Keynote Speech at Amundi Investment Day
by Ambassador Hye Min LEE

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Thank you, *Mr. Pellis* for your kind introduction.
I'd like to extend my appreciation to Amundi for inviting me here to speak before this privileged audience. It is my honour to be with you this afternoon.

Today I'd like to share with you my views on emerging markets and the institutional mechanisms to reduce risks in investing in them. Having worked for 36 years in international economics, including my current capacity as the G20 Sherpa of Korea's President, I am used to speaking with government officials of my own or from other countries on how to shape policies to attract more investment from foreign investors. Today, to you private investors, I would reverse-engineer my usual remarks and discuss how we can understand the broad spectrum of the international trade and investment regime when deciding to invest in emerging markets.

(EM's characteristics)

So, to get started, let us quickly take a look at what we generally think of as emerging markets. They are characterized, in a nutshell, as places with the potential for high returns, but they also come with high risk. Though emerging markets are often alluring and attract a lot of attention, they lose some of their shine during times of economic crises or when commodity prices fall. Above all, they are considered a target for tactical or short term investment.

This general perception seems to be slowly changing. Many developing countries are becoming detached - or decoupled as they say - from the problems of advanced economies. Some of them are less affected by the ongoing global economic turmoil because of increasing south-south trade. It was counter-intuitive at first, but nowadays investors are trusting emerging markets more than before. Look at us - we are discussing if emerging markets are a new safe haven, a destination for strategic investment.

(High return)

The high returns from emerging markets are associated with their fast economic growth. And the two foremost factors that will affect the future rates of return from investing in emerging markets, are first, instability or a slowdown of the Chinese economy and second, the tight monetary policy of advanced economies. But I am not here to tell you if China will continue its 6 to 7% growth or when it will fall below 5%, or when the US Federal Reserve will turn hawkish and start to absorb dollars.

Rather, I believe that understanding the circumstances that enabled fast growth in emerging markets, including in my own country Korea, can shed some light on their prospects for sustaining such growth in the future, and the conditions under which it can be nurtured.

(East Asian economic growth)

So, let me touch on how some countries have developed faster than others. Each country has its own story, so, I will limit the scope to East Asia. There are already too much literature on the East Asian miracles covering everything from econometrics to public policy to historical studies.

Nobody agrees on exactly what factors caused the region's explosive growth. For example, some argue that massive labor and capital accumulation in these countries enabled it, and others emphasize that the region's long term growth—which lasted for more than 30 years—was made possible only through technological progress. I would like to pick up a number of factors frequently cited and reflect upon their relation to the present situation.

First, most industrialization started with light industries such as textiles that benefited from the mobilization of massive labor forces. Korea had a good primary education system in place and almost universal literacy. East Asian people had a strong reputation for being "industrious" as well. However, rapid economic growth today depends very much on innovation and is driven by a few leading companies. So advanced education in science and technology is of greater importance. How these countries can transform the basis of human resources development into the demands of a new innovation-led economy will be the yardstick for future growth

Second, capital accumulation and a high investment rate is widely credited as one of the causes of the high rates of growth in the past. This remains important. The high saving rate among the general public is an often-cited secret of success in Korea. A famous story about Koreans in 1997 Asian financial crisis is the gold collection campaign across the country to help ease the country's foreign currency shortage. It is a Korean family tradition to receive gold rings for a child's first birthday. The family usually hoards the rings deep in a cabinet so they can be used when money is needed after the child has grown up. To deal with the 1997 Crisis, the entire nation sacrificed. The government and private firms were forced to sell off promising businesses, and households sold off these birthday rings.

It is quite a touching story, but some raise doubts about the overall narrative. If Korea's rapid development was supported by hard work and savings, in other words, the sacrifice of the consumption and leisure by the people, it raises the question whether the next generation will continue to sacrifice. Even if they do, the present economic situation in many countries needs consumer spending to boost the market rather than savings, not to mention the Keynesian paradox of thrift.

The third often-cited key to success of East Asian countries is government industrial policy. Again it is no surprise that the government's role in economic development is both praised and criticized, depending on whether you are a liberalist or an interventionist. In the primitive stage of industrialization, governments mobilized resources and channeled it to promising industries through national economic development plans and a variety of policy tools. In Korea, the increased capital stock helped competitive conglomerates flourish through economies of scale.

There were also controversial policies, such as targeted subsidies, the protection of domestic industries through import barriers such as high tariffs, and the artificial depreciation of currency. The majority view now denounces these kinds of policies, referring them to "beggar-thyneighbor" or "race to the bottom." They are also seriously regulated by trade agreements such as the WTO and numerous Free Trade Agreements.

Professor Francis Fukuyama of Stanford University argues in his recent book "Political order and political decay" that the common feature of the fast-growing economies of East Asia is that they all possess competent, high-capacity governments even before they started industrialization. At the same time, his insight further suggests that the challenge for these countries is constraining the power of the government in balance with society – meaning both civil society and businesses. This view is probably an extension of his famous thesis in favor of the Western type of democracy and market economies. However, it is difficult to disagree with the idea that state intervention or government policy must be carefully and wisely exercised, and only those countries that succeed in managing this balance will sustain further national growth.

Lastly, the explanation for East Asia's rapid economic growth that is probably most relevant to today's topic is the role that increased trade and foreign investment played in the region's economic development. In the case of small East Asian countries, exposure to the foreign trade as measured by the ratio of trade volume to GDP was close to 100%. Trade has also been important to China's economic growth, though it is not a small economy by any means, as well as Japan's, which industrialized and achieved an advanced economy much earlier than the rest of the region.

Through international trade, the region's industrial development was matched by the vast world market. At the same time, the openness of their economies exposed their companies to advanced technology from developed countries and promoted competition with them, providing the grounds for the further growth. The systemic basis of international trade was the multilateral trading system known as the GATT – the General Agreement on Tariffs and Trade of 1947, which later became the WTO in 1995 with the conclusion of the Uruguay Round of Multilateral Trade Negotiations. Indeed, global economic growth, in particular, East Asian's growth, owed a lot to this multilateral economic system which enabled easy access of their products to the markets of the developed countries.

(Export-oriented economy / Domestic demand)

However, trade-dependent economies, in other words, those oriented to exports, and export-dependent growth face one tremendous limitation. It is not just a theory but the reality in the current world. Growth has slowed in the most developed countries that have provided stable markets for products from developing countries. As the demand abroad shrinks, developing countries now need to give more weight to their own domestic markets.

The bigger domestic demand in developing countries has other merits. First, it means less need to compete in foreign markets through lowering prices and providing subsidies. This will result in better profit rates for their products. It also reduces the risk of inviting backlashes from importing countries to exert protectionist measures. Second, they can provide their own markets for products from other developing countries. As I said earlier, growing south-south trade will prevent economic problems in advanced countries from being contagious to developing countries.

One such problem is high household debt rates. Efforts to boost the domestic demand in developing countries are often frustrated by the low purchasing power of their consumers. In some advanced countries, the governments have eased access to consumer credit to boost consumption. However, this is not sustainable and has caused other problems such as household insolvency.

The international community, including the G20, therefore, encourages so-called "inclusive growth," where domestic demand can be boosted by increased wages and government spending on the social safety net. Effectively addressing the inequality of wealth would be an important pillar necessary for this domestic boost. Much research on economic development suggests that less wealth inequality provides better conditions for national growth.

(High Risk)

Now I would like to turn to the other side of coin, high risk. If someone is hesitant to call emerging markets a safe-haven, it is of course due to these risk factors. There are many guidelines on good governance and best practice in investment policy from the IMF, World Bank, OECD or G20 that can help the governments of developing countries attract more investment. As investment is another important element of gross demand, attracting investment, either domestic or foreign, is a key policy objective in any country. Among many other policy tools, today I would like to discuss trade and investment agreements as institutional mechanisms to reduce the risks in investing in developing countries.

Trade agreements that generally aim to dismantle barriers in trade help reduce risks by enhancing predictability and transparency in the country. Also, due to their market enhancing effects, these agreements can induce foreign investment, whose strategy is to use the tariff free network among input sources, processing places, and product markets.

(Investment Agreement)

Investment agreements aim to protect investors and investments from the host government's adverse actions. Indeed, how an investment will be protected, in high risk countries in particular. is one of the most important factors investors consider when making an investment decision. The investment agreement generally includes the principles of National treatment, MFN - Most Favored Nations, Minimum standard of treatment, Prohibition of expropriation without fair compensation as well as the freedom of transfers relating to a covered investment. It may also contain a dispute resolution mechanism called ISD (Investor State Dispute) where the investors can directly resort to international arbitration in case of the violation of the agreement by the host government.

Many investment agreements are stand-alone treaties, generally called BITs (Bilateral Investment Treaty). There are some agreements that take the form of a chapter in a broad Free Trade Agreement, for instance, NAFTA, Korea-US FTA and TPP. We have a multilateral trading system called the WTO, but to date there is no multilateral investment agreement. It does not mean that we have not tried. Negotiations on MAI (Multilateral Agreement on Investment) have been conducted from 1995 to 1998 under the auspice of the OECD. The MAI negotiators have succeeded in producing a draft text of an agreement, but the negotiations have not continued further. The WTO's DDA negotiations launched in 2001 originally included a section on investment, but the topic was dropped, mainly due to opposition from developing countries.

(EU's investment negotiations)

For more concrete aspects, let me touch upon the EU's investment treaties and negotiations. I was in the leadership of Korea's FTA negotiations team when we concluded two major FTAs with the United States and the European Union between 2006 and 2009. One of the most common questions I am asked is why the EU FTA has no investment chapter while the US FTA does. Previously, until the Lisbon Treaty entered into force in 2009, investment policy in the EU was vested in individual members. So, Korea could not negotiate an investment chapter with the European Union at that time. Of course Korea already had many bilateral treaties with the Union's individual members. Now, however, investment falls within the common commercial policy of the European Union and both Brussels and member states share competence on investment negotiations.

Since then, the European Union has negotiated a number of investment agreements, for example, with Canada as a part of the FTA called CETA (Comprehensive Economic and Trade Agreement), and also with Singapore and Vietnam. It is currently negotiating others, most notably with the United States as a part of TTIP (Trans-Atlantic Trade and Investment Partnership), and also with Japan. Until such EU-wide investment agreements take effect, previous treaties negotiated with individual members will still apply. The EU's negotiations have not progressed quickly mainly due to internal consultations surrounding criticism of the ISD system from the public and the European Parliament. Individual members may choose to initiate negotiations for a new individual treaty or update their existing ones with authorization from the EU.

(Need for Reforms)

It is said that there are over 3,000 investment agreements world-wide and the EU members are a party in about a half of them. The majority of the agreements were signed in early days and were very short without many details.

For example, these agreements do not provide details on the meaning of 'fair and equitable treatment' that governments have to provide to investors. 'Fair and equitable treatment', sometimes referred to as 'minimum treatment', is a more serious obligation than it may sound. Many ISD claims are based on this obligation. It is an unconditional obligation that governments must provide to investors, while such obligations as non-discriminatory treatment requires the government to treat covered investors as favorably as it treats its own, or investors from other countries. Later agreements added some more details and caveats to the meaning of this obligation.

In disputes based on these early treaties, the arbitration panel would have broad discretion to interpret the meaning of the obligations, sometimes in favor of investors and at other times to their detriment.

(Direction of Reform)

The general criticism from civil society on investment agreements and the ISD system is that the balance is tilted too much toward investors. So, most discussions on the reform of ISD in many countries are directed not to further enhance the protection of investors, but to guarantee the government's right to regulate and not to give too much advantages to investors in the international arbitration vis-a-vis the domestic court.

But, in order to garner support for reforms from the investors' side, I believe that they should work both ways. One way the reform agenda can help investors reduce risks is to address the fragmented rulings of arbitration panels. It is not the best dispute resolution system if you get it all when you are lucky and nothing when you unlucky in a case. More coordination in dispute resolution, and more predictability in judgments and awards would definitely help spread out risk. Actually there are already cautious discussions on establishing an appellate system for the ISD panel's decisions or reviving negotiations for a multilateral agreement to host the multilateral appellate system. In particular, the EU and Canada agreed in their FTA text to pursue with other trading partners the establishment of an international investment tribunal and appellate mechanism for the resolution of investment disputes. They intend to replace their bilateral appellate system with this multilateral system. However, as the FTA text envisages, it requires cooperation from other countries. They would, above all, need to persuade the United States, which remains skeptical.

One reason for the opposition to this idea is the cost borne by the claimants to go through another round of arguments. However, according to research, the average claim in ISD cases exceeds 620 million US dollars. Given the enormous amounts at stake, the cost for an appellate procedure may be considered as an insurance premium. Another concern is the prolonged time until the final award. The WTO's appellate body has already been suffering from the heavy case load, and new ISD claims every year already outnumbered new WTO cases. So, it is not difficult to anticipate the cases soon clogging in the investment appellate body. The issue of multilateral appellate system needs careful consideration and efforts to seek solutions to the anticipated problem.

Another important issue is the denial of benefits clause that intends to prevent paper companies from enjoying the protection of investment agreement. It is one of the core provisions of current investment agreements, but had not been included in the agreements of the 70s and 80s. Countries like Korea desire to amend the old generation agreements, but sometimes face resistance from other countries, especially those with very few or light regulations on investment and business activities. These countries might fear that amending this clause may diminish their status as a preferred investment destination.

As amending each past bilateral agreement not only takes time and efforts but also needs to overcome the opposition of the other parties, I think the efforts at the regional and global levels should be pursued to fix the defects of the past agreements despite the previous failures in the OECD MAI and WTO DDA negotiations.

With regard to the prospects in the multilateral context, I would like to note a recent achievement in G20, which is the G20 Guiding Principles for Global Investment Policymaking endorsed at the G20 summit in Hangzhou in September. Although the current version lacks full details about investment due to the sensitivity of the topic, its value is not insignificant in two aspects. First, the guidelines call for international coherence in investment policymaking that can provide greater predictability and certainty for investors and, at the same time, a better chance of economic and social development for host countries. Second, investment is a sensitive topic on which developed and developing countries have very different positions. As you know the G20 is a mixed group of developed and developing countries and the agreement was made under the chairmanship of China. Moreover, through careful negotiations, the Guiding Principles aim to strike a balance between the protection of investment and the government's right to regulate, and also a balance between the promotion of a favorable investment environment and observance of responsible business conduct and corporate governance. I have high hopes that the topic of investment will continue to make progress in the G20 under the German and Argentine presidency in the coming years.

(Uncertainty)

Finally, let me turn back to the broader aspects of uncertainty in the global economy and the trade and investment environment. I said earlier that the performance of the Chinese economy and the US Fed's interest rate policy are important factors that will affect the economic cycle in the near future. From the systemic point of view, though, I would list growing protectionism and Brexit as the two most important risk factors for businesses to consider.

First, by growing protectionism I mean not only raising import barriers, but also diminishing support for open trade. The non-progress of the WTO negotiations, as symbolized by the practical death of the Doha Development Agenda, is the most worrisome. The growth prospects of developing countries that depend on trade are adversely affected by the stagnation in the WTO. Some would accuse growing regionalism of causing countries to turn away from multilateralism. However, these two concepts – regionalism and globalism - are compatible and can work in parallel to advance the open trade agenda. The TPP is also languishing at the door of the US Congress. The result of next week's presidential election, in either case, will not help. TPP is definitely dead if the candidate who once made a threat to kill existing FTAs wins. Its prospects are not significantly brighter if the other wins, because she has made public her opposition to the TPP. Some optimists hope that she will skillfully change her position on the grounds that President Obama did the same in regards to the Korea-US FTA. But the politician's position is a reflection of their constituents, of the grass-roots, and of businesses. The destiny of the global trade and investment agenda, whether it is TPP or a Multilateral Investment Agreement, depends on all of us. I'd say open trade and investment is like freedom, or like air if I can stretch the analogy further. It surrounds us and is not so tangible, but is hard to imagine living without.

Second, let's talk some more about Brexit before we finish. From an institutional point of view, we have to separate the UK's relationship with the rest of the EU, that will be EU 27, from the UK's relationship with the rest of the world.

On the first part, the immediate effect of Brexit will be that the UK will lose the privilege to access the European single market. It is said that the impact will be heaviest on the UK's financial services industry that has benefited from the privilege, and been successful even without joining the single currency. As shown in the debate over Hard vs Soft Brexit, the important question is under what status the UK will end up accessing the European market. Many are concerned about how this risky story will unfold. There is cautious optimism about this as well. Wolfgang Muenchau, a Financial Times editor, once wrote that Brexit could be a shock that shifts the UK in the right direction of national transformation, analogous with the case of Germany and Japan whose wartime defeats allowed them to reinvent themselves. Much remains to be seen.

On the latter part, the most intriguing issue is how the UK will separate its commitments under the WTO from the EU's common schedule on a wide range of issues from tariff concessions to services offers to government procurement offers. The UK International Trade Secretary Liam Fox's speech in September stated that the UK would maintain the same schedule after it left the EU. However, many, including the WTO's Director-General, are doubtful that the matter is that simple. Even technically it would require re-negotiations of the schedule in the EU-wide quantitative commitments. For example, the EU's agricultural import schedules are full of TRQs – tariff rate quotas, which specify the quantity of agricultural products that the EU must import from the rest of the world at a low tariff level. How much of them the UK will bear and how much by the EU will be subject to negotiations. If the negotiations take longer than what is allowed under the EU's relevant terms and conditions, we should worry about the legal vacuum created in the transition. The prolonged uncertainties will have a negative impact on foreign investment in the UK, in particular, in manufacturing sectors.

To make it more complex, it is not just the WTO that the UK and the EU have to deal with, but also numerous FTAs and other preferential trade agreements they have concluded together in the past. In this case, the connected problem is the lack of capacity in the UK government for trade and investment negotiations, as it has delegated this authority to Brussels since 1973. If an optimist sees this, too, as a blessing in disguise, and hopefully the UK quickly revives these old skills, it may come back as a major country in the international trade and investment scene. Currently, the WTO's super powers are the United States, the European Union, China, India and Brazil. The UK has the potential to muster Commonwealth support without the burden of a defensive agricultural policy, and is geographically located to mediate across the Atlantic. All these best wishes for the UK are premised on the result of negotiations for the next few years on how the country will find its place in the new environment. What I can say with a certain degree of certainty is that the road ahead will be very bumpy and challenging.

(Conclusion)

I wonder if all these thoughts just add to your confusion about the prospects of emerging markets rather than provide clearer view. But, we must admit that we are living in a risky world, politically in some places and economically in others. Reportedly, a renowned banker complained that an investment group's market projection, no matter how precise it is, can be all undone by a single swing of political shock such as heavy government intervention in the market or an unprecedented situation like Brexit. I'd respond that he is not alone in this kind of frustration. For example, the Korean government's efforts to induce foreign investment are hindered by such external risks as a hostile brother's missiles and nuclear tests. In this vein, the IMF's 2016 Annual Report listed a number of global challenges that the world economy faces, with "uncertainty around Brexit" on the top of the list. The report did not forget to mention the importance of monitoring geopolitical spillovers that could threaten the global recovery. It would be fair to say that our economic system depends on global and regional political and security orders that are currently very unstable and unpredictable.

With that excuse, I would like to conclude here today by re-emphasizing that more stable legal and institutional mechanisms in international trade and investment can help reduce risks in emerging markets. Trade and investment agreements, whether they are bilateral, regional or global, are useful tools to enhance the transparency and predictability of the regulatory regimes of emerging economies, thereby significantly reducing their risks. For this reason, I hope for the continued and vigorous support of business society to build, maintain, and strengthen this system. Thank you for your attention. /END/