admitted no discussion. And as long as the agreement is in force, it will be impossible to avoid patents on pharmaceutical processes and products, according to the provisions of the first part of art. 27.1

> "...patents shall be available for any inventions, whether products or processes, in all fields of technology...".

It is in the pharmaceutical sector where the perverted characteristics of monopolies are most evident. While in the other industrial sectors abuses by patent holders can entail economic and financial damage, drugs and food products have an impact on the very lives of people. Furthermore, it is in this sector where the absence of similar products causes the most disproportionate price rises. New drugs for old diseases are typical examples of an inelastic demand. New cancer drugs tend to have no similar products. And the patients' demand for this new drug is only limited by their own and even their families' purchasing power.

The worldwide spread of AIDS clearly illustrates this. It is an extremely serious condition that affects individuals of all ethnic and social backgrounds and has a high mortality rate in African countries, due to the lack of available drugs. The drugs are there, and in the US, the "kit" is sold at US$10,000 per patient-year. Most of the African countries where the disease is prevalent have an annual per-capita income of less than US$ 500. The combined health budgets of these countries lie far below the sum needed to buy the AIDS drugs.

Where generic drugs do exist, they cost just a tiny fraction of the prices charged by the companies that hold the patents. According to a report by the *Panos Institute*, a non-profit organisation based in London,

> "in January 2001, the South African HIV-AIDS activist Zackie Ahmat went to Thailand to buy 5,000 pills of the generic version of an anti-fungal drug patented by the US pharmaceutical Pfizer. He paid $0.21 for each pill. In South Africa, the patented version cost US$13".

The pharmaceutical companies refuse to provide these countries with drugs at reasonable prices. They fear that the drugs might be diverted for resale in industrialised countries. And, that the tax payers there might discover how much they are paying for the monopoly included in patents.

Various countries, including Brazil, have tried to find a solution in the framework of the WTO. Although the "Doha Declaration", signed by government ministers on November 14, 2001, clearly established the supremacy of health issues over patent-protection rights, there was neither a follow-up nor any practical consequences. The exceptions and prerequisites moderate the document and the necessary provisions are not laid down in detail; combined, these factors mean that the African tragedy that kills 600 South Africans daily has condemned these populations to a new, cruel form of "apartheid".

Brazil has a serious AIDS problem, too. To this day, tough negotiations with the patent-holding companies, together with Brazilian companies producing the necessary generic drugs, have permitted the Brazilian state to fulfil its legal duty of guaranteeing the free treatment of every AIDS patient. At the moment there are serious worries about the future of the programme. New patented drugs are being launched at high prices. With respect to new drugs, the production of generics that up until now has relied on India and Thailand is being affected by the new Indian law of 2005 that seeks an adaptation to the TRIPS agreement by permitting patents on pharmaceutical processes and products. Until 2005, Indian legislation did not allow patents in the nutritional and pharmaceutical sectors, as was the case with Brazilian legislation until 1996.

There is a strong tension in the TRIPS agreement between the IPRs on the one hand, and the request of developing countries for cheap drugs on the other hand. If the request of the developing countries is not attended to, TRIPS might come under question because of the very sector that fought hardest for the agreement - the pharmaceutical industry. Monopolies on drugs that lead to prices unacceptable for poor countries may be perceived as an exaggeration of patent-holders' rights, thus creating a movement against the patent system.

3. THE BRAZILIAN STANDPOINT

Brazil looks back on a long tradition of applying the patent system and participating in international intellectual property agreements. With the deed of January 28, 1809 signed by King *Dom* João VI., Brazil became the fourth state to adopt an industrial property law, after England (Statute of Monopolies, 1623), the United States (1790) and France (Law on the Privilege for Inventions, 1791).

It also belonged to the 11 original signatories of the Paris Convention, in 1883.

Art. 179, 26 of the 1824 constitution stipulated that:

> "*inventors shall have the ownership of their discoveries or products. The law shall guarantee them a temporary exclusive privilege or compensate them for any loss they may endure from the popularisation.*"

The law of August 28, 1830 stipulated patents only for nationals. Foreign nationals interested in the local exploitation of their inventions were called "introducers", and they were offered subsidies - not a monopoly. Since the law which was necessary to release the subsidy sums was not passed, the government ministers went on to grant patents to foreign nationals, too, "*ad referendum*" of the legislative power. The same law introduced the exhaustion instrument for patents that had not yet been locally exploited after a period of two years.

Law nr. 3129 of October 14, 1882 lengthened the period for the event of exhaustion from two to three years and introduced the priority principle (set at seven months) that would be confirmed by the Paris Convention in the following year.

The Brazilian government approved the subsequent revisions of the Paris Convention, with the exception of the Stockholm revision of 1967, to which it has only adhered from 1992. The Stockholm revision created the requirement of a prior compulsory licence as a precondition for exhaustion, which contradicted the Brazilian view on the issue. Furthermore, the compulsory licence became non-exclusive by default, which removed its efficiency. In view of this, Brazil remained associated to the Convention under the Hague revision (1925), just like Poland and the Dominican Republic.

In 1970, the Brazilian government approved Law nr. 5,648, which converted the DNPI into the National Intellectual Property Institute; its aim was to *carry out on national territory the norms regulating industrial property taking into account its social, economic, juridical and technological functions*. A year later, the government approved Law nr. 5772/71, which introduced the new Industrial Property Code.

In 1975, the World Intellectual Property Organisation (WIPO), the administrator of the Paris Convention, initiated a new revision of the Convention, which had its origin in a UN document from 1964 ("The Role of Patents in Developing Countries") that the Brazilian government had initiated. The revision was aimed at modifying the Convention text so as to permit a differentiated treatment for developing countries. To start, the committee established its principal objectives of a) achieving a reasonable balance between the right of patent holders and development; b) promoting the efficient use of the patents; c) improving the creation and transfer of technology in and to developing countries; d) controlling cases of abuse of the system.

The negotiations went on until 1979, when the parties came to an agreement that was finally approved at the Ministerial Meeting in Nairobi in 1981. To the general surprise of all, the text that had been negotiated for five years before its final approval was completely rejected by the US delegation in Nairobi. With this began the application of the US decision to move the IPR issue from WIPO to GATT, where developed countries have more persuasive power, since there they can link IPRs to trade topics.

These historical observations prove that Brazil has always been involved in the discussion of intellectual property at an international level. They also prove that the country always understood the patent system as a contract between the state and the inventor, according to which the inventor receives a temporary exclusive monopoly in exchange for the full and detailed disclosure of the invention, as well as its local exploitation. Brazil has never agreed to grant exclusive rights just to stimulate the creation and multiplication of inventions.

For the Brazilian government, the patent system has to be an instrument of industrial policy, and as such, the rights granted to the patent holders have their counterparts in unequivocal obligations that have to be fulfilled.

3.1. Local Exploitation as the Right of the State

The late affiliation in 1992 to the Stockholm revision of the Paris Convention has to be seen as an accident resulting from the pressure the Brazilian government had been exposed to in the early 1990s. As a result of the increasing pressure, Brazil abandoned its traditional allies (among them India) in the fight against the TRIPS project. After the approval of TRIPS in the context of the creation of the World Trade Organisation (WTO), the draft law approved by the National Congress was criticised because it went even further, in some aspects, than TRIPS itself.

However, even in this very draft law that was criticised as being too lenient, Brazil maintained its position according to which the local exploitation of patents can be required by states that grant patent privileges. Law nr. 9279/96, art. 68 which provides for the implementation of compulsory licences stipulates:

> "*A compulsory licence is also indicated in the case of: I - non-exploitation of the patent on Brazilian territory due to lack of production or incomplete production of the product, or also the lack of use of the patented process,- excepting cases of economical non-viability, when the import shall be accepted; or II - that the commercialisation does not satisfy the market needs.*"

The United States questioned this legal disposition at the WTO, alleging that it contradicted TRIPS in its article 27.1:

> "*...patents shall be available and patent rights enjoyable without discrimination as to the place of invention, the field of technology and whether products are imported or locally produced*".

The controversy was overcome by mutual understanding before the installed WTO panel judged it. The United States withdrew its complaint on June 25, 2001, while Brazil committed itself to informing the US government whenever it wished to apply this legal provision against a US company.

Brazil had strong arguments on its side. In addition to the point that the text of art. 27.1 of TRIPS is not clear, it was stressed that the content of art. 2.1 refers the issue to the text of the Paris Convention:

> "*In respect of Parts II, III and IV of this Agreement, Members shall comply with Articles 1 through 12, and Article 19, of the Paris Convention (1967).*"

The article 5.(2) of the mentioned document reads as follows:

> "*Each country of the Union shall have the right to take legislative measures providing for the grant of compulsory licenses to prevent the abuses which might result from the exercise of the exclusive rights conferred by the patent, for example, failure to work.*"

The provision of the Brazilian law criticised by the United States clearly complies with the document of the Convention, which it quotes almost literally.

3.2. Prevent TRIPS plus and Act in the WTO for a Modification of TRIPS

After the creation of the WTO and the approval of TRIPS, various bilateral or regional trade agreements were negotiated that included clauses relating to intellectual property, extending the rights guaranteed by TRIPS to patent holders. The NAFTA agreement between the USA, Canada and Mexico, the agreement signed by the US and Caribbean countries, and the agreement between the US and Jordan are a few examples.

As far as Brazil is concerned, the country deals with intellectual property issues in five different forums: in the WTO, Mercosur, with the European Union, with the United States and in the WIPO. In the WTO, in meetings on specific aspects of TRIPS that were scheduled when the agreement had been approved. In Mercosur, in discussions which aim at a potential harmonisation of the different member states' laws dealing with the subject. With the European Union, in an attempt to build a common market with Mercosur. With the United States, in the initiative that aims at building a common market with all the countries on the American continent, except for Cuba. And in the WIPO, where various projects related to intellectual property are in progress.

The correct proceeding would be to concentrate all negotiation efforts in the WTO (and according to the subsidiarity principle in the WIPO), to correct the excesses of TRIPS, and to avoid treating the matter in other negotiations. Discussing the same issue in various forums rather weakens the Brazilian position and leads to concessions which may be reflected in future WTO negotiations.

An intellectual property committee was created in the SGT-7 group of **Mercosur** (related to industry). For a start, a harmonisation protocol on trademarks, declarations of origin and appellations of origin was signed, but the National Congress rejected it. A protocol on patents is on its way (though progress is slow); a protocol on dispute settlement was signed and is already in force in Brazil. A protocol on the harmonisation of industrialdesign standards has made considerable progress. This document reduces the bureaucratic requirements of international procedures; it complies with TRIPS provisions, and for the first time, the theory on the exhaustion of industrial design rights is applied in the Mercosur area.

In this forum, there is no risk of coming to a *TRIPS plus* situation. It is expected that after a period of standard harmonisation, Mercosur will try to establish a consensus on some issues, which could help with negotiations in other forums. It is important that the Mercosur countries insert such issues in their national laws to legitimise their claims in other forums.

In future negotiations, certain topics should be included in all national laws of the Mercosur countries: the right to see the local exploitation of patents as an obligation of the right holder, restrictive commercial clauses as an abuse of the right holder, and the recognition of the exhaustion of rights through parallel imports.

With the **European Union**, the issue of intellectual property was included at the request of the EU delegation. The last meeting of both delegations took place in Buenos Aires in March of 2004. It was the 12th meeting of the bi-regional negotiation committee. In the section on IPRs in the concluding report, each delegation presented its own priorities:

The priorities of the European Union are:

1. To maintain a high level of protection for intellectual property, showing the need to sign and apply the new WIPO treaties (Copyright Treaty - WCT -, and *Performers and Producers of Phonograms Treaty* - WPPT-) as well as protection for new plant varieties through the UPOV,
2. Implementation in the national legislations of the enforcement measures stipulated by TRIPS,
3. Cooperation,
4. Geographic indications. This issue is considered *preferential*.

Mercosur set up the following priorities:

1. Connections between TRIPS and the Convention on Biodiversity,
2. Connections between TRIPS and public health,
3. Connections between TRIPS and rules on unfair competition practices,
4. Technology transfer: improve the chapter on cooperation and set up a list of measures that contribute to technology and innovation transfer.

Obviously, the European Union has two main preoccupations: to apply pressure on Mercosur to sign and apply the new WIPO treaties (WCT and WPPT), as well as a proposed agreement on wines (widening the rights linked to appellations and declarations of origin).

As regards Mercosur, there is an interest in finding an appropriate balance between the rights and obligations of right holders, as well as in improving the technological capacities of the receiving countries. Mercosur is obviously worried about the fact that concessions in bilateral or regional treaties on intellectual property issues create precedents in the line of TRIPS *plus* that may eventually surface in the WTO, forcing the country to concessions in addition to those it has already made in TRIPS.

Although the Brazilian government prefers to discuss the IPRs within the framework of the WTO, negotiations with the European Union continue. They are following a slow pace because they are being hampered by more important discussions between the parties on the agricultural subsidies of EU countries.

The FTAA negotiations (Free Trade Area of the Americas) are somewhat behind schedule, seeing as they should have ended by 2005. The chapter on intellectual property introduced on the initiative of the US delegation presents a novelty: instead of demanding substantial changes in the rights for right holders, so as to bring about a TRIPS *plus* agreement, the US proposal puts emphasis on the attempt to move Mercosur to insert the so called "enforcement clauses" of the TRIPS agreement (art. 41 - 61) into its national legislations.

The existing documentation on the current negotiating stage (FTAA.ngip/w/80/Ver.2, part III) shows that the main focus of the US proposals aims at enforcement issues that seem to go far beyond the scope of the negotiation of industrial property. Imposing the inclusion of legal provisions in the internal legislation of each country entails serious problems. In this field, each concession means creating new arguments in support of yet more concessions. Issues such as handling indemnisations for losses and damages (art. 2.3, 4.4), restrictions on the liberty to define certain legal periods (art. 3.2), proceedings of judicial authorities concerning the seizure of goods (art. 4.3, 4.4), limiting the factors states have to justify enforcement difficulties (art. 1.9), should not be used as bargaining stock in international negotiations. Such a move would risk a breach of the constitution and may restrict the action of national judiciaries.

Since 2003, the Brazilian delegation for the FTAA negotiations has declared vis-à-vis the US delegation that Mercosur did not want to keep the negotiations on intellectual property at the same level as the discussions on market access that are the core of the FTAA. For the topics that are considered accessory, bilateral agreements are planned, if necessary. Concentrating the negotiations on market access would be a viable way to bring the negotiations back to a desirable pace. The USA appears to have agreed to this form of negotiation some time ago, as the Brazilian foreign minister confirmed in a statement quoted by the newspaper "Jornal do Brasil":

> "*For Amorim, the immovable basis for the negotiation is the one sealed in Miami, in 2003 that can be resumed as follows: concise general norms and openness for wide negotiations according to the interests of each country or block. The US is also totally committed to the Miami parameters, said the Brazilian ambassador in Washington, Roberto Abdemir*". (*Jornal do Brasil,* 29-04-05, p. B 7)

Unless there are fundamental changes in the course of negotiations, there can be no plans to deepen the issue of intellectual property in the FTAA.

The **World Trade Organisation** (WTO) is the main discussion forum for intellectual property and the negotiating efforts should be concentrated there, after the wise decision by Brazil to avoid discussing intellectual property in bilateral or regional forums.

The TRIPS agreement, in force since 1994, stipulates that certain of its provisions are to be revised. In addition to the provision in art. 27.3.b concerning protection for plants and animals, which shall be reviewed four years after the implementation date of the WTO agreement, the organisation has already been asked for a statement on a solution that will enable the poorest countries, which have insufficient or no pharmaceutical production capacity at all, to reduce the prices of drugs for the serious diseases that affect them (Doha Declaration). At the moment, no general revision is planned; this might be delayed until 2005, the anticipated end of the period given to the developing countries to fully implement the content of TRIPS (art. 66.1 of TRIPS).

Brazil has an interest in the following issues, which will be proposed in due time for their discussion in the framework of TRIPS:

1) Local exploitation: A clear statement that member states can require in their legislations that patent holders have the obligation of local production of patented processes and products. Not meeting this obligation has to be considered as an abuse by the right holder, as already established in the provisions referring to the compulsory licence.

2) Defining that authorities can declare revocation through nullity without having previously to grant a compulsory licence. This proposal consists of returning the nullity to the situation that had been established by the Paris Convention in the Hague revision to

which Brazil had been associated until 1992. Nullity is a stronger instrument than the compulsory licence when it comes to exerting pressure on the right holders to produce locally, due to an automatism that exempts parties from prior negotiations. Furthermore, considering the difficulty in finding competent applicants for compulsory licences in developing countries, the only remaining instrument for the state to stimulate local production is nullity.

3) The Technological Development of Developing Countries

TRIPS mentions the transfer and dissemination of technology as one of its recognised objectives, giving it the same significance as the promotion of technological innovation,(art. 7).

However, after the part on principles and objectives, the text maintains complete silence with respect to concrete provisions aimed at stimulating technology transfer and a productivity increase at the licensed companies, as a means to widen the technological and economical development of the country.

There are three provisions that could have a positive impact:

1) tax incentives of the member states for patent holders who exploit their patents in a developing country through licences for nationals;
2) financial incentives of the member states for technical staff of the licence holders from developing countries to undergo professional training in the country of origin;
3) commitments to ensure that publicly funded research benefits are available for all, including the developing countries. Suggestions nr. 1 and 3 appear on p. 26 of "Integrating Intellectual Property Rights and Development Policy" by the *Committee on Intellectual Property Rights* of the United Kingdom.

3.3 The Brazilian-Argentinian Initiative in the WIPO

Although the principal discussion forum on IPRs is the WTO, the main initiative in which Brazil is currently involved in is the World Intellectual Property Organisation, WIPO. This organisation, which was emptied of substance with the arrival of the WTO, seeks to engage in highly relevant parallel programs. Among them is the coordination of discussions in the framework of the *Standing Committee on the Law of Patents* (SCP) to establish the text of a *Substantive Patent Law Treaty* (SPLT), which deserves much attention.

The text under discussion raises patent protection standards considerably and creates obligations that could not easily be met by developing countries. Not only that, the initiative only considers the rights of patent holders, attempting to define and widen them and secure their application without ever engaging in the needs of the countries where such patents will be applied, especially in the developing countries.

It seems to be a repetition of what happened with TRIPS. In spite of having put on equal footing the incentive for promotion of technological innovation and the transfer and dissemination of technology (art. 7), the text centres completely on incentives and compensations for producers, never showing any interest in technology transfer or a balance between rights and obligations.

Worried about a situation where the interests of developing countries are only present in the initial provisions that voice their wishes and good intentions, without a corresponding commitment in the binding provisions, Brazil and Argentina formulated a highly substantial proposal to be submitted to the WIPO general assembly to set up a WIPO development agenda.

This document was presented on 26 August, 2004 and was registered under WO/GA/31/11.

The document starts out by stressing the need for development of the LDCs (least developed countries) as one of the main challenges for the international community. Many declarations signed at international meetings confirm this interpretation.

It recognises the importance of technological innovation, science and creative activities as the basis of welfare and material progress. Nevertheless, statistics prove that an ever-increasing knowledge gap still separates rich and poor countries. Intellectual property should act as an instrument to promote not just technological innovation, but also the transfer and dissemination of technology. In practice, however, its application has been unbalanced, since the need to transfer and disseminate technology has received little attention. Studies prove that in many cases the costs certain countries sustain from the patent system exceed the benefits they derive from it.

To correct this imbalance, the proposal demands the inclusion among the WIPO goals and attributions of the quest for development of its member states. In practice, this means incorporating the preoccupation with development in all its activities, instead of restricting itself to promoting the protection of intellectual property.

One of the anticipated measures is to revise the founding convention of the WIPO to guarantee that the development dimension is unequivocally included as an essential element of the working programme of this organisation.

The proposal demands practical measures. It requests that the <u>*Substantial Patent Law Treaty* (SPTL) project discussed in the *Standing Committee on the Law of Patents* (SCP), which will lead to a significant increase in patent-protection standards, takes into account</u> the proposals of the developing countries as a means to reduce the costs of its implementation. The inclusion of the developing dimension in the Standing Committee should be aimed at preserving the flexibilities related to public interest, using the provisions of art. 7 and 8 of the TRIPS agreement.

It also requested that technology transfer, considered as an important goal in the TRIPs agreement, be an issue in the WIPO work. It hopes for the definition of measures that will secure an effective technology transfer to the developing countries, for instance, the use of the results of publicly funded research in developed countries.

Finally, it requests that the preoccupation with the development of the member states be stressed in the studies which aim at imposing enforcement measures in member states, while respecting their legal systems. And that the help and technological cooperation offered by the

WIPO to developing countries in the field of intellectual property answer the overriding goals of the UN, which include the holistic development of its member states.

The proposal presented by Brazil and Argentina with the support of several other countries that call themselves "Friends of Development" has the necessary substance to be seriously considered and have an impact on current programs, even including the scope of the WIPO work, because it proposes changes in the proper objective of this organisation.

Brazil has the authority to make this proposal, due to its history of participation in and contributions to the forums of intellectual rights protection: the country was one of the 11 original signatories of the Paris Convention, to which it has belonged without interruption ever since. The UN study “The Role of Patents in Developing Countries” goes back to a Brazilian initiative that led to the revision work of the Convention initiated in 1975, which aimed at making flexible the Convention terms and adapting them to conditions in developing countries. Finally, it already started adhering to the WTO TRIPS agreement in 1994, applying it immediately to its national law, making no use of the 10 year adaptation period it was entitled to both as a developing country and because it had included new sectors in the patent regulations (art. 65, 2 e 4 of TRIPS).

Its history of participation provides Brazil with the necessary authority in international forums to present innovation initiatives like this one at the discussions on intellectual property.

4. CONCLUSIONS

In the past 150 years, intellectual property has undergone constant and deep changes, always towards the confirmation and extension of the rights of right holders, reducing the preoccupation with their obligations almost to the point of their disappearance. At no point in history has there been a successful attempt to shift the weight towards an equilibrium that would take into account the direct interests of the developing countries and their consumers. (The attempt to amend the Paris Convention to reserve a differentiated treatment for developing countries failed after five years of negotiations at the Nairobi conference in 1982.

From a period when the local exploitation of inventions was required as a fundamental precondition for granting or keeping a patent (used by England, Switzerland, France, the United States and others), we have arrived at a moment in history where such a requirement is considered illegal, as happened when the United States made a complaint at the WTO against Brazil for having included this interpretation in its patent law.

From a period when nullity was a normal and efficient instrument for securing local exploitation, we have come to a phase where the compulsory licence has replaced nullity, turning it into dead paper for the benefit of patent holders.

From a period when the compulsory licence was presented as a state instrument capable of preventing abuse by right holders, we have come to a compulsory licence that can no longer be applied in practice due to the changes in its nature, which have made it non-exclusive and necessitate financial compensation.

From a period when each country had the right to independent intellectual property legislation as a financial-policy instrument that defined in which sectors it would allocate monopoly rights, withthei respective duration and conditions, we have now come to an international agreement where all economic sectors have patent protection with rights standardised at a high level, and with no restrictions for the right holders.

Still worse, the negative impact of the transformations has been felt strongest in the developing countries. The compulsory high-level standardisation did not take into account that income is lower in these countries. That the monopoly effect is often strengthened by the fact that in many developing countries new inventions do not compete with similar products. That the gap between them and the industrialised countries increases daily because of the limitations in industry and research centres in developing countries. And that the patent system has the very same effect on them as a market reservation.

Add the fact that some of these inventions belong to the area of drugs and food that have a direct impact on the life and the dignitiy of human beings.

The TRIPS agreement includes objectives that would have restricted the perverse effect of the patent system on developing countries when applied in practice. In art. 7 it presents as its main objective, alongside technological innovation, the transfer and dissemination of technology in a way to produce social and economic welfare and establish a balance between rights and obligations. But this objective disappears in the following provisions, i.e. the norms that constitute the treaty.

It is clear that developing countries are not interested in a patent system that does not include the possibility of a demand for local exploitation. It is clear that a system without flexibility has a negative impact on development. It is unreasonable to grant 20-year monopolies without any retribution, just to serve the principle of inventor compensation and to stimulate the promotion of inventive activities. To grant market reservation for products that only arrive in a country through imports, without any specific benefit, goes against human reason.

This is why the actions of Brazil in the negotiations on intellectual property have had so many repercussions and why it has received so much support. To demand the inclusion of the development dimension in the treaties that govern the practical application of intellectual property helps to support the international system of intellectual property. To demand an effort be made towards the objective of facilitating the transfer and dissemination of technology contributes to the acceptance of TRIPS, at a lower cost to developing countries. The interpretation that local exploitation can be required by a patent-granting country should not be considered erroneous. In the middle of last century, the great Paul Roubier taught us that:

> "*if the state accepts to give the inventor a monopoly to exploit (a patent), it is under the condition that there is an efficient exploitation (of the patent)*" (*Le droit de Propriété Industrielle*, 1952).

The next years will tell if a treaty that is as biased as TRIPS, in a sector that is as sensitive as that of technological innovations, and as important for developing countries, will have a long life expectancy. The success story of the Paris Convention, with its flexibility with respect to the legislation of each member state, leads us to believe that TRIPS has to become more flexible with regard to developing countries, so that they all can benefit from the creation of new inventions.

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