



Asia-Pacific
Economic Cooperation

**Workshop on the Relationship between
Investment and Trade in Services in RTAs and
Other International Investment Agreements**

18 April 2007

**Investments Experts Group and Group on Services
APEC Committee on Trade and Investment**

July 2007

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APEC Secretariat
35 Heng Mui Keng Terrace Singapore 119616
Tel: (65) 67756012 Fax: (65) 67756013
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APEC: Joint IEG-GOS Workshop on the Relationship between Investment and Trade in Services in RTAs and Other International Investment Agreements

Report by the IEG and GOS Convenors

The APEC Group on Services (GOS) and the Investment Experts Group (IEG) held a Joint Workshop in Adelaide on 18 April 2007. The purpose of the workshop was to explore the interface between the provisions on investment and trade in services in APEC regional trade agreements (RTAs) and bilateral investment treaties (BITs).

The key objectives of the Workshop were to:

- examine, discuss and deepen collective understanding of the investment and services sections of APEC member economy RTAs, FTAs and BITs with a view to analysing the key interactions;
- improve understanding of the impact of the various approaches (NAFTA- or GATS-based) on the degree of investment promotion and liberalisation;
- through this better understanding of the issues, contribute to the goal of high quality, transparent, broadly consistent and comprehensive RTAs/FTAs and BITs in the region and identify possible further capacity building needs; and
- discuss and understand the implications of MFN provisions in RTAs/FTAs compared to the WTO's MFN rule.

In Session 1 “The Coverage of Investment Provisions Regarding Services”, discussion focussed on the main scheduling patterns of chapters on investment and trade in services:

Ms. Anna Joubin-Bret (UNCTAD) discussed some of the key issues of arising from UNCTAD studies (such as the *World Investment Report*). In particular Ms. Joubin-Bret emphasized the shift towards FDI in the services sector as a key feature shared amongst developed rather than developing nations. While the mixed approach to RTAs/FTAs is common among APEC economies, protectionism in the architecture persists APEC member economy uptake of BITs mirrors the global experience; cumulatively they are rising, but annually they are decreasing or stabilising. However, there is still room for growth in BITs among APEC members.

Session 2: The Interaction between the Services and Investment Chapters;

Major points raised and discussed in this session included:

- **Ms. Maryse Roberts (Organisation of American States)** discussed the NL approach as being the more common approach in the Americas and suggested the recent uptake of RTAs in Latin America has led to increased services liberalisation commitments when compared to those under GATS;
- **Ms. Jane Drake-Brockman (Trade and Environment Solutions)** pointed out that trade negotiators had minimal experience in investment negotiations — as this

- expertise normally rests with Treasuries and Finance Departments, and therefore there are implications in getting messages heard during negotiations;
- Scheduling issues in services and investment chapters of RTAs/FTAs are fluid, and a GATS-style approach can accommodate either a positive list or negative list;
 - Ms. Drake-Brockman suggested a negative list approach to services and investment commitments has been delivering superior outcomes and reiterated a common theme: that in addition to policy issues impacting on RTA/FTA investment chapter negotiations — the message to the private sector should be that FDI is welcome;
 - And, while investment experts debate architectural issues — by and large, to the private sector these issues remain confusing and elusive.

Session 3: Degree of liberalisation achieved by different approaches to services/investment in RTAs

This session dealt with GATS+ Services liberalization in East Asia, architectural issues and achievements and a comparison between the NAFTA-inspired and GATS-inspired approaches in terms of the degree of liberalisation achieved.

Mr Martin Molinuevo (World Bank) introduced recent research investigating the architectural aspects and achievements of services liberalization in East Asian FTAs; that challenges the view that a NAFTA based negative list approach produces better outcomes in terms of transparency, predictability and degree of liberalization. While some agreements show few commitments *beyond* GATS level (AFAS, Thailand-Australia) others exhibit much broader, not *deeper*, commitments (US-Lao PDR, US–Singapore, Japan–Singapore). Mr Molinuevo also suggested that beyond obligations to market access and national treatment; there is generally no mechanism to bind actual levels of openness, thereby making architectural issues irrelevant. Caution was also urged in trying to create a better/worse dichotomy when discussing architectural approaches — as each has no inherent benefit or disadvantage in regards to transparency and liberalisation.

Mr Sebastien Miroudot (OECD) proposed that liberalisation is more of a trade, rather than investment concept and some RTAs do not actually liberalise investment as commitments merely correspond with the status quo. Miroudot pointed out that OECD analysis did not prove a quantitative link between BITs and FDI flows. However, the joint effect of a BIT and a RTA with substantive and actual investment provisions may positively impact on FDI. One of the key points concerned liberalisation as it relates to different approaches — it's not a matter of how listing is approached but rather what is listed.

Session: 4 What are the implications for the MFN rule at the regional/bilateral level?

Views on the implications of the MFN rule were presented by Australian experts (Mr **Andrew Stoler**, the Institute for International Trade, University of Adelaide; **Professor Chris Findlay**, University of Adelaide; and **Mr Tony Hinton**, former Commissioner, Australian Productivity Commission).

A robust and challenging discussion on MFN issues was held between the three panellists, with some panellists suggesting MFN should not be a major concern at the regional/bilateral level. Indeed it was questioned why different economies should receive preferential treatment at all MFN also introduces risks and inconsistencies — especially regarding investor-state disputes. Comments from the panel and the floor noted there was much to learn about the complex nature of the co-existence of multilateral, regional and bilateral agreements and the arrangements and approaches to investment issues contained therein while others cautioned against ‘treaty shopping’. Avoiding the conflicts with RTAs/FTAs/WTO GATS rules was one area identified for future discussion — possibly in the form of a case study or further workshop.

Overview

The Joint seminar was well-attended and like the previous joint seminar held by IEG and the MAG exploring the nexus between trade in goods and investment, the session was extremely thought-provoking and encouraged shared information and experience amongst experts, negotiators, academics and the business community. Several areas for future cooperation between IEG and GOS should be possible as a result of this seminar. A CD with the Seminar presentations is available upon request from jhook@treasury.gov.au and on the IEG website.

Joint IEG/GOS Workshop on the Relationship between Investment
and trade Services in RTA's and Other International Investment
Agreements
18 April 2006 – Adelaide Hilton Hotel

Program

09.00–09.15	Introduction by the IEG/GOS Convenor(s) Roy Nixon & Gloria Pasadilla
09.15 – 10.30	Session 1: The Coverage of Investment Provisions regarding Services Part 1 Anna Joubin-Bret: UNCTAD <i>Services in International Investment Agreements</i>
10.30 – 10.45	Morning tea
10.45 – 12.30	Session 2: The Interaction between the Services and Investment Chapters Part 1 Maryse Robert: Organisation for American States <i>Liberalizing services and investment: Lessons from the Americas</i> Part 2 Jane Drake-Brockman: Trade & Environment Solutions
12.30 – 14.00	Lunch break: Hosted by: TBC
14.00 – 15.30	Session 3: Degree of liberalisation achieved by different approaches to services/investment in RTA's Part 1 Martin Molinuevo: World Bank/World Trade Institute <i>GATS+ Services liberalization in East Asia: Architectural Aspects and Achievements</i> Part 2 Sebastien Mirodout: OECD <i>Comparison between the NAFTA-inspired and GATS-inspired approach</i>
15.30 – 15.45	Afternoon tea
15.45 – 17.00	Session 4: What are the implications for the MFN rule at the regional/bilateral level Part 1 Andrew Stoler: Institute for International Trade, University of Adelaide Part 2 Chris Findlay: University of Adelaide <i>Market access in services: Reform paths, and implications for the value of the MFN rule</i> Part 3 Tony Hinton
17.00 – 17.15	Concluding Remarks by the IEG/GOS convenor



Asia-Pacific
Economic Cooperation

2006/SOM2/IEG/010

Agenda Item: 5(c)

**Outline for Proposed Joint IEG/GOS Workshop
on the Relationship Between Investment and
Trade in Services in RTAs/FTAs and Other
Investment Agreements**

Purpose: Consideration

Submitted by: Australia



**Investment Experts' Group
Ho Chi Minh City, Viet Nam
22-23 May 2006**

Outline For Proposed Joint IEG/GOS Workshop on the Relationship Between Investment and Trade in Services in RTAs and Other International Investment Agreements

This proposed workshop is designed to examine investment issues and the complexity created by incorporating rules on investment in trade in services, notably via commercial presence (Mode 3), in regional trade agreements (RTAs). It will consider the issue of coherence in the face of overlapping investment commitments between the investment-related provisions in the investment and services chapters. The aim of this workshop is to give participants an enhanced understanding of relevant policy questions. The workshop builds to some extent on the joint workshop with MAG on investment and market access issues in preferential trade agreements held in Ha Noi in February 2006, and the Japan-UNCTAD workshop on emerging issues arising out of bilateral investment treaties and international investment agreements held in Tokyo in September 2005.

Session 1 : The Coverage of Investment Provisions regarding Services

A fundamental question that should be posed and analysed is why provisions should be different for investment in trade in services through commercial presence. Is there a fundamental distinction between trade in goods and trade in services that justifies treating investment provisions in goods and rules on trade in services through commercial presence differently? If the answer is yes, how do the various RTAs compare in tailoring their provisions to accommodate this difference? If not, are there implications for provisions on investment protection and liberalisation? This session aims to identify the main scheduling patterns of investment and trade in services chapters and to discuss the issues that may arise from the co-existence of alternative types of commitments.

Session 2 : Are Investment Provisions adding more Disciplines in the Services Area?

To some extent, investment chapters in RTAs build on the treatment and protection provisions of bilateral investment treaties (BITs). They often combine these protection obligations with liberalisation commitments. Trade in services chapters in RTAs, on the other hand, often follow a GATS-type approach. Thus, they do not contain protection elements as generally understood under investment agreements. To what extent do RTAs extend the coverage of investment protection provisions to services? And, reciprocally, the GATS includes provisions on balance of payment (BOP) safeguards whereas most BITs do

not include explicit BOP safeguards. Do GATS provisions regarding provisions such as BOP safeguards extend to all investments in some trade agreements?

Session 3 : Specific Rules on Financial Services

Many RTAs include a separate chapter on trade and investment in financial services. Financial services are by definition of crucial interest to promote investment. Rules on investment in financial services are not only rules on a specific services sector but also rules that may impact on all types of investments (including in the manufacturing sector). Financial services need specific rules, e.g. on prudential regulations. Is it a specificity that has to be taken into account in the design of investment rules? What is the rationale for a financial services chapter regarding investment?

Session 4: Modalities for Liberalisation

Three possible modalities will be considered: an investment definition approach, GATS versus NAFTA-style investment liberalisation, and the Most Favoured nation (MFN) rule.

While a broad asset-based definition of investment is the norm in many investment chapters, services chapters that include Mode 3 base their definition of investment on the concept of “commercial presence”, which is one of four modes of supply of trade in services under the GATS. As this concept is generally considered to be narrower than the asset-based definition, what are the implications of liberalising investment in the investment chapter rather than the services chapter?

NAFTA, the first major RTA with investment content, groups provisions on investment for all sectors — including services sectors — with a negative list of reservations in Chapter 11. The GATS-type approach that is followed in other types of agreements combines the positive listing of sectors where countries voluntarily undertake liberalisation commitments with a negative list of non-conforming measures that countries wish to maintain in scheduled sectors. Are agreements with a GATS-approach in services more likely to reproduce the same level of commitments as in GATS? Does the architecture of the RTA make any difference in the actual level of liberalisation?

A very common provision on investment that can be found both in investment chapters and trade in services chapters is MFN, which requires a party to provide investors and investments from the other party treatment “no less favourable” than it accords “in like circumstances” to investors and investments of any other party. What are the implications of the MFN rule? How do investors from one party benefit from the provisions on investment included in other agreements signed by the other party? Are there any systemic risks or potential inconsistencies in the multiplication of RTAs with investment provisions granting MFN treatment?

Timeline

1. Discussions with GOS to agree on a way forward.
2. Dialogue with the OECD's Investment Committee to draw on its work and with ABAC for business implications.
3. A Joint Workshop at SOM 2 in 2007 (coinciding with ASCC where some experts may already be attending)?

Funding

It is expected that many of the presenters and participants will be from APEC economies and attending APEC meetings that week anyway. Funding for one or two key non-APEC member expert presenters may come from the host economy or other interested economies with a particular interest in this work in either IEG or GOS.



Services in IIAs

Joint IEG/GOS workshop on Investment and Trade in Services

Anna Joubin-Bret
Senior Legal Advisor
IA programme
UNCTAD



The share of services FDI inward stock

- In 2004 and 2005 services sectors accounted for at least \$ 6 trillion FDI inward stock representing about 57% of global FDI inward stock
- Finance and Business sectors alone accounted for \$ 3.4 trillion in 2004 and 2005

APEC countries (based on responses from 9 countries):

- In 2004 and 2005 alone, at least \$ 3.5 trillion FDI inward stock in the services sector
- Finance and business sectors alone accounted for over \$ 2 trillion FDI inward stock in 2004 and 2005





UNCTAD

- * Foreign banks invested about \$12 billion in 2005 in China's banking industry, compared to \$3 billion in 2004
- * The top targets of cross-border M&As were finance, transport, storage and communications, and business services (mostly real-estate)



UNCTAD

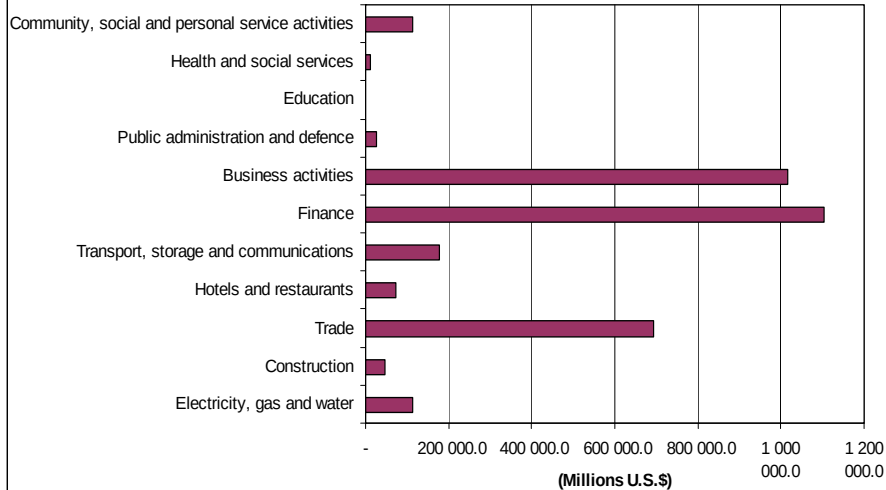
Rising FDI in Asian real estate

- * Real estate market in Asia attracted considerable FDI
- * Investors enter real estate market through various channels, including establishing new real estate developers, and acquiring local ones
- * FDI into China real estate industry was at least \$5.4 billion in 2005
- * Foreign investment now accounts for 15% of China's real estate market

Source: UNCTAD, World Investment Report 2004



Services sectors that attracted most FDI inward stock in 2004 and 2005, (based on responses from 9 APEC countries)



Additional patterns of the shift of FDI towards services

- * Shift towards services in all country groups
- * Shift is fastest in developed countries
- * Wide variations among individual economies
 - Inward stock:
 - * More than 80%: Denmark, Hong Kong (China), Luxembourg, Switzerland
 - * 30% or less: Bangladesh, Sweden, Venezuela
 - Outward stock:
 - * More than 70%: Austria, Colombia, Denmark
 - * Less than 40%: Australia, Croatia, Sweden.



What services attract the most FDI?

- * **Traditionally:**
 - Financial services (40% in 1990, 29% in 2002)
 - Trading (25% in 1990, 18% in 2002)
- * **Emerging industries:**
 - Telecommunications
 - Electricity
 - Business services



Services IIAs

- * Broad definition of international investment agreements (IIAs): agreements at the bilateral, regional and multilateral levels that address investment issues.
- * Substantive criteria
- * IIAs cover, in varying degrees, FDI in services: « Services IIAs ».



Services IIAs

- * Some IIAs deal only with investment: e.g. BITs. Investment in services is covered.
- * Some IIAs cover a broader range of issues and single out services. Investment is one of the issues.
- * Most FTAs/RTAs fall into this second category.



Approaches to services in IIAs

- * Three approaches for IIAs coverage of FDI in services: Evolution over time ?
 - The FDI-based approach: FDI is exclusively covered by the disciplines of the investment chapter or agreement.
 - The services-based approach: services FDI is exclusively covered by the services chapter or agreement
 - The mixed approach: services FDI is covered by both the investment and the services chapter of an agreement.



UNCTAD

The FDI-based approach

- * The NAFTA: the agreement covers services and non-services investments without differentiating between them.
- * Services investment in BITs: non-differentiation.
- * BITs with liberalization commitments: market access for services.



UNCTAD

The services-based approach

- * The GATs: mode 3
 - « Commercial presence: any type of business of professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.
 - Narrower definition, « entreprise-based », no protection, Perf.requirements allowed, State-state dispute settlement.
- * The 1995 ASEAN Framework Agreement on Services



The mixed approach

- * A growing number of FTAs/RTAs in the APEC region.
- * 2002 Japan-Singapore Agreement: a special provision in the investment chapter exclude services FDI from the scope of a specific discipline or more generally from the investment disciplines.
- * Key: interaction. Techniques to avoid overlaps.



Salient features

- * Structure and architecture
- * Definition: broad asset-based for protection, Mode3/enterprise based for liberalization.
- * Negative vs. Positive list reservations
- * Protection: in mixed approach: liberalization rules in the services chapter, investment protection rules in investment chapter. Both apply to services FDI.

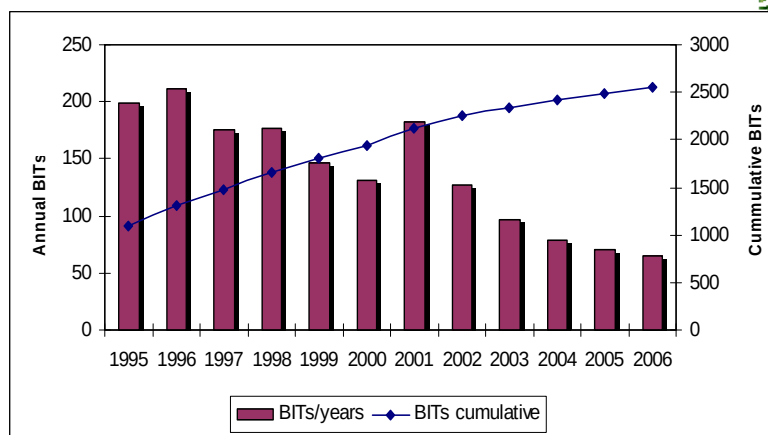


Provisions covering specific industries

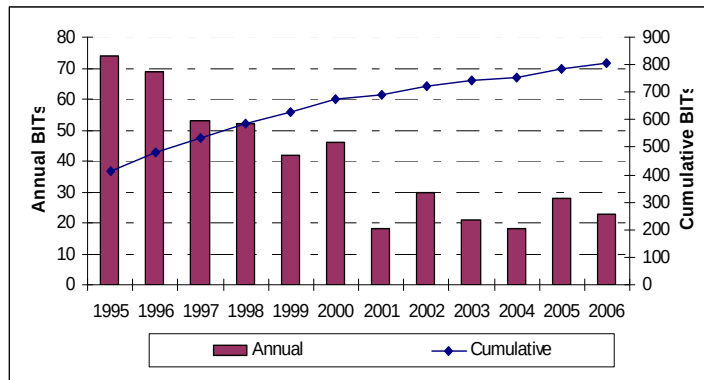
- * Industry specific commitments.
- * NAFTA: separate chapter for financial services
- * Some EU agreements: special provisions for maritime transport.
- * Energy-related services
- * Air transport



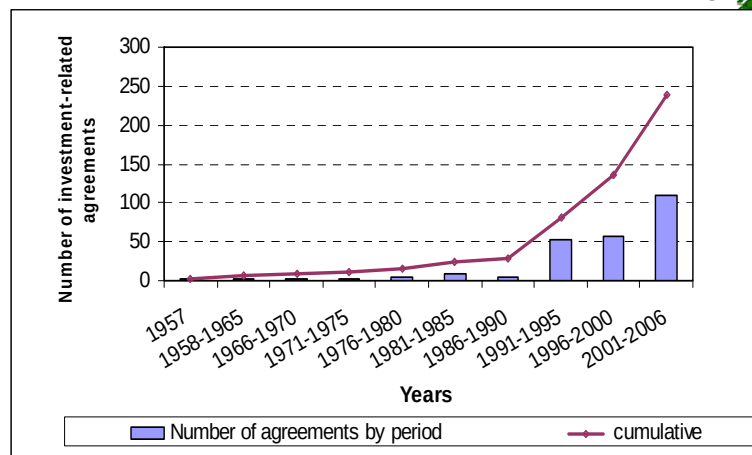
The network of BITs continues to grow rapidly, there are now over 2500 BITs



Number of BITs concluded by APEC countries, cumulative and annual, 1990 –2006



There are over 240 economic integration agreements with investment provisions (EIAs)





Intra-APEC EIAs with investment provisions, end 2006

- * There are currently 36 intra-APEC EIAs with investment provisions**
- * Most recent EIAs include the U.S.-Peru FTA, the Japan-Philippines EPA and Japan-Chile EPA.**



Intra-APEC BITs, end 2006

- * There are over 75 intra-APEC BITs**
- * China, the Republic of Korea and Viet Nam have the highest numbers of intra-APEC BITs.**

Liberalizing Services and Investment Lessons from the Americas

Maryse Robert

Joint IEG/GOS Workshop on the Relationship
between Investment and Trade in Services in
International Investment Agreements
April 18, 2007, Adelaide, Australia

Type of RTAs in the Western Hemisphere: Pre-NAFTA Agreements

- Simple structure
- Scope: focus only on trade in goods
- No provisions on rules other than for goods
- No binding dispute settlement

2

Type of RTAs in the Western Hemisphere: NAFTA-type Agreements

- Comprehensive approach to trade liberalization: goods, services, investment
- Far-reaching objectives for behind-the-border integration
- Deep disciplines in new areas: Investment, Government Procurement, IPR, Competition Policy
- Sophisticated dispute settlement mechanism

3

Services and Investment: Main Objectives for RTAs

- To consolidate market-oriented policy reforms
- To enhance competitive position on world markets and attract investment
- Certain forms of regulatory cooperation are more feasible and desirable within a smaller group of countries (regulatory harmonization, mutual recognition).
- Easier to innovate

QUESTION:

Can these objectives be achieved in same way at multilateral level?
Perhaps, but movement is slower
Countries are doing both

4

Observations from the Practice of Regionalism in Services Trade and Investment in the Americas

- Many RTAs show broad commonality, as regards the disciplines that are included
 - Scope/coverage (similar carve-outs – e.g. air transport, public services)
 - Core disciplines typically similar
 - Exceptions also typically similar

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Architectural Divergences at the Regional Level

- Essentially two competing models
- RTAs covering services either:
 - replicate the GATS structure (e.g. MERCOSUR), including positive list approach to scheduling of services commitments; or
 - follow a NAFTA-type approach of comprehensive sectoral coverage through scheduling on the basis of negative lists of non-conforming measures

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Western Hemisphere: Strong Interest in Services Trade and Investment Liberalization

- Sub-Regional Level:
 - 25 regional trade agreements (RTAs) including services and investment negotiated or revamped since 1994

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Regional Agreements on Services and Investment in the Americas Innovate in Three Ways

- MODALITY (most adopt a negative list approach for services and investment liberalization)
- STRUCTURE (separate chapters for modes of service supply and for selected sectors)
- RULE-MAKING (depth of disciplines)

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Choice of Liberalization Modality

Positive List

- MERCOSUR 1998 (in force since Dec. 2005)

Two-Step Approach

- CARICOM 1998 (CSME-2006)
- Andean Community 1998
- --Inventory of measures
- --Removal of restrictions

Negative List

NAFTA	1994
Group of Three	1995
Mexico-C. Rica	1995
Mexico-Bolivia	1995
Chile-Canada	1997
Chile-Mexico	1999
Mexico-Nicaragua	1999
CACM-Dominican Rep.	1999
Chile-CACM	1999
CARICOM-Dominican Rep.	2000
Mexico-Northern Triangle	2001
Central American Common Market (CACM)	2002
Panama-El Salvador	2003
Chile-United States	2004
CAFTA-DR-US (in force for all except CRica) (signed)	2004
Peru-US (signed)	2006
Colombia-US (signed)	2006
Chile-Panama (signed)	2006
Chile-Peru (signed)	2006
Chile-Colombia (signed)	2006
Panama-US (negotiations completed)	2007
Colombia-Northern Triangle (neg. compl.)	2007

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Negative List Approach

- Under the negative list approach model, services disciplines address issues of cross-border trade (modes 1 and 2), complemented by generic (i.e. non-services specific) disciplines on investment and the temporary entry of business people
- Approximate symmetry of treatment is established through separate chapters for the various modes
- Specific sectoral treatment carried out through individual chapters on telecoms; financial services

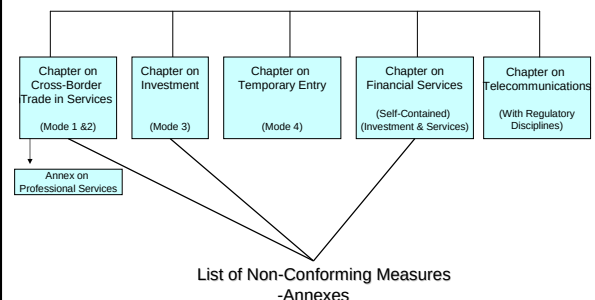
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Positive vs Negative Listing

- Both approaches can yield similar results in liberalization
- Negative list approach promotes gains in transparency, locks-in the *status quo* in bound sectors and encourages a domestic regulatory audit of service sector regimes
- Downside: administratively burdensome; fear of depriving policy action for future measures

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Structure of most RTAs for Services in the Americas (Negative List Approach)



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Cross-border Services Chapter

- Covers modes 1, 2 and 4 (the latter to a limited extent)
- Often contains an Annex on Professional Services to facilitate this exchange
- Basic disciplines: Scope and Coverage, MFN, NT, market access; no local presence; denial of benefits
- Recent agreements: also include market access, transparency, and domestic regulation (these obligations apply to both cross-border trade in services and investment in services)

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Investment Chapter (1)

Three Pillars:

- Protection: Legal security through clear and transparent rules
- Market Access: Status quo or liberalization of barriers to investment
- Dispute Settlement

- Coverage:
 - Goods
 - Services
 - Sector-specific

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Investment Chapter (2)

Scope (Including definition of investment and investor)

- Market Access
 - National Treatment
 - MFN Treatment
 - Performance Requirements
 - Senior Management and Boards of Directors
 - Non-Conforming Measures
- Protection of the investor and his investment
 - Free Transfer
 - Protection Against Expropriation
 - Minimum Standard of Treatment
 - Compensation for Losses
- Investor-State Dispute Settlement Mechanism

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Chapter on Temporary Entry for Business Persons

- Provisions to facilitate administrative and legal procedures for temporary entry
- No obligations for visas – employment considerations outside agreement
- Generally no market access component (specific quotas may be specified separately)
- Since US-Chile US RTAs do not include a chapter on temporary entry for business persons.

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Chapter on Financial Services

- Covers cross-border trade and a broad definition of investment – financial services
- Regulated financial institutions are covered by FS Chapter, whereas fin. services providers (which might include non-regulated fin. institutions) are covered by the Investment Chapter
- Contains specific disciplines for the liberalization of trade in financial services
- Addresses specificity of financial services
- Includes trade-related aspects of regulatory disciplines but not specific types of regulations
- Prudential carve-out

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Chapter on Telecommunications

- Contains specific disciplines for the telecommunications sector
- Disciplines are of a "pro-regulatory" nature, part of competition policy
- No explicit market access component
- Further elaboration on the WTO Reference Paper for Telecom 1997

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List of Non-Conforming Measures – Annexes: What Do They Contain ?

- Annex I: Existing Non-Conforming Measures
- Existing Restrictions
 - National Treatment (Services; Investment; Financial Services)
 - MFN (Services; Investment; Financial Services)
 - No Local Presence (Services)
 - Market Access (Services; Financial Services)
 - Performance Requirements (Investment in Goods & Services)
 - Senior Management / Board of Directors (Investment in Goods & Services; including Financial Services)
 - Cross-Border Trade (Financial Services)
- Annex II: Future Measures:
 - List of sectors and activities for which a Party can maintain existing non-conforming measures or adopt measures that are more non-conforming

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List of Non-Conforming Measures

- Annex 1: Existing Non-Conforming Measures (law, regulation, procedure, requirement or practice) which violate some obligations (cross-border trade in services: NT, MFN, no local presence; investment: NT, MFN, performance requirements, senior management and boards of directors; cross-border trade in services and investment in services: market access) of the chapter.
- 1) Non-conforming measures must be listed, or must be modified to be consistent with the obligations of the Agreement
- 2) Several non-conforming measures include explicit liberalization commitments (in NAFTA: Mexico)
- 3) "Ratchet" (once liberalized, a non-conforming measure included in Annex I is eliminated for good)

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Content of FTAs Involving Latin American Countries in the Americas

FTAs	CAFTA-DR	CHILE-US	CENTRAL AMERICA-PANAMA	CANADA-COSTA RICA	CENTRAL AMERICA-CHILE	CHILE-MEXICO	MEXICO-NICARAGUA	G3	NAFTA
Entry into Force	2006, 2007 except CTR	2004	2003	2002	2002	1999	1998	1995	1994
Investment	X	X	X	X	X	X	X	X	X
Services	X	X	X	X	X	X	X	X	X
Cross-Border Trade	X	X	X		X	X	X	X	X
Temporary Entry for Business Persons		X	X	X	X	X	X	X	X
Financial Services	X	X	X		X	X	X	X	X
Telecommunications	X	X	X		X	X	X	X	X

Source: OAS Department of Trade, Tourism and Competitiveness

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Rule Making: GATS "PLUS" Features for RTAs in the Americas

- Comprehensive Sectoral Coverage (except Air Transport)
- General Application of Key Disciplines : MFN, NT, No Local Presence, Perf. Req., Senior Management and Boards of Directors, Market Access
- Disciplines on Domestic Regulation
- Transparency: Existing Restrictions set out in Annexes
- Non-Conforming Measures (Reservations) bound at level of regulatory practice (Built-in Liberalization Dynamic – Ratchet Clause)
- Guarantee of modal neutrality (comprehensive coverage of investment)
- Incorporation of rules on government procurement

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Regional Liberalization Has Been More Challenging

- Progress on Mode 4 trade uneven and generally limited even in RTAs
- Sensitive sectors tend to remain the same across negotiating settings (e.g. maritime, aviation, audio-visual services, despite limited advances in some agreements)
- Some sectors (e.g. land transport) lend themselves more readily to RTA liberalization

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Some Evidence of Liberalization Synergy between RTAs and the WTO

- In some instances, WTO has gone further because timing was right or because bargaining dynamics were favorable (e.g. basic telecoms)
- RTAs allow progress to be made in areas where regulatory conditions evolve rapidly or where new pro-liberalization constituencies arise (i.e. e-commerce/digital trade; express delivery, environmental services)
- Iterative nature of market opening advances illustrates RTA-WTO complementarities

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Does Regional Liberalization Facilitate Subsequent Multilateral Commitments?

- Some supporting evidence in the Americas, where a few RTAs predated or coincided with the establishment of GATS
- More difficult to ascertain for more recent RTAs, little evidence in Doha Round initial offers; but more in terms of greater engagement by developing countries which may reflect regional learning by doing between WTO rounds

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Increased Participation after the Uruguay Round

- Twenty Latin American and Caribbean (LAC) countries participated actively in the Agreement on Basic Telecommunications (1997)
- Seventeen LAC countries submitted improved schedules for the Financial Services Agreement (1997)
- Active LAC participation in agricultural and services negotiations since 2000
 - LAC countries made 12 out of 45 proposals in the agricultural negotiations (2000 – end 2002)
 - LAC countries made 23 out of 68 total offers to the services negotiations (May 2002 – June 2005)

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RTAs Have Even Contributed to Process of Multilateral Trade Negotiations

- Learning effects from RTAs negotiations carried over
- Development of consistent and comprehensive hemispheric data bases on trade
- Supply of trade-related technical assistance for government officials by international and hemispheric organizations
- Building of political consensus and private sector support for the liberalization process
- Generation of additional pressure towards timely implementation of WTO commitments

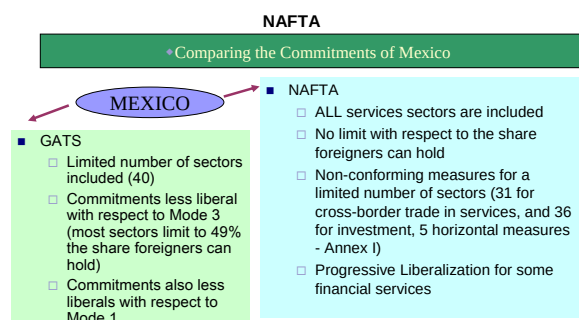
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Do RTAs Facilitate Regulatory Convergence?

- Evidence is mixed; harmonization and mutual recognition are challenging even among a limited subset of partners
- EU-NAFTA experience attests to such difficulties, but RTAs have registered some progress, especially in professional licensing
- RTAs promote regulatory dialogue, the benefits of which may be reaped outside of trade agreements but in a manner that nonetheless facilitates and promotes trade and investment

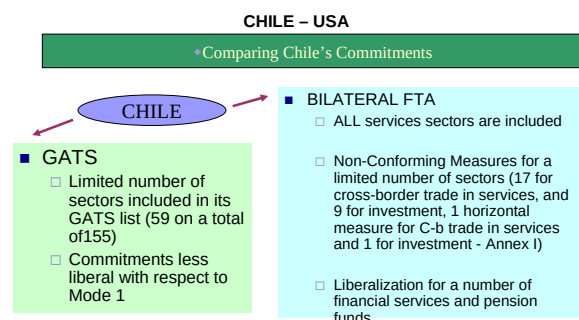
28

Comparing Mexico, Chile and Costa Rica's Commitments in the GATS and their FTAs



29

Comparing Mexico, Chile and Costa Rica's Commitments in the GATS and their FTAs



30

Comparing Mexico, Chile and Costa Rica's Commitments in the GATS and their FTAs

CAFTA

Comparing Costa Rica's Commitments

COSTA RICA

GATS

- Limited number of sectors included in its GATS list (21 on a total of 155)
- Telecom and Insurance NOT included
- Commitments less liberal with respect to Mode 1

CAFTA

- ALL services sectors are included
- Non-Conforming Measures for a limited number of sectors (28 for cross-border trade in services, and 14 for investment, no horizontal measure - Annex I)
- Progressive Liberalization for some services (insurance and telecom)

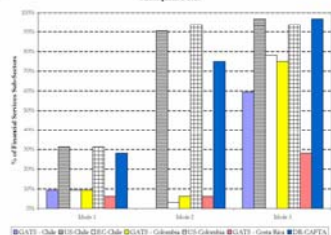
31

Conclusion

- Have recent RTAs led to increased services liberalization commitments for relevant LAC countries when compared to those made under GATS?
- The question can only be answered empirically by reviewing the MA and NT commitments scheduled under GATS and under the RTAs.
- Yes, in general. For example: *Chile and Costa Rica in financial services*. See: Pereira Goncalves, Marilyne and Stephanou, Constantinos, *Financial Services and Trade Agreements in Latin America and the Caribbean: An Overview*, World Bank Policy Research Working Paper 4181, April 2007, Page 34

32

Figure 5: Proportion of Financial Services Sub-Sectors Committed by Chile, Colombia and Costa Rica in the GATS and in Subsequent FTAs



Source: authors' interpretation based on WTO and ILO information; Constantinos, P. and P. A. Stephanou (2006), Constantinos, P. (2003), Sassi, B. (2006), Arbalade, M. A., Flores, A. and Salazar, N. (August 2006) and Echeburu, R. (2006).
Note: Three levels of market access commitments are applied in the above analysis: by financial services sub-sector and mode; some degree of service; partial (value of 0.5) and full commitment (value of 1). Mode 4 commitments, as well as all national treatment commitments and horizontal restrictions, are excluded. All pre-commitments to liberalize additional sub-sectors and/or modes in future years are included.

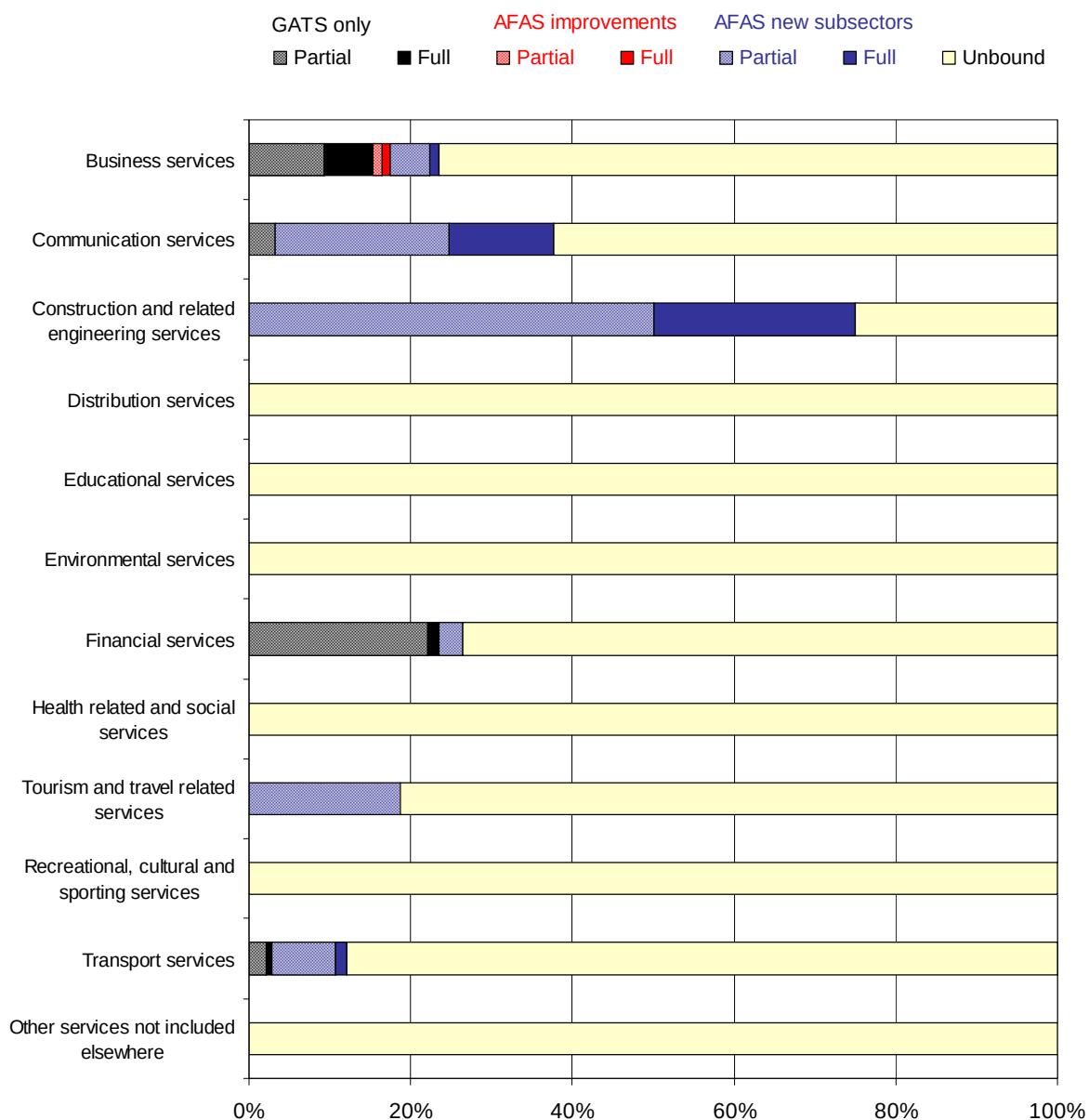
Source: Pereira Goncalves, Marilyne and Stephanou, Constantinos, *Financial Services and Trade Agreements in Latin America and the Caribbean: An Overview*, World Bank Policy Research Working Paper 4181, April 2007, Page 34

33

Annex A

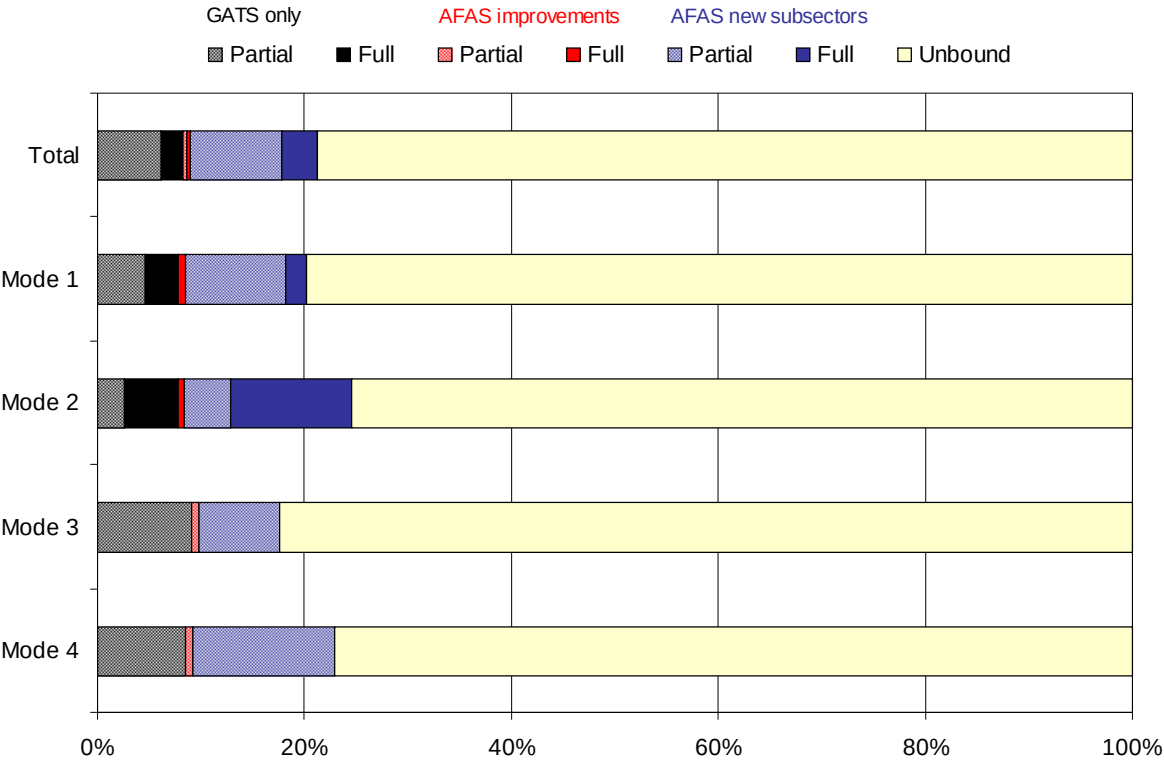
Overview of Individual Agreements

Figure A1a: ASEAN Framework Agreement on Services (Schedule of Brunei Darussalam)



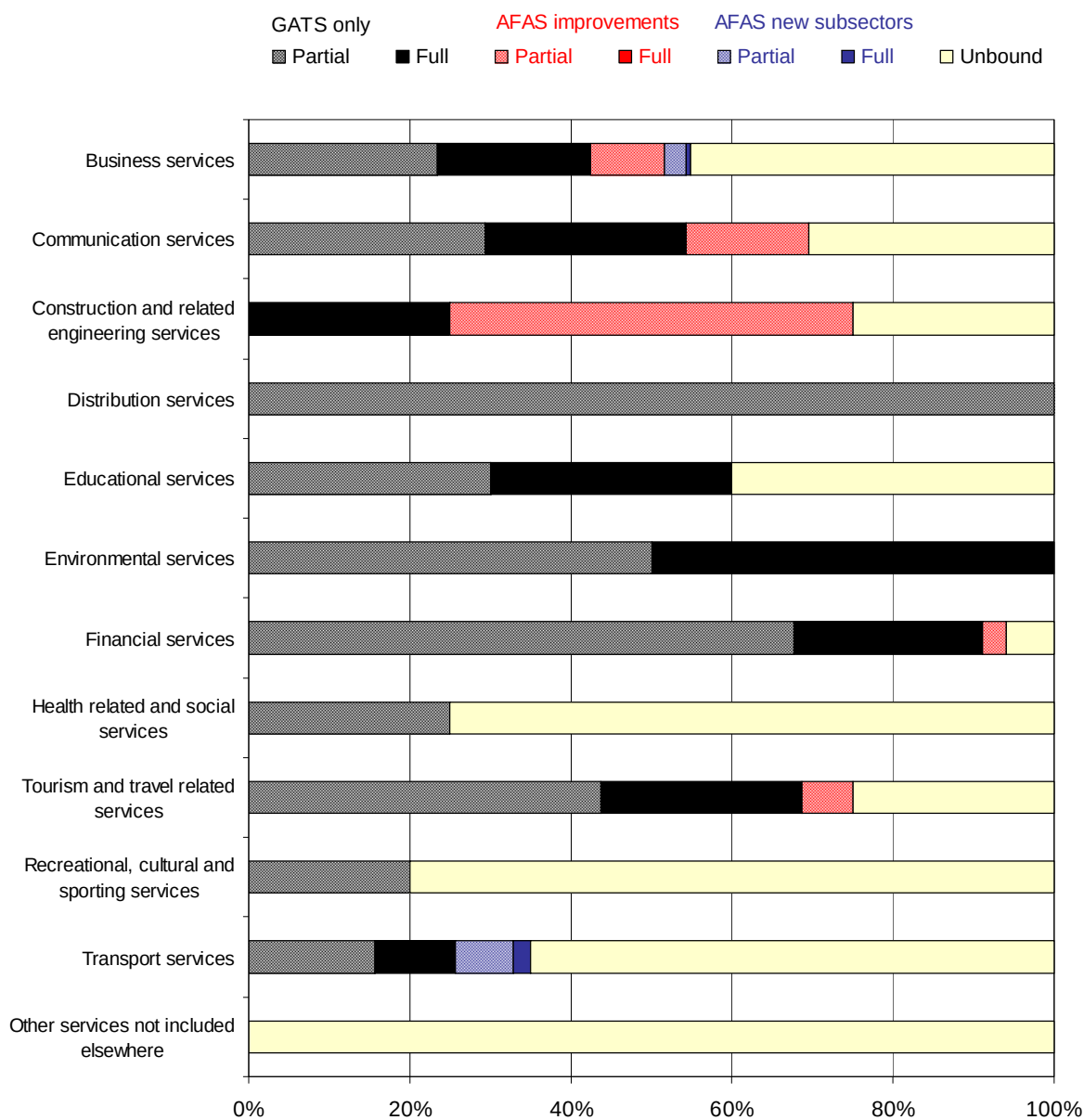
Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A1b: ASEAN Framework Agreement on Services (Schedule of Brunei Darussalam)



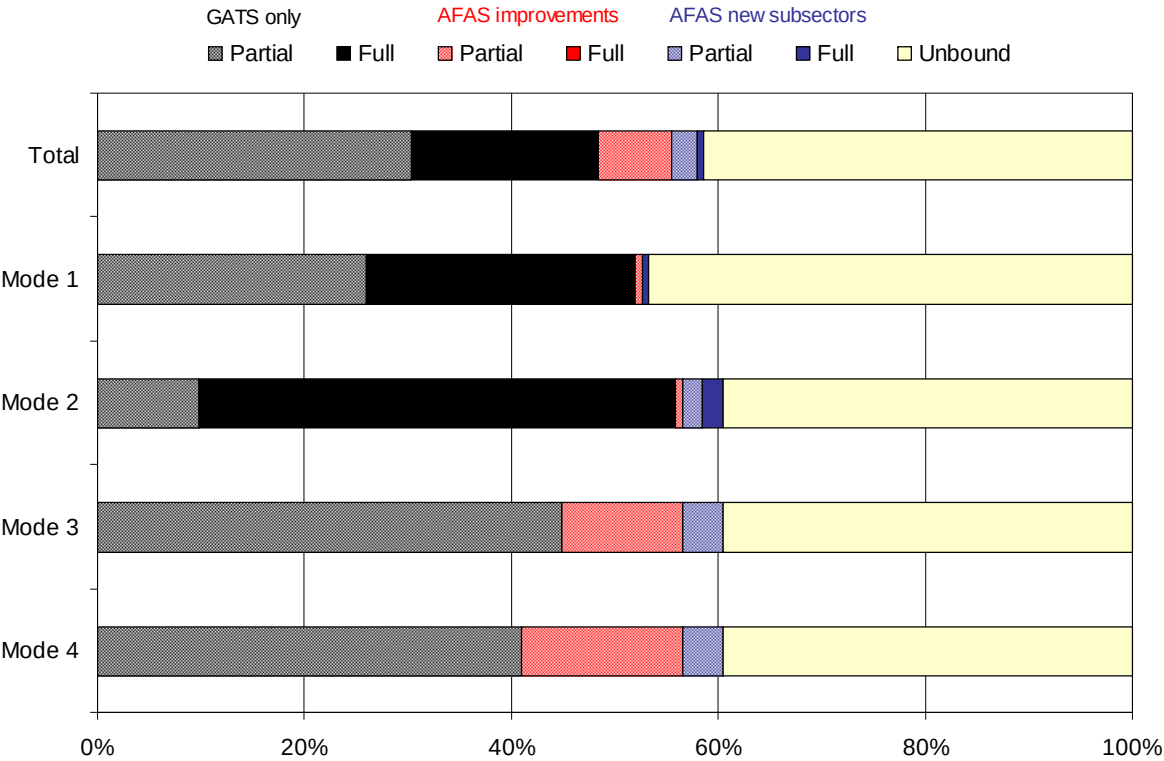
Notes: See notes to Figure A1a.

Figure A2a: ASEAN Framework Agreement on Services (Schedule of Cambodia)



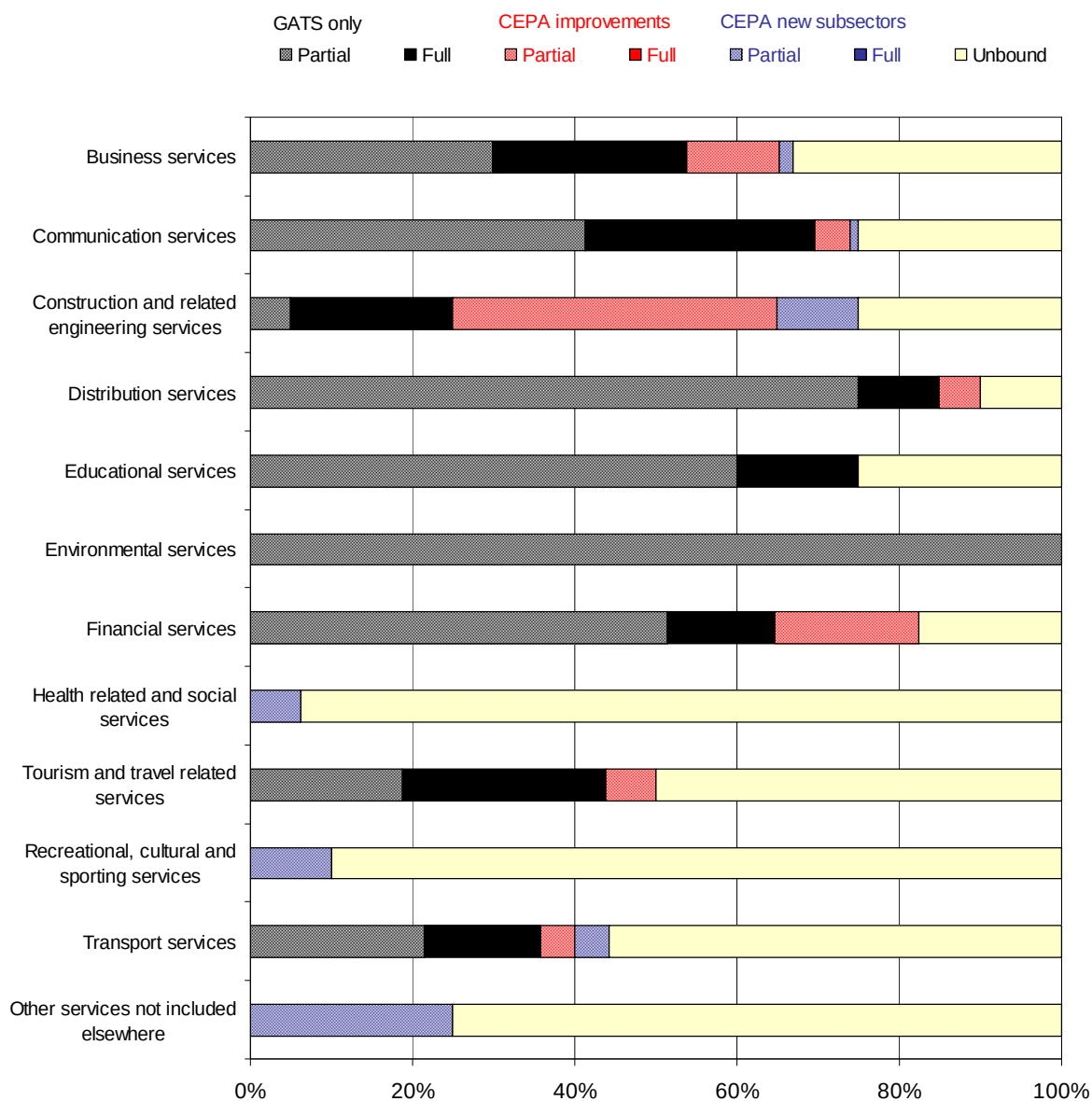
Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A2b: ASEAN Framework Agreement on Services (Schedule of Cambodia)



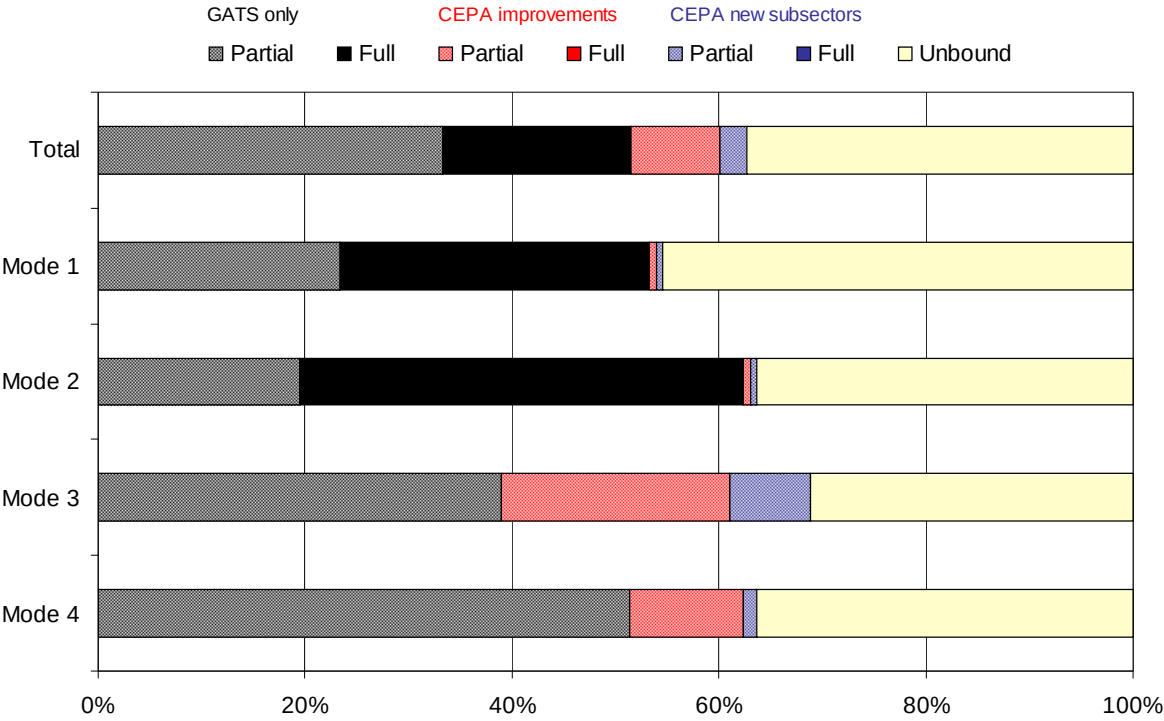
Notes: See notes to Figure A2a.

Figure A3a: Mainland-Hong Kong Closer Economic Partnership Agreement (Schedule of China)



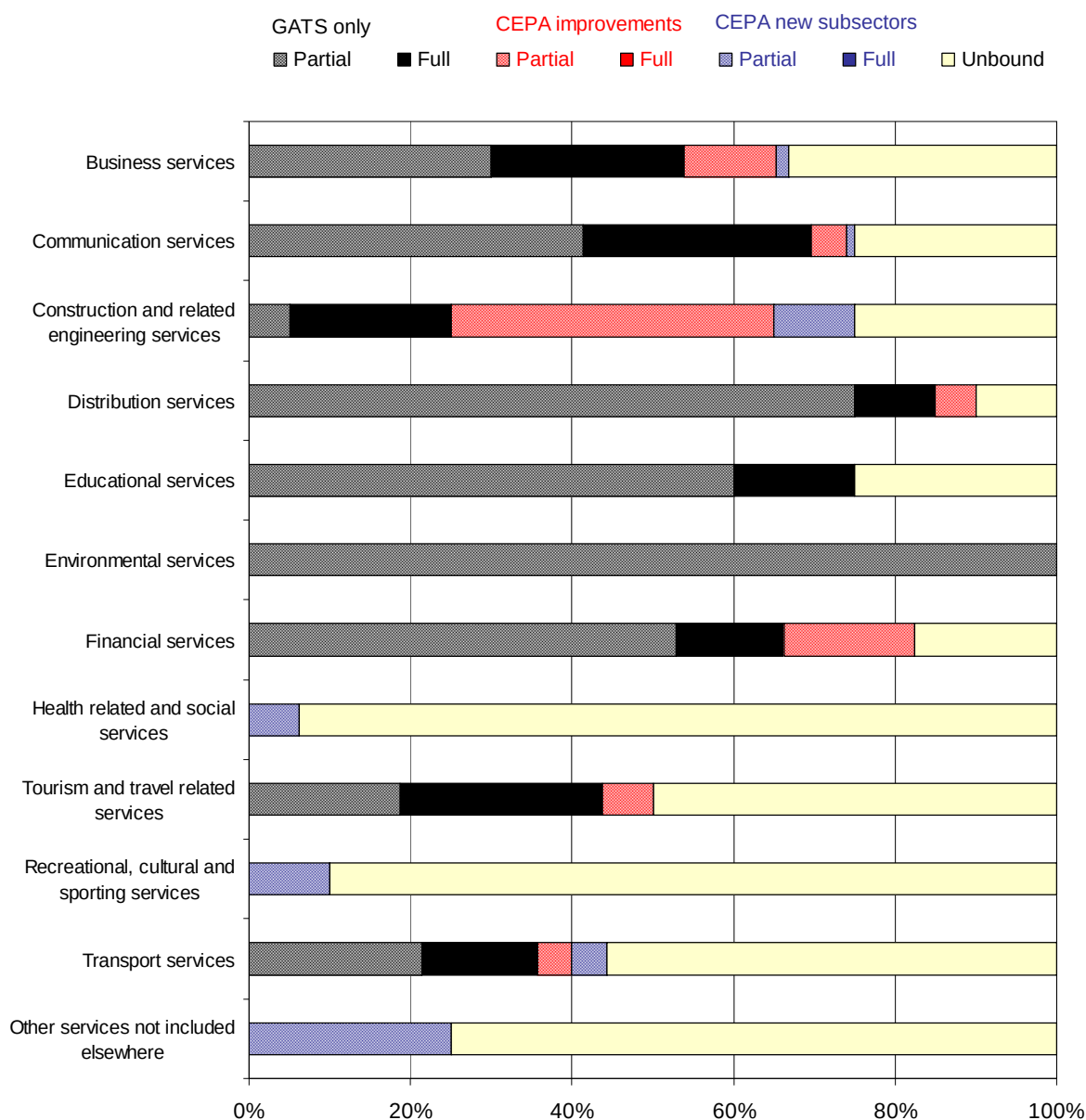
Notes: The commitments shown here take into account the original Closer Economic Partnership Agreement (CEPA), which entered into force in January 2004, and two supplementary liberalization packages negotiated in October 2004 and October 2005. CEPA commitments are evaluated relative to China's GATS commitment as of 2008, by which time all transition periods inscribed in the GATS schedule will have expired. Thus, this approach does not capture transitory trade preferences offered to Hong Kong service suppliers in certain sectors between 2004 and 2008.

Figure A3b: Mainland-Hong Kong Closer Economic Partnership Agreement (Schedule of China)



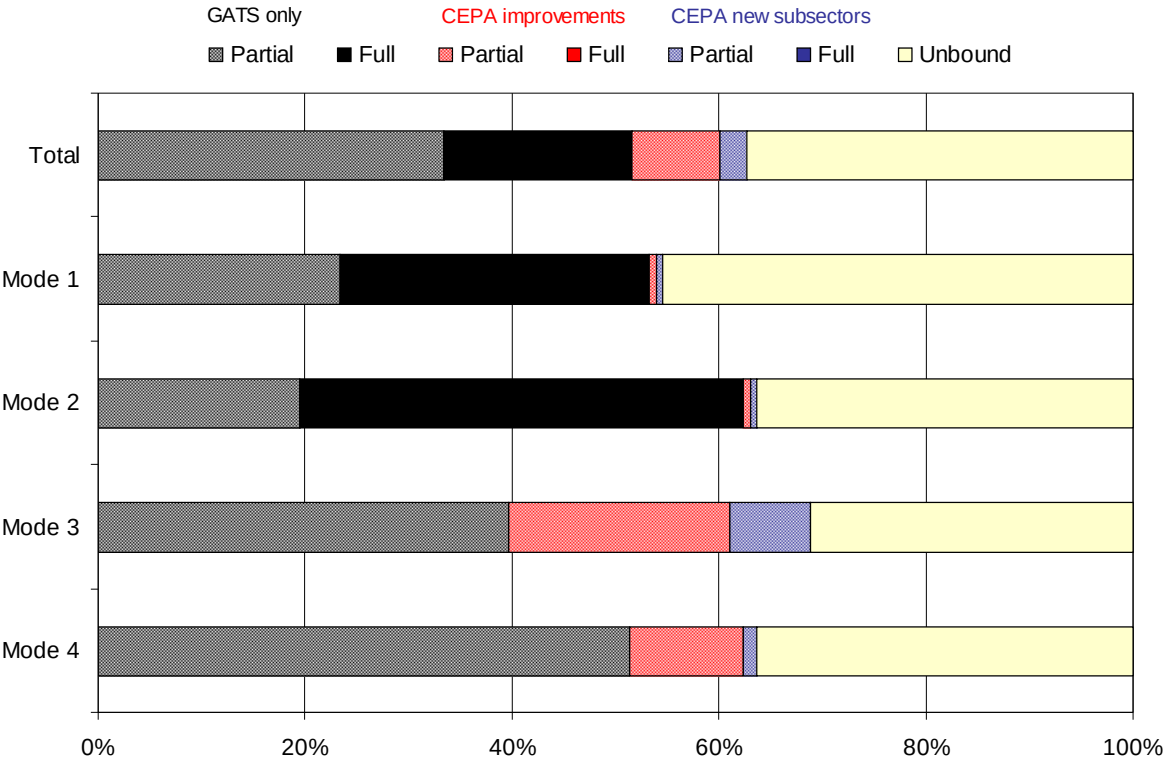
Notes: See notes to Figure A3a.

Figure A4a: Mainland-Macao Closer Economic Partnership Agreement (Schedule of China)



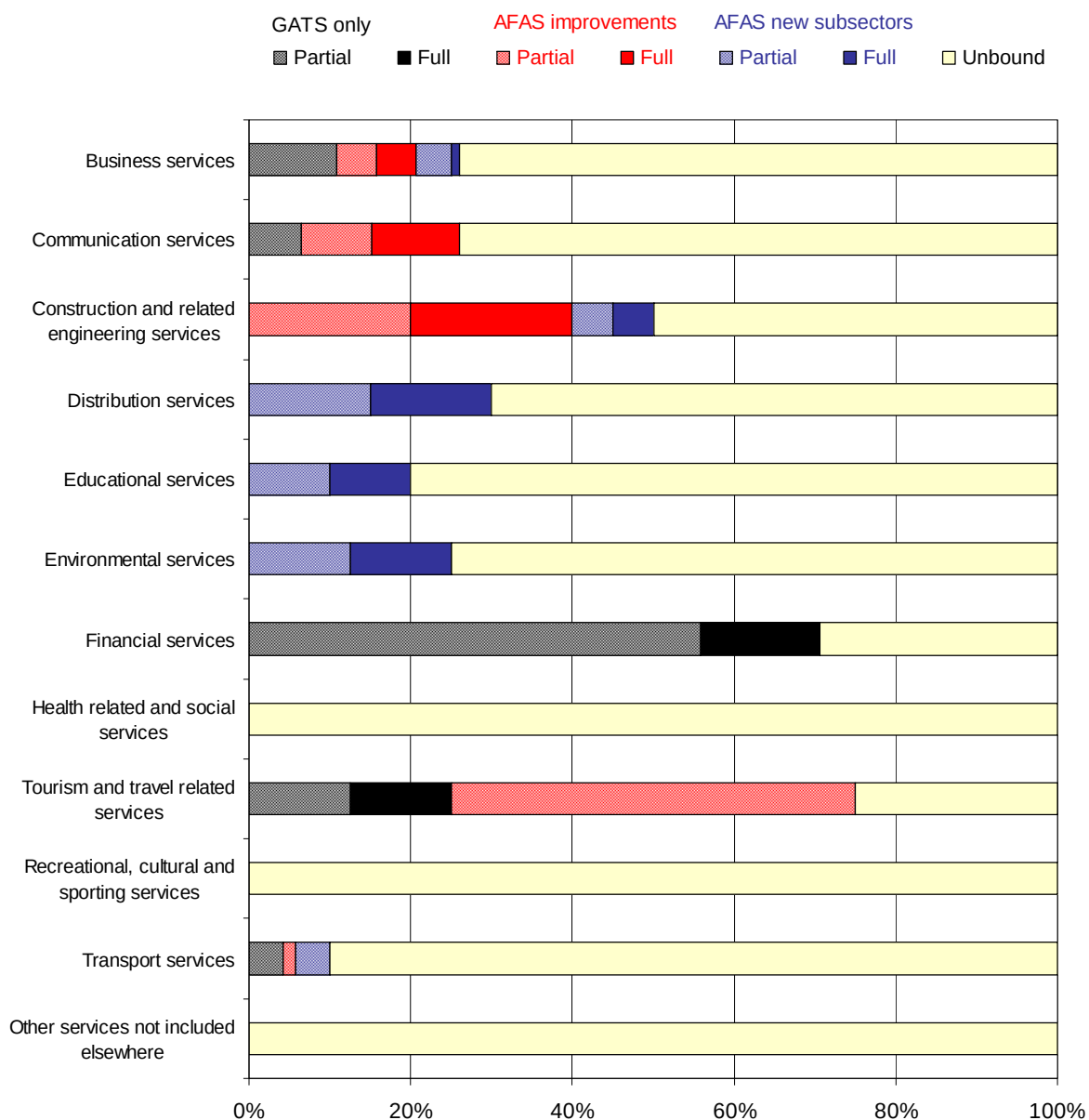
Notes: The commitments shown here take into account the original Closer Economic Partnership Agreement (CEPA), which entered into force in January 2004, and two supplementary liberalization packages negotiated in October 2004 and October 2005. CEPA commitments are evaluated relative to China's GATS commitment as of 2008, by which time all transition periods inscribed in the GATS schedule will have expired. Thus, this approach does not capture transitory trade preferences offered to Macao service suppliers in certain sectors between 2004 and 2008.

Figure A4b: Mainland-Macao Closer Economic Partnership Agreement (Schedule of China)



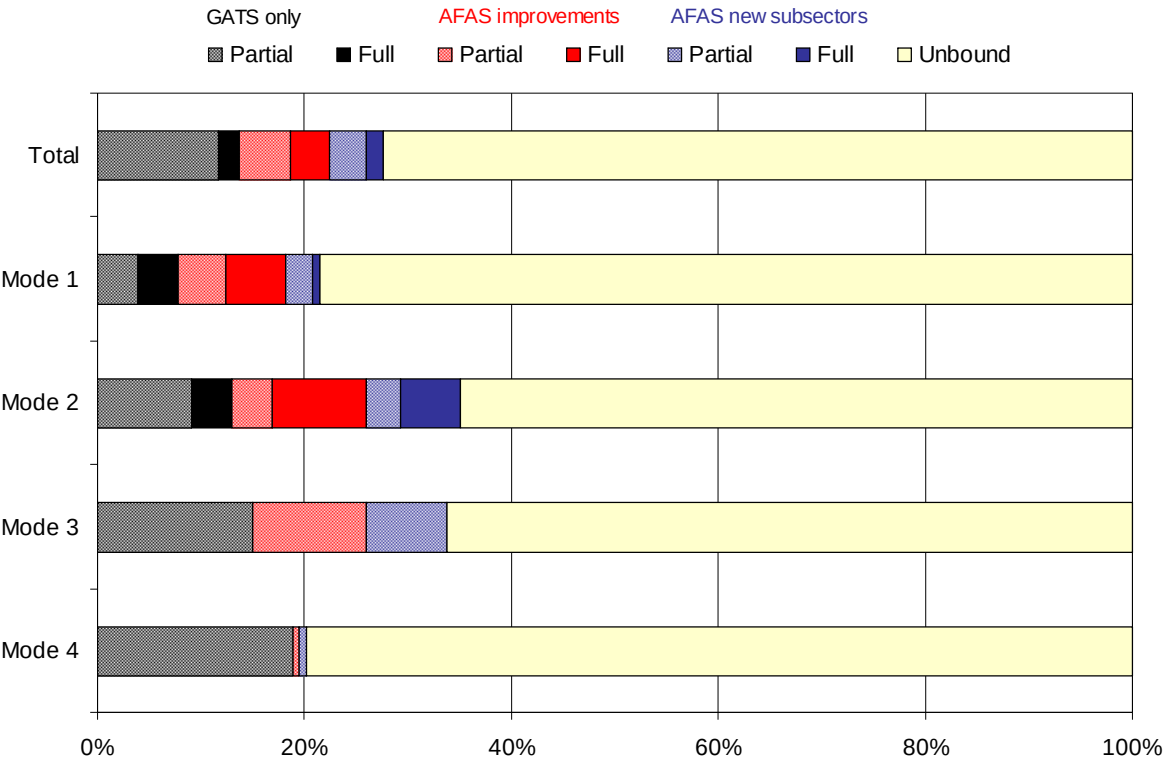
Notes: See notes to Figure A4a.

Figure A5a: ASEAN Framework Agreement on Services (Schedule of Indonesia)



Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A5b: ASEAN Framework Agreement on Services (Schedule of Indonesia)



Notes: See notes to Figure A5a.

Figure A6a: Japan-Malaysia Economic Partnership Agreement (Schedule of Japan)

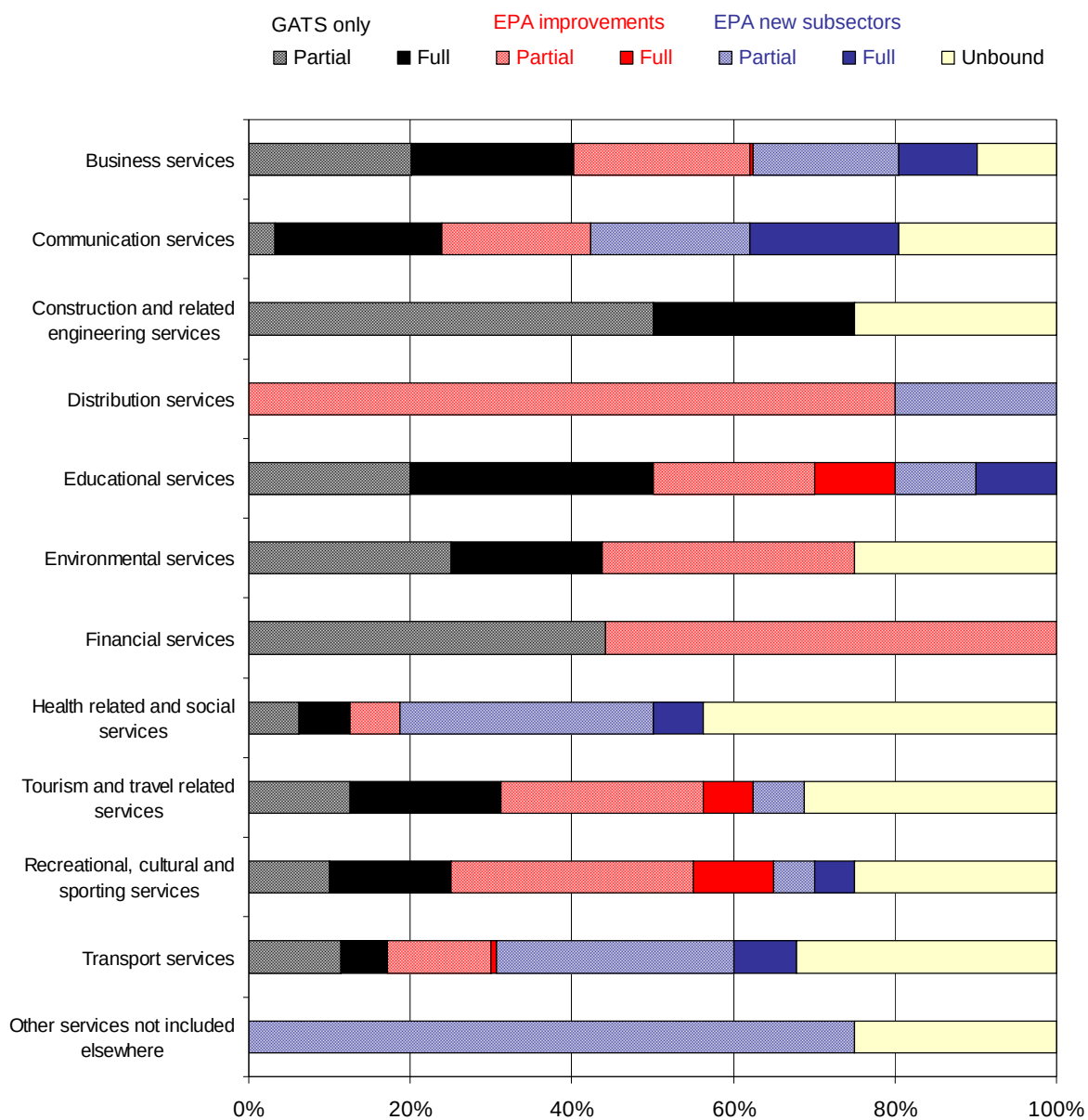


Figure A6b: Japan-Malaysia Economic Partnership Agreement (Schedule of Japan)

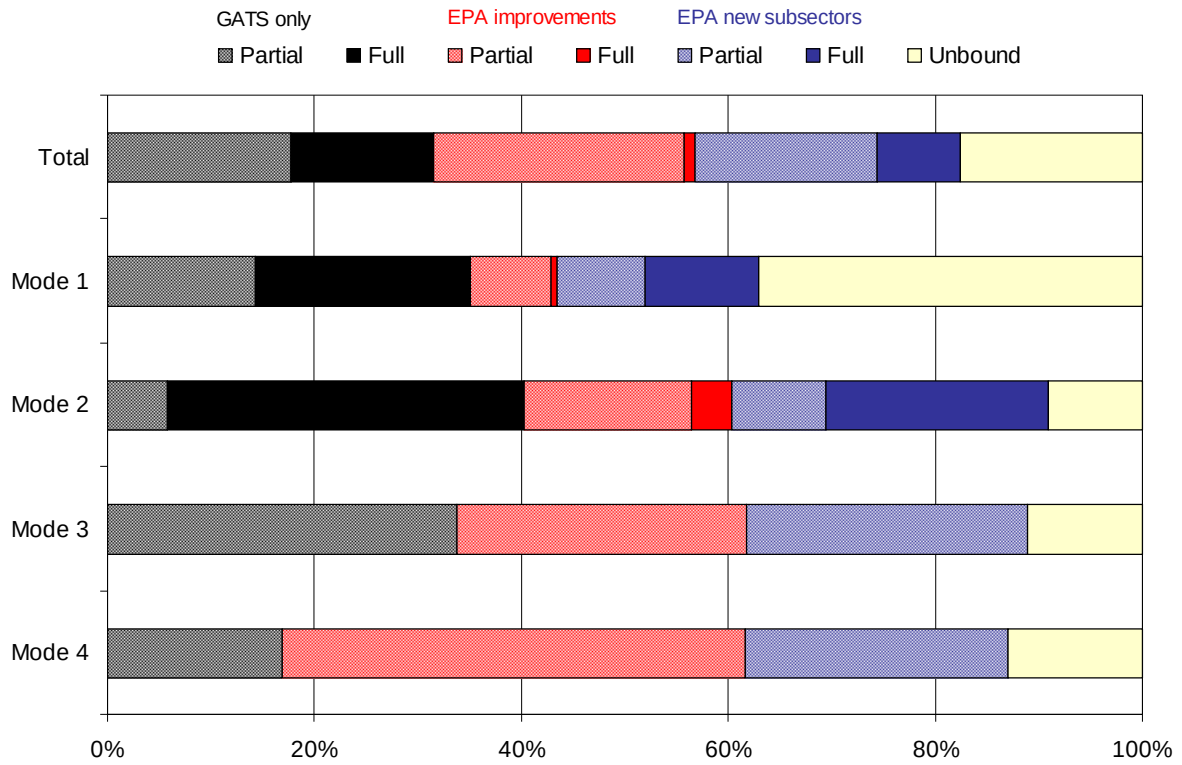


Figure A7a: Japan-Mexico Economic Partnership Agreement (Schedule of Japan)

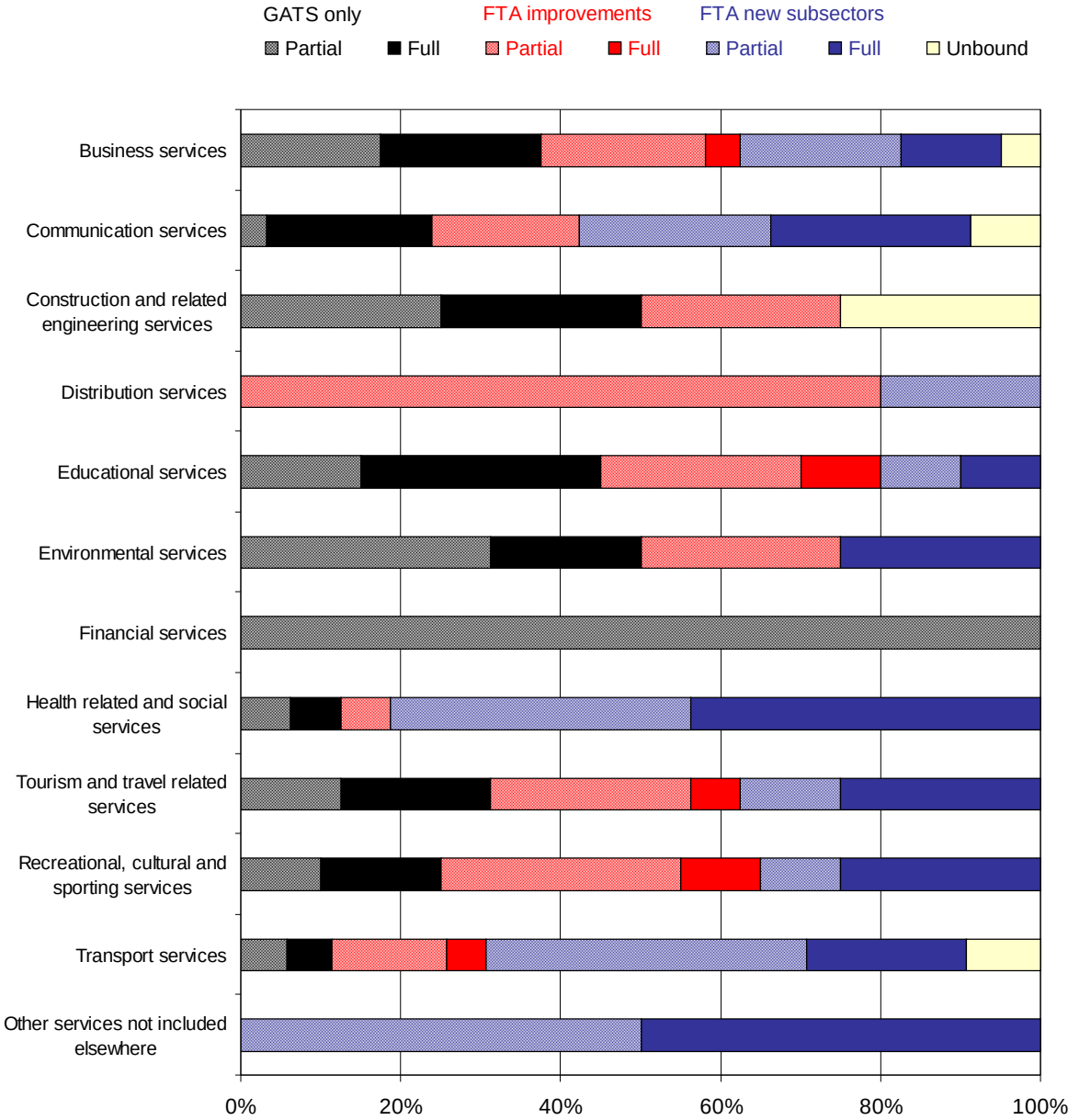


Figure A7b: Japan-Mexico Economic Partnership Agreement (Schedule of Japan)

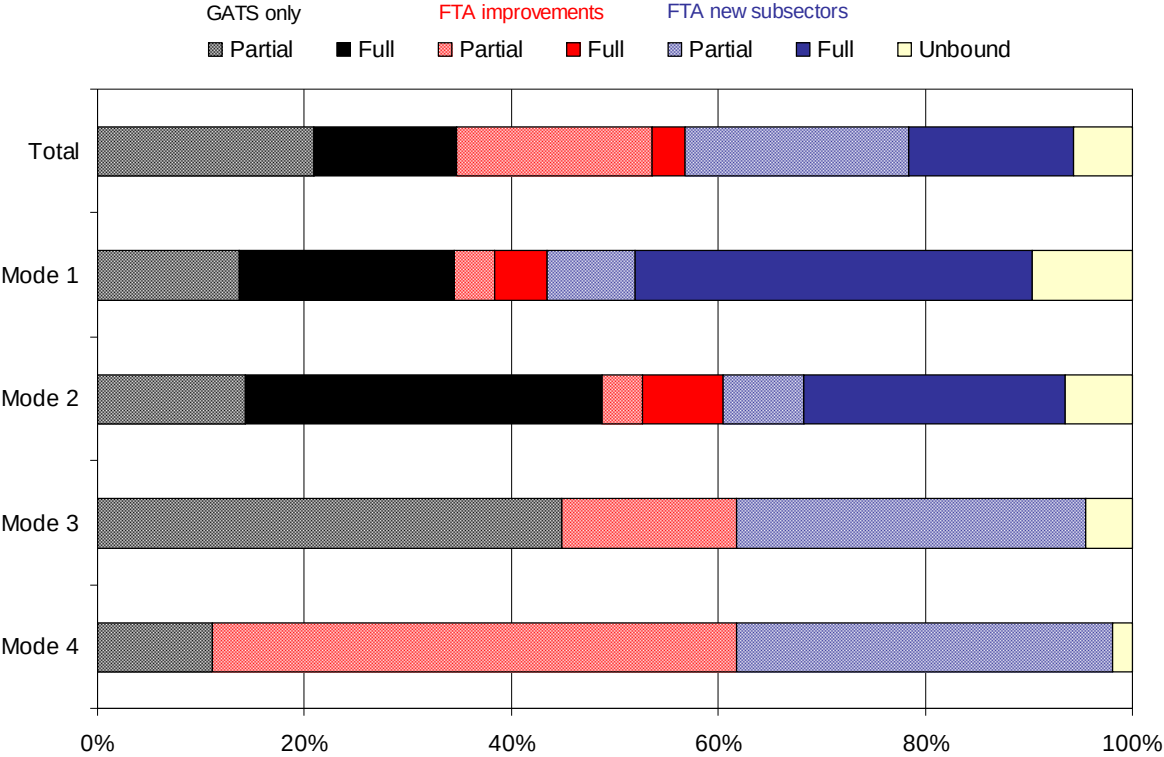


Figure A8a: Japan-Singapore New-Age Economic Partnership Agreement (Schedule of Japan)

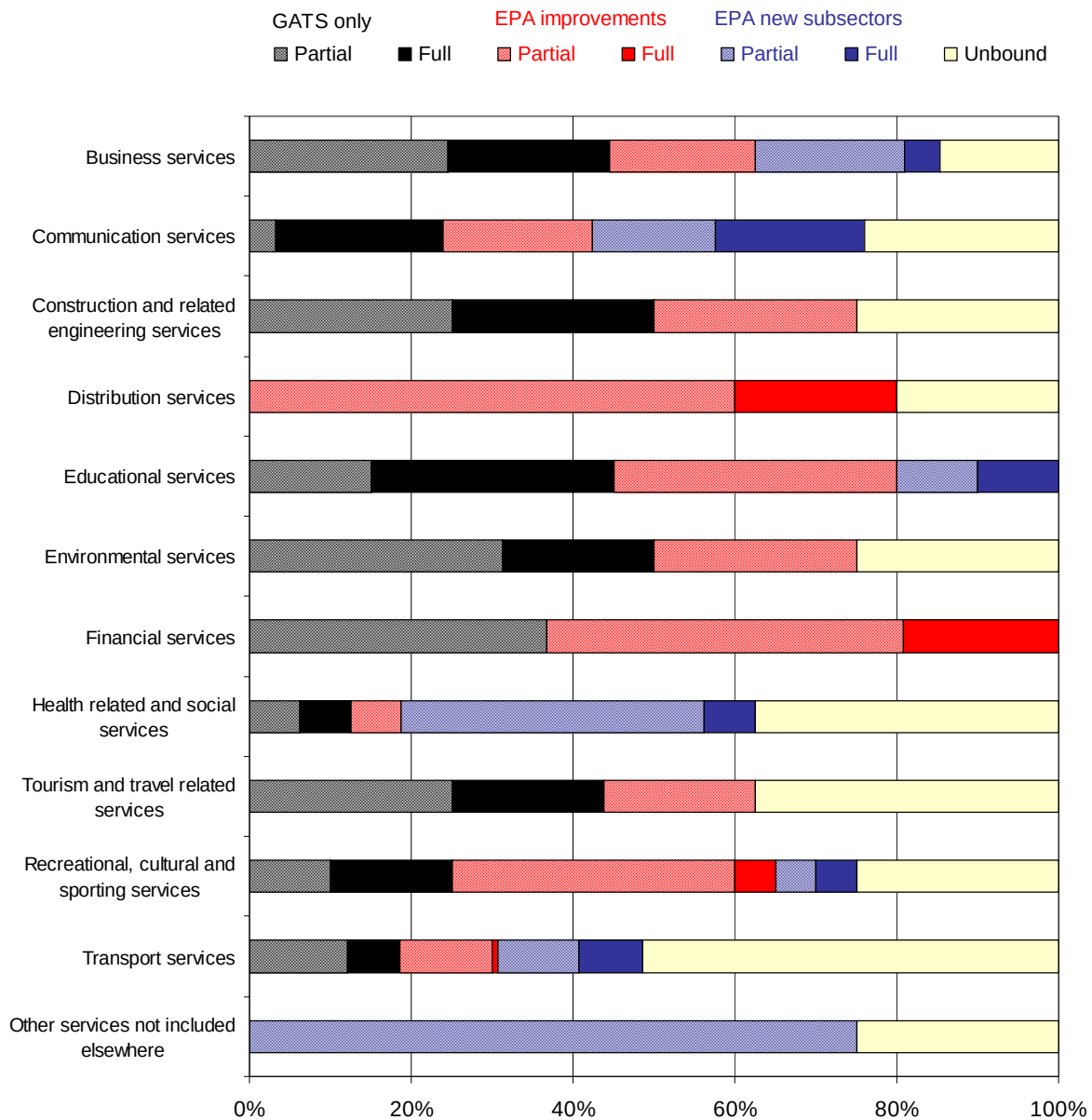


Figure A8b: Japan-Singapore New-Age Economic Partnership Agreement (Schedule of Japan)

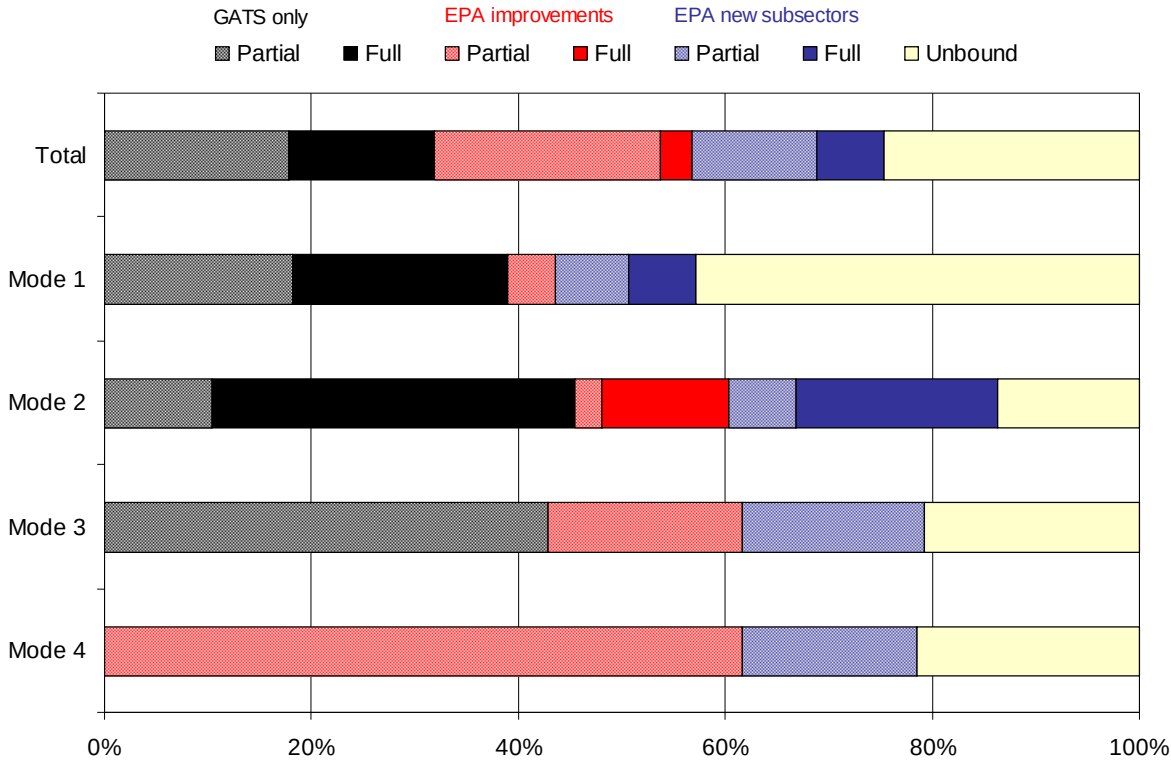


Figure A9a: Chile-Korea Free Trade Agreement (Schedule of Korea)

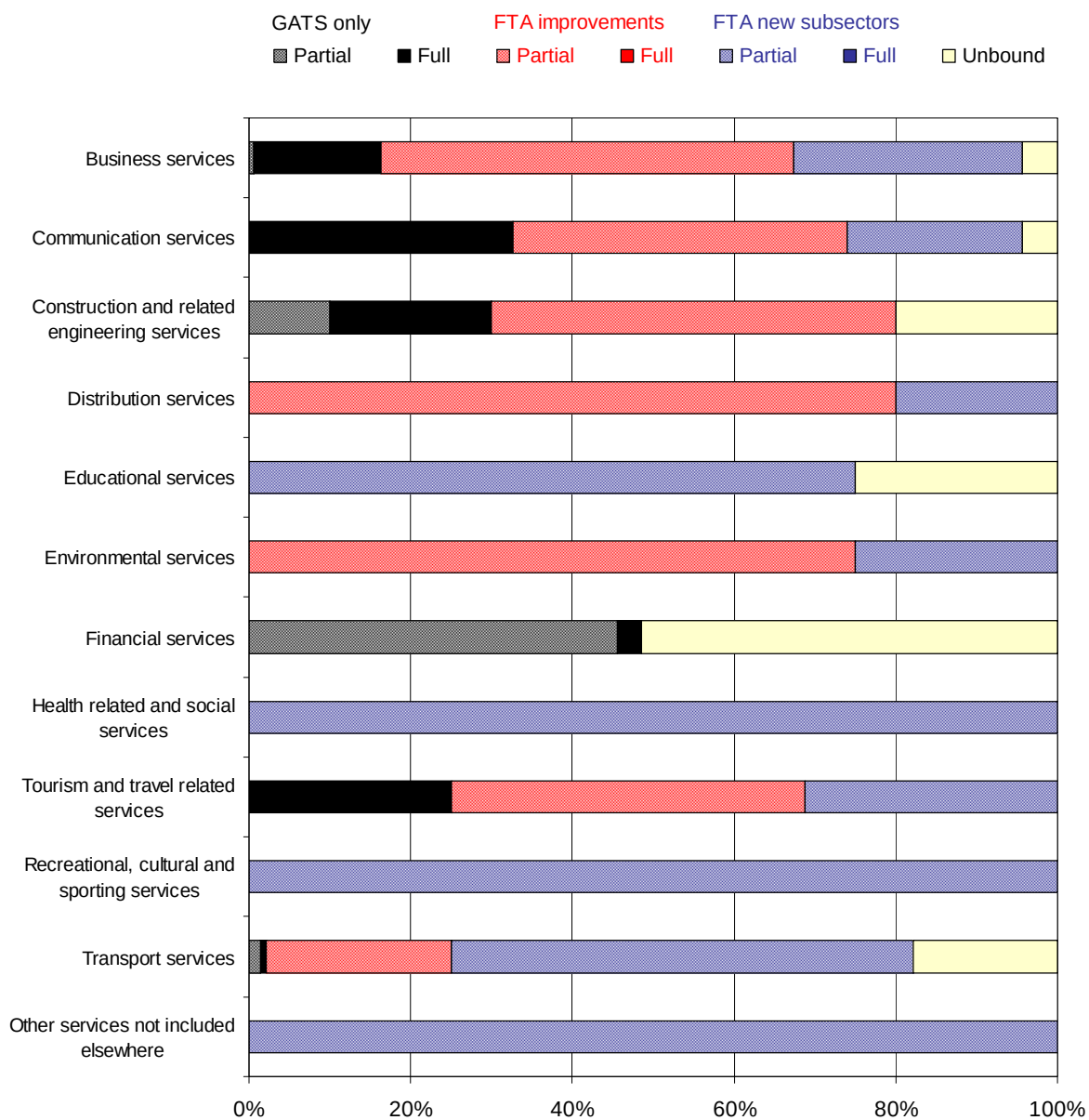


Figure A9b: Chile-Korea Free Trade Agreement (Schedule of Korea)

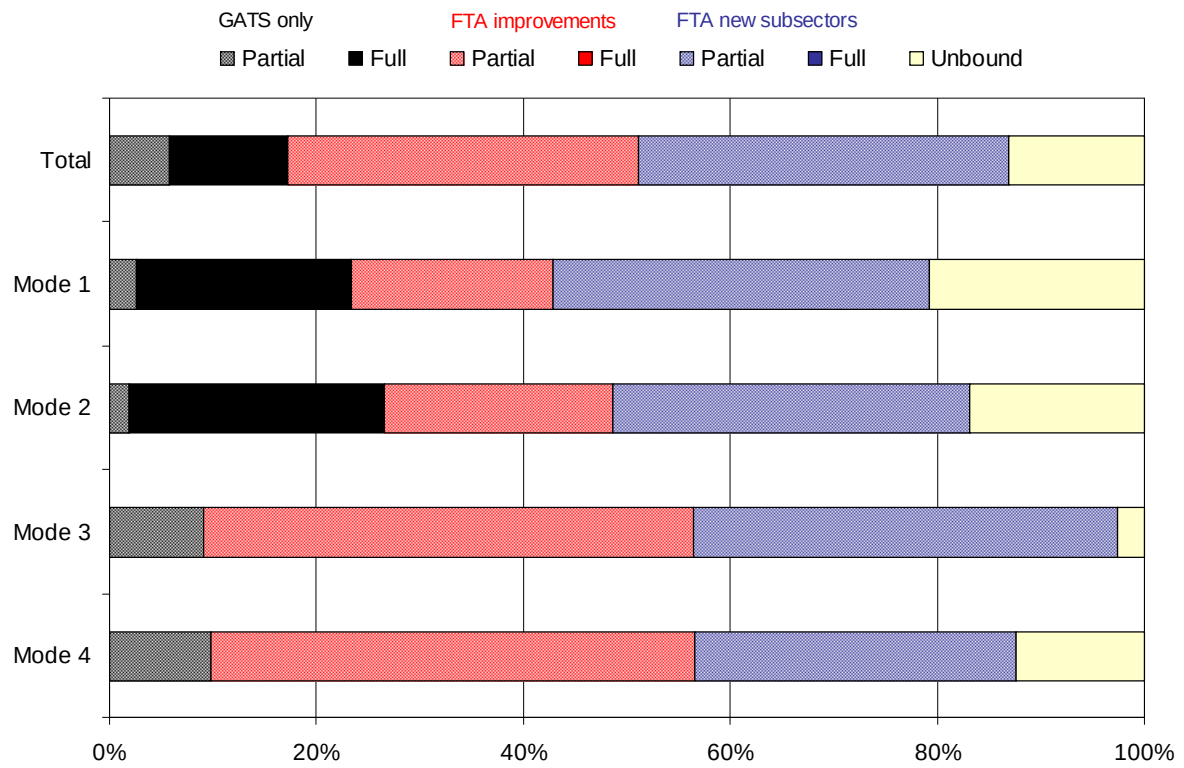


Figure A10a: EFTA-Korea Free Trade Agreement (Schedule of Korea)

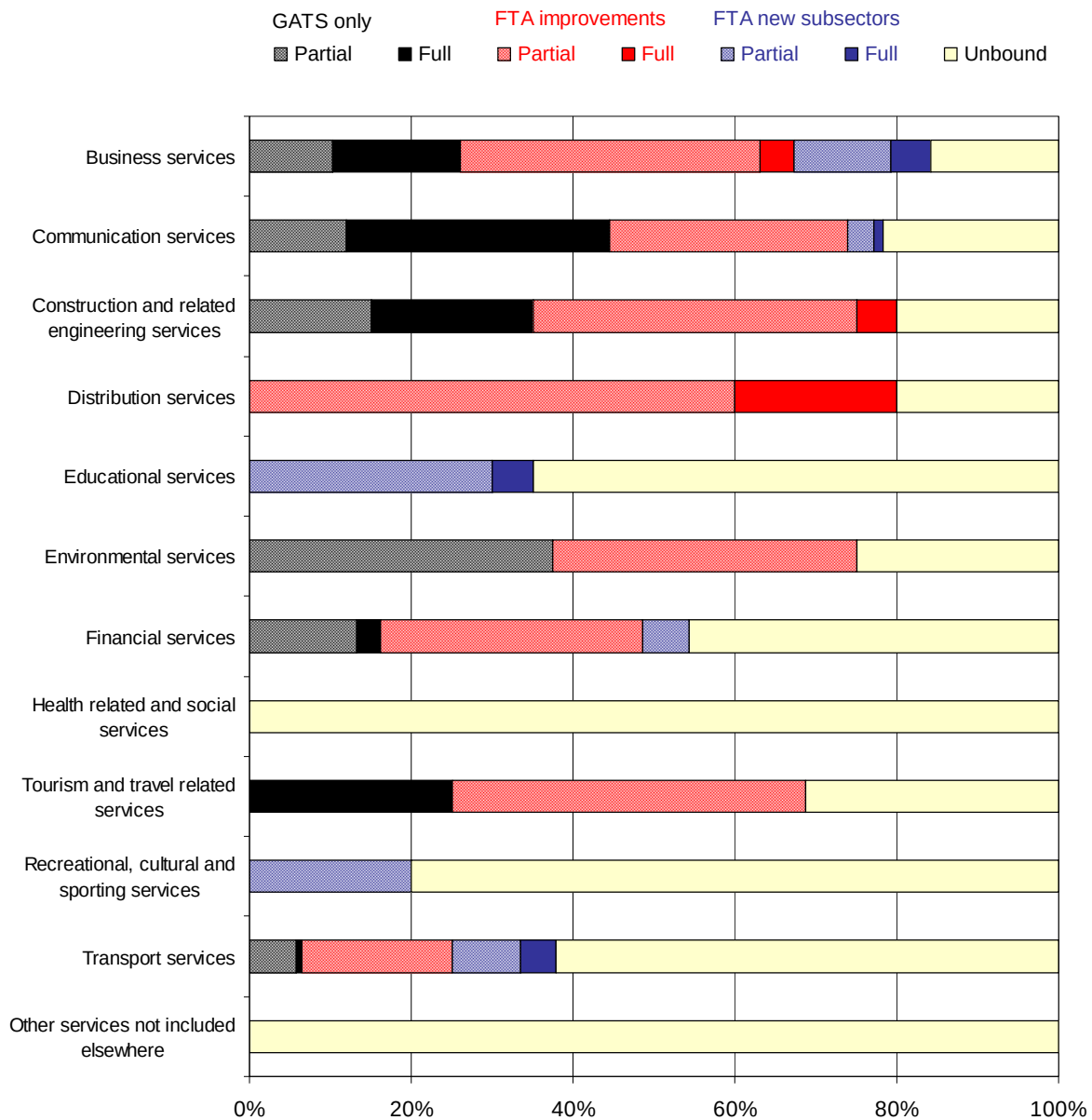


Figure A10b: EFTA-Korea Free Trade Agreement (Schedule of Korea)

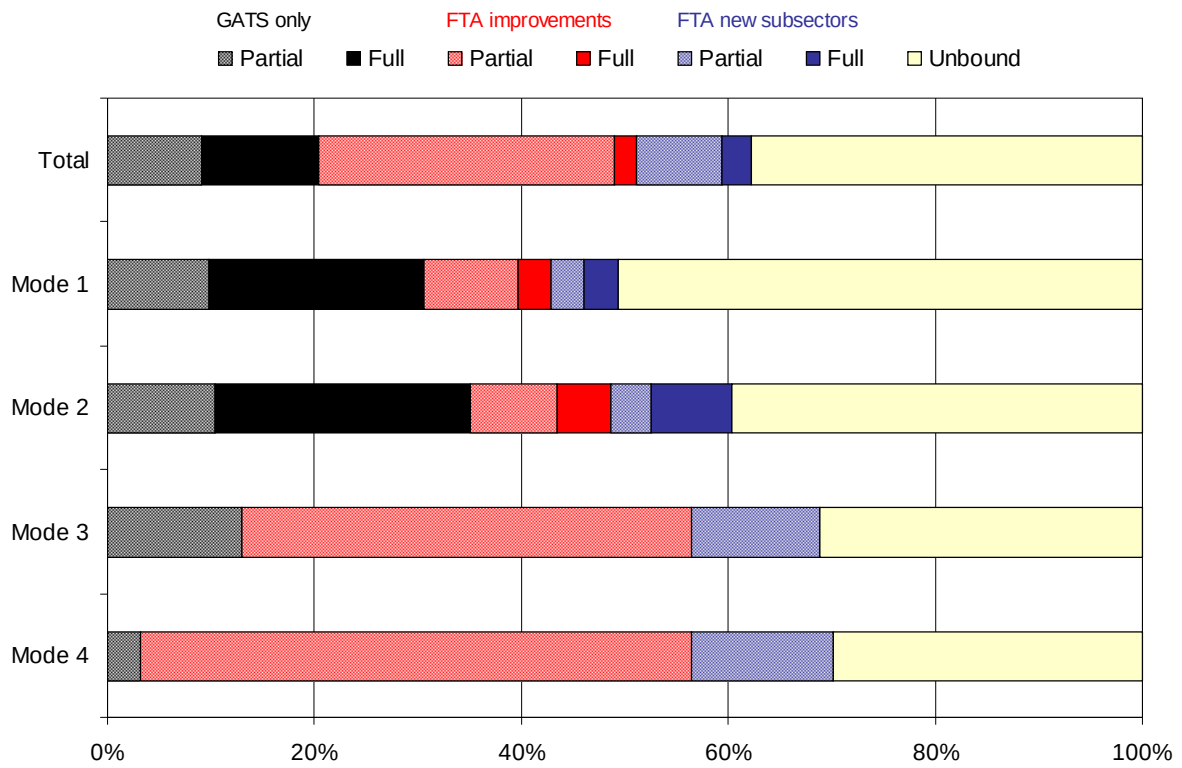


Figure A11a: Korea-Singapore Free Trade Agreement (Schedule of Korea)

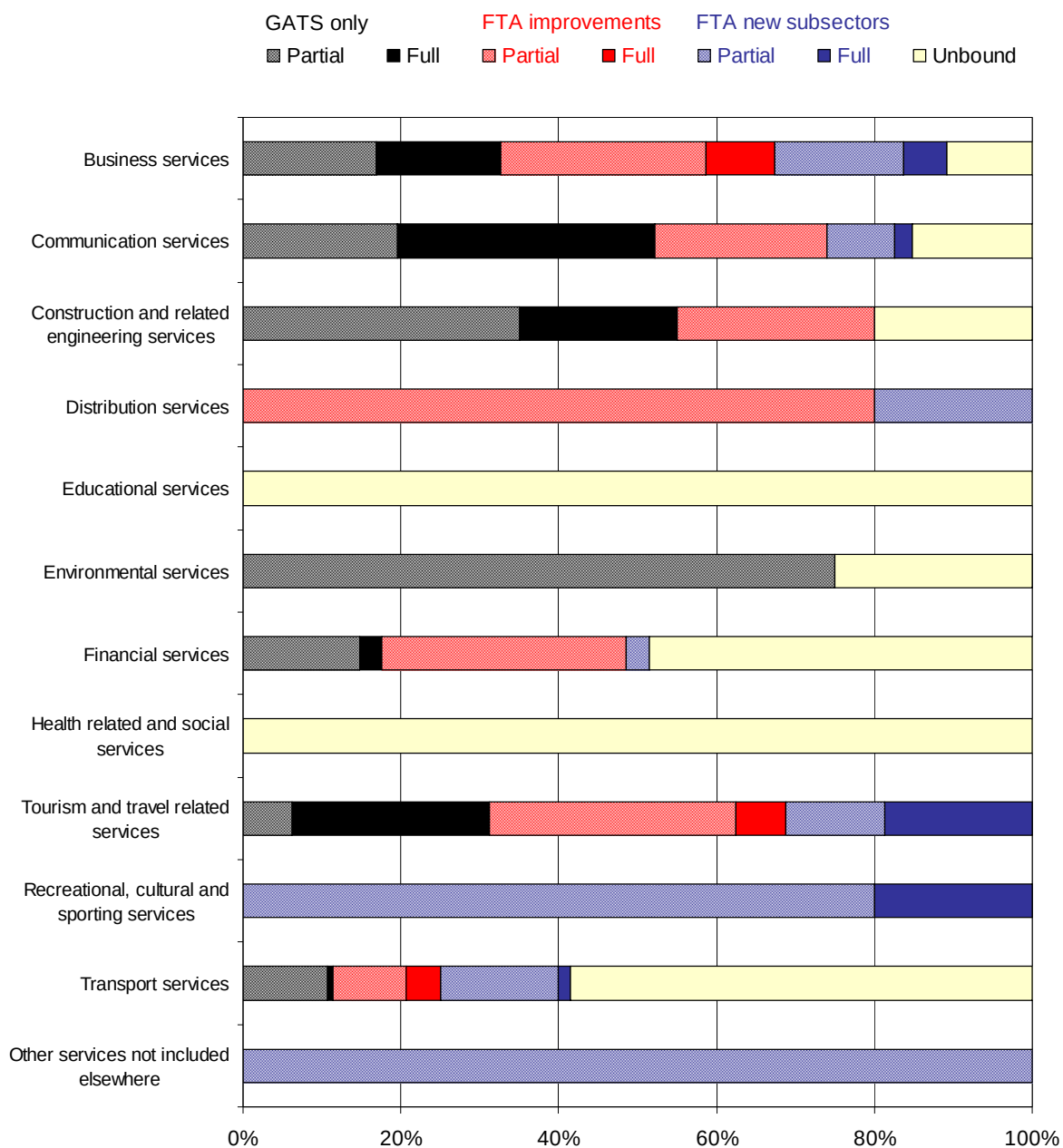


Figure A11b: Korea-Singapore Free Trade Agreement (Schedule of Korea)

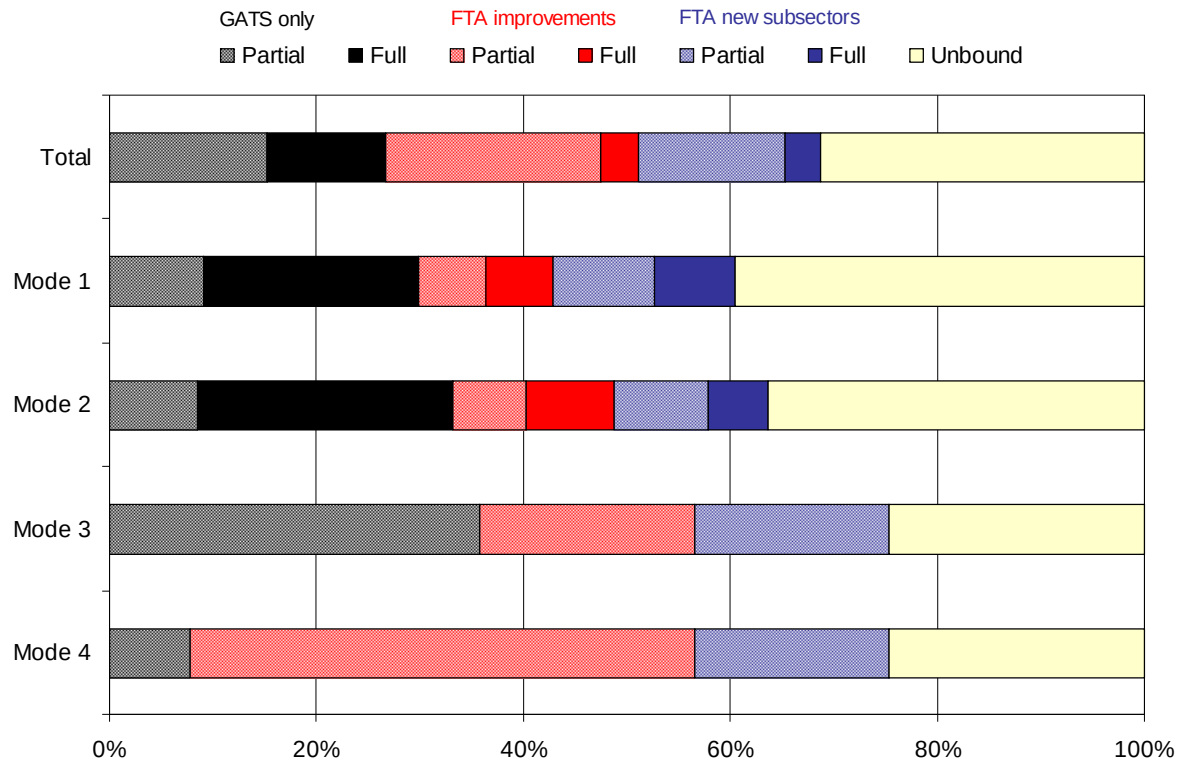
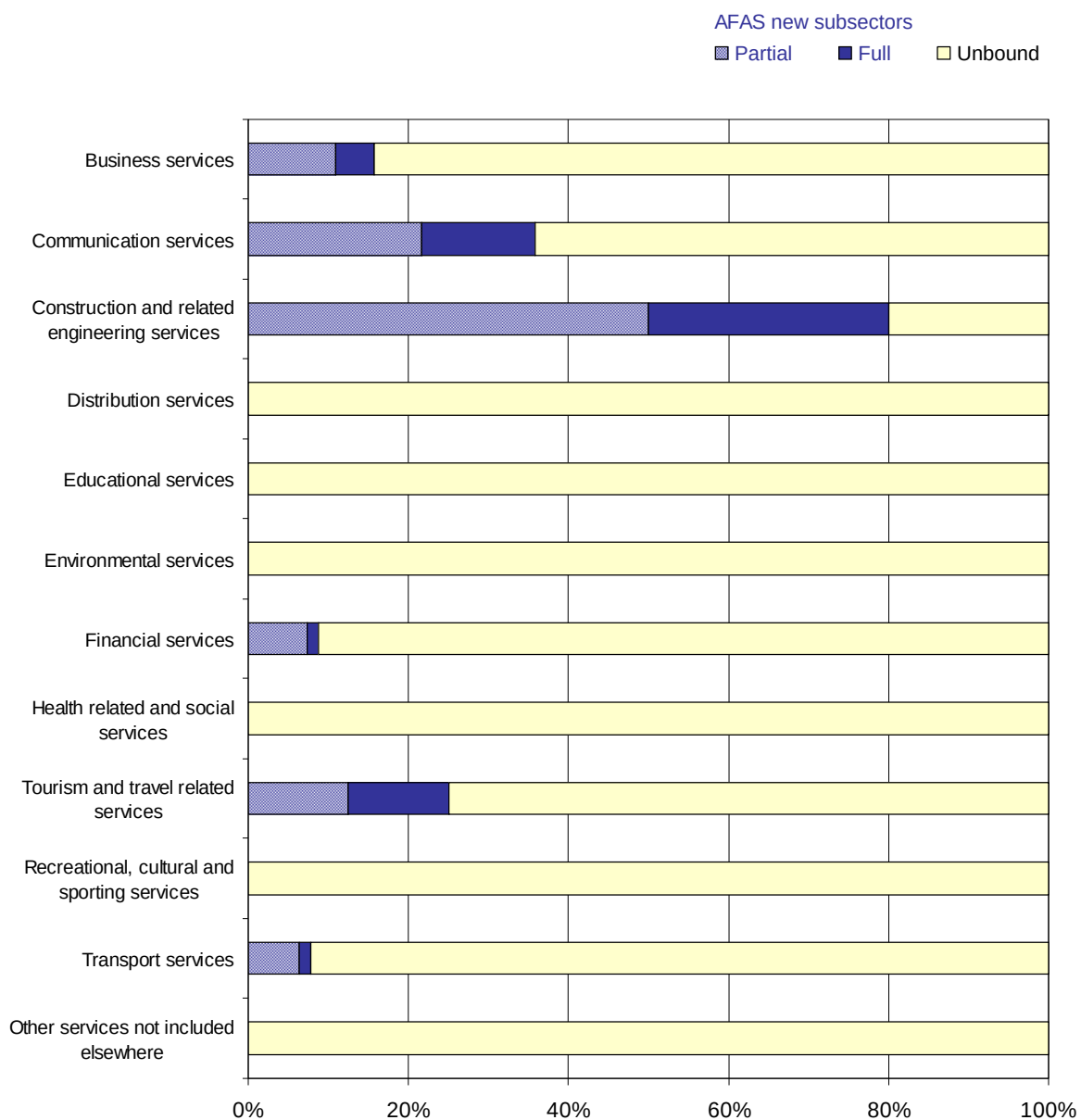
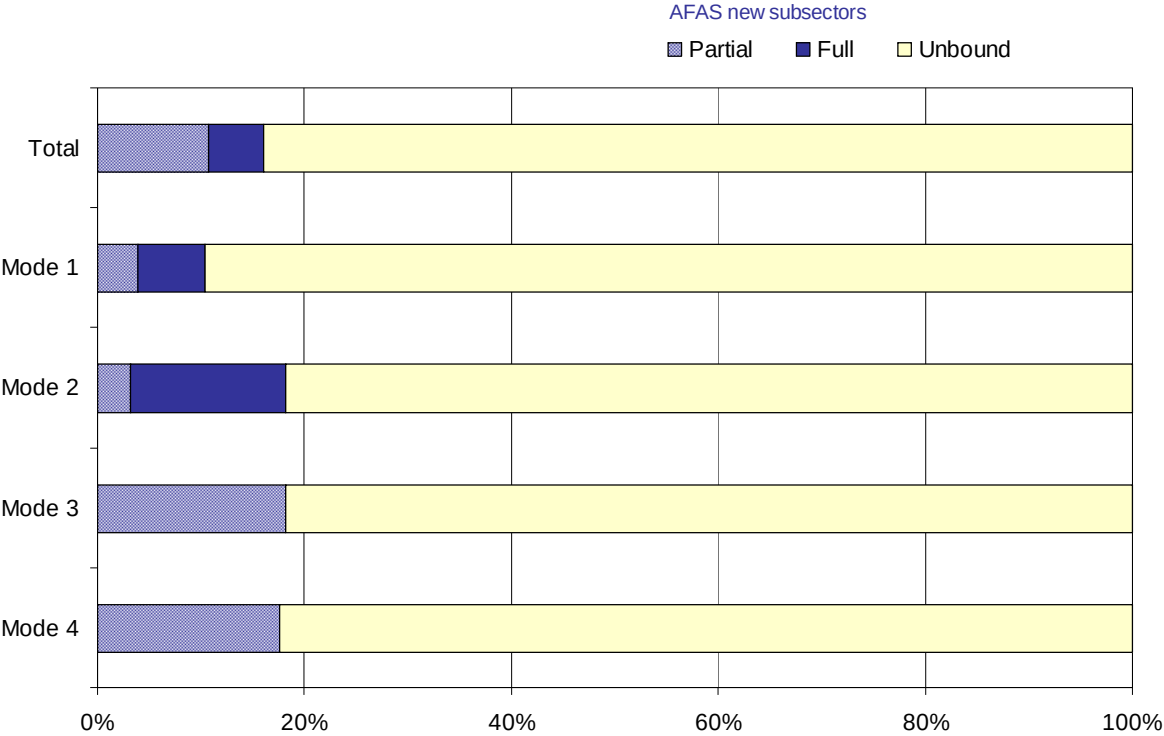


Figure A12a: ASEAN Framework Agreement on Services (Schedule of Lao PDR)



Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A12b: ASEAN Framework Agreement on Services (Schedule of Lao PDR)



Notes: See notes to Figure A12a.

Figure A13a: US-Lao PDR Bilateral Trade Agreement (Schedule of Lao PDR)

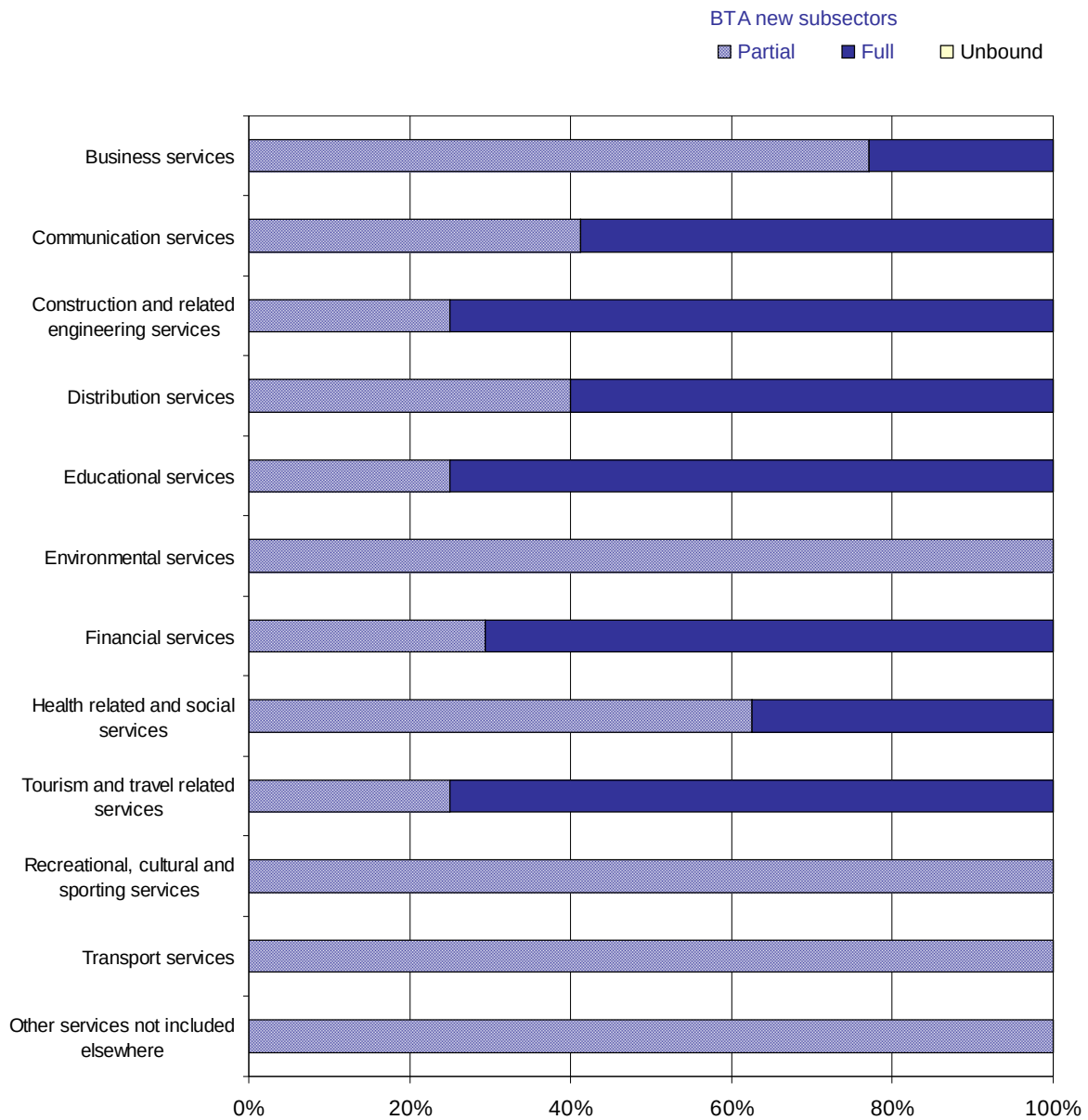


Figure A13b: US-Lao PDR Bilateral Trade Agreement (Schedule of Lao PDR)

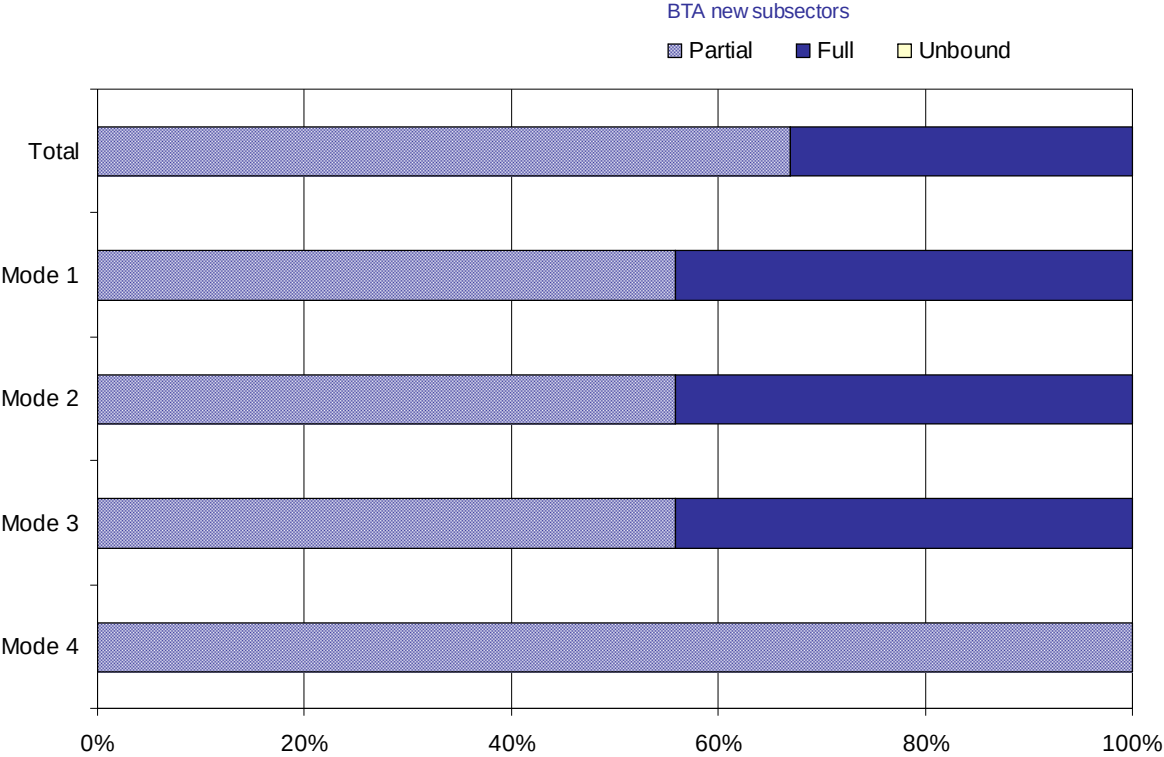
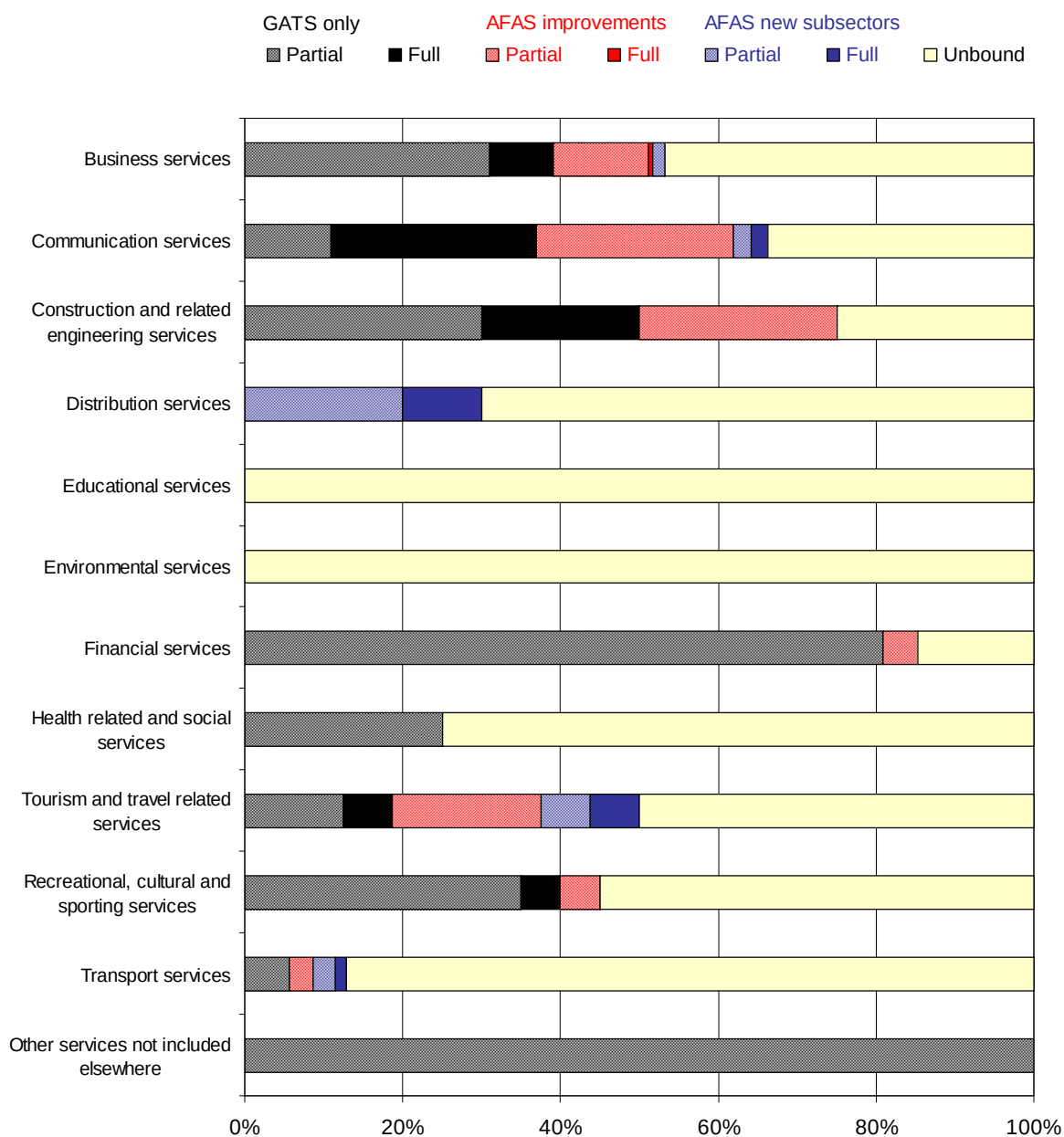
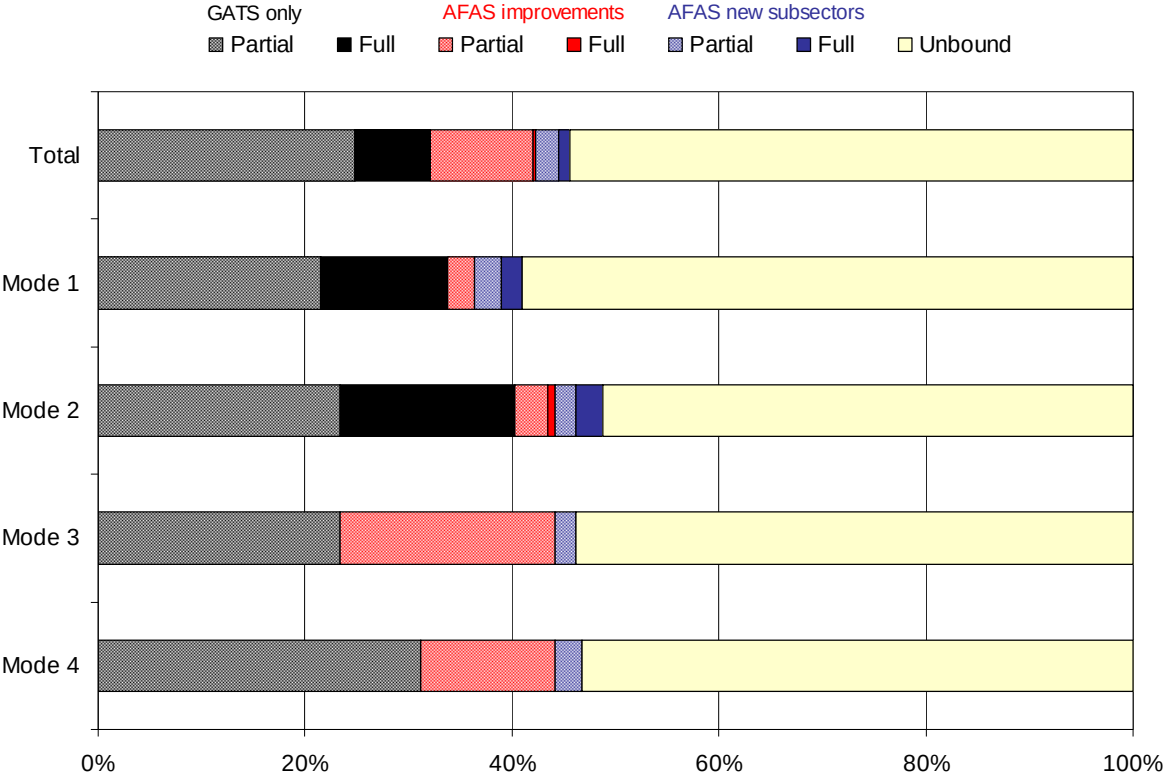


Figure A14a: ASEAN Framework Agreement on Services (Schedule of Malaysia)



Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A14b: ASEAN Framework Agreement on Services (Schedule of Malaysia)



Notes: See notes to Figure A14a.

Figure A15a: Japan-Malaysia Economic Partnership Agreement (Schedule of Malaysia)

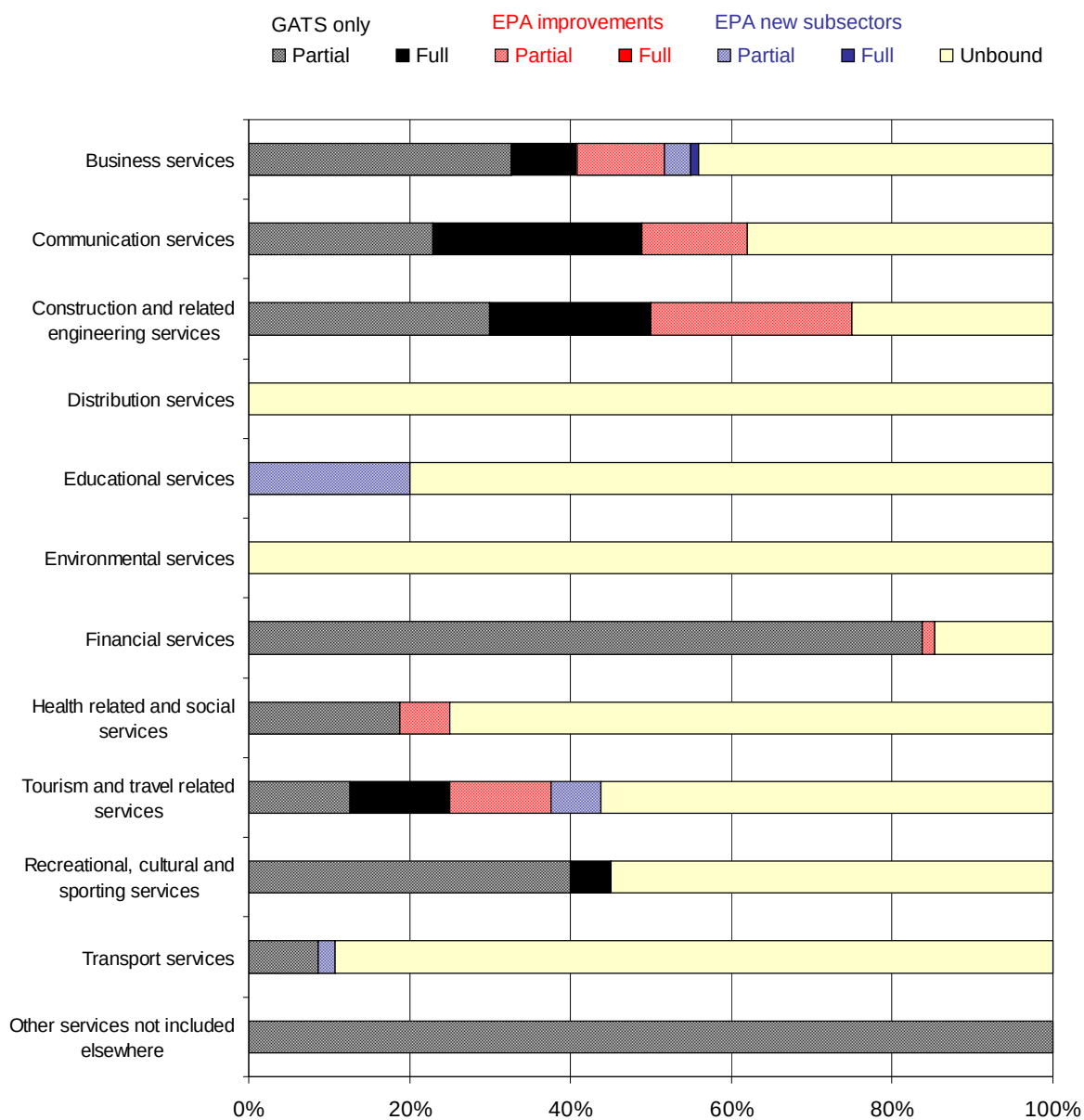


Figure A15b: Japan-Malaysia Economic Partnership Agreement (Schedule of Malaysia)

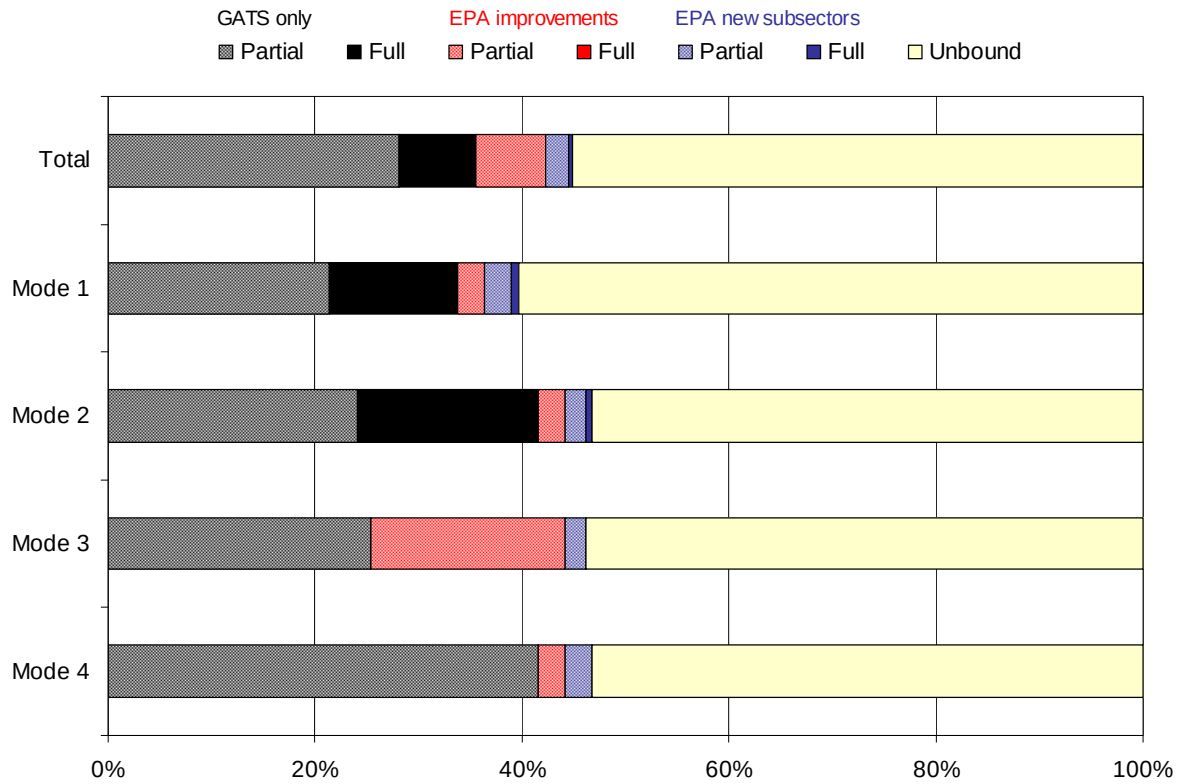
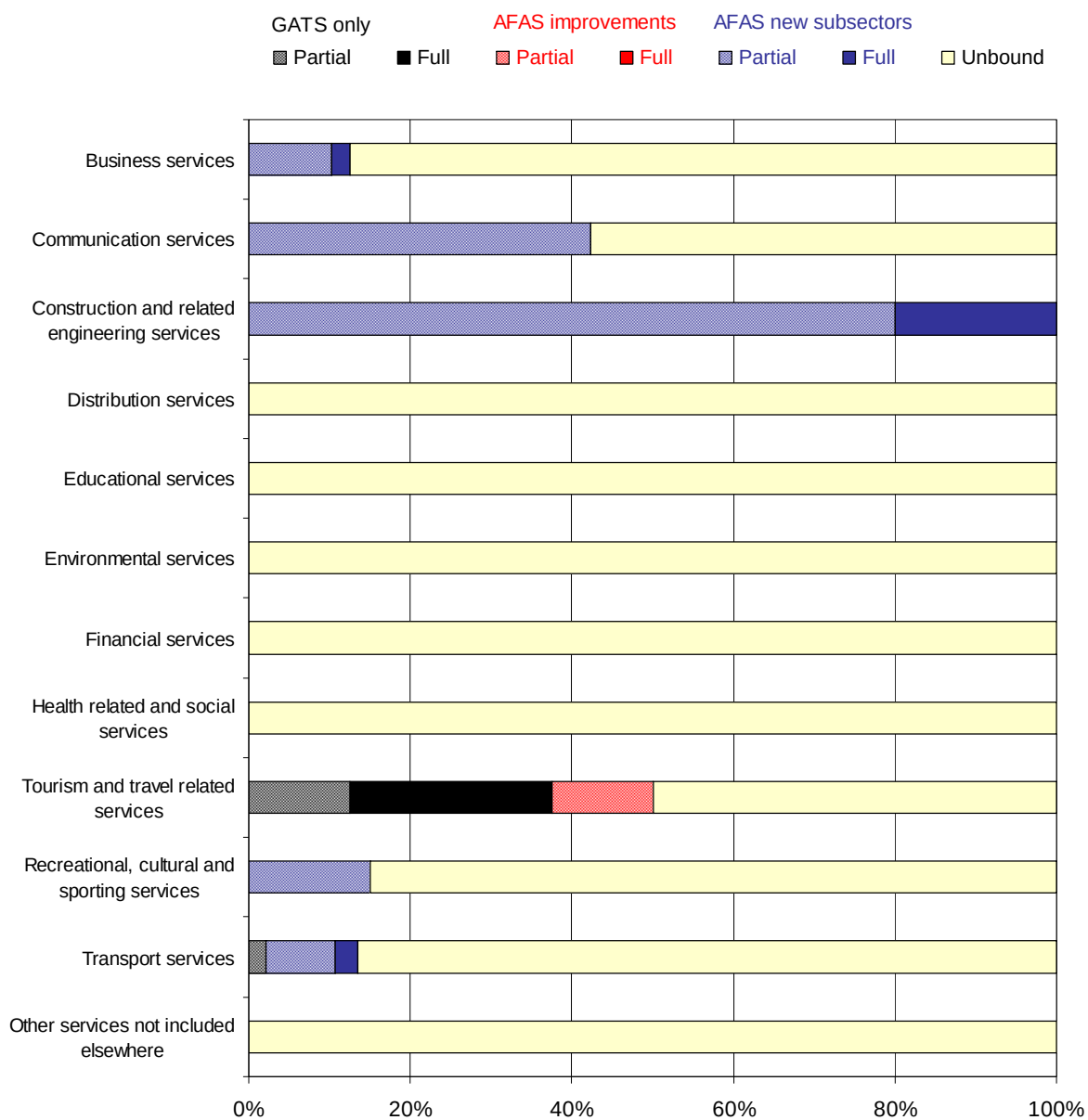
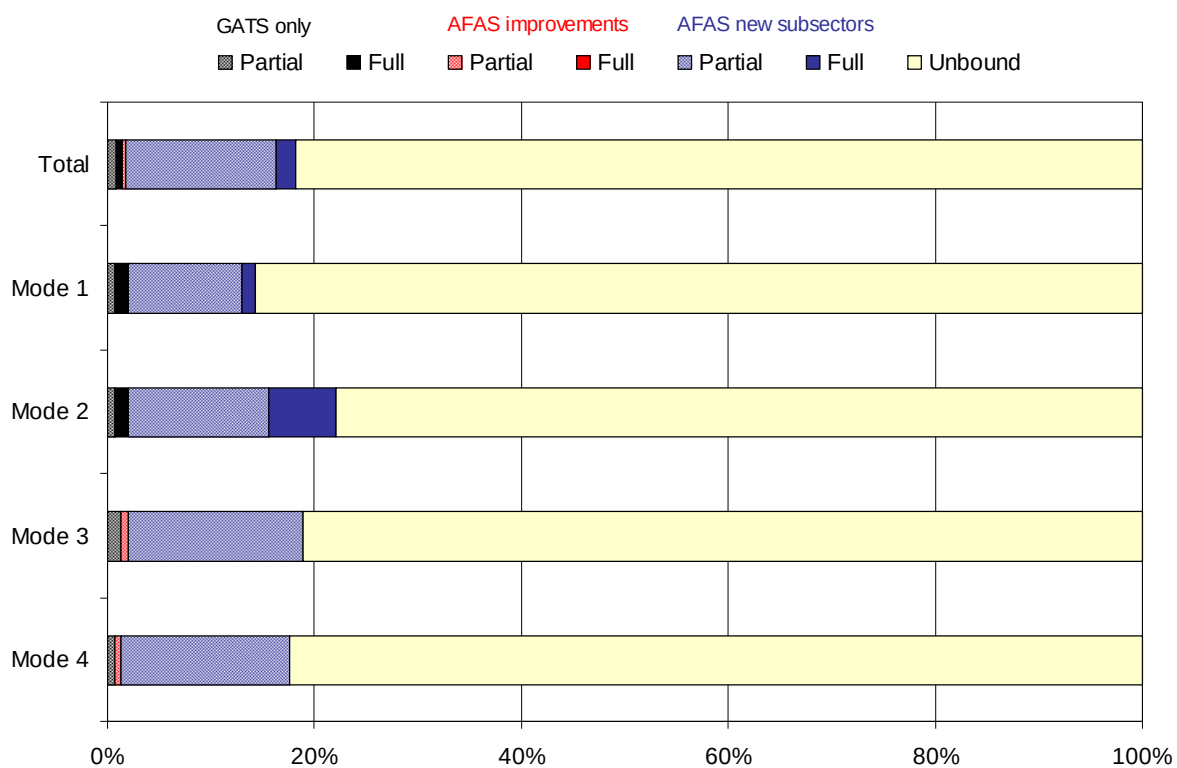


Figure A16a: ASEAN Framework Agreement on Services (Schedule of Myanmar)



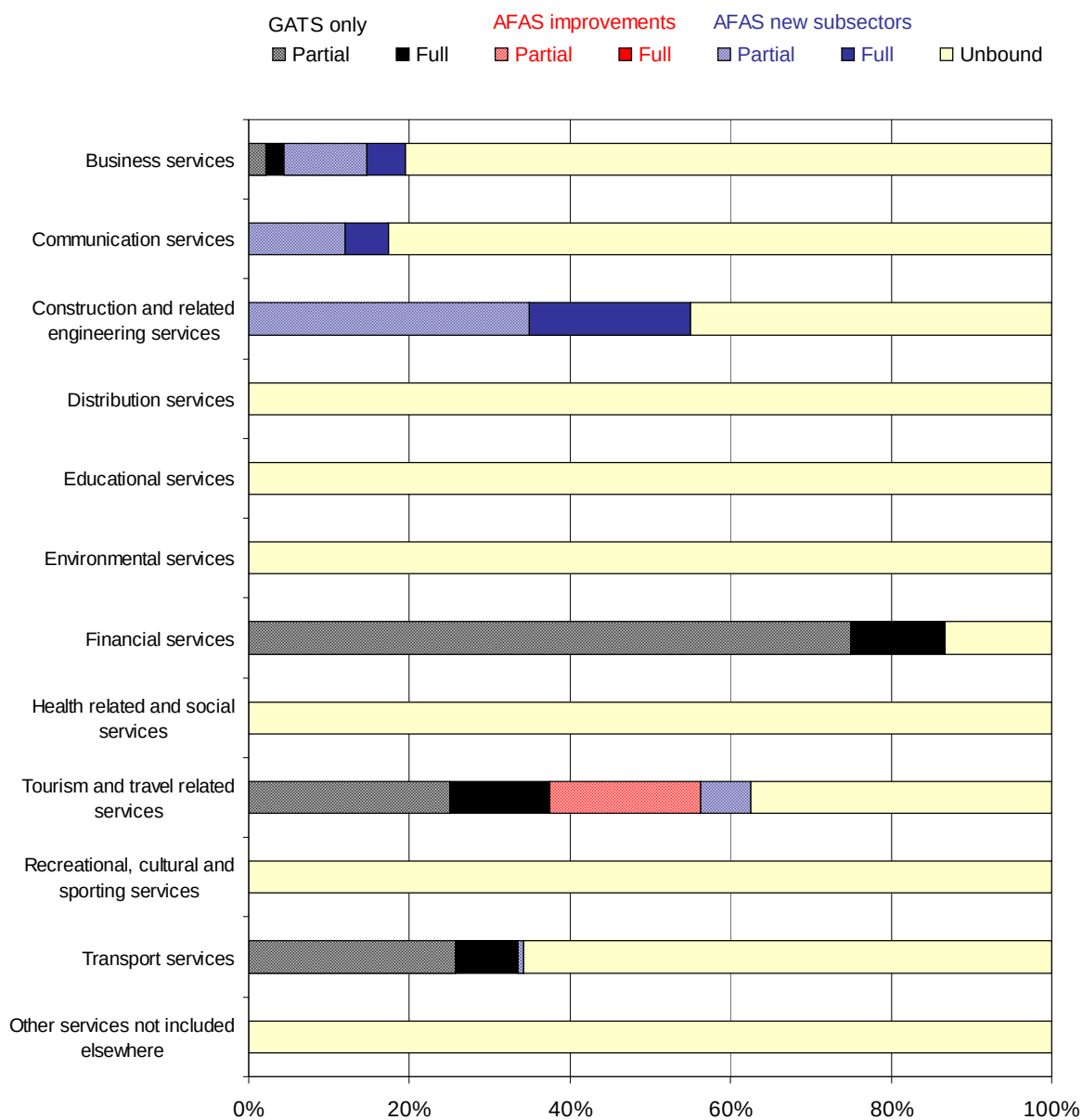
Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A16b: ASEAN Framework Agreement on Services (Schedule of Myanmar)



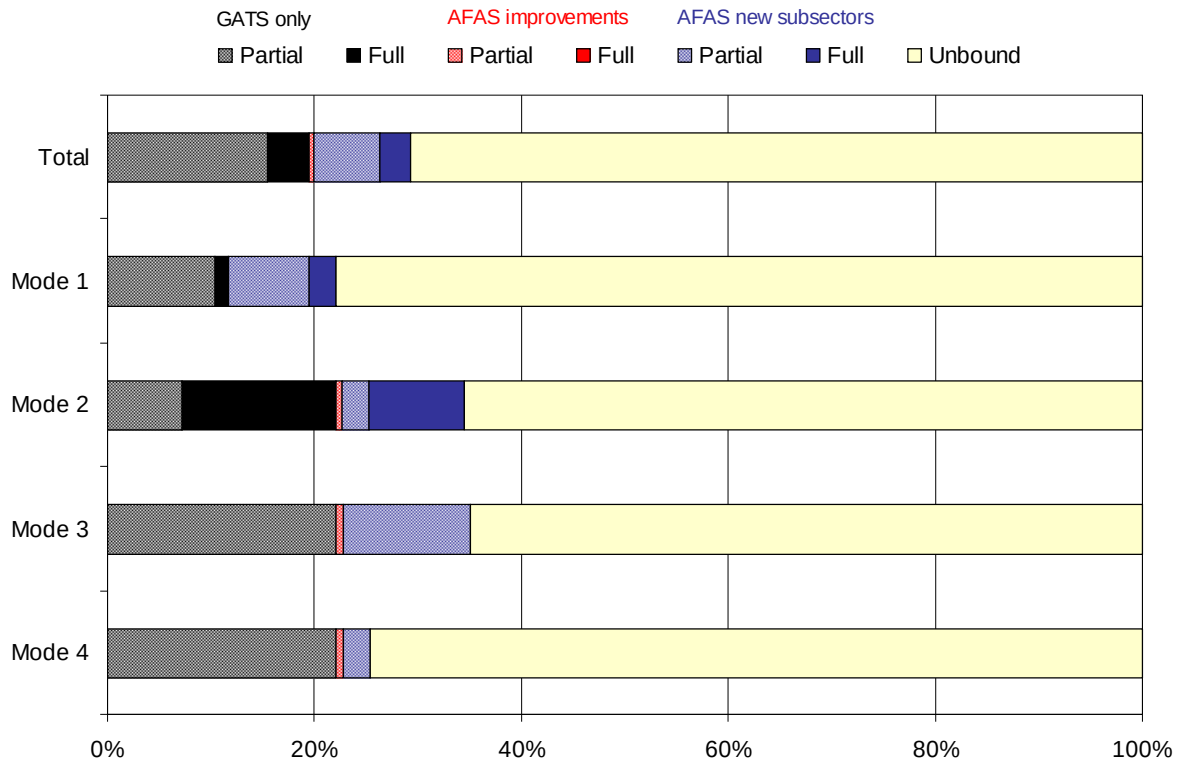
Notes: See notes to Figure A16a.

Figure A17a: ASEAN Framework Agreement on Services (Schedule of the Philippines)



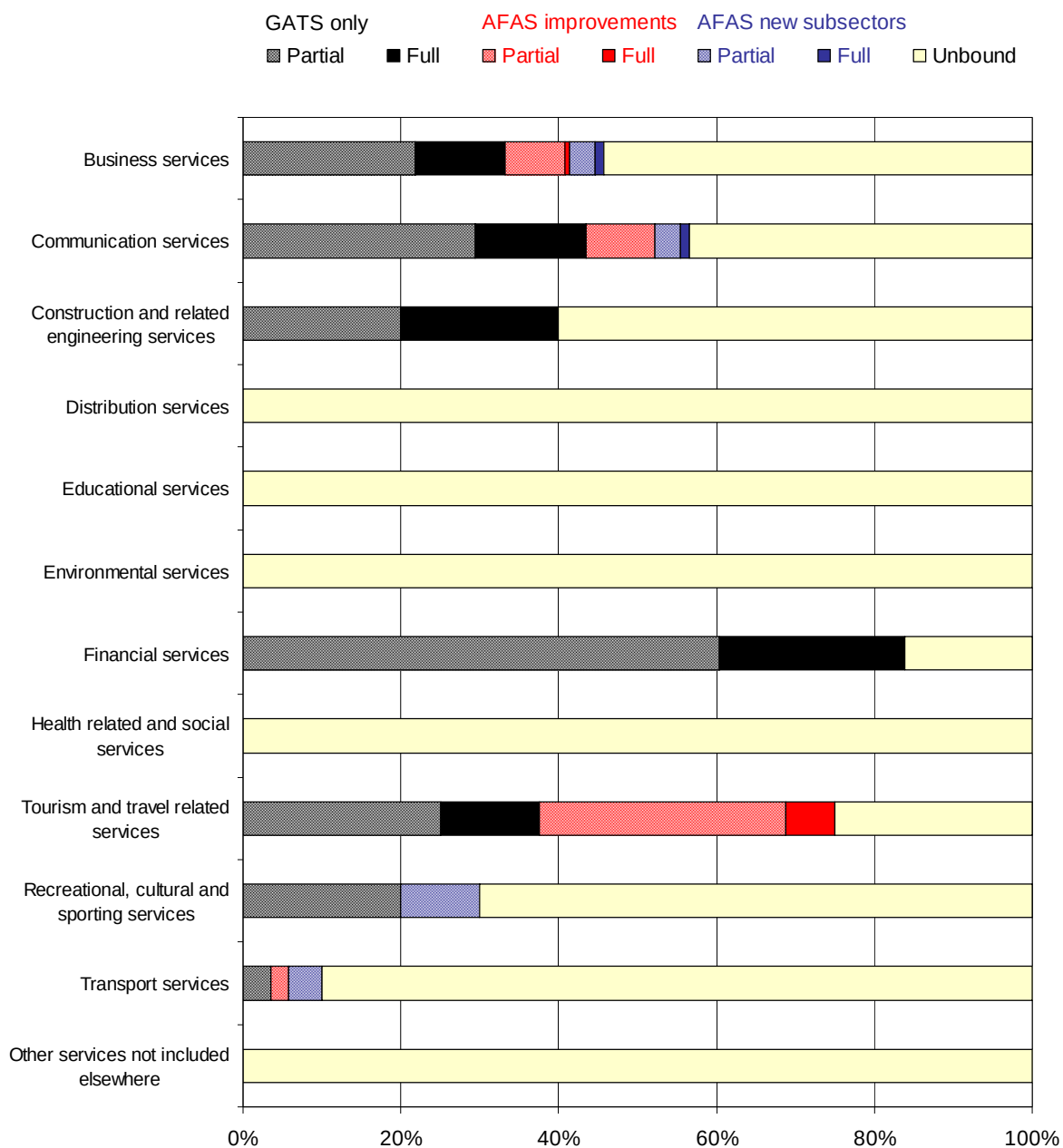
Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A17b: ASEAN Framework Agreement on Services (Schedule of the Philippines)



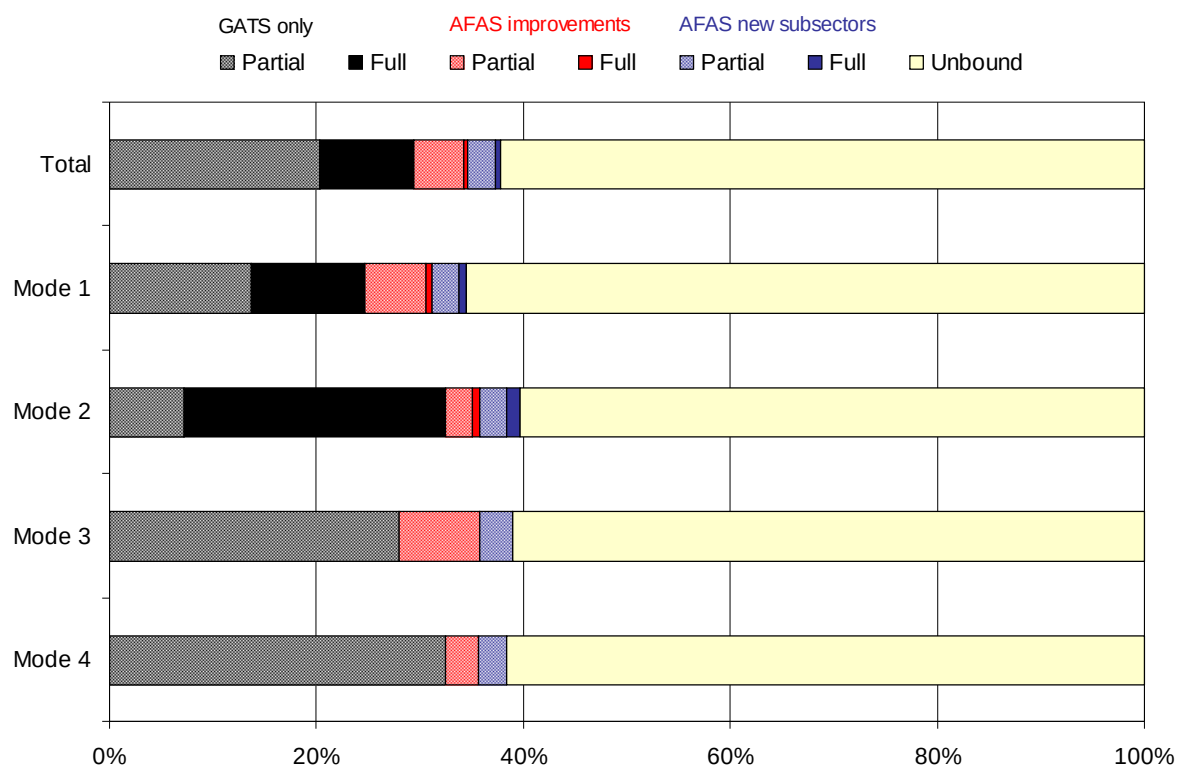
Notes: See notes to Figure A17a.

Figure A18a: ASEAN Framework Agreement on Services (Schedule of Singapore)



Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A18b: ASEAN Framework Agreement on Services (Schedule of Singapore)



Notes: See notes to Figure A18a.

Figure A19a: Australia-Singapore Free Trade Agreement (Schedule of Singapore)

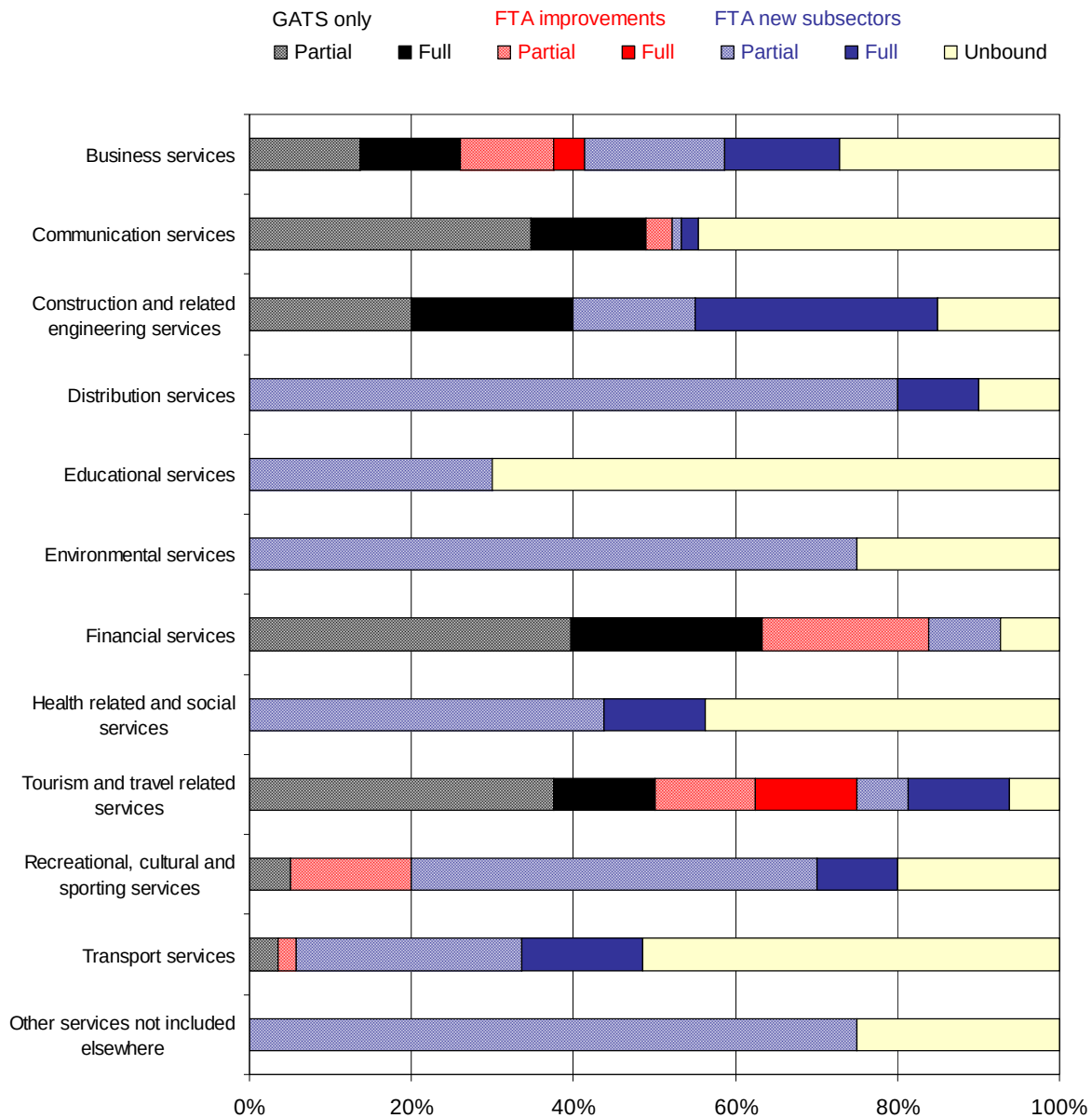


Figure A19b: Australia-Singapore Free Trade Agreement (Schedule of Singapore)

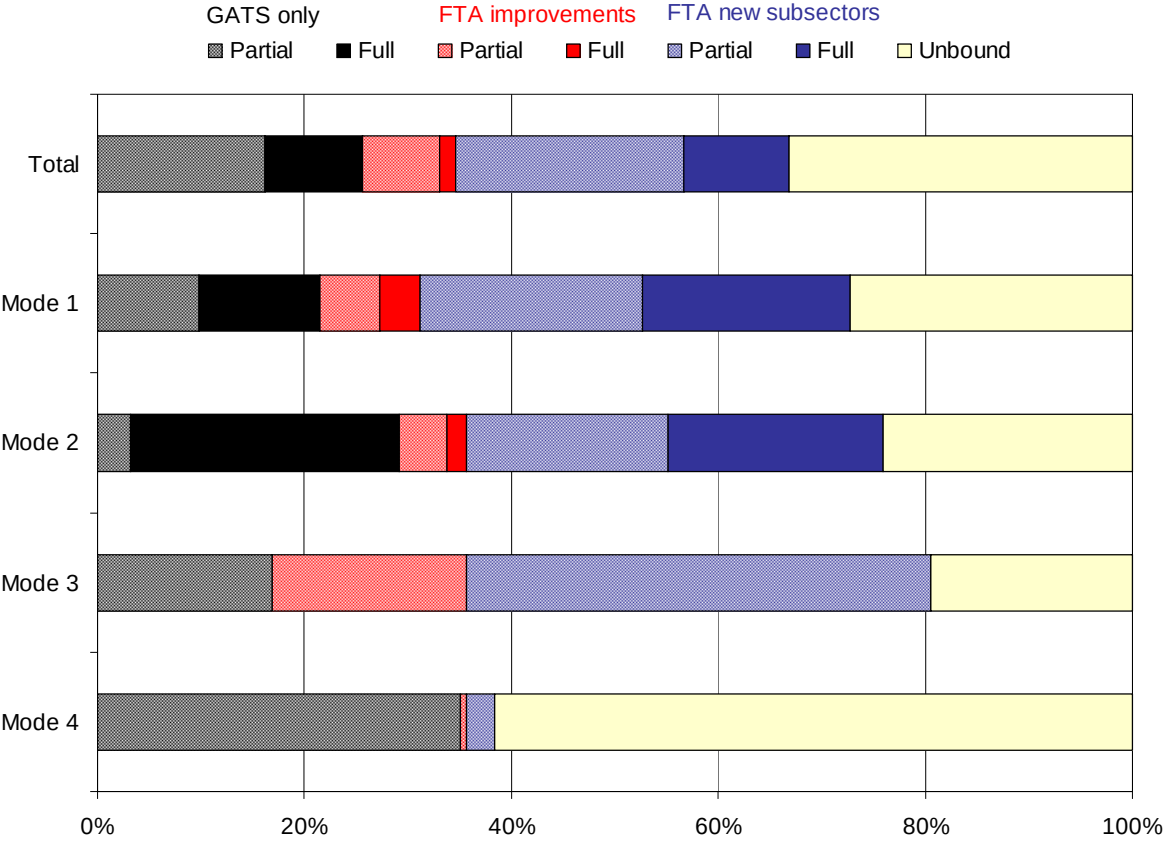


Figure A20a: EFTA-Singapore Free Trade Agreement (Schedule of Singapore)

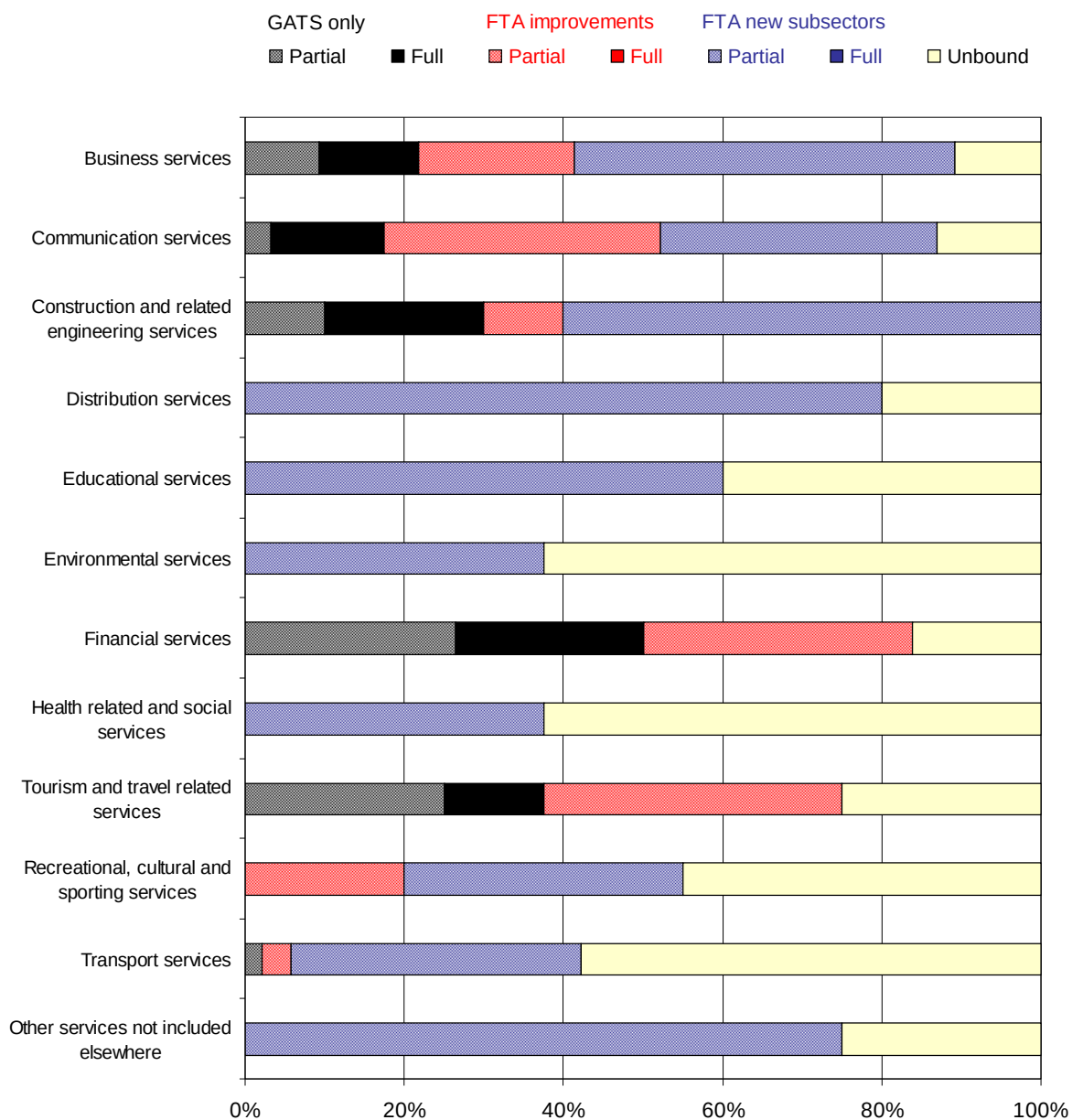


Figure A20b: EFTA-Singapore Free Trade Agreement (Schedule of Singapore)

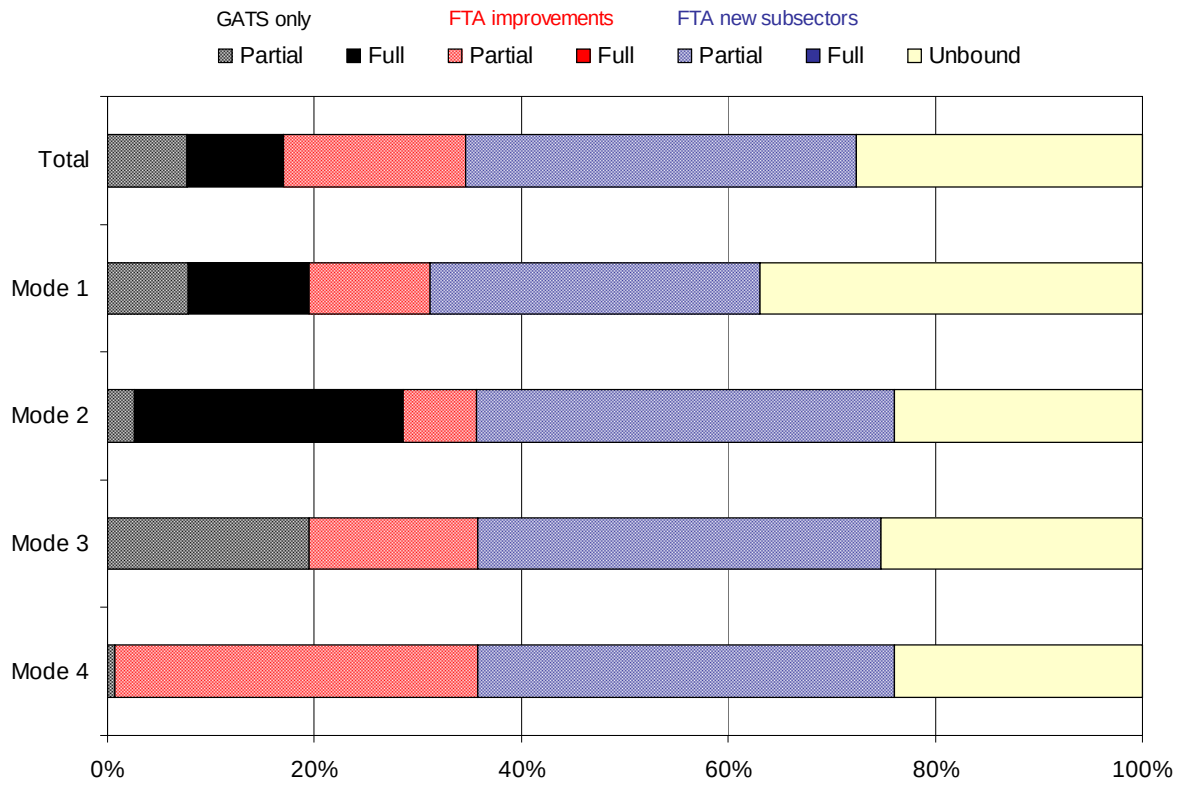


Figure A21a: India-Singapore Economic Cooperation Agreement (Schedule of Singapore)

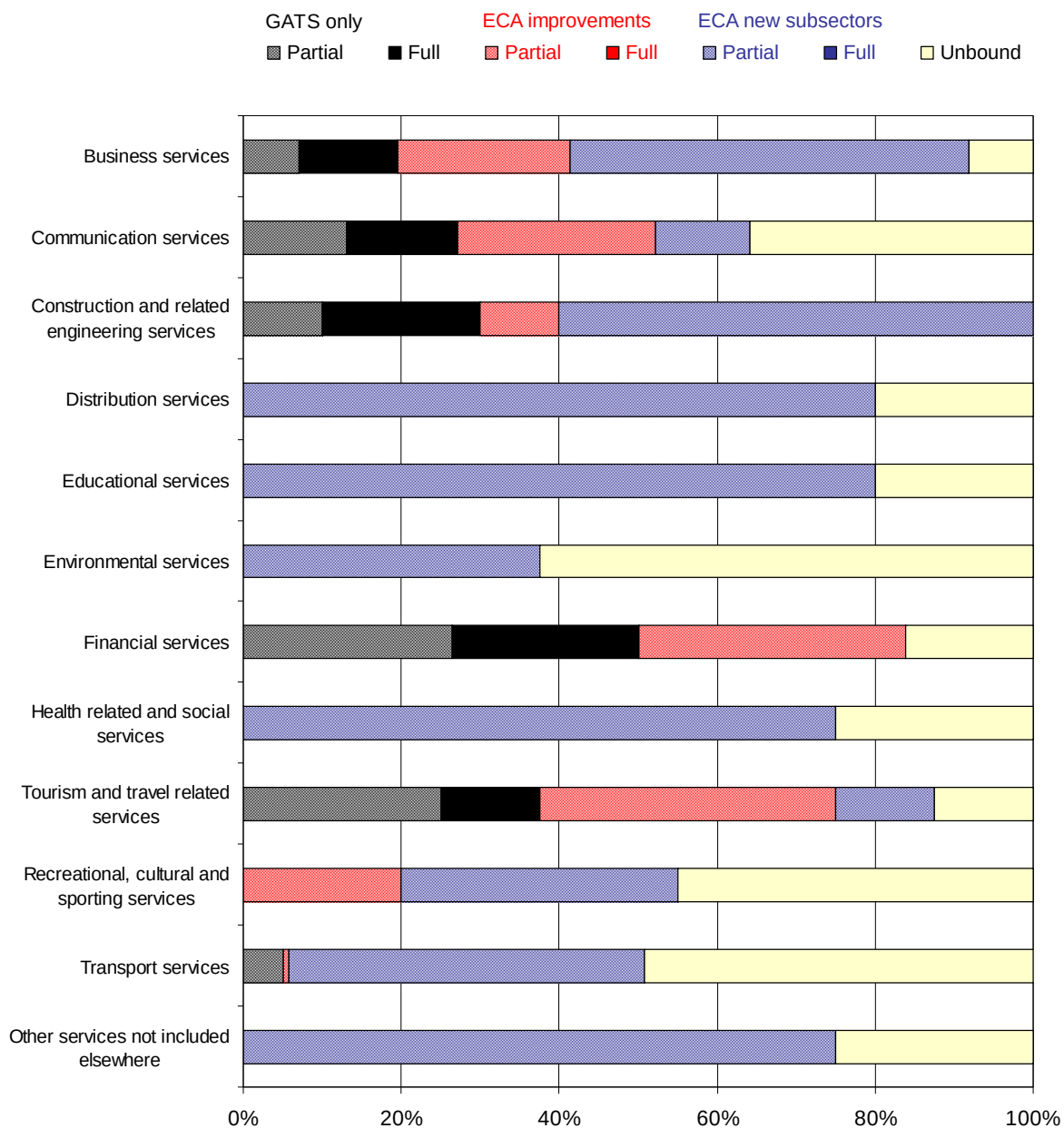


Figure A21b: India-Singapore Economic Cooperation Agreement (Schedule of Singapore)

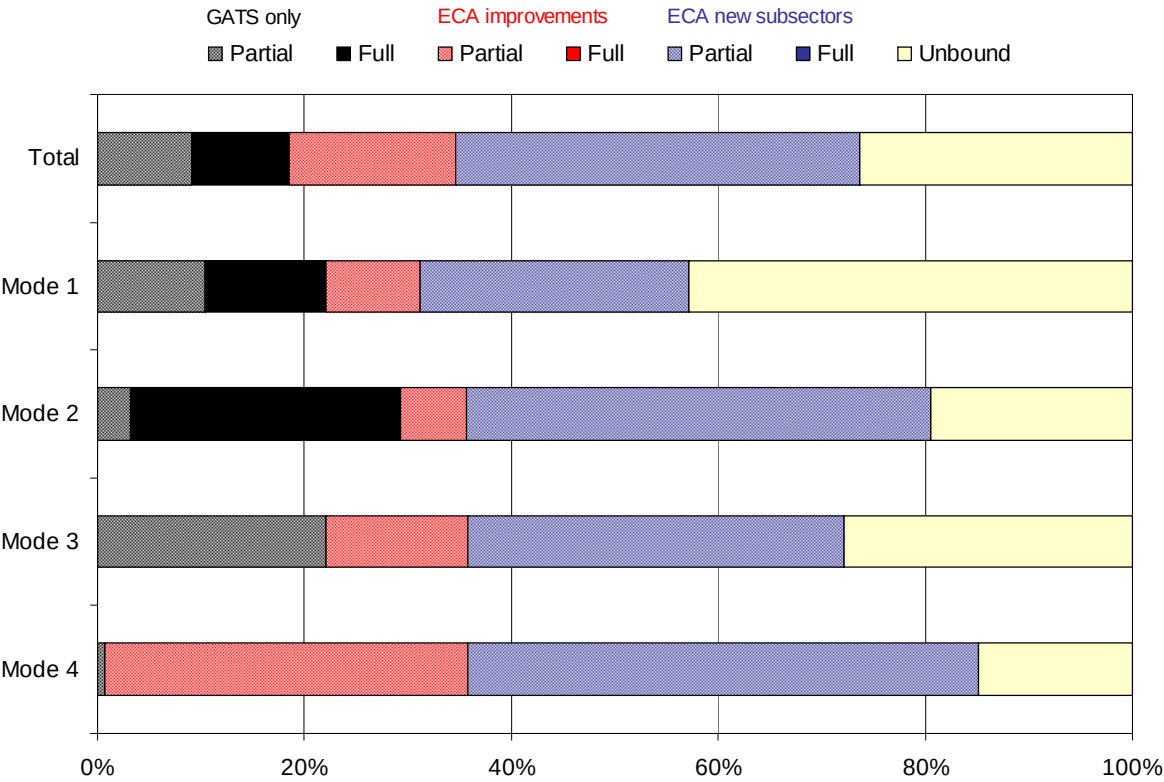


Figure A22a: Japan-Singapore New-Age Economic Partnership Agreement (Schedule of Singapore)

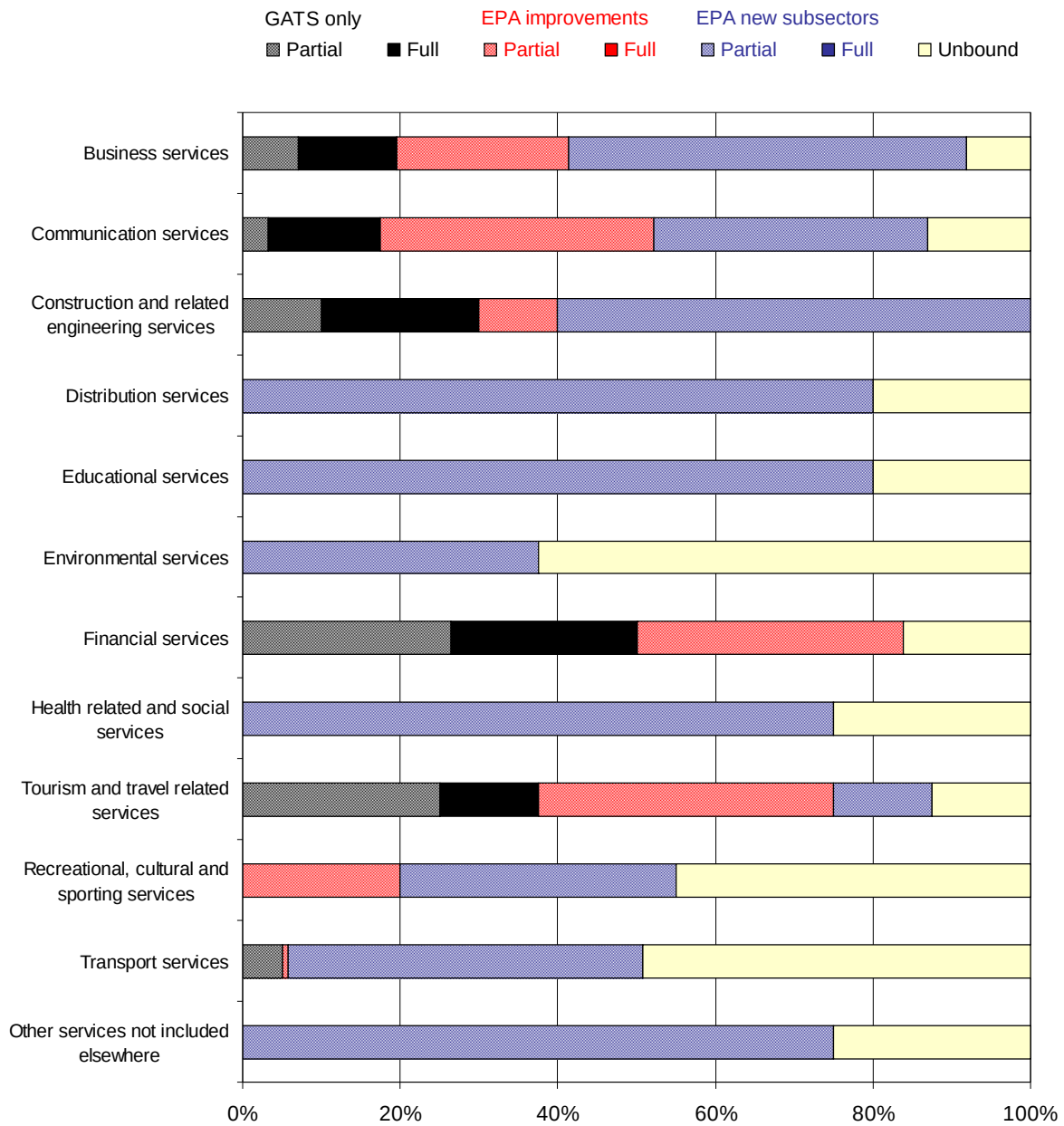


Figure A22b: Japan-Singapore New-Age Economic Partnership Agreement (Schedule of Singapore)

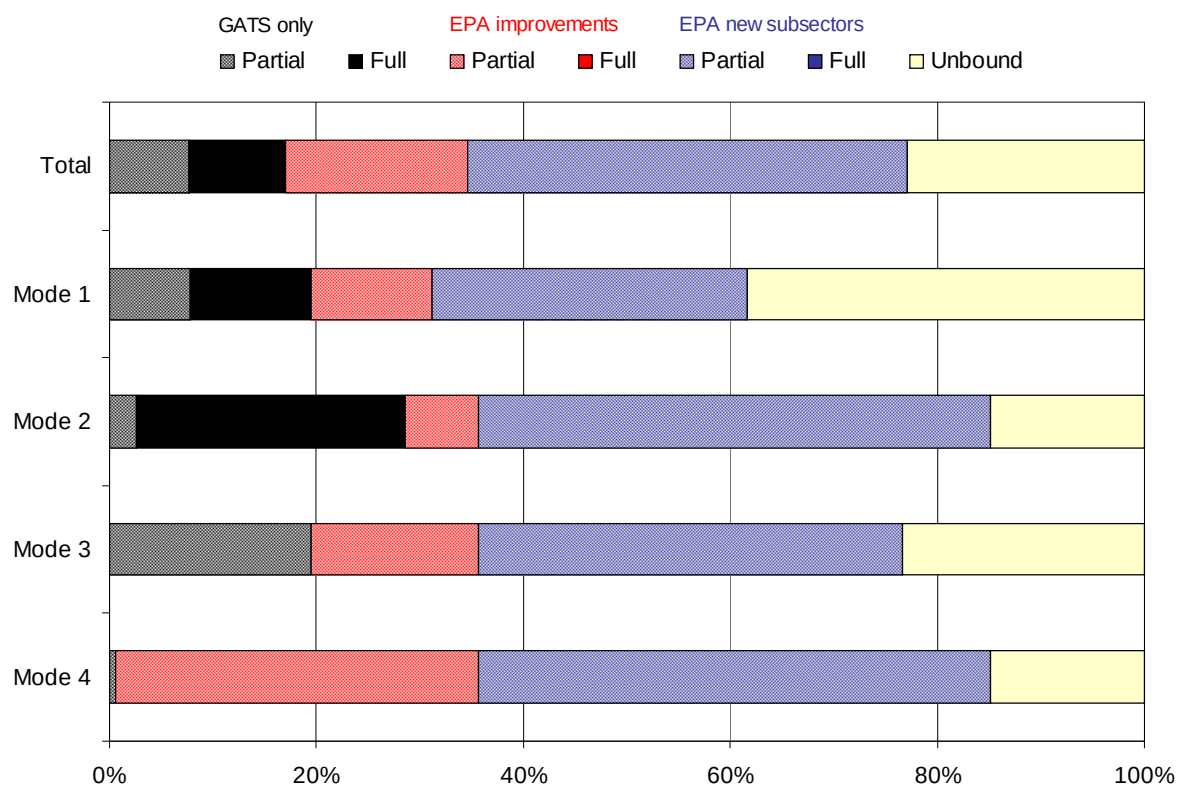


Figure A23a: Jordan-Singapore Free Trade Agreement (Schedule of Singapore)

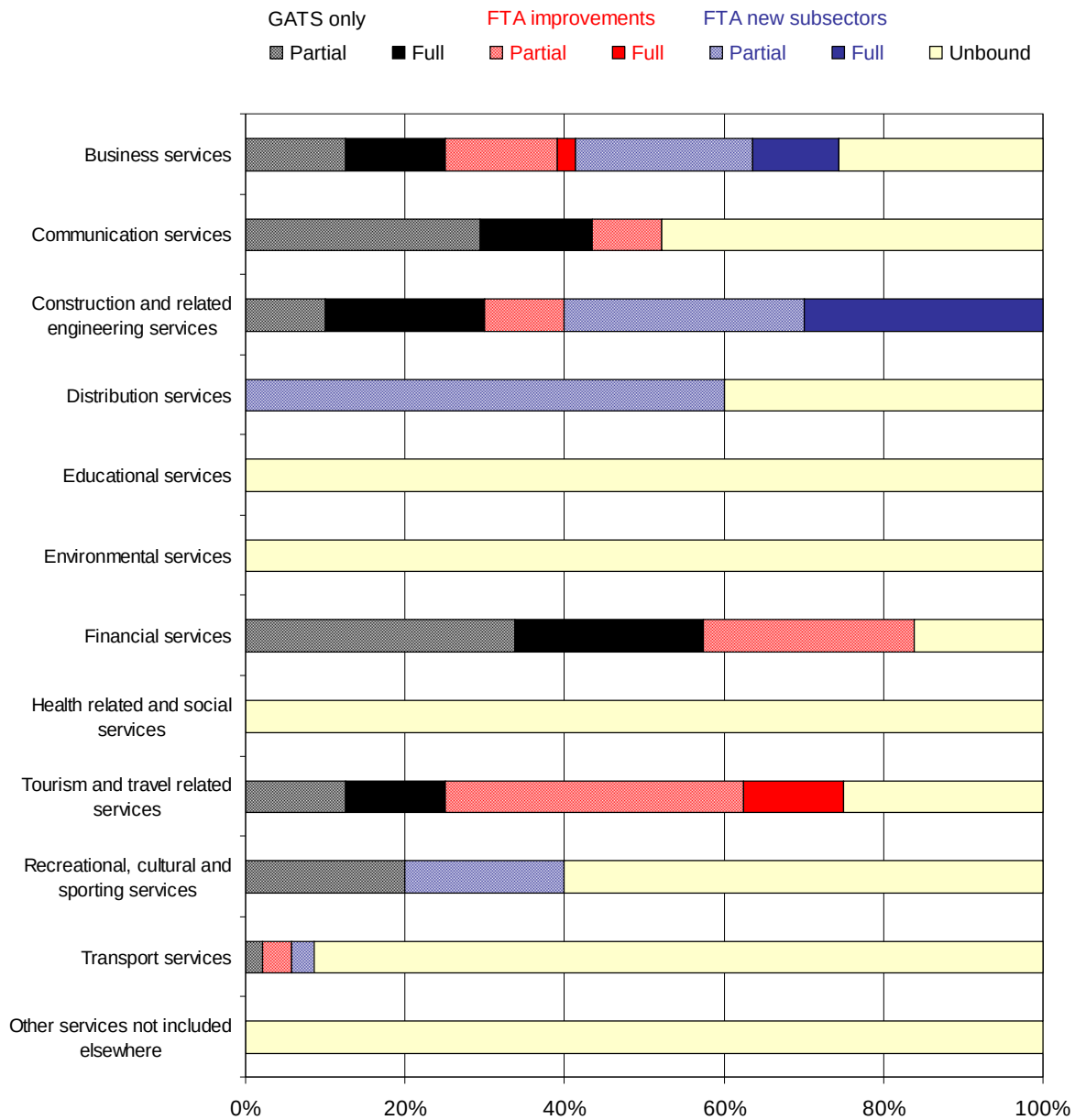


Figure A23b: Jordan-Singapore Free Trade Agreement (Schedule of Singapore)

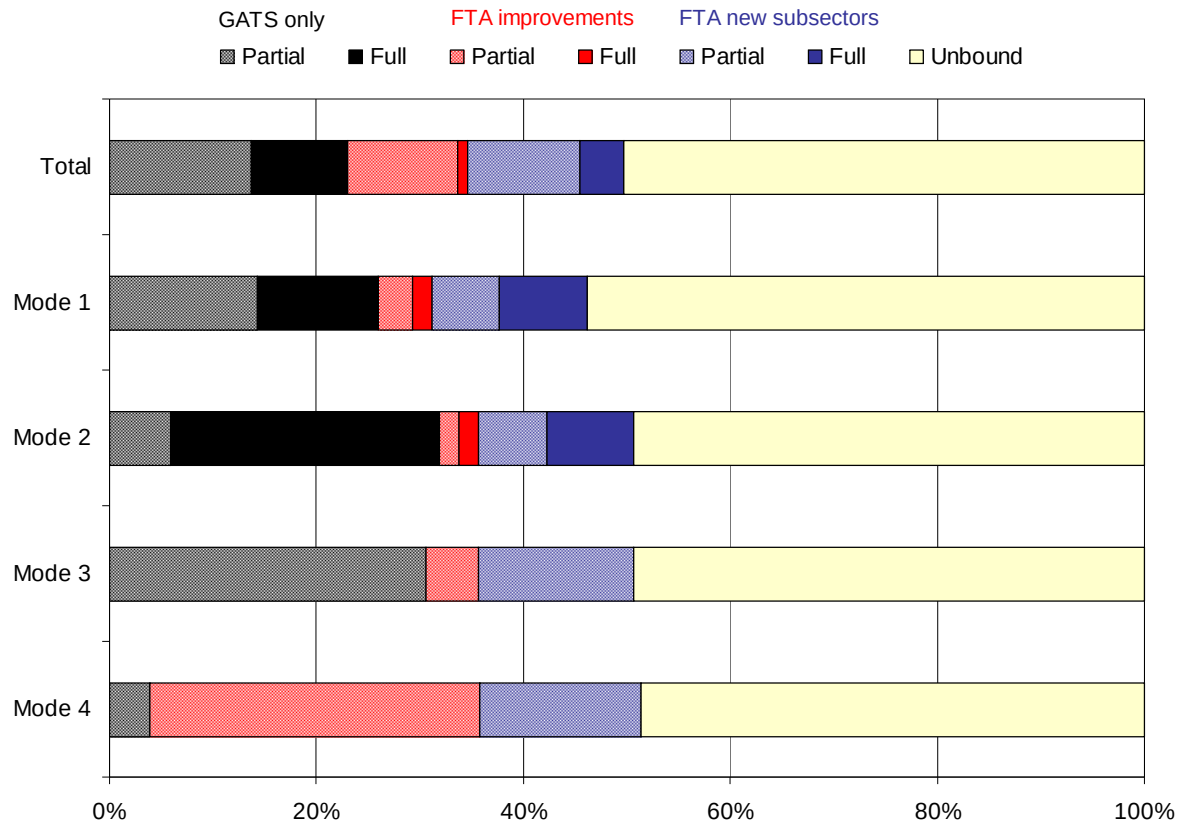


Figure A24a: Korea-Singapore Free Trade Agreement (Schedule of Singapore)

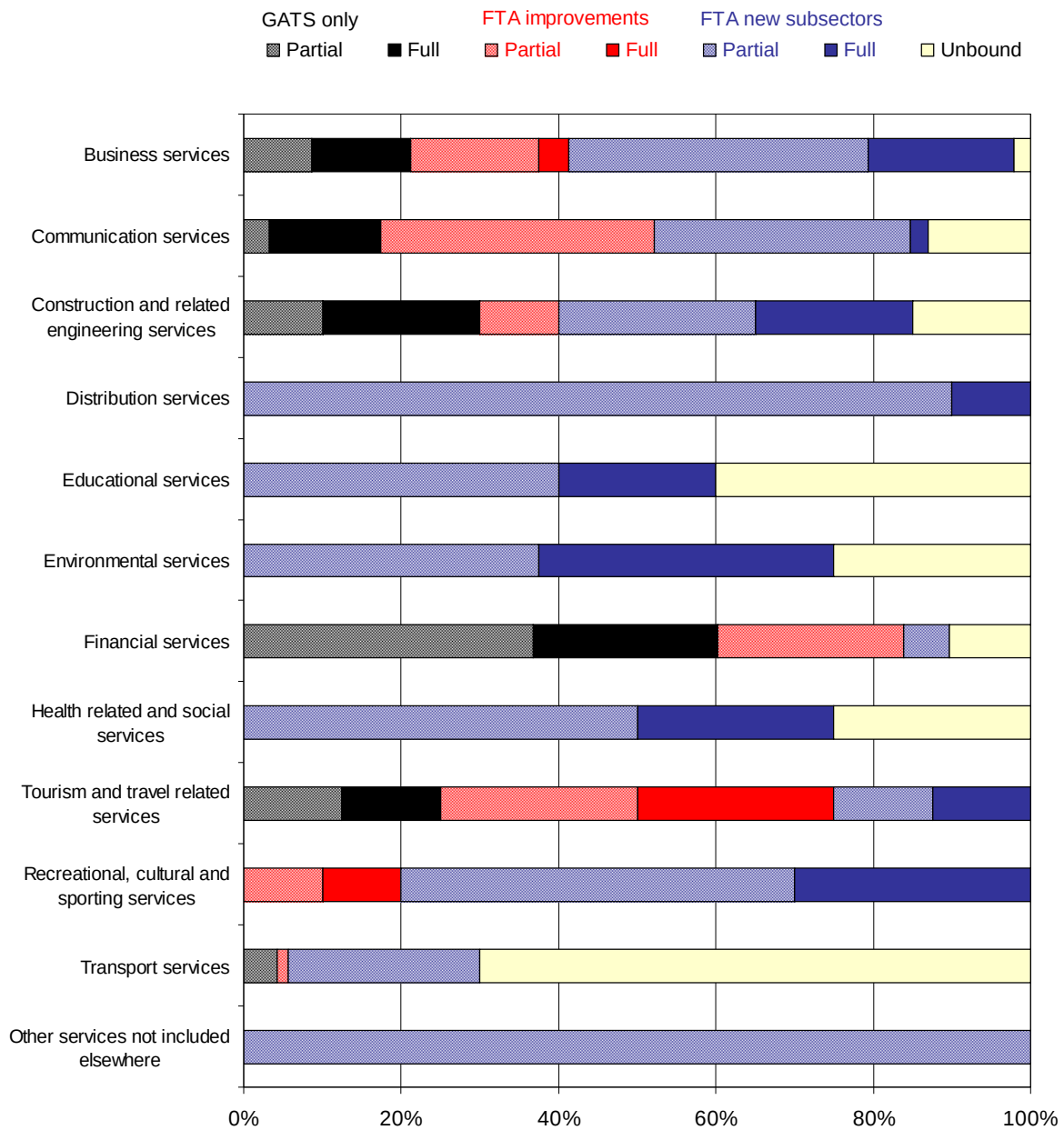


Figure A24b: Korea-Singapore Free Trade Agreement (Schedule of Singapore)

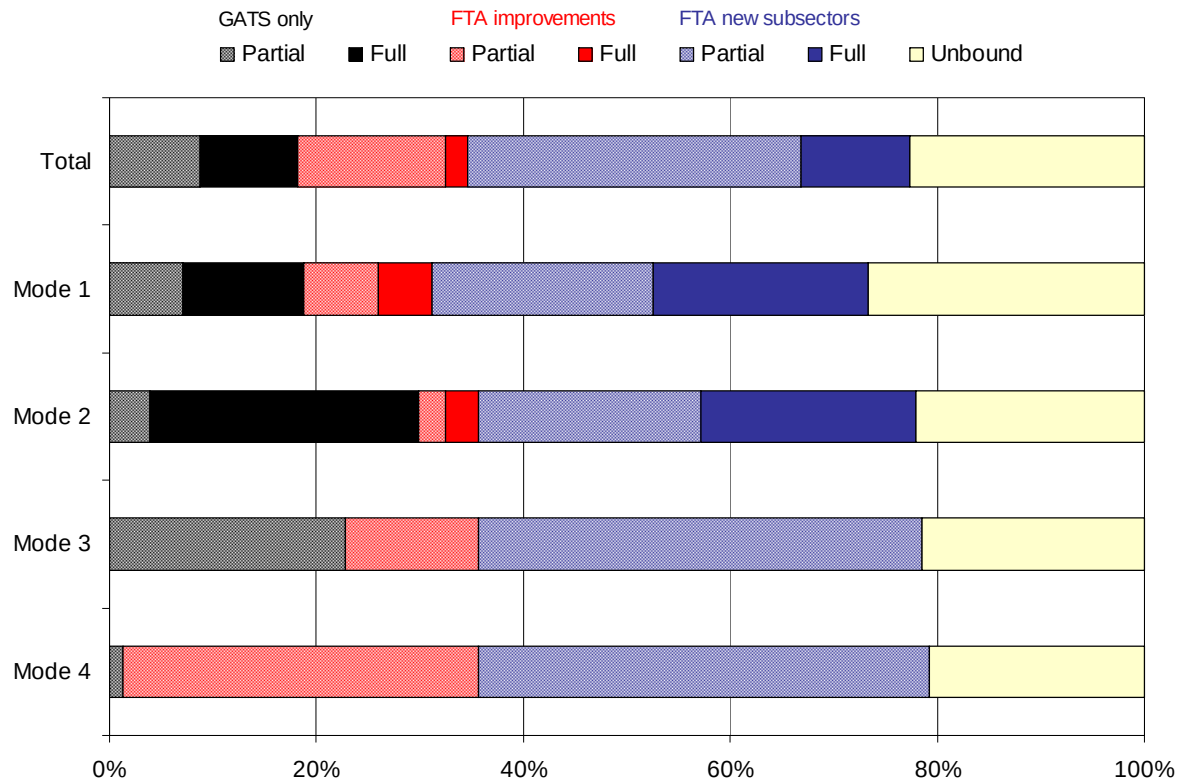


Figure A25a: New Zealand-Singapore Free Trade Agreement (Schedule of Singapore)

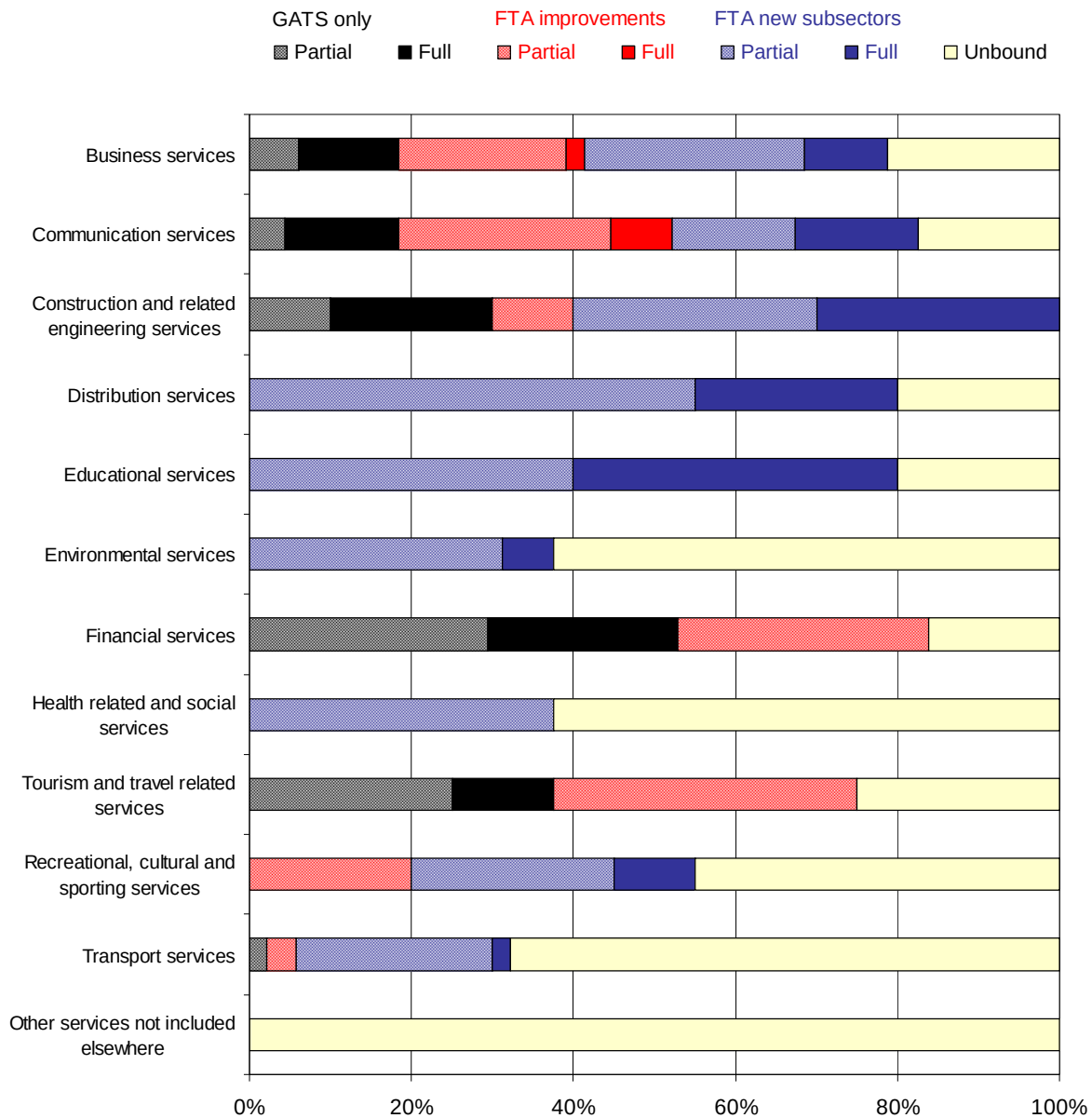


Figure A25b: New Zealand-Singapore Free Trade Agreement (Schedule of Singapore)

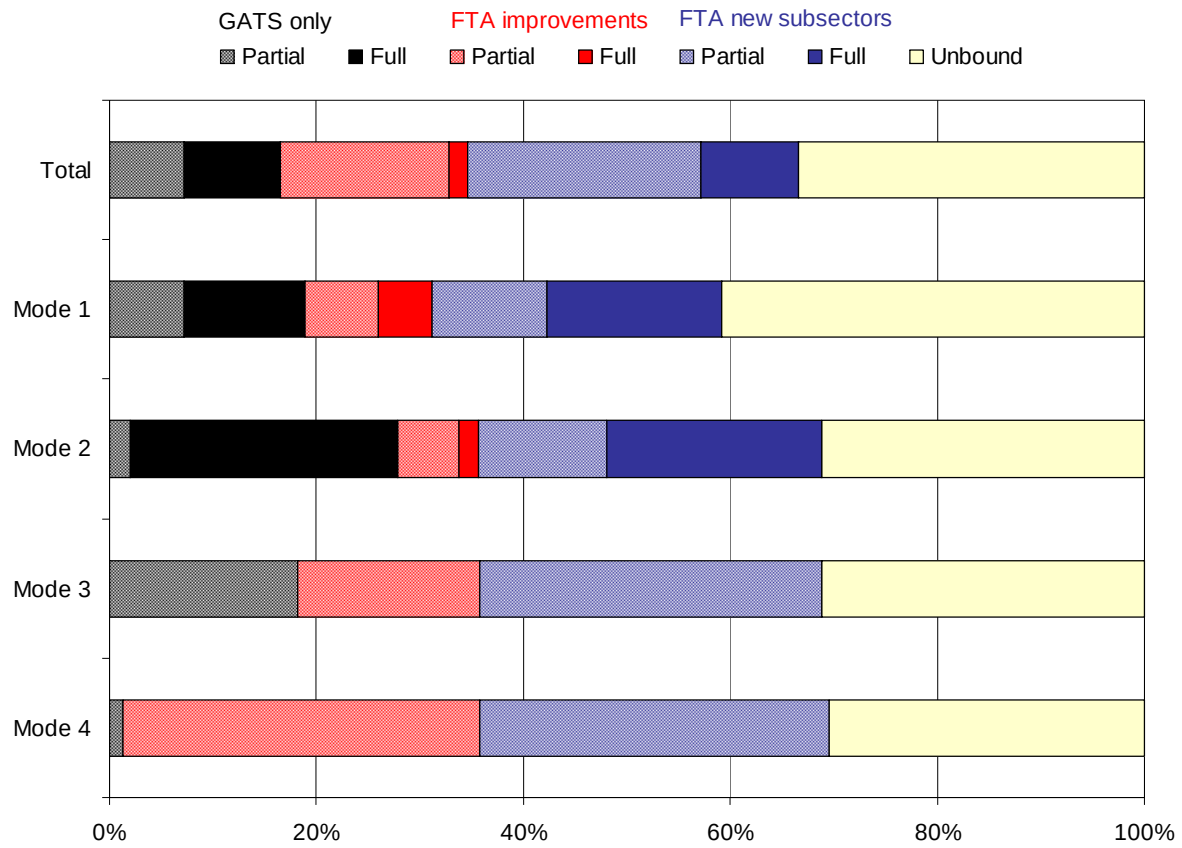


Figure A26a: Panama-Singapore Free Trade Agreement (Schedule of Singapore)

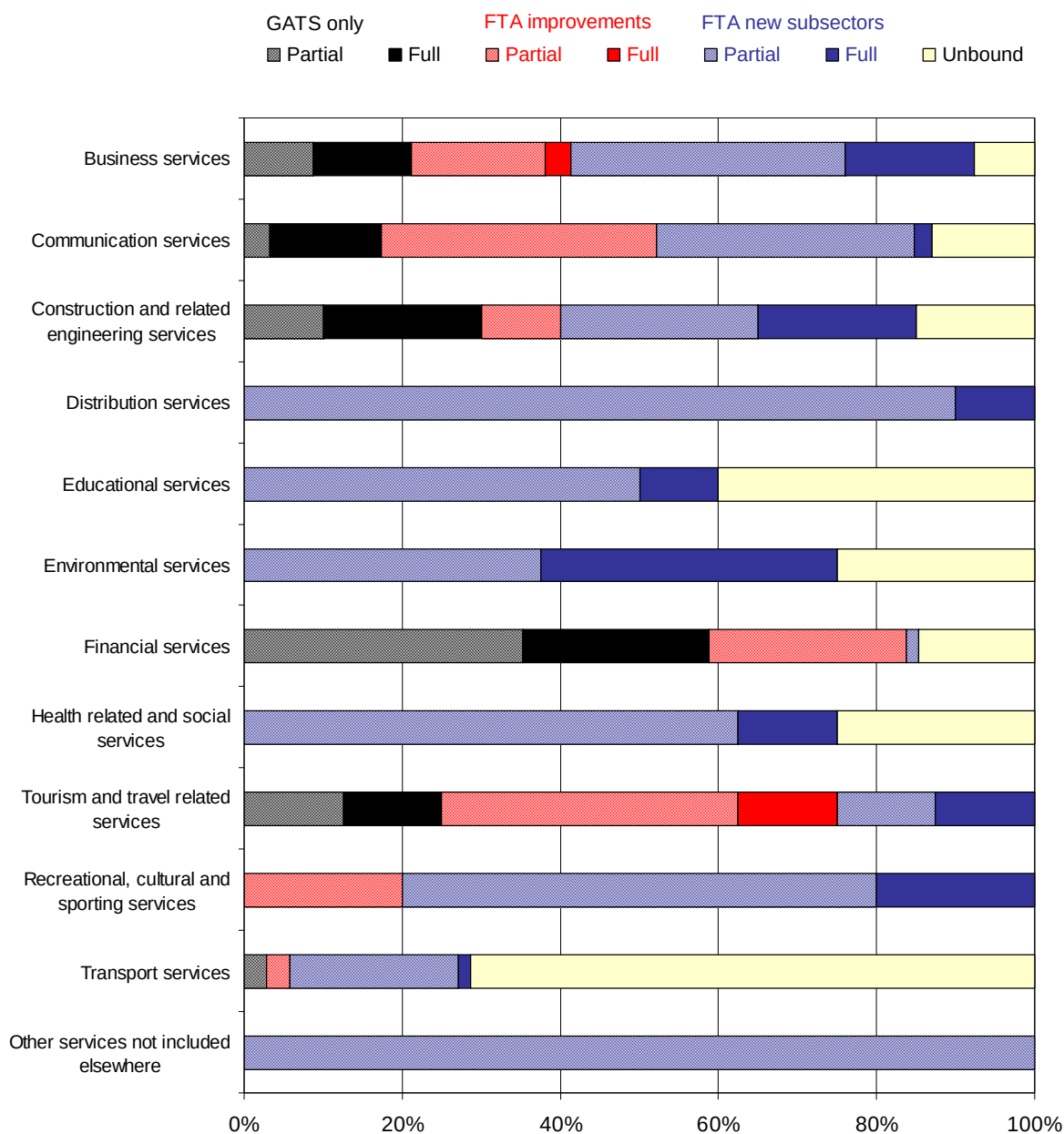


Figure A26b: Panama-Singapore Free Trade Agreement (Schedule of Singapore)

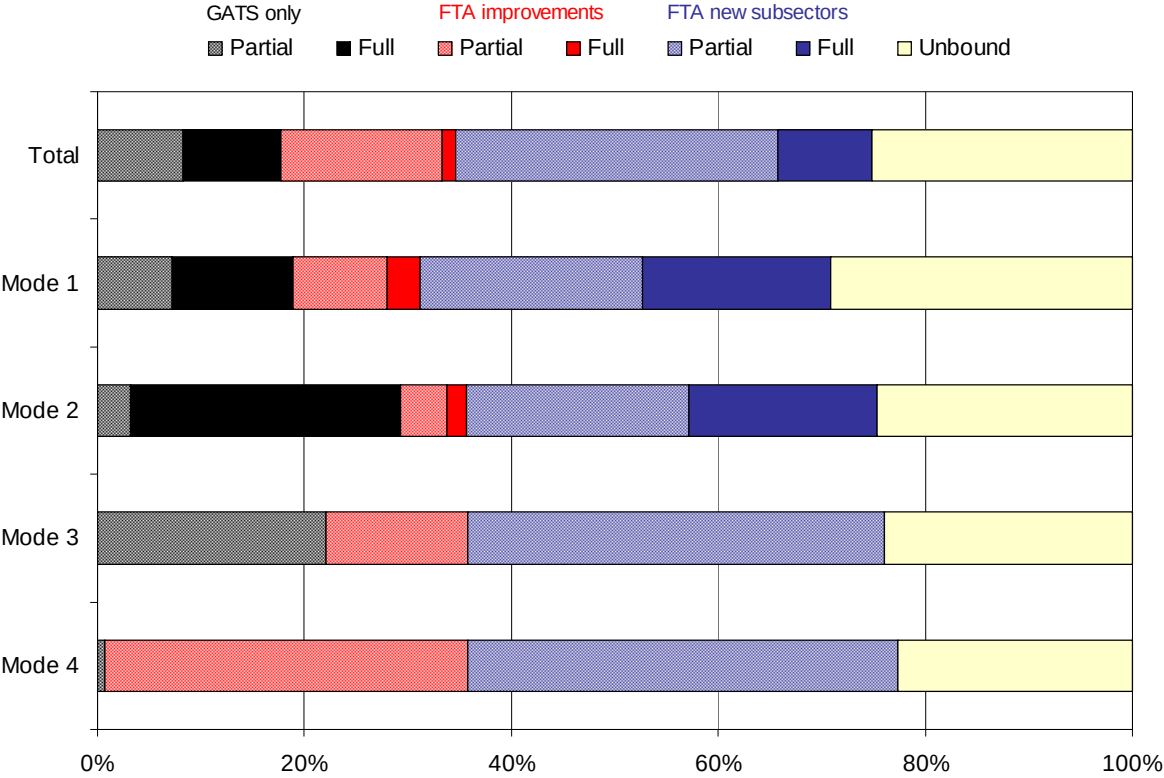


Figure A27a: Singapore-United States Free Trade Agreement (Schedule of Singapore)

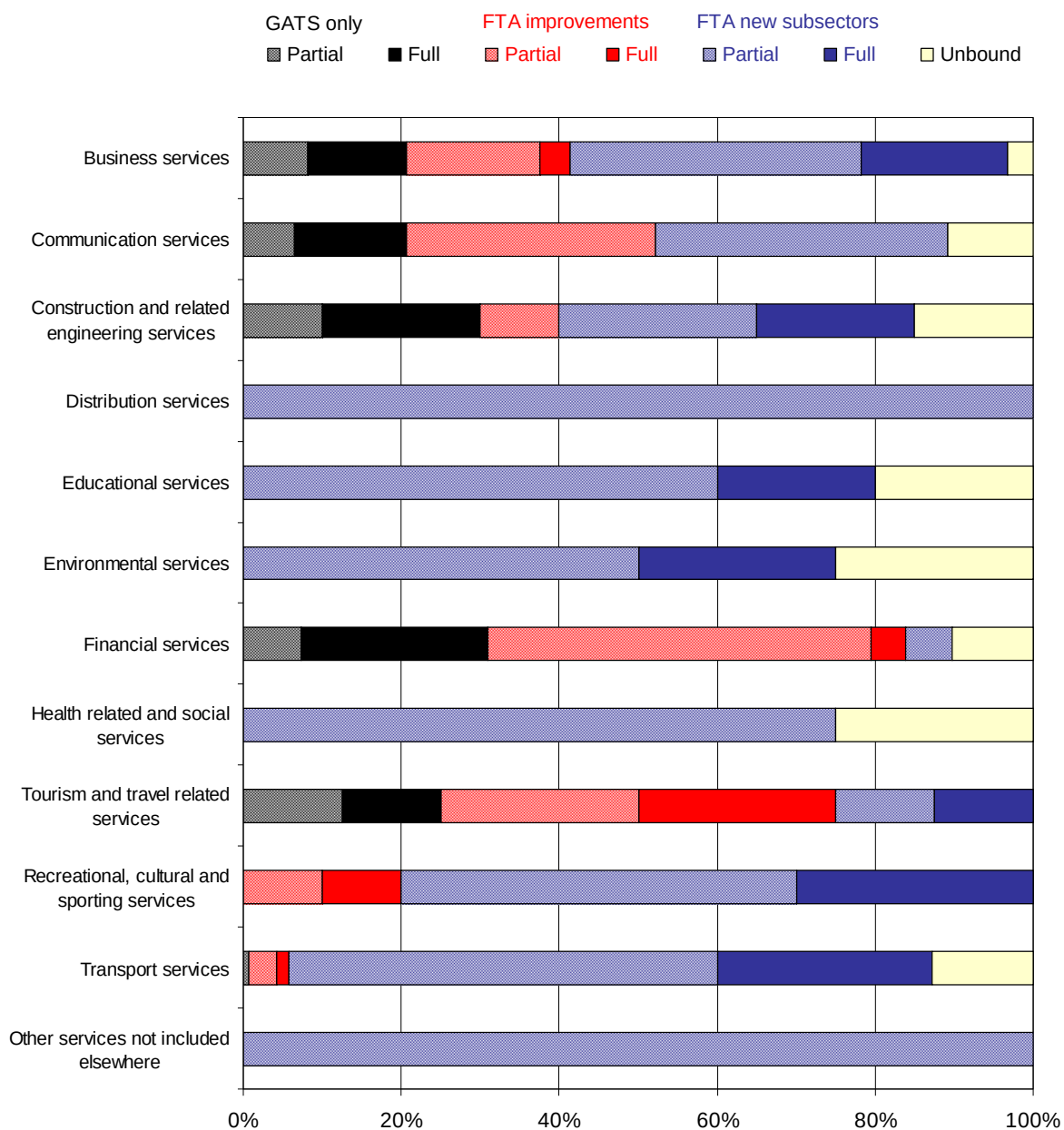


Figure A27b: Singapore-United States Free Trade Agreement (Schedule of Singapore)

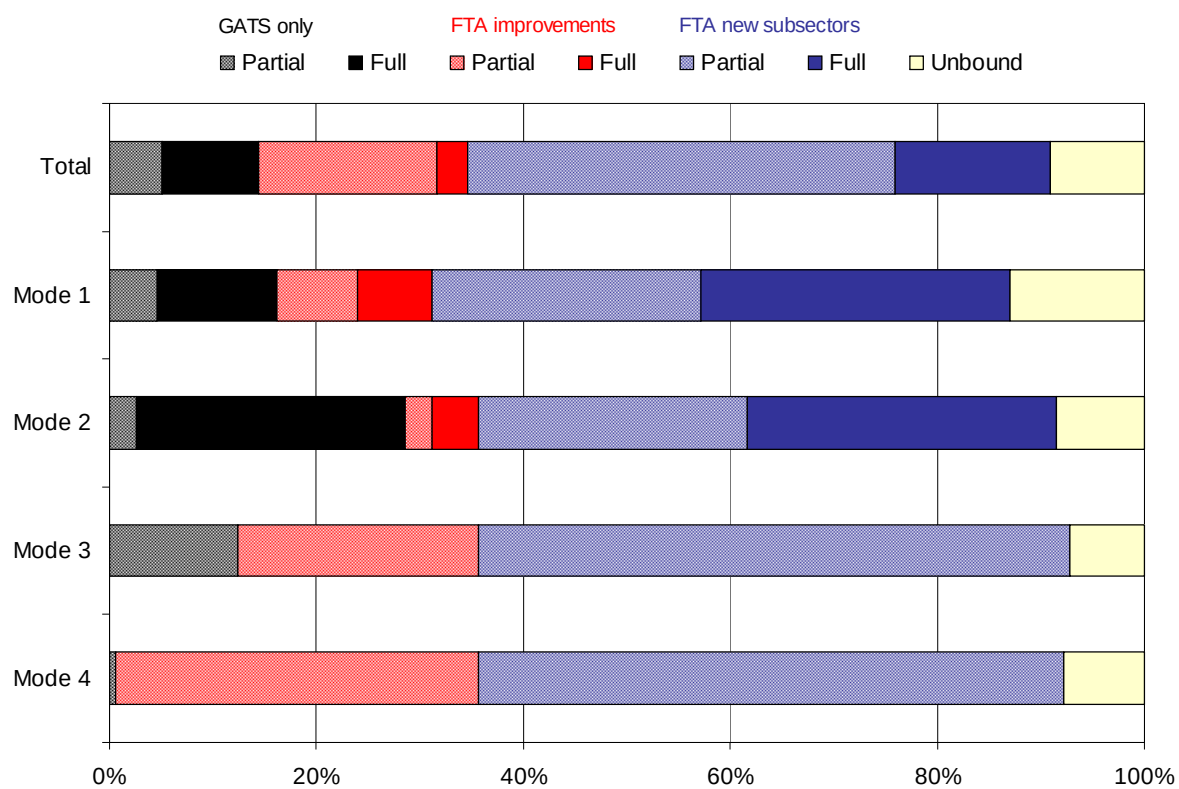


Figure A28a: Trans-Pacific Strategic Economic Partnership Agreement (Schedule of Singapore)

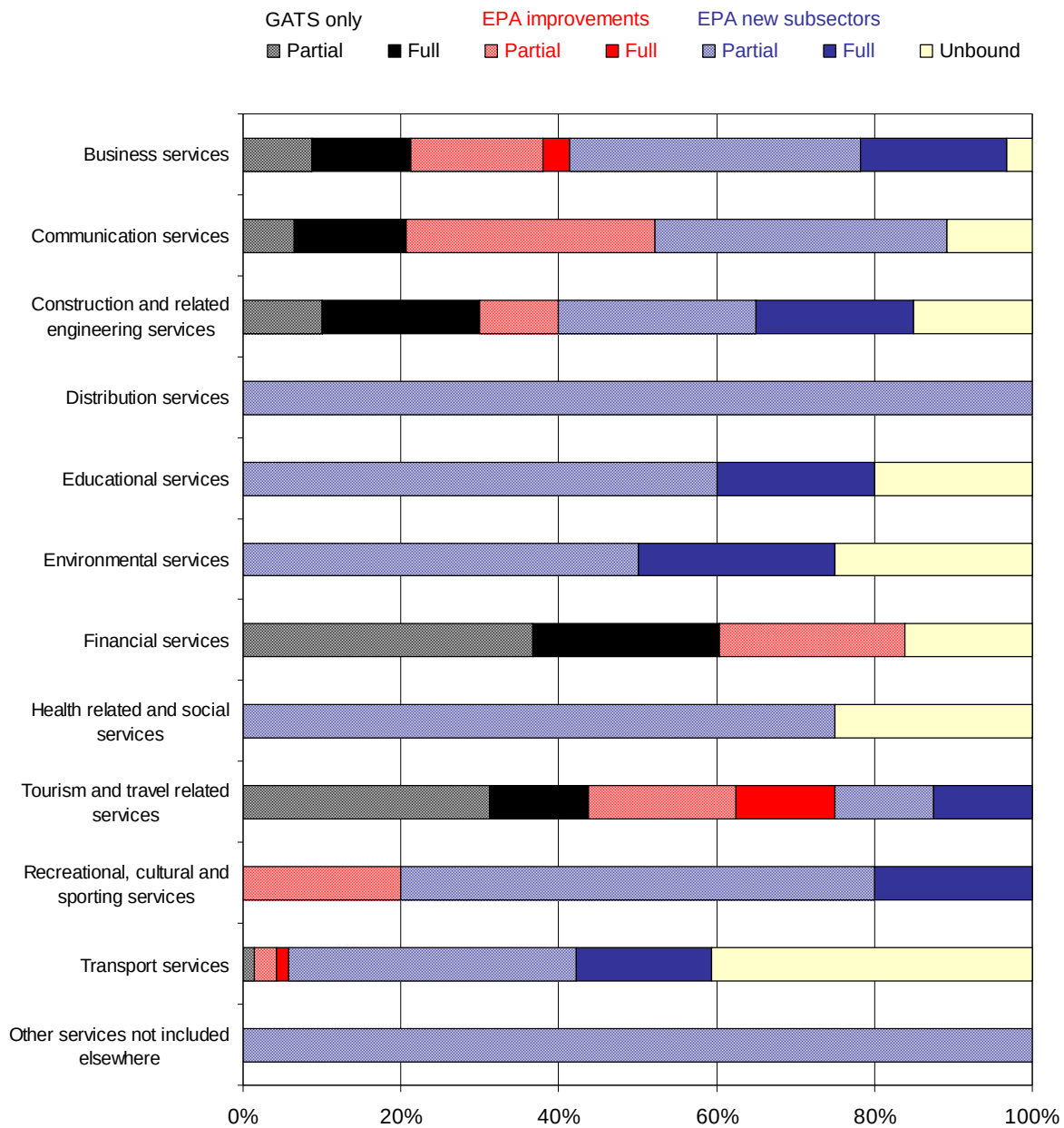


Figure A28b: Trans-Pacific Strategic Economic Partnership Agreement (Schedule of Singapore)

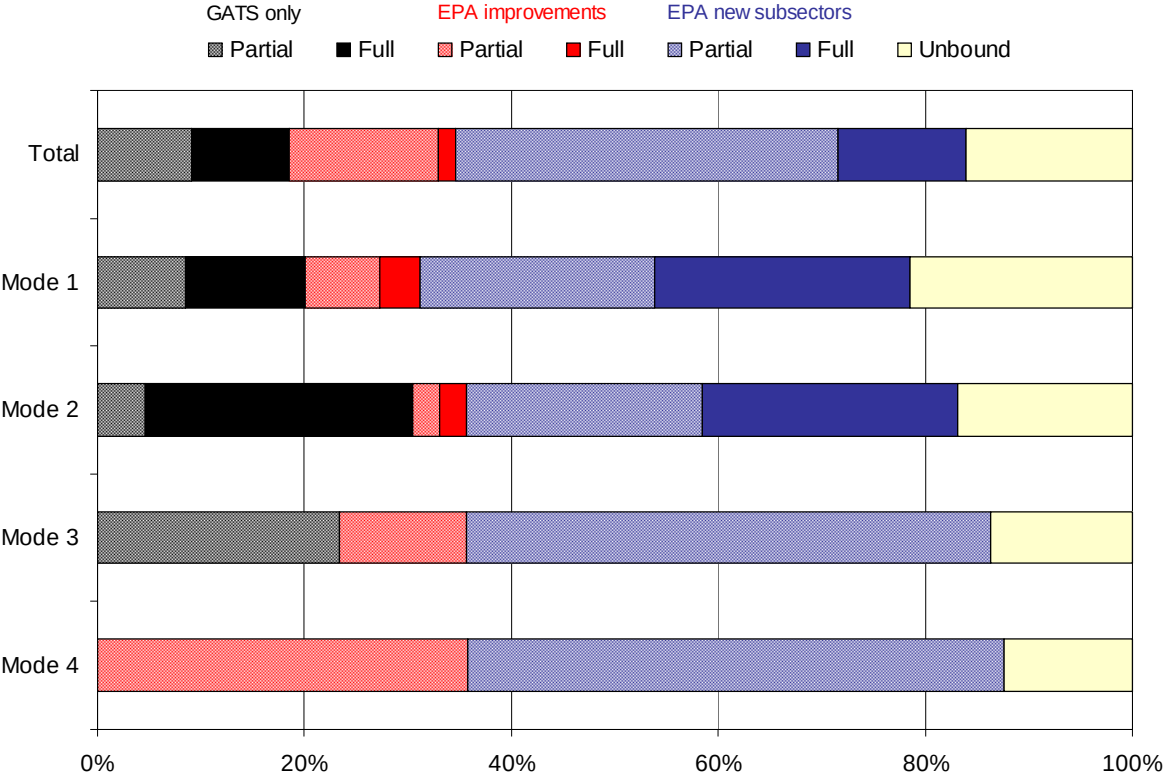
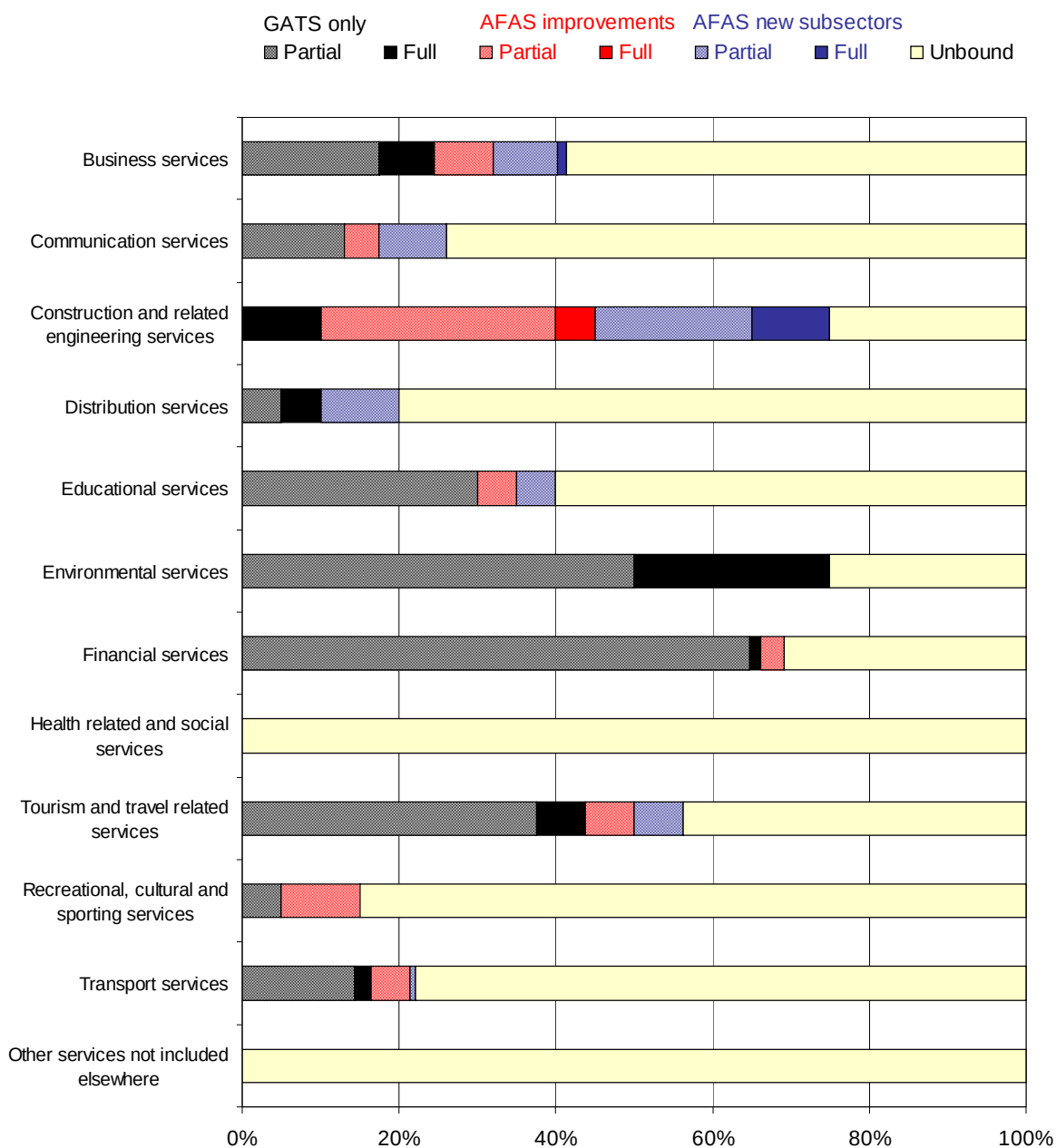
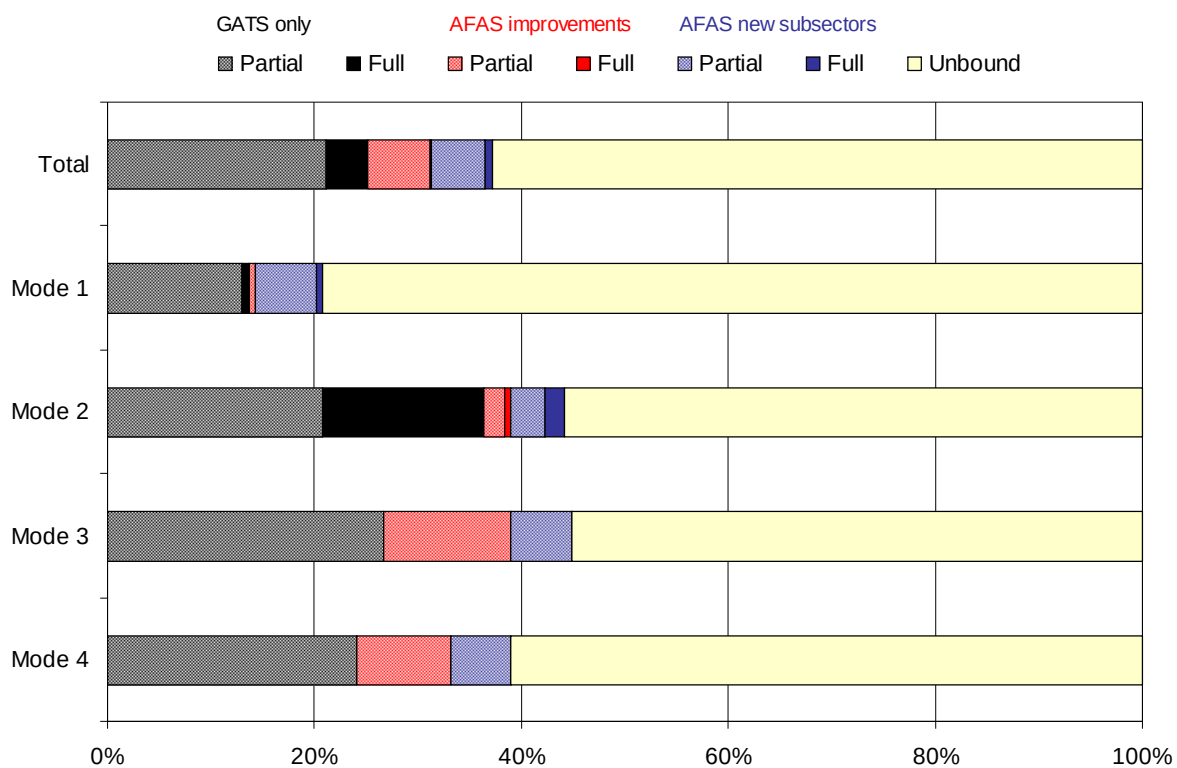


Figure A29a: ASEAN Framework Agreement on Services (Schedule of Thailand)



Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A29b: ASEAN Framework Agreement on Services (Schedule of Thailand)



Notes: See notes to Figure A29a.

Figure A30a: Australia-Thailand FTA (Schedule of Thailand)

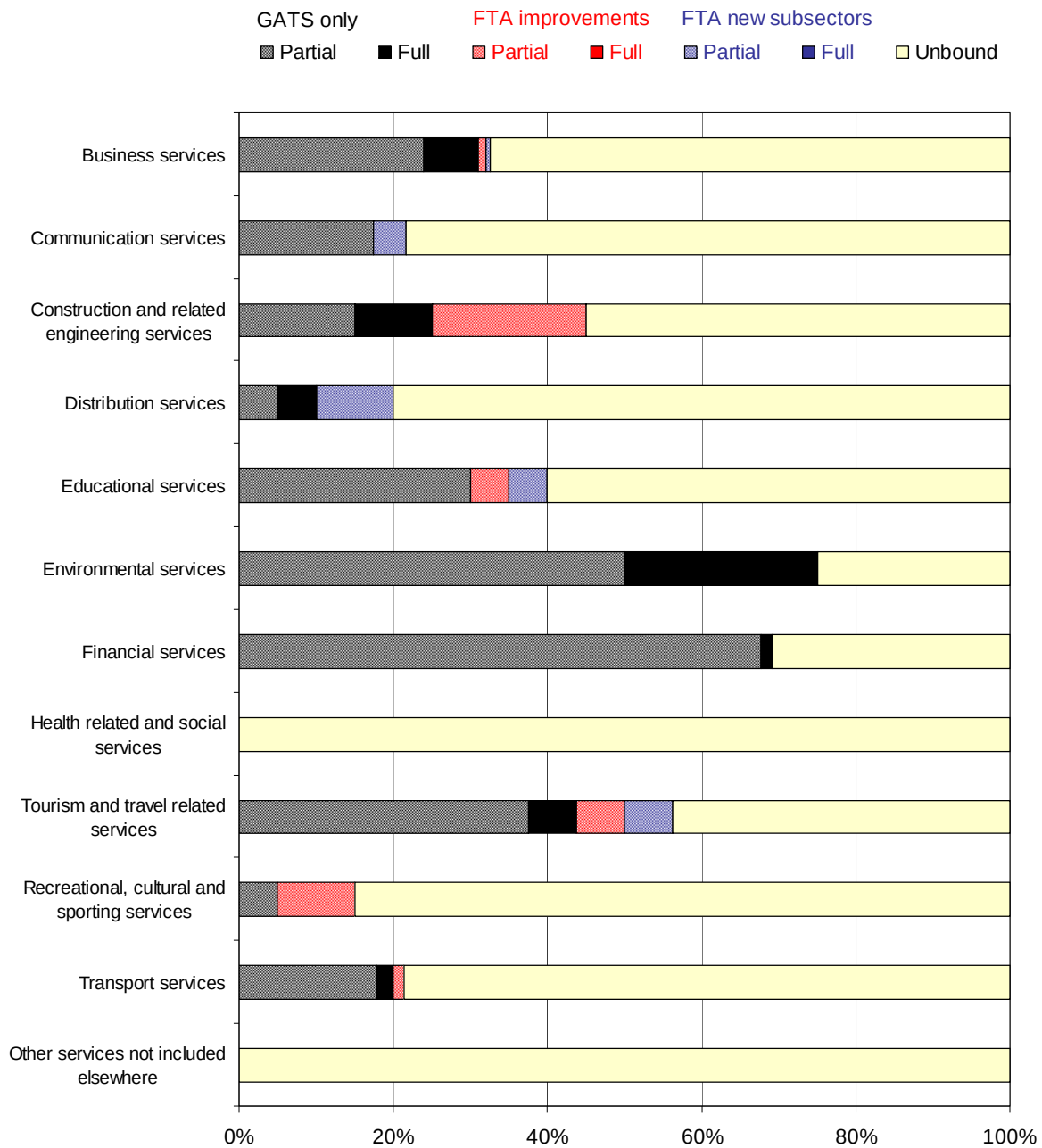


Figure A30b: Australia-Thailand FTA (Schedule of Thailand)

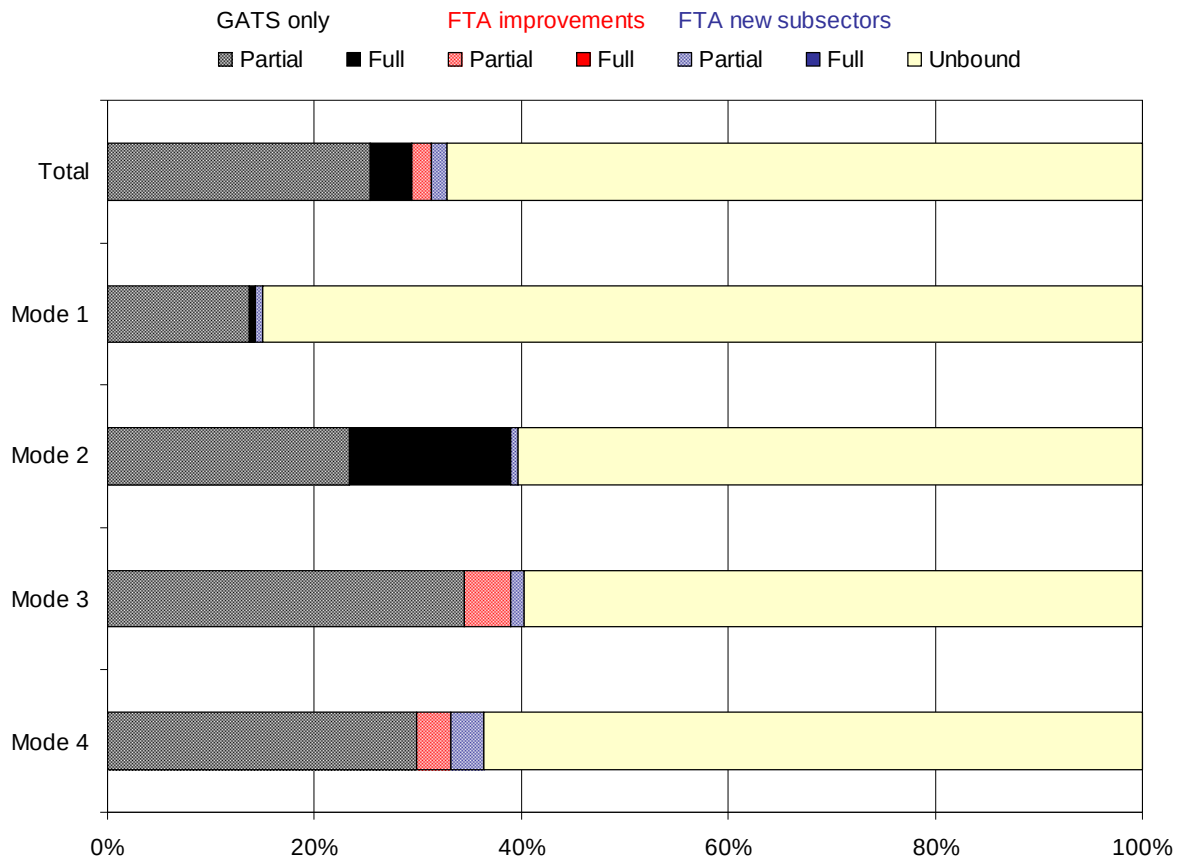
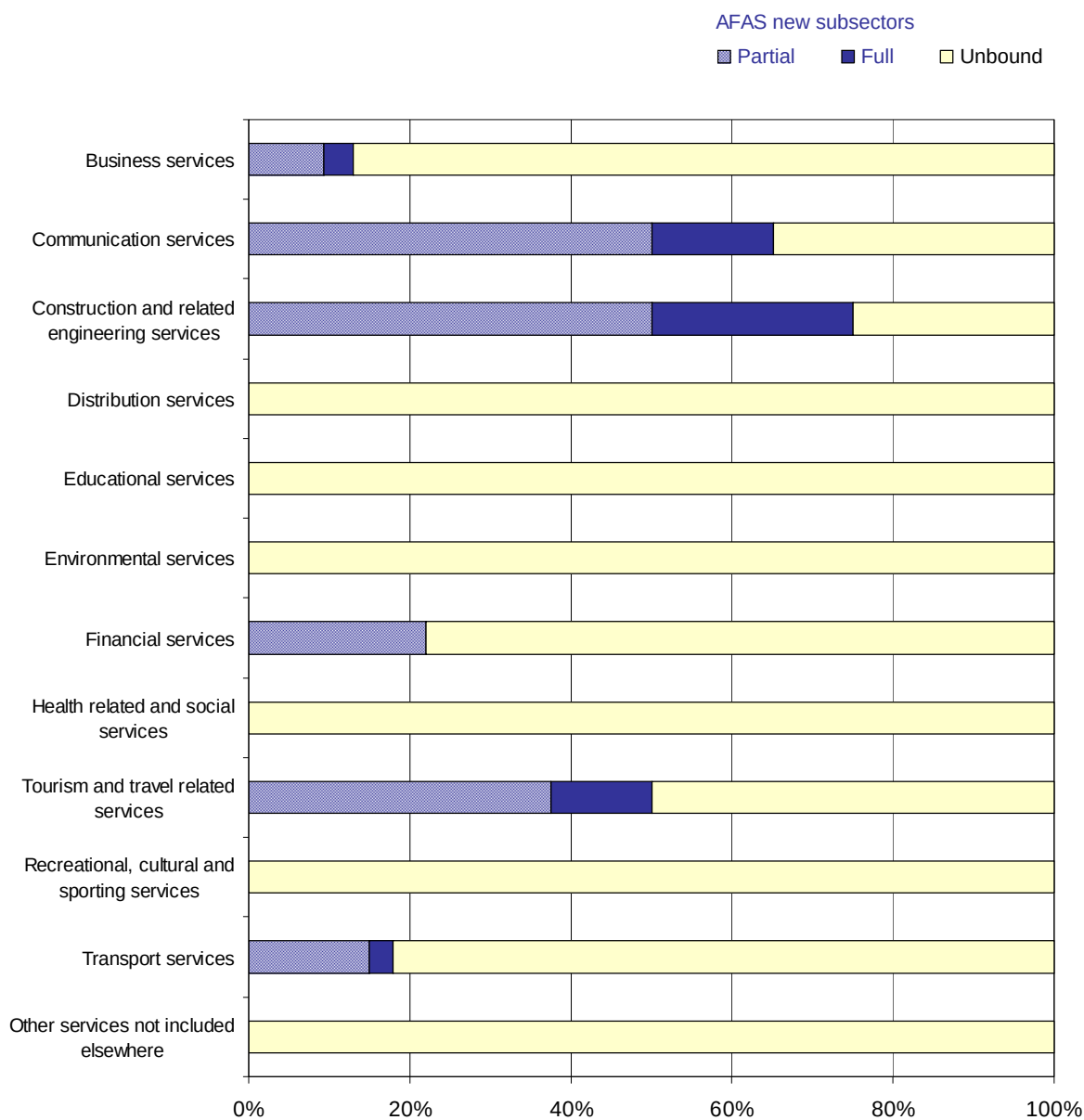
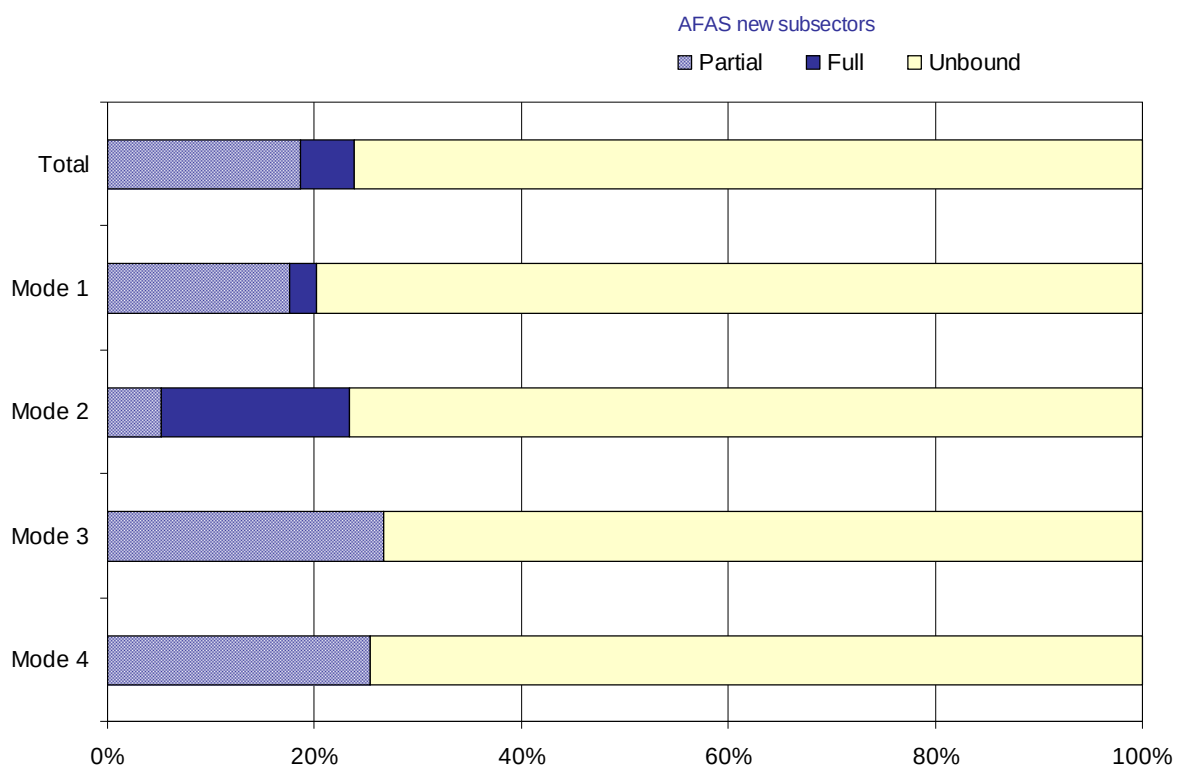


Figure A31a: ASEAN Framework Agreement on Services (Schedule of Vietnam)



Notes: The commitments shown here take into account four liberalization packages negotiated up to December 2004.

Figure A31b: ASEAN Framework Agreement on Services (Schedule of Vietnam)



Notes: See notes to Figure A31a.

Figure A32a: US-Vietnam Bilateral Trade Agreement (Schedule of Vietnam)

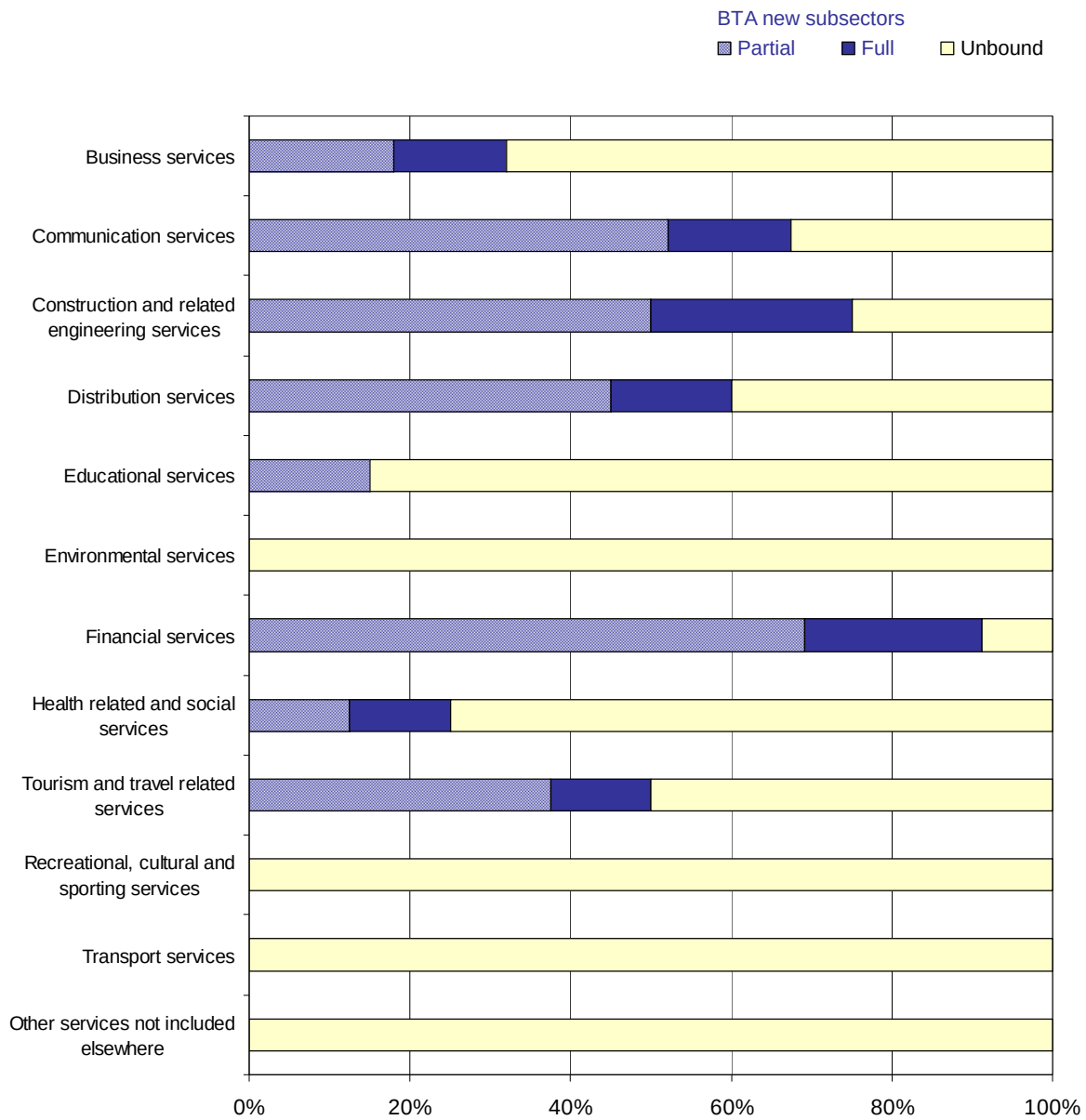
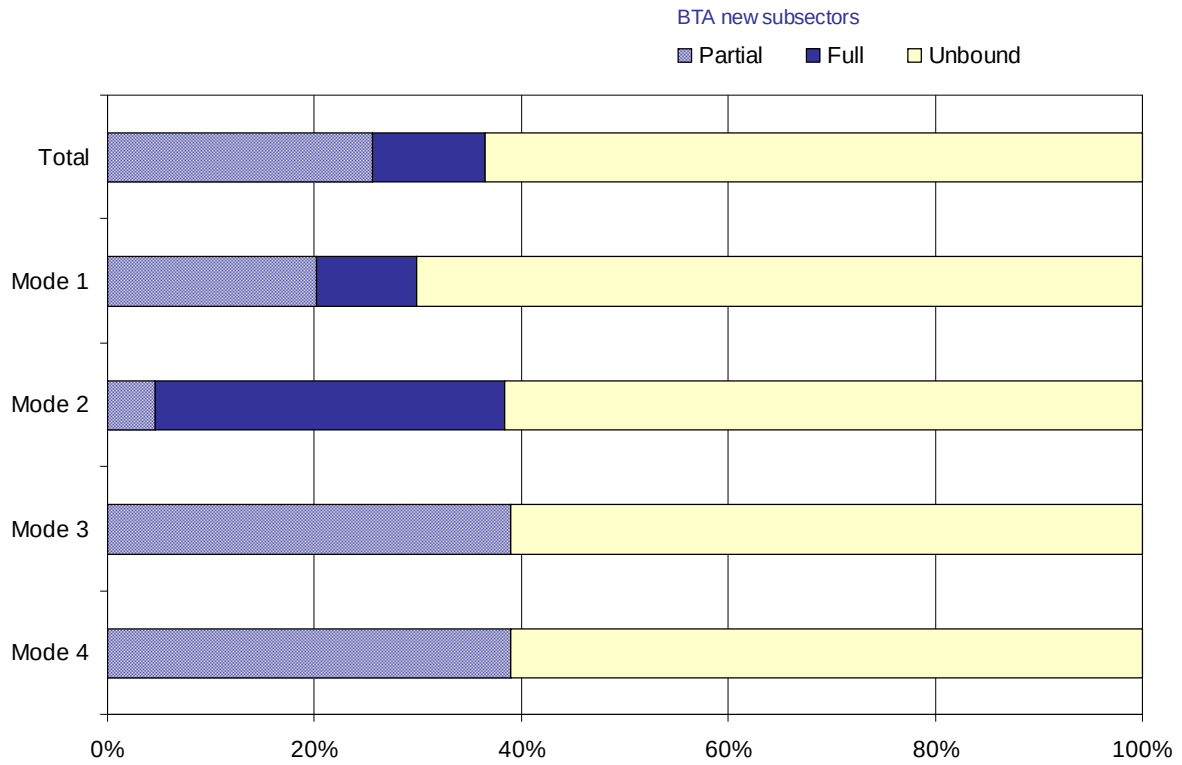


Figure A32b: US-Vietnam Bilateral Trade Agreement (Schedule of Vietnam)

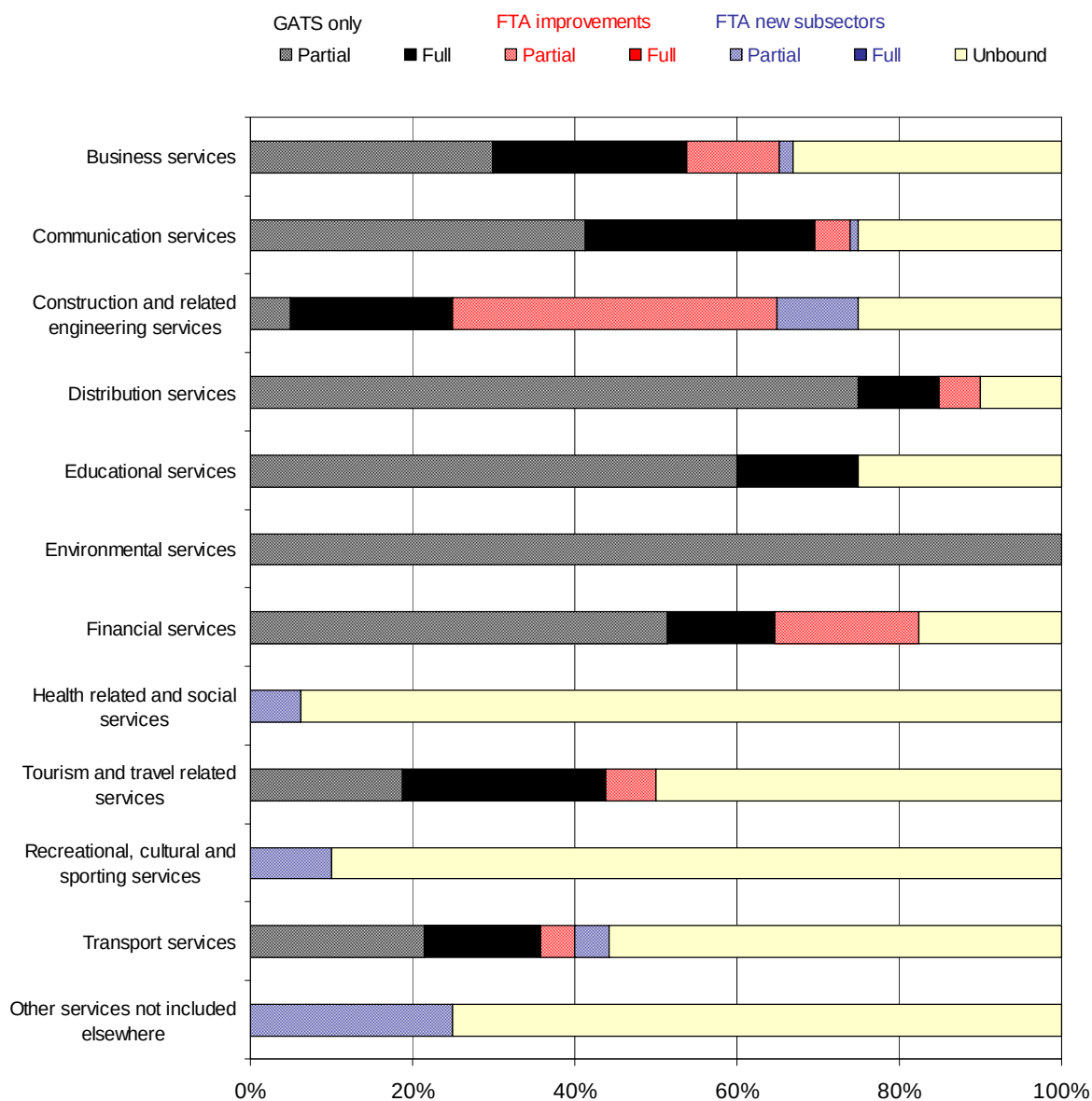


Annex B

Overview of Commitments by Country¹

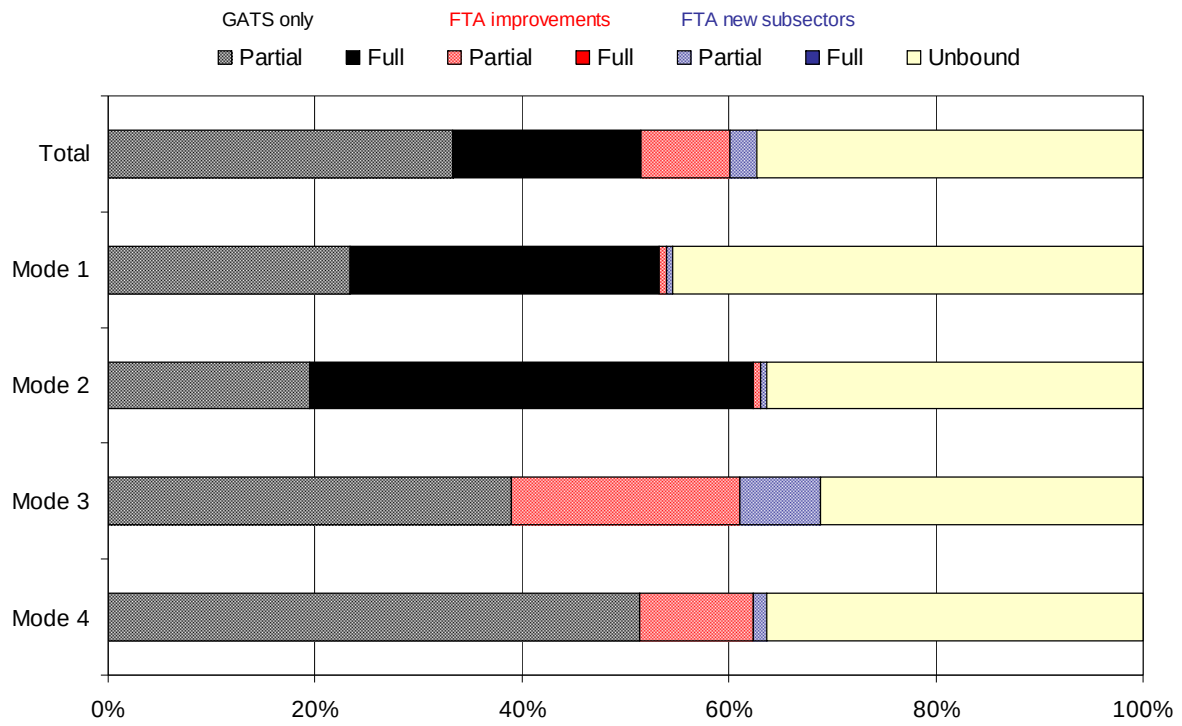
¹ Only countries with two or more FTAs are included in this Annex. Commitment counts are based on the maximum of commitments across all FTAs concluded by a country. In other words, if an improved commitment or a new subsector relative to a country's GATS schedule is found in *at least* one FTA, the relevant subsector is allocated to the FTA segments of the horizontal bars presented in this Annex.

Figure B1a: China



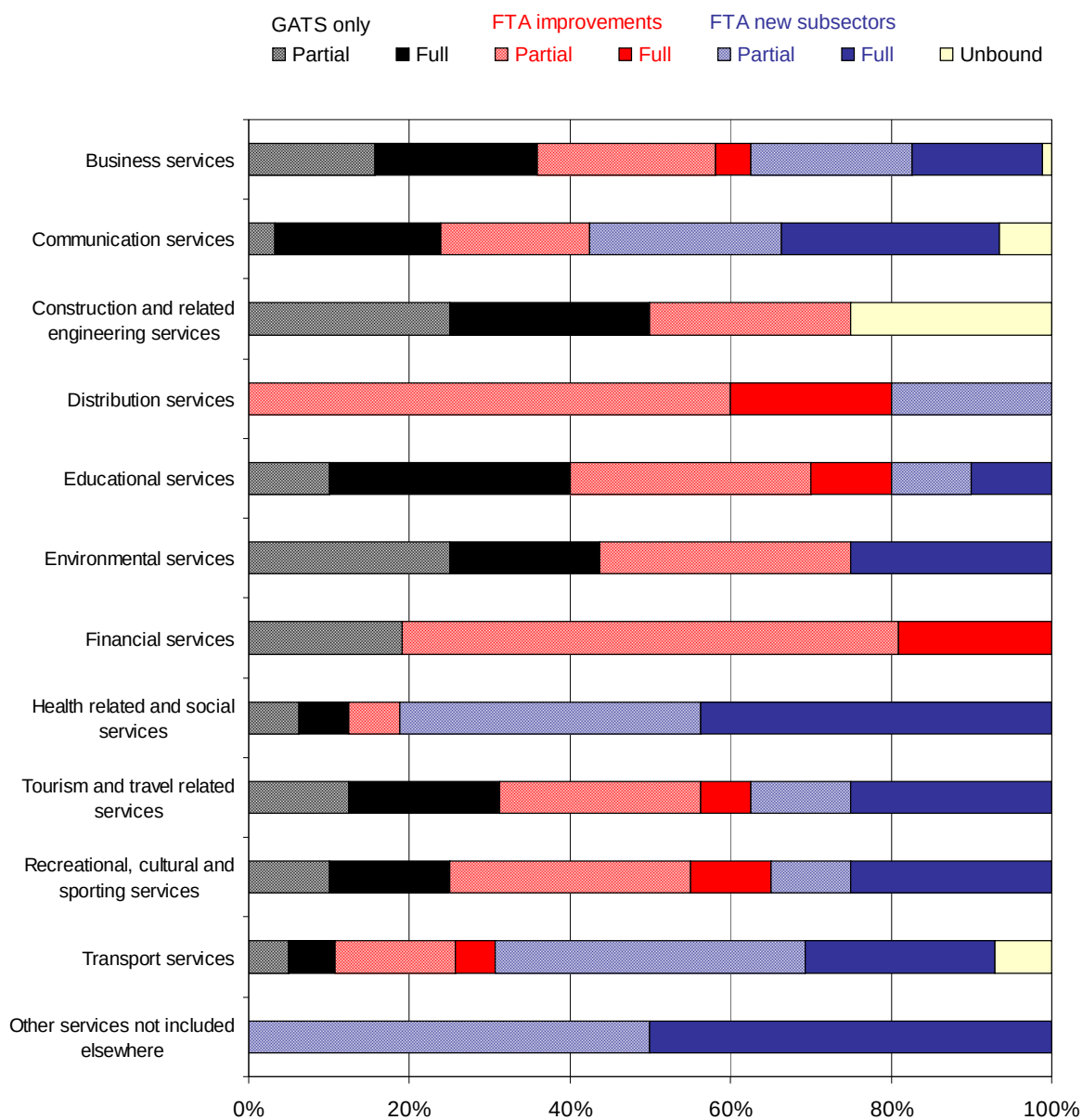
Notes: Based on the following 2 agreements: (1) Mainland-Hong Kong Closer Economic Partnership Agreement; and (2) Mainland-Macao Closer Economic Partnership Agreement. See also notes to Figures A2a and A3a.

Figure B1b: China



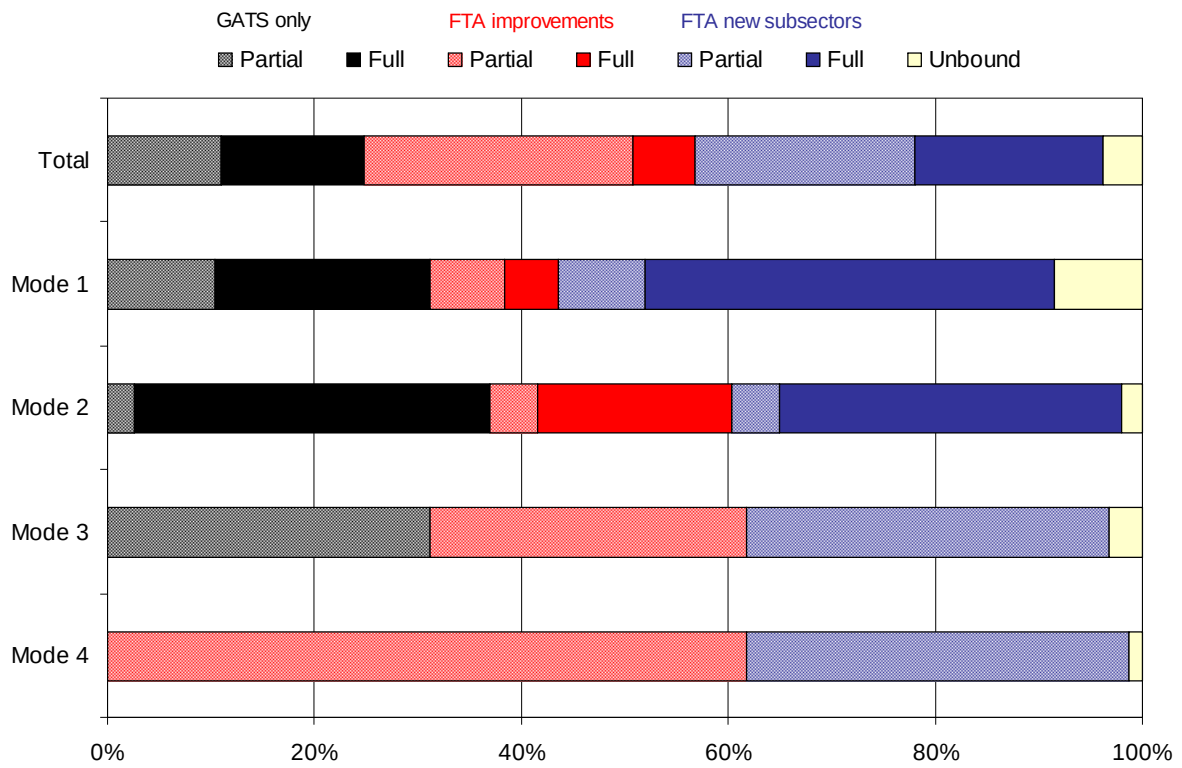
Notes: See notes to Figure B1a.

Figure B2a: Japan



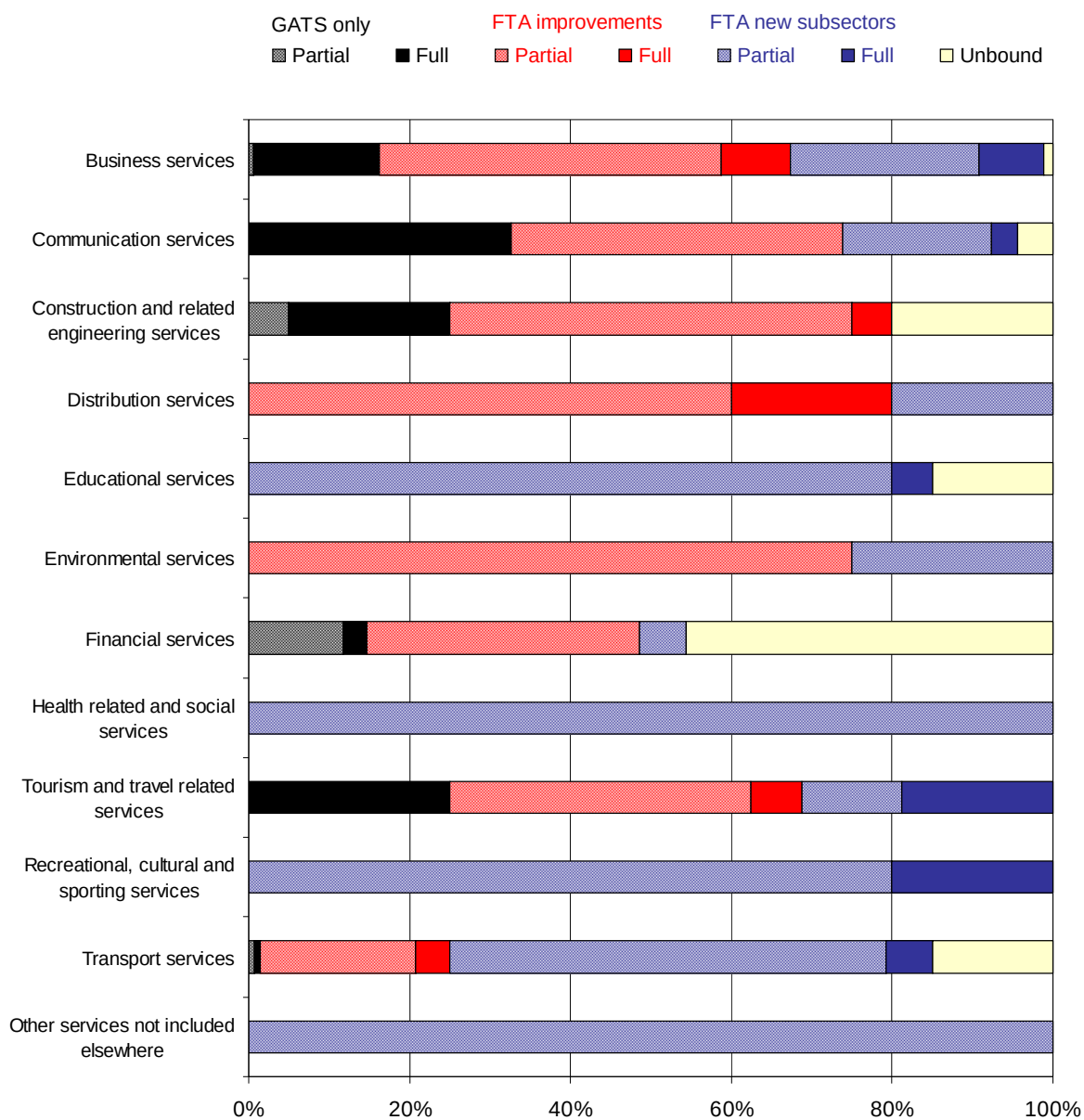
Notes: Based on the following 3 agreements: (1) Japan-Malaysia Economic Partnership Agreement; (2) Japan-Mexico Free Trade Agreement; and (3) Japan-Singapore New-Age Economic Partnership Agreement.

Figure B2a: Japan



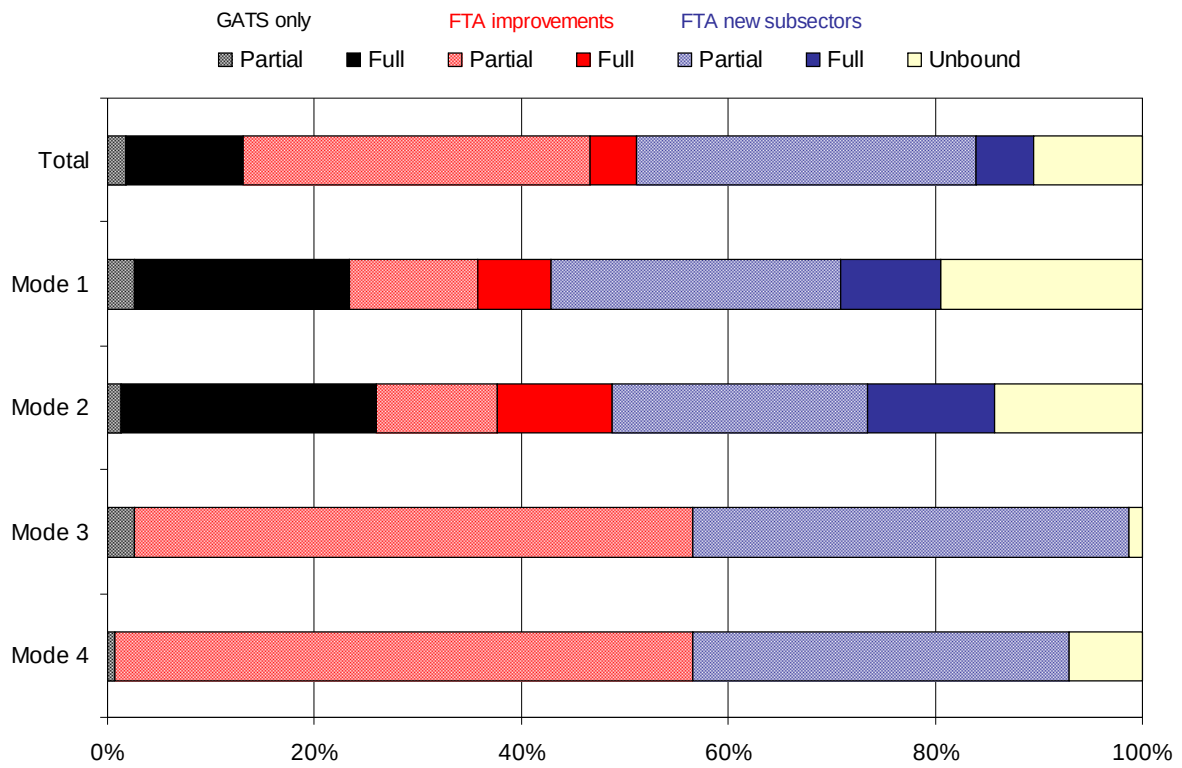
Notes: See notes to Figure B2a.

Figure B3a: Korea



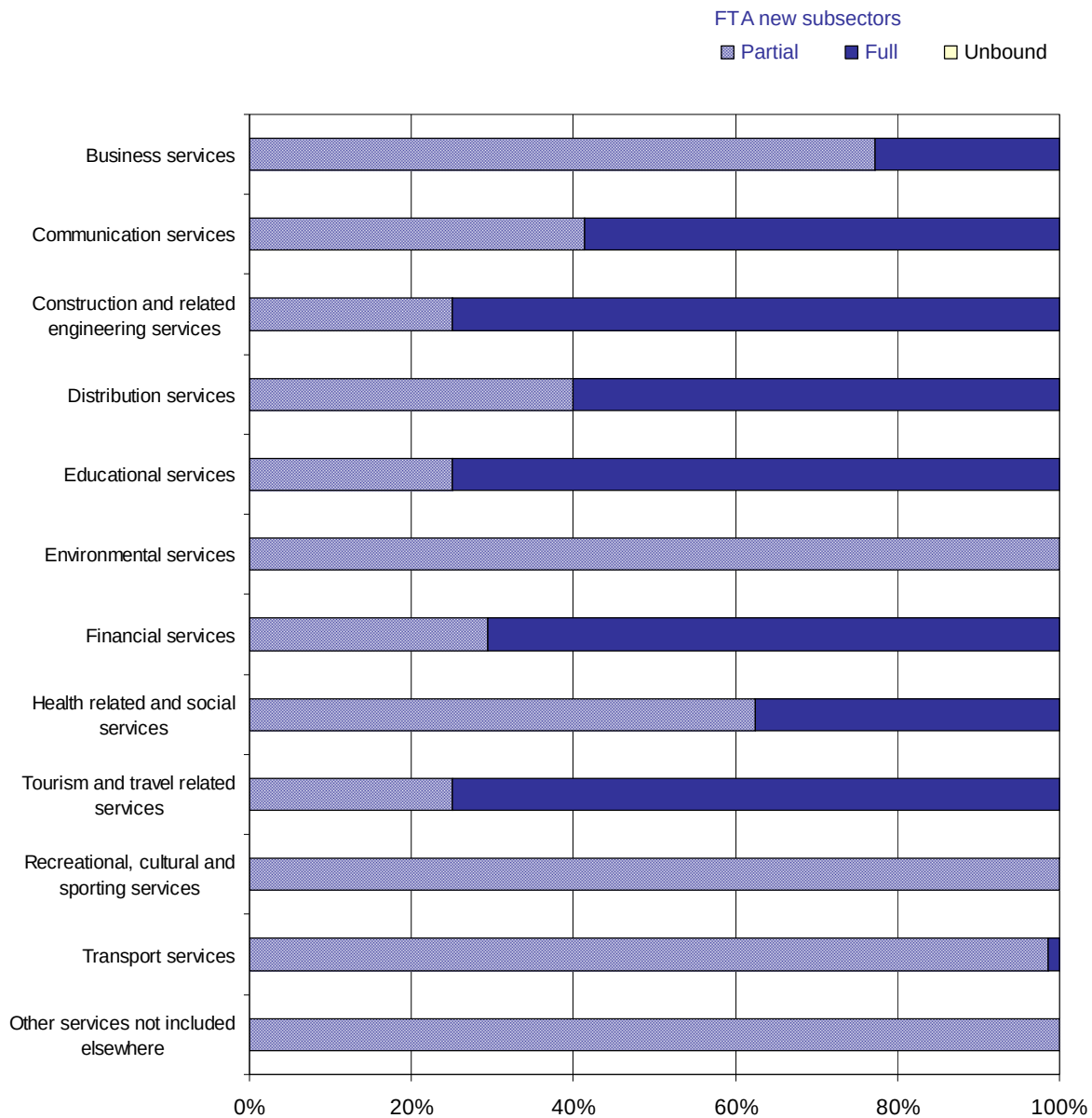
Notes: Based on the following 3 agreements: (1) Chile-Korea Free Trade Agreement; (2) EFTA-Korea Free Trade Agreement; and (3) Korea-Singapore Free Trade Agreement.

Figure B3b: Korea



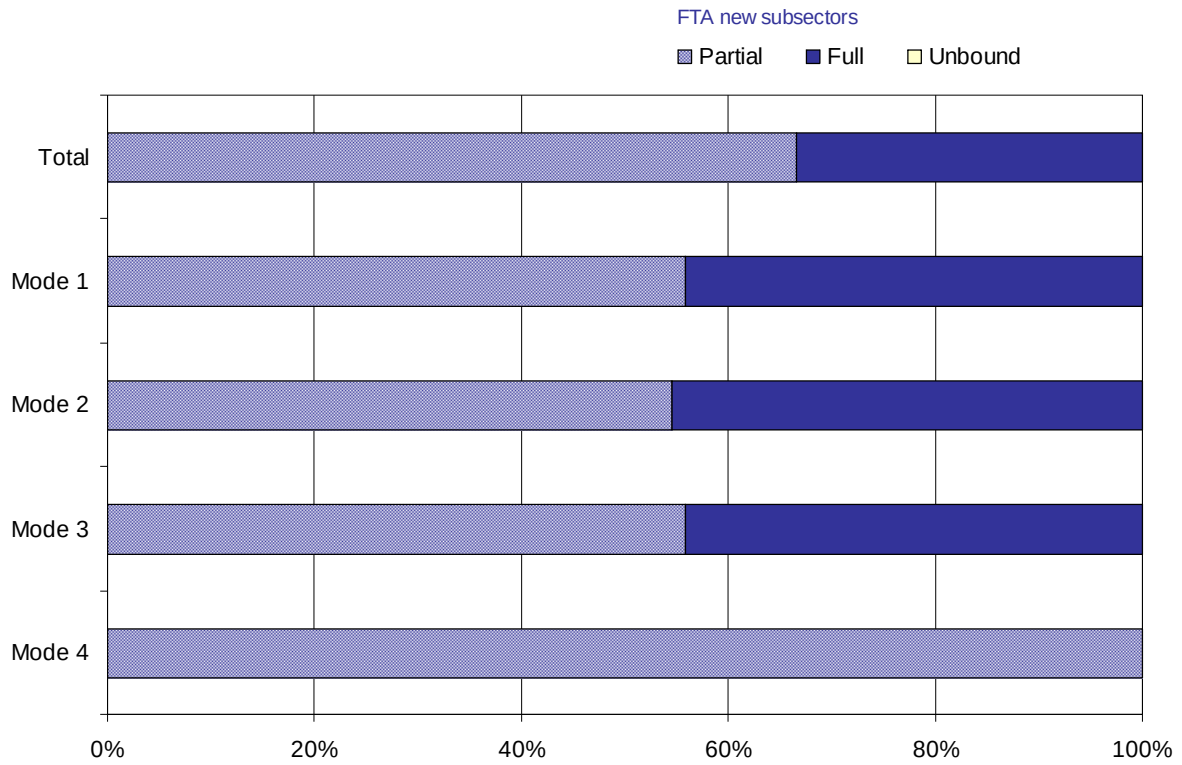
Notes: See notes to Figure B3a.

Figure B4a: Lao PDR



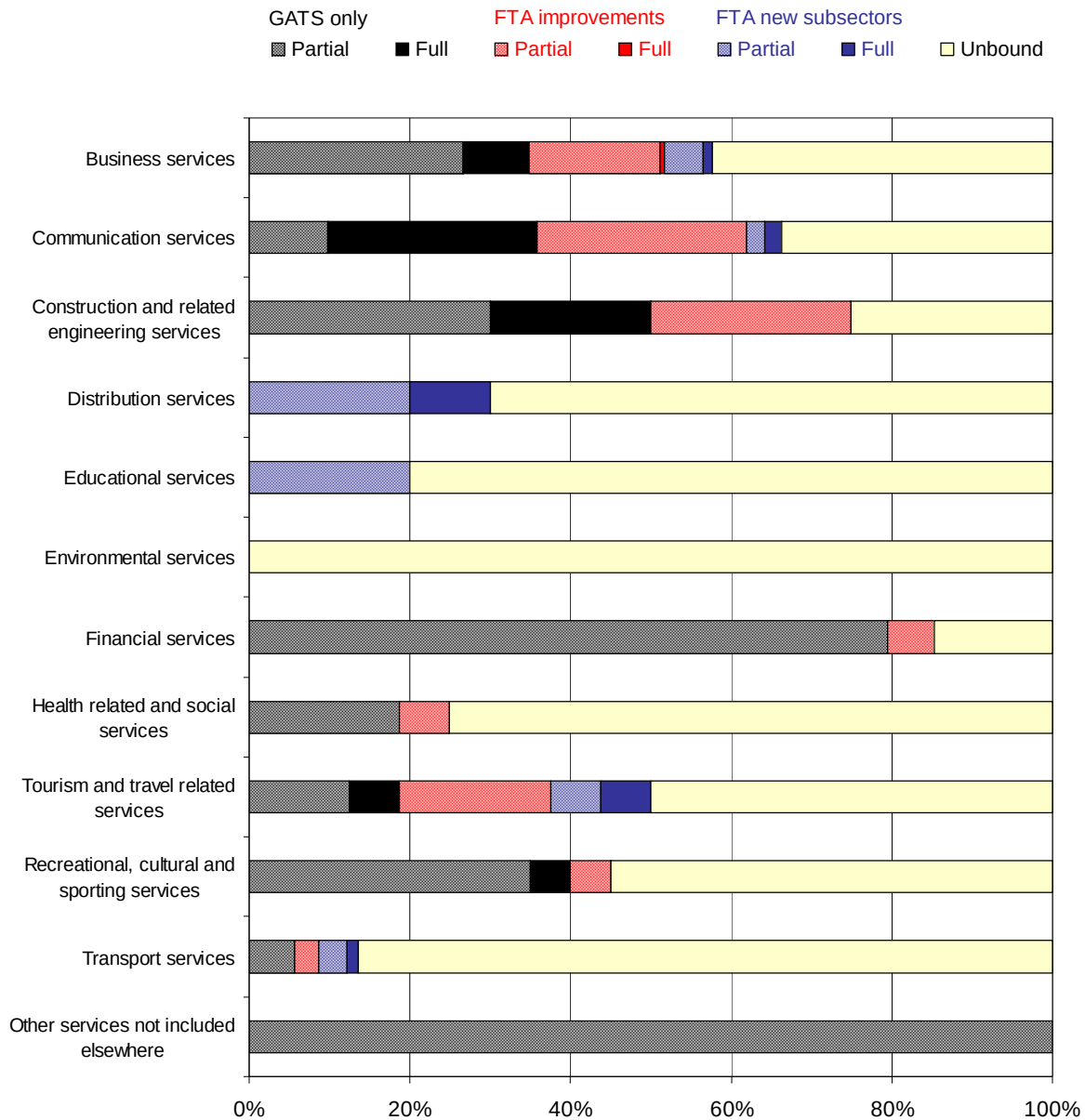
Notes: Based on the following 2 agreements: (1) ASEAN Framework Agreement on Services; and (2) US-Lao PDR Bilateral Trade Agreement.

Figure B4b: Lao PDR



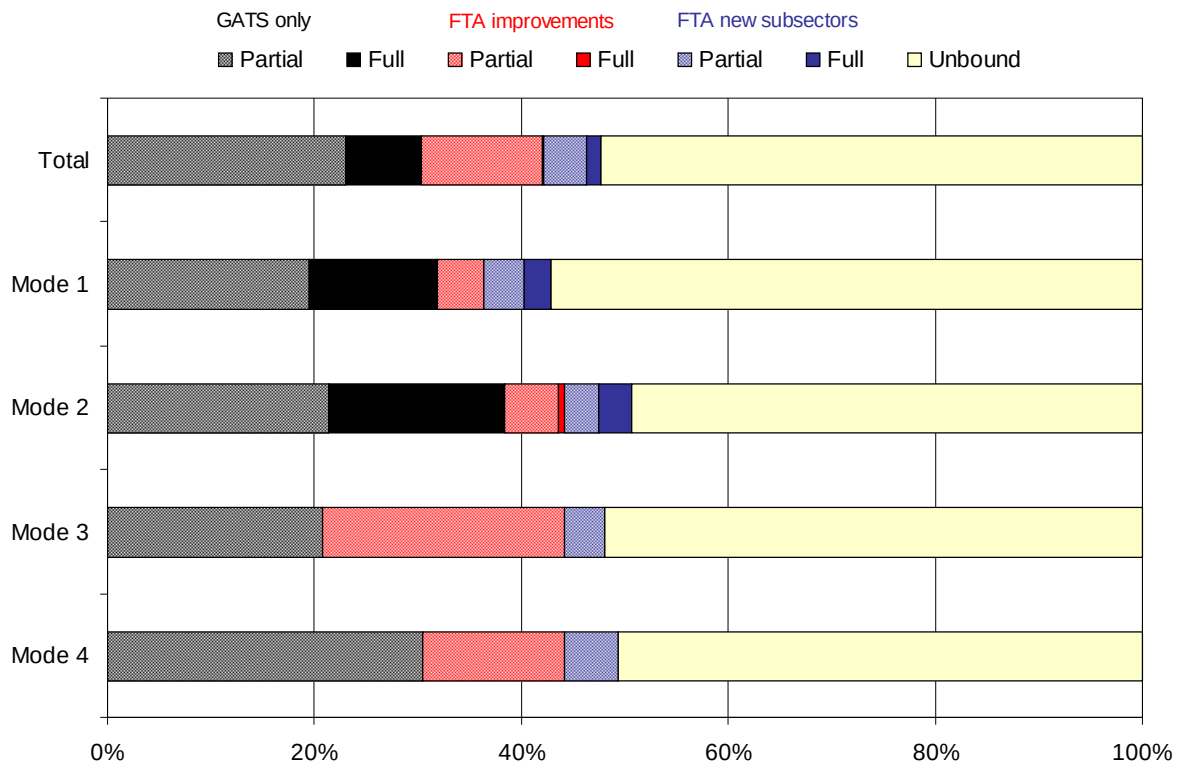
Notes: See notes to Figure B4a.

Figure B5a: Malaysia



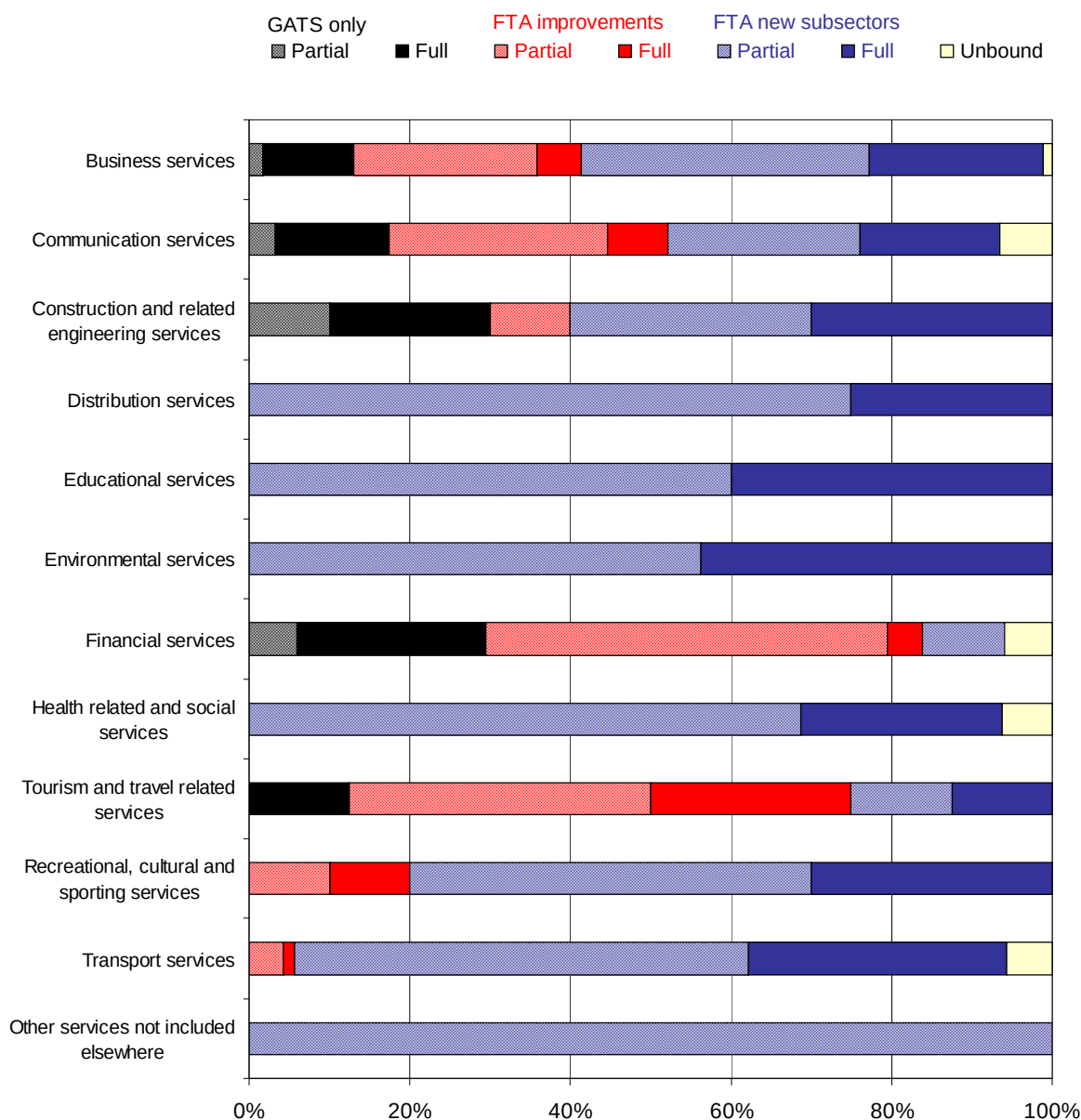
Notes: Based on the following 2 agreements: (1) ASEAN Framework Agreement on Services; and (2) Japan-Malaysia Economic Partnership Agreement.

Figure B5b: Malaysia



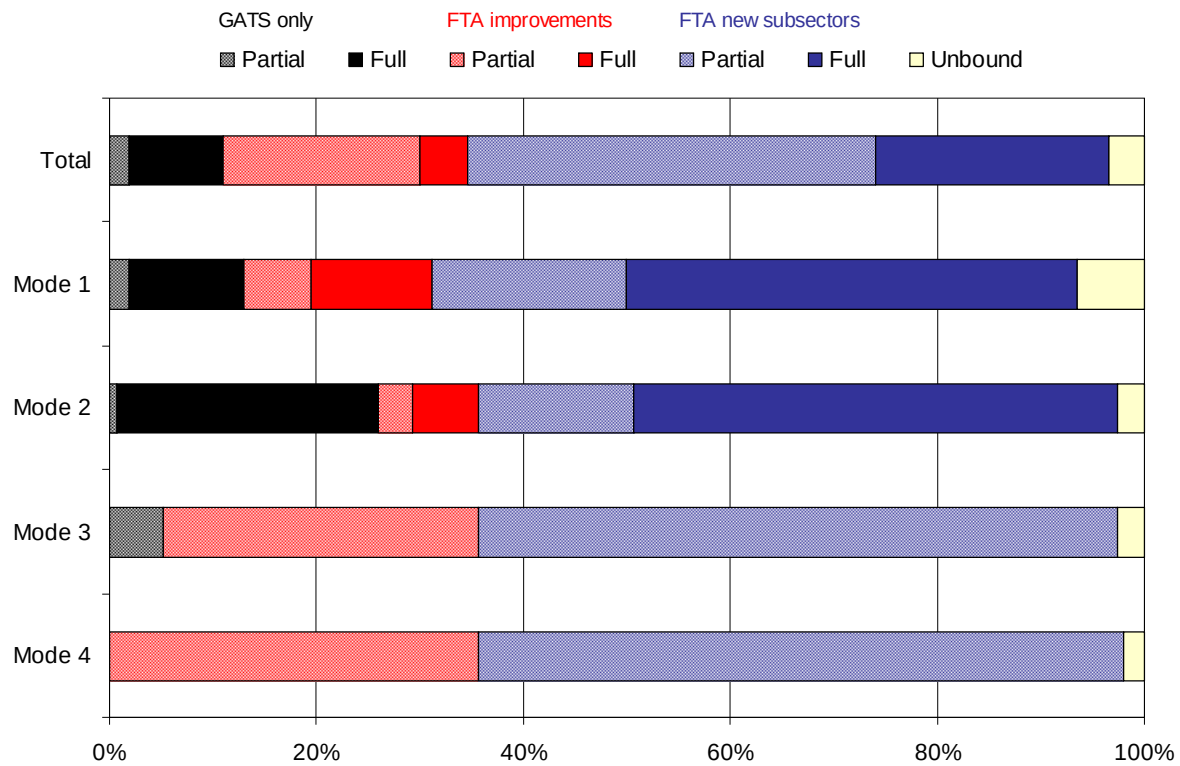
Notes: See notes to Figure B5a.

Figure B6a: Singapore



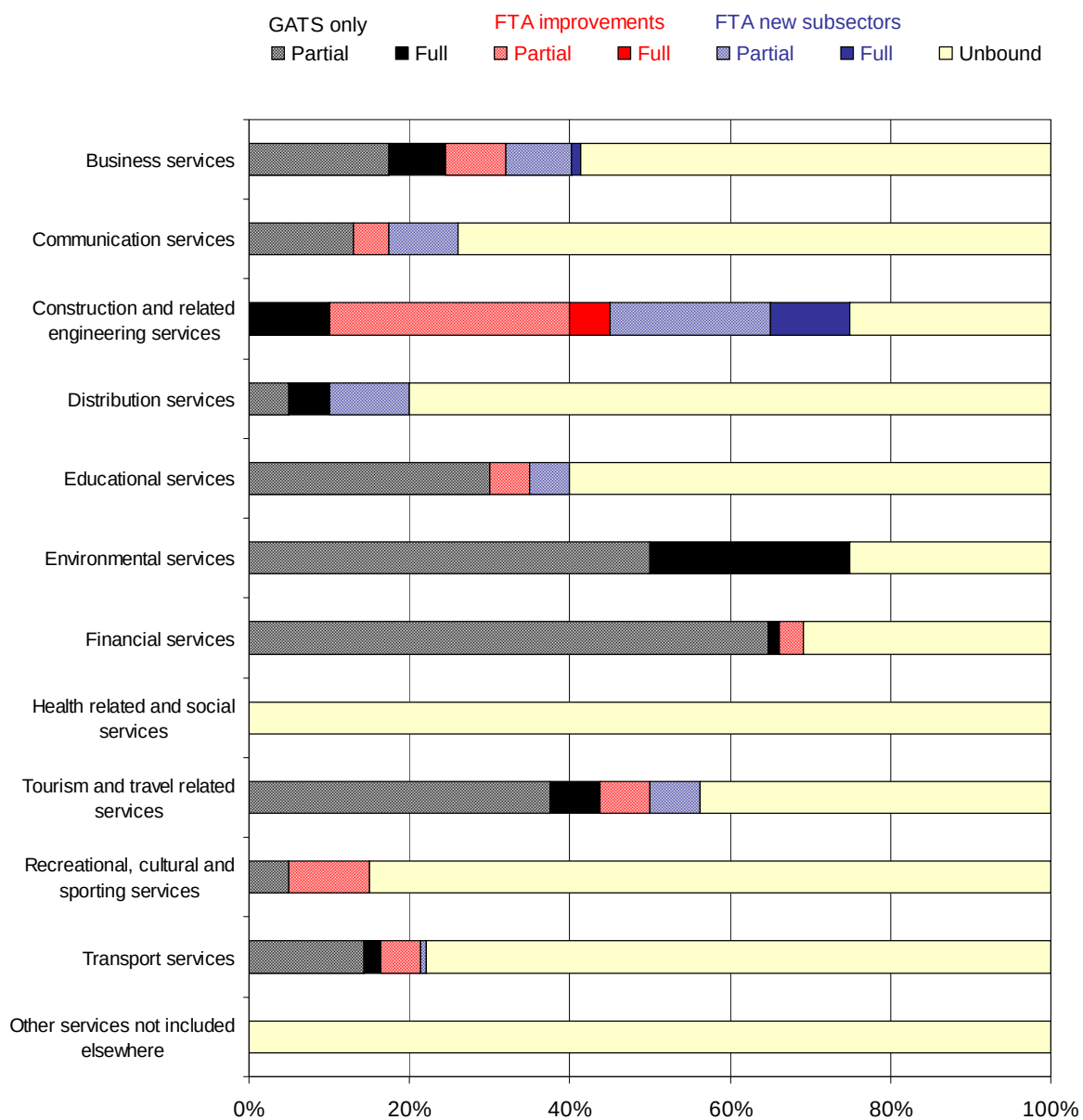
Notes: Based on the following 11 agreements: (1) ASEAN Framework Agreement on Services; (2) Australia-Singapore Free Trade Agreement; (3) EFTA-Singapore Free Trade Agreement; (4) India-Singapore Comprehensive Economic Cooperation Agreement; (5) Japan-Singapore New-Age Economic Partnership Agreement; (6) Jordan-Singapore Free Trade Agreement; (7) Korea-Singapore Free Trade Agreement; (8) New Zealand-Singapore Free Trade Agreement; (9) Panama-Singapore Free Trade Agreement; (10) Singapore-United States Free Trade Agreement; (11) Brunei-Chile-New Zealand-Singapore (Trans-Pacific) Strategic Economic Partnership Agreement.

Figure B6b: Singapore



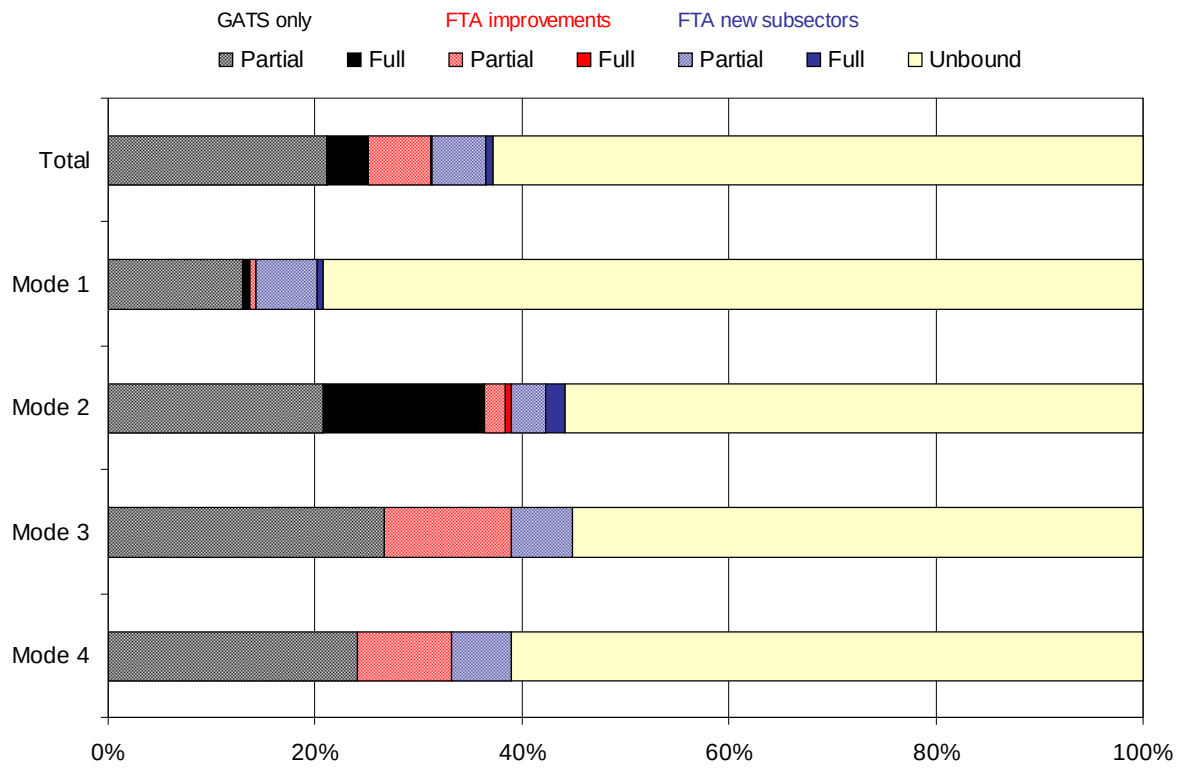
Notes: See notes to Figure B6a.

Figure B7a: Thailand



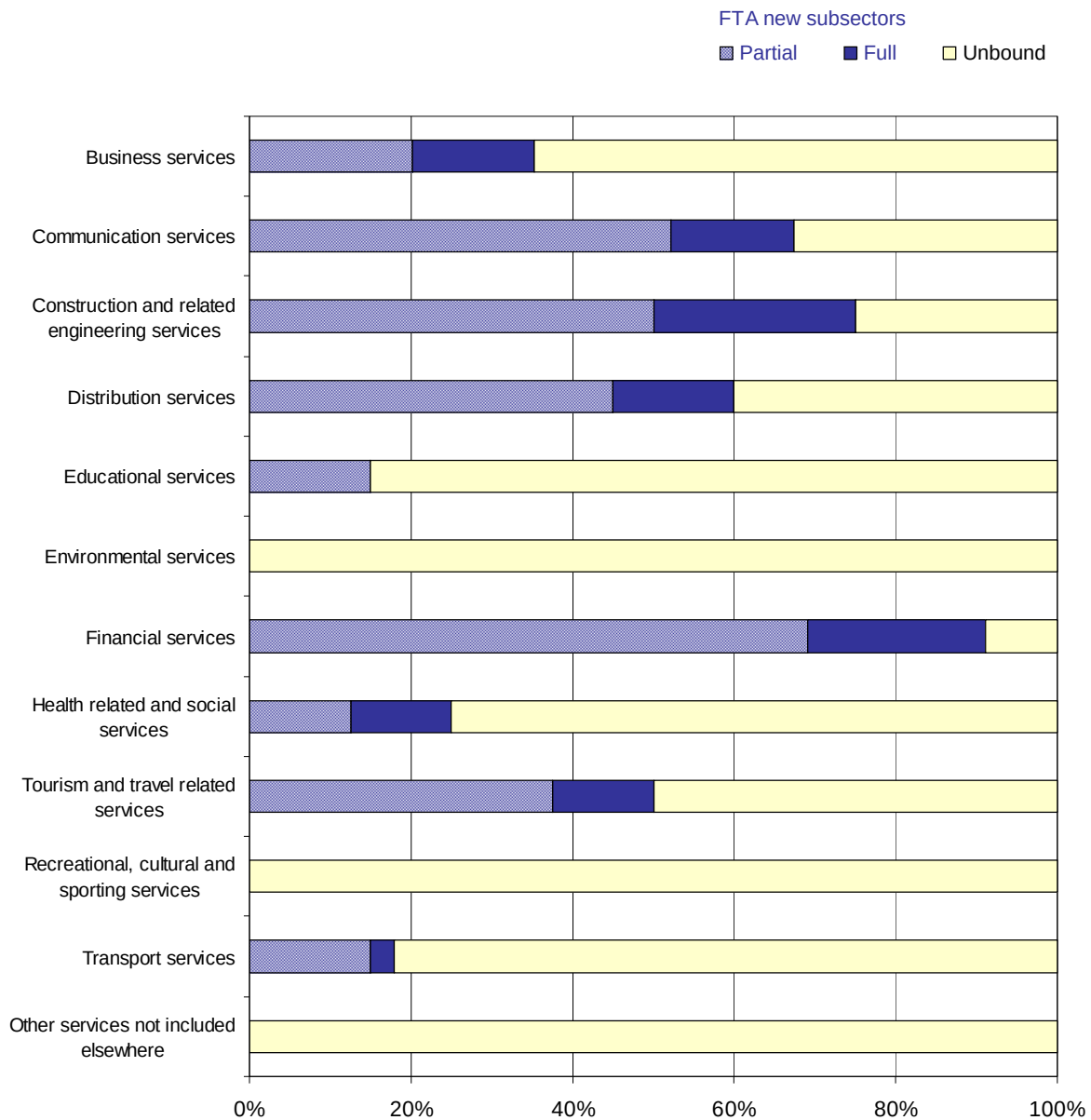
Notes: Based on the following 2 agreements: (1) ASEAN Framework Agreement on Services; and (2) Australia-Thailand Free Trade Agreement.

Figure B7b: Thailand



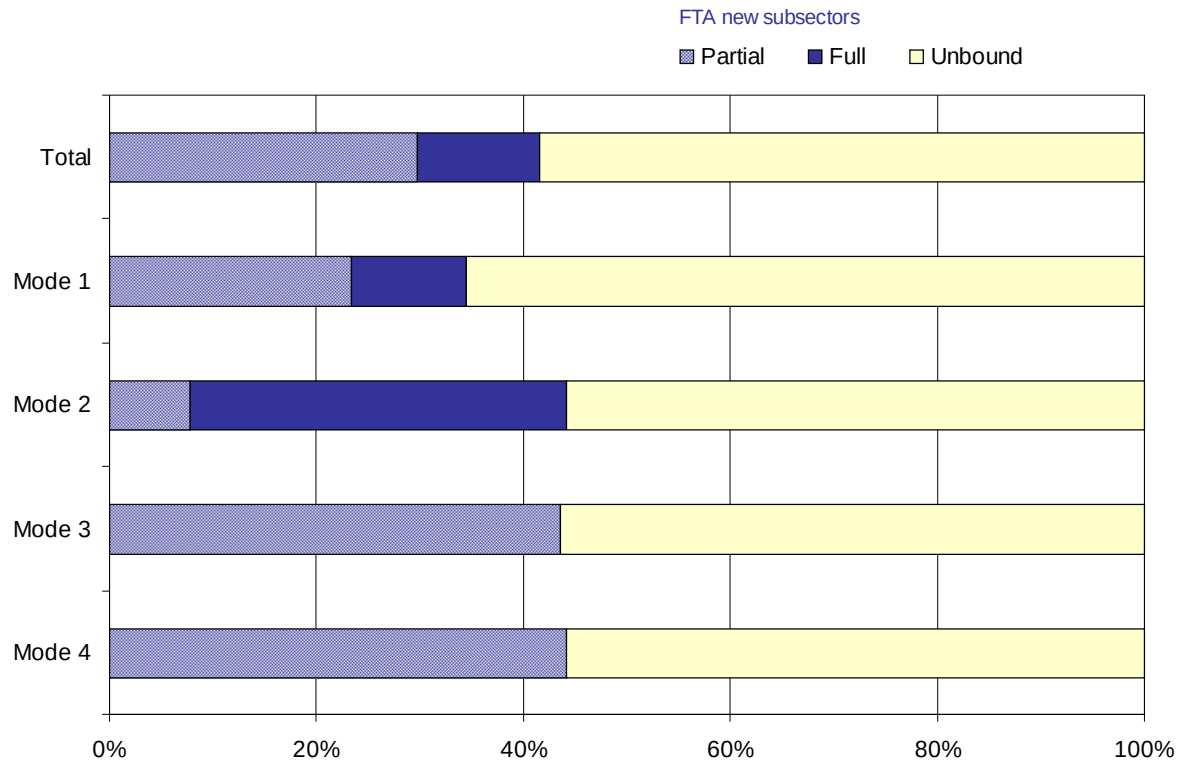
Notes: See notes to Figure B7a.

Figure B8a: Vietnam



Notes: Based on the following 2 agreements: (1) ASEAN Framework Agreement on Services; and (2) US-Vietnam Bilateral Trade Agreement.

Figure B8b: Vietnam



Notes: See notes to Figure B8a.

East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas?

Carsten Fink and Martín Molinuevo^{*}

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^{*} Carsten Fink is a Senior Economist at the World Bank Institute. Martín Molinuevo is a Research Fellow at the World Trade Institute and a Consultant to the World Bank. This paper was partially funded by the World Bank's Poverty Reduction and Economic Management Department for East Asia. The authors are grateful to Rolf Adlung, Panos Delimatsis, Roberto Fiorentino, Krista Lucenti, Juan Marchetti, Glenda Reyes, and Mahani Zainal-Abidin for helpful comments and suggestions. The views expressed in this paper are the authors' own and do not necessarily represent those of their respective institutions.

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1. Introduction

Bilateral and regional free trade agreements (FTAs) are proliferating across the globe, fundamentally altering the governance of world trade. From 1950 to 1995, less than three of these agreements were on average notified annually under the General Agreement on Tariffs and Trade (GATT). Since 1995, this number has jumped to 11 agreements per year. Between January 2004 and February 2005 alone, the World Trade Organization (WTO) received 43 notifications, setting a historical record.¹

There are various reasons why governments seek bilateral or regional trade agreements. Foreign policy considerations often play an important role. Improving trade relations may be a vehicle to strengthen strategic ties between nations or to overcome historic animosities. But notwithstanding politics, economic considerations are more often the driving force behind the conclusion of FTAs. Trade agreements can enhance commercial opportunities abroad for domestic businesses, while offering a vehicle for anchoring home-grown policy reforms. Multilateral trade negotiations have in recent years not been successful in fostering an exchange of market opening commitments. Despite more than five years of negotiations, there has been no conclusion to the WTO's Doha Development Agenda (DDA). In fact, DDA negotiations were suspended in July 2006 with uncertain prospects for their revival. For countries ready to commit to market opening, a bilateral or regional forum may deliver quicker results.

Many of the recently concluded FTAs are comprehensive in their coverage, seeking not only the dismantling of barriers to traditional trade in goods but also the liberalization of trade in services—the focus of this paper. The widening of the scope of FTAs reflects underlying economic forces. Technological progress and the trend towards private and competitive provision of infrastructure services have enabled international commerce in a wide range of service activities that were previously considered non-tradable. In many countries, services account for the fastest growing segment of international trade (World Bank, 2002).

What have FTAs in services accomplished? Have they established stronger disciplines on measures affecting trade in services? Have they led to liberalization undertakings that go beyond those to which countries are committed under the WTO's General Agreement on Trade in Services (GATS)? Few analyses have been conducted to answer these questions. Stephenson (2000), OECD (2002), and Sauvé (2005) review some of the key architectural innovations of services FTAs. Stephenson (2005) and Roy et al. (2006) evaluate the liberalization content of selected bilateral and regional agreements.

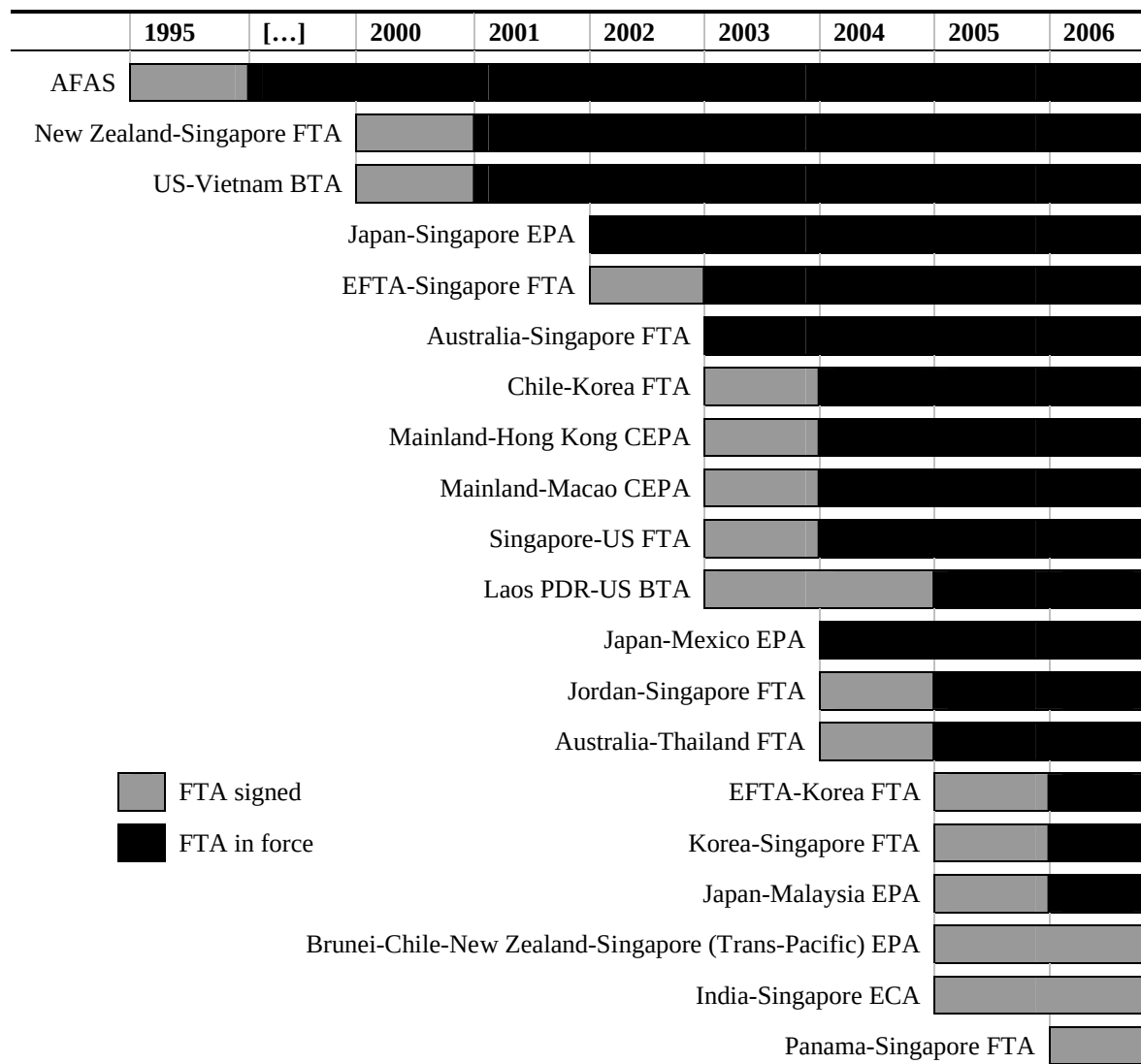
This paper offers a comprehensive assessment of the new generation of services agreements that have been concluded in the East Asia region. Until recently, this region had been hesitant in entering into bilateral or regional arrangements. As of 2003, there were only 2 FTAs per country in East Asia, compared to a world average of 5 FTAs per country (World Bank, 2005a). But the region is catching up fast. Figure 1 lists the existing East Asian FTAs that have a substantial services component.² Until 2000, the only trade agreement in services in the region was the ASEAN Framework Agreement on Trade in Services (AFAS). Since 2000, nineteen agreements were signed with trading partners inside and outside of East Asia.

¹ See Crawford and Fiorentino (2005). These figures underestimate the number of concluded FTAs, as numerous agreements have not (or not yet) been notified to the WTO.

² Thailand has concluded bilateral agreements with Bahrain, India, New Zealand, and Peru that foresee the negotiation of trade in services in future. The same holds for the Bangladesh-India- Myanmar-Sri Lanka-Thailand Economic Cooperation (BIMSTEC) Free Trade Area.

Table 1 shows all FTAs that are currently being negotiated. This list is changing frequently and not all envisaged FTAs may include a services component. But if all negotiations were concluded successfully, there would be another 42 agreements with at least one party in East Asia.

Figure 1: East Asian FTAs with a substantial services component



Notes: As of August 2006. Some agreements have not yet been included in the analysis presented in this study, partly due to their recent vintage. These agreements include Taiwan's FTAs with Guatemala, Nicaragua, and Panama, as well as the Japan-Philippines EPA. They will be incorporated in the final version of this study.

Our analysis consists of two main parts. The first part—presented in Section 3—will provide a comparative review of the key architectural elements of the 20 East Asian FTAs shown in Figure 1. In particular, we will consider the scheduling approach adopted by agreements, the main disciplines that determine their liberalization content, the treatment of investment in services, the treatment of labor mobility, the rules of origin adopted, trade rules, and provisions for the settlement of disputes. In reviewing the various architectural choices encountered, we will specifically assess to what extent those choices create incentives for liberal negotiating outcomes, promote the transparency of services policies, and foster the credibility of these policies.

Table 1: FTAs under negotiation

Country	FTA partner(s)
ASEAN	Australia & New Zealand, China, India, Japan, Korea
Brunei	Japan
China	Australia, ASEAN, Chile, Gulf Cooperation Council, New Zealand, Pakistan, Southern African Customs Union
Indonesia	Japan
Japan	ASEAN, Brunei, Chile, Indonesia, Korea, Philippines, Thailand, Vietnam
Korea	ASEAN, Canada, India, Japan, Malaysia, United States
Malaysia	Australia, India, Korea, New Zealand, Pakistan, United States
Philippines	Japan
Singapore	Bahrain, Canada, Egypt, Kuwait, Mexico, Pakistan, Peru, Qatar, Sri Lanka, United Arab Emirates
Taiwan	Dominican Republic, El Salvador, Honduras
Thailand	Japan, United States
Vietnam	Japan

Note: As of August 2006.

The second part—presented in Section 4—will evaluate the liberalization content of the 20 FTAs, drawing on a database in which we recorded the valued added of FTA liberalization undertakings relative to pre-existing multilateral services commitments. This database enables us to assess the depth and breadth of liberalization undertakings by the main service sectors, the four modes of supplying services, and the scheduling approach of agreements. It also allows us to evaluate how far individual East Asian countries have liberalized across all their FTAs and whether market opening commitments to different FTA partners have been alike or dissimilar.

To motivate our analysis, Section 2 will first discuss the main economic and bargaining considerations surrounding FTAs in services. By their nature, FTAs create trade preferences from which only member countries benefit, thereby discriminating against service suppliers from non-members. This type of discrimination raises several important economic and bargaining issues, which need to be taken into account in assessing the accomplishments of FTAs.

Finally, the proliferation of FTAs has important implications for the multilateral trading system. The GATS has established certain requirements for FTAs in services that WTO members need to meet. Our analysis can shed light on the considerations that might be relevant in assessing compliance with these requirements. We will discuss these considerations in Section 3. More broadly, economists have long debated whether FTAs are building blocks or stumbling blocks towards further multilateral integration. In the concluding section, we will ponder on what our findings can say in support or opposition of either camp.

2. Economic and bargaining considerations

FTAs seek the liberalization of trade in services among a small number of countries—often only two trading partners.³ FTAs are thus *preferential* in nature. Only parties to an agreement benefit from the trade commitments negotiated under an FTA. Service suppliers from non-parties are discriminated against. By contrast, services liberalization under the GATS takes place on non-discriminatory terms. The WTO's most-favored-nations (MFN) principle requires members of the multilateral trade body to extend any trade benefit immediately to all other members.

Most East Asian countries are members of the WTO. The only two exceptions are Laos and Vietnam, which are currently in the process of acceding to the WTO. In other words, service suppliers from most countries—inside or outside the region—have access to East Asian service markets at least at the level of existing GATS commitments. Thus, in order for a bilateral or regional agreement to be meaningful, its parties need to commit to additional market opening beyond their liberalization undertakings under the GATS.

Liberalizing trade in services promises significant economic gains, but also imposes unique challenges—mainly in ensuring the sound regulation of private service markets. These gains and associated policy challenges have been well documented elsewhere (see, for example, World Bank, 2002). However, there are certain economic and bargaining considerations from liberalizing trade in services on a preferential rather than MFN basis. In this section, we briefly outline these considerations, setting the scene for the assessment of East Asian FTAs in the subsequent sections of this paper.

Before proceeding, one clarifying remark is in order. In principle, parties to an FTA may choose to implement their preferential trade commitments on an MFN basis. In addition, FTAs commitments may go deeper than the GATS, but may not provide for actual policy liberalization and, as such, no actual trade preferences. In these cases, FTAs do not discriminate against non-parties and most of the arguments developed in this section do not apply. The economic effects of non-discriminatory liberalization under FTAs approximate those from unilateral liberalization and, again, are well-documented elsewhere.

Economic considerations

Mattoo and Fink (2004) analyze the economic effects of preferential versus MFN-based liberalization of trade in services. They draw the following main conclusions, from the viewpoint of a country that engages in liberalization:

- First, relative to the status quo, preferential liberalization in services brings about static welfare gains. This finding differs from the more ambiguous conclusion drawn in the goods case. The key difference is that protection in services does not generate fiscal revenue, as do tariffs on imported goods. Thus, trade diversion effects associated with preferential liberalization in services do not lead to any loss in government revenue that can lead to negative welfare effects in the case of goods.

³ Throughout the paper and unless other terms are employed, we use the term 'FTA' loosely to also include other types of trade agreements that seek the liberalization of trade in services—such as bilateral trade agreements (BTAs) or economic partnership agreements (EPAs). Similarly, we refer to 'countries' in a broad sense, so as to encompass any geographical entity with international personality and capable of conducting an independent foreign economic policy. The designations employed do not imply the expression of any opinion concerning the legal status of any country or territory.

- Second, MFN liberalization generally yields greater welfare gains than preferential liberalization. Non-discriminatory market opening does not bias competition from abroad and therefore promotes entry of the most efficient service providers. Additional gains from trade, associated with greater economies of scale and knowledge spillovers, are also likely to be greater if liberalization proceeds on an MFN basis. There is one exception to this conclusion. If ‘learning by doing’ effects are important, preferential liberalization may enable domestic service suppliers from member countries to become more efficient, as they face some competition from within the FTA territory, but are not yet exposed to global competition. In theory, preferential liberalization can thus prepare infant domestic suppliers for competition at the global level.⁴
- Third, there is a special long-term trade diversion effect to worry about. Preferential liberalization offers a first-mover advantage to potentially second-best service providers from within the FTA territory. Since many service industries are characterized by high location-specific sunk costs, first-best providers from outside the FTA territory may not enter the market when trade is eventually liberalized on an MFN basis. Thus, even if preferences are temporary, they may have long-term implications for a country’s ability to attract the world’s most efficient service providers.

The degree of trade preferences—and thus the potential for trade diversion effects—depends critically on the rules of origin adopted by an FTA. In a nutshell, rules of origin in the services context determine the extent to which service suppliers from non-parties established in the territory of a party benefit from the market opening negotiated under an FTA. If rules of origin are restrictive, the set of service suppliers eligible for trade preferences is small and trade diversion effects will be more pronounced. If rules of origin are liberal, preferential liberalization approaches MFN liberalization. However, it will always fall short of the latter, because non-party service suppliers will need to have at least some presence in one FTA party.⁵

Additional considerations apply from the viewpoint of a country that would see an expansion in services exports as a result of market opening in an FTA partner country. What may be considered as trade diversion from a global perspective amounts to an export opportunity from the perspective of the country benefiting from preferential market access abroad. Such export opportunities may underpin possible ‘learning-by-doing’ effects mentioned above. In addition, preferential access to foreign markets may attract export-oriented investment from abroad. Indeed, a country with liberal entry conditions for suppliers from outside the FTA area can become a hub for companies wishing to access markets within this area. The benefits from export-oriented foreign investment depend on the nature of the services supplied, but can include short-term employment gains, increased tax revenues, and the transfer of knowledge and managerial skills.

Again, the rules of origin adopted in an FTA are critical in shaping the eventual economic outcome. If they are restrictive, the benefits of preferential access would mostly be captured

⁴ The ‘learning-by-doing’ rationale has mainly been invoked for agreements among developing countries, where firms operate below best-practice productivity levels.

⁵ For a more detailed discussion of the economic effects of different rules of origin in services, see Fink and Nikomborirak (2006). Section 3.E offers a comprehensive review of the rules of origin found in the East Asian FTAs.

by domestic firms and the learning-by-doing rationale would be strengthened. If they are liberal such that it is easy for service suppliers from outside the FTA area to become eligible for trade preferences, incentives for export-oriented foreign investment would be strengthened.

In sum, the welfare implications of preferential versus MFN-based liberalization differ for the preference-granting and preference-receiving countries and depend on a number of complementary factors—such as the rules of origin adopted and the significance of learning-by-doing effects. Unfortunately, the economic literature provides only little guidance on what type of economy would gain or lose under which circumstances.⁶

Bargaining considerations

Why do countries sign trade agreements, be they preferential or non-discriminatory? As Krugman (1997) famously pointed out, the economist's case for open markets is essentially a unilateral case. If trade liberalization brings about economic benefits and governments are convinced of these benefits, market opening should be pursued regardless of what other countries may do. In addition, experience has shown that the success of services reforms hinges on the development of sound regulatory institutions, which is primarily a challenge of domestic policy.

Notwithstanding these considerations, can trade agreements somehow support governments in their pursuit of greater openness? In principle, trade agreements can make three types of contributions:

- First, trade negotiations are mercantilist in nature, involving the reciprocal exchange of market opening concessions. While trade economists would object to the notion of liberalization as a concession, mercantilism can serve a useful political economy purpose. Suppose that a government is convinced that certain liberalization measures will generate overall economic benefits, but those measures are opposed by vested interests that stand to lose from foreign competition. Negotiated as part of a package of trade commitments, a government may be in a better position to proceed with market opening, because it can muster support from those constituents that stand to gain from improved market access in foreign countries.
- Second, trade agreements offer a forum for regulatory cooperation between trading partners. In certain regulation-intensive service sectors, the removal of explicit trade barriers may be insufficient for foreign service suppliers to compete. Differences in regulatory standards or professional qualification requirements may pose de facto barriers to foreign participation. Regulatory cooperation—in the form of harmonization of standards and recognition of professional qualifications—can overcome these barriers without compromising legitimate regulatory objectives.
- Third, trade agreements can enhance the transparency and credibility of the domestic trade regime. Lack of information about how to do business in a foreign country can in itself represent a trade barrier. In addition, commitments in trade agreements are bound under international law and are not easily reversible. They can thus assure foreign traders and investors that policy will not become more restrictive. This aspect

⁶ Mattoo and Fink (2005) review available evidence from the EU's Single Market Program. However, they note that this evidence remains difficult to interpret in welfare terms.

is particularly important for infrastructural services, for which foreign participation typically requires commercial establishment in the importing country and non-recoverable investments in location-specific assets.

Where are these benefits of trade agreements best pursued—at the multilateral level or at bilateral and regional levels? As pointed out in the introduction, the choice of negotiating forum may be dictated by political considerations. From a more narrow negotiating perspective, multilateral agreements offer both advantages and disadvantages. One key advantage is that countries can form negotiating alliances at the WTO, allowing members with small economies to leverage their bargaining power. In addition, certain trade policy measures—particularly agricultural subsidies—by nature cannot be reduced on a preferential basis. Countries seeking to offer deeper liberalization in services in exchange for the reduction of agricultural subsidies abroad can only do so at the WTO.

At the same time, bargaining itself may be more productive at the bilateral or regional level, where negotiations involve only few players. The WTO now has 149 members at all levels of development and the multilateral trade agenda has much expanded since the GATT days. Trade negotiations at the multilateral level therefore tend to be complex and time-consuming. As already pointed out, the WTO's Doha Development Agenda was suspended in July 2006, after more than five years of negotiations. As prospects for concluding the multilateral negotiations remain uncertain, a bilateral or regional forum may deliver quicker results.

Another handicap of multilateral negotiations is that countries can free-ride on the bargaining efforts of others. Multilateral services negotiations have proceeded on a bilateral request and offer basis, but eventual commitments are made on an MFN basis. Thus, even though one WTO member may be interested in improved market access in another member, it may be reluctant to engage in reciprocal bargaining if there are third members interested in the same market access. The end result may be a less ambitious negotiating outcome. In principle, FTAs offer a way out, as the smaller number of players reduces the scope for free-riding on the bargaining efforts of others.⁷

Yet again, the greater bargaining effectiveness of preferential agreements depends critically on the rules of origin of these agreements. Under liberal rules of origin, non-parties would to some extent benefit from the trade concessions of FTA parties, reintroducing the free-rider problem. For free-rider problems to be less severe in a bilateral or regional context, FTAs need to adopt restrictive rules of origin.

This argument has an important corollary, which is of relevance to the bargaining situation of many East Asian countries. Suppose a country negotiates sequentially two or more bilateral FTAs. If it commits to open service markets in the first FTA and this FTA adopts a liberal rule of origin, the trading partner for the second FTA may be unwilling to 'pay' for obtaining the same commitment in the second FTA. In other words, with a liberal rule of origin, it may not be possible to 'sell' the same market opening commitment twice.

As to the pursuit of regulatory cooperation, bilateral and regional trade agreements may also be a more productive negotiating forum. Harmonizing regulatory standards and recognizing professional qualifications may not be feasible among the 149 members of the WTO. But it may well be achievable among smaller groups of countries that share similar legal and

⁷ This point is elaborated more fully in Schwartz and Sykes (1996).

educational systems. In Sections 3E and 3F, we will review to what extent East Asian FTAs have been able to deliver on this potential.

Finally, the transparency and credibility benefit of binding trade policies under domestic law can, in principle, be harnessed at the WTO and in FTAs. The precise transparency and credibility value of policy bindings will depend on the nature and clarity of trade commitments and the mechanism available to enforce them. Throughout Section 3, we will evaluate how key architectural elements of the East Asian FTAs have affected the transparency and credibility of services trade policies.

3. Architecture

In this section, we review key architectural elements of the 20 East Asian FTAs that have a substantial services component. Ultimately, trade agreements seek to promote international commerce. They can do so in three ways: by reducing barriers to foreign participation, by making trade policies more transparent, and by enhancing the credibility of the trade regime. Architectural choices can make an important difference in this respect. In comparing the different approaches found in East Asia, we specifically seek to evaluate to what extent agreements promote trade along these three dimensions.

Our review starts with the scheduling approach adopted by FTAs—one of the key distinguishing characteristics of trade agreements in services. We then consider the main disciplines that determine the liberalization content of FTAs, the treatment of investment in services, the treatment of labor mobility, the rules of origin adopted, trade rules, and provisions for the settlement of disputes.

A. Scheduling approach

No trade agreement in services has established immediate free trade in all service sectors. The East Asian FTAs make no exception in this regard. For a variety of reasons, governments wish to exempt certain activities from the coverage of trade disciplines or maintain certain trade-restrictive measures. A critical question in the design of an FTA is how these exemptions and limitations are inscribed into an agreement.

As a first step, most FTAs allow for *sectoral carve-outs* that exempt one or more activities from the scope of the agreement. Activities falling under such an exemption are not subject to any of the disciplines established in the agreement. Table 2 summarizes the sectoral carve-outs found in the 20 East Asian FTAs analyzed here. The most frequently encountered carve-out pertains to air transport. Thirteen FTAs exempt core air transport services related to the exercise of air traffic rights.⁸ This exemption is also found in the GATS and is explained by the fact that the provision of these services has historically been negotiated through separate bilateral treaties. Four FTAs also carve out cabotage in maritime transport—a sector in which foreign participation is often deemed sensitive. More significantly, three FTAs fully

⁸ However, this exception usually does not apply to aircraft repair and maintenance services, the selling and marketing of air transport services, and computer reservation system services.

exempt financial services from the scope of the agreement—an issue to which we will return later.⁹

Table 2: Sectoral carve-outs

Agreement(s)	Carve-out(s)
Australia-Singapore FTA, India-Singapore ECA, EFTA-Korea FTA, EFTA-Singapore FTA, Jordan-Singapore FTA, Korea-Singapore FTA, Panama-Singapore FTA, Singapore-US FTA	Core air transport services
Japan-Malaysia EPA, Japan-Singapore EPA	Core air transport services and cabotage in maritime transport
Chile-Korea FTA, Trans-Pacific EPA	Core air transport services and financial services
Japan-Mexico EPA	Core air transport services, cabotage in maritime transport, and financial services
ASEAN Framework Agreement on Services, Australia-Thailand FTA, Lao PDR-US BTA, Mainland-Hong Kong CEPA, Mainland-Macao CEPA, New Zealand-Singapore FTA, Vietnam-US BTA	None

Seven FTAs do not provide for any carve-out of service activities, making all service sectors subject to the agreements' underlying provisions. However, it does not automatically follow that all sectors are subject to liberalization undertakings. The liberalization content of FTAs is detailed in country-specific market-opening schedules. A variety of approaches exist in drawing up these schedules. Fundamentally, these approaches differ along two dimensions: (i) the listing of service activities subject to liberalization commitments and (ii) the listing of levels of openness. Lists can either be done on a *positive* basis—identifying what is covered or allowed—or on a *negative* basis—identifying what is not covered or not allowed, though mixed approaches are also possible.

Table 3 indicates the scheduling approaches adopted by the 20 East Asian FTAs, which for ease of reference are also graphically illustrated in Figure 2. In what follows, we first describe key features of these scheduling approaches. We then compare and assess these approaches, focusing on the three dimensions outlined above: incentives for liberalization, transparency and credibility.

Agreements with a positive list of sectors

Thirteen East Asian FTAs have adopted a positive list of sectors in which trade commitments are undertaken. In other words, only the sectors that parties have expressly identified are subject to market opening undertakings. Countries are free to maintain or impose trade-restrictive measures in all non-scheduled sectors, although those measures may still be subject to an agreement's general disciplines (such as on transparency).

⁹ In addition to the sectoral carve-outs found in the services chapters of FTAs, investment chapters may also exclude certain activities from the scope of investment disciplines. For example, under the Japan-Mexico EPA, Mexico scheduled a list of activities reserved to the state—including telegraph services, postal services, and electricity distribution—for which foreign entry may be refused.

Table 3: Scheduling approaches

Agreement(s)	Listing of sectors	Listing of level of openness
Lao PDR-US BTA	Positive	Not applicable, as no trade-restrictive measures are scheduled
Mainland-Hong Kong CEPA; Mainland-Macao CEPA	Positive	Positive
ASEAN Framework Agreement on Services, Australia-Thailand FTA, India-Singapore ECA, Japan-Malaysia EPA, Japan-Singapore EPA, EFTA-Korea FTA, EFTA-Singapore FTA, Jordan-Singapore FTA, New Zealand-Singapore FTA, Vietnam-US BTA	Positive	Hybrid
Australia-Singapore FTA, Chile-Korea FTA, Japan-Mexico EPA, Trans-Pacific EPA	Negative	Negative
Singapore-Panama FTA, Singapore-US FTA	Negative, except for cross border trade in financial services for which a positive list is adopted	Negative
Korea-Singapore FTA	Negative, except for financial services for which a positive list is adopted	Negative, except for financial services for which a hybrid list is adopted

Once a sector is scheduled, the next question is how to set the level of openness in that sector. Interestingly, this question is not relevant for one of the East Asian FTAs—the Lao PDR-US BTA. For this agreement, Laos is committed to unrestricted market access in all listed sectors. National treatment is a general obligation, not subject to the scheduling of limitations.¹⁰ However, the Lao PDR-US BTA should be considered a special case and, indeed, is unparalleled in its ambition. All other trade agreements in services allow parties to not immediately commit to free trade in sectors subject to liberalization undertakings. For the remaining twelve East Asian FTAs with a positive list of sectors, we observe two approaches for specifying levels of openness: pure positive lists and GATS-style hybrid lists.

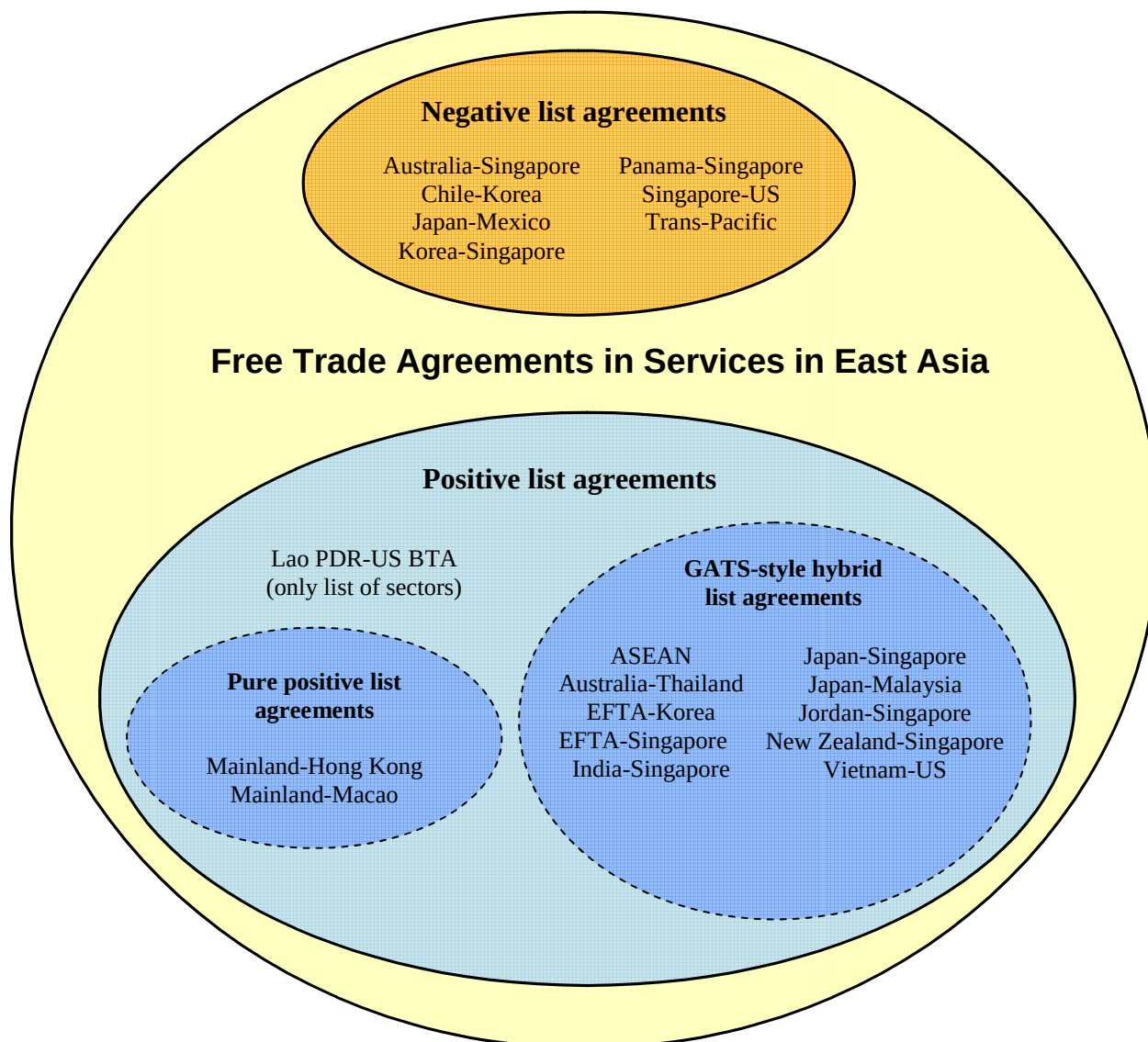
Pure positive list agreements

Under a pure positive list, parties to an agreement specify for each listed service sector the level (and type) of foreign participation that is allowed. Only two East Asian FTAs follow this approach: the Mainland-Hong Kong and the Mainland-Macao CEPAs. Interestingly, these two agreements do not establish classes of trade-restrictive measures, such as the ones created by the GATS market access and national treatment provisions (see Section 3.B). They also do not define any modes of supply, as is done for most other trade agreements in services (see below). In fact, the legal disciplines established by the agreements' services chapters are arguably the weakest among all the East Asian FTAs. Yet, China's market

¹⁰ In principle, the agreement specifies that “each party” is not allowed to maintain any restriction on market access in the listed sectors and on national treatment. However, the agreement also provides that the obligations of the US are subject to the market access and national treatment limitations scheduled by the US under the GATS (see Articles 32 and 33 of the Lao PDR-US BTA). In addition, market access and national treatment do not apply to the United States with respect to the financial services sector (see Article 35 of the agreement).

opening undertakings under the two CEPAs grant service providers from Hong Kong and Macao substantial trade preferences—as will be further discussed in Section 4.

Figure 2: Classification of East Asian FTAs by scheduling approach



GATS-style hybrid list agreements

Under a GATS-style hybrid list, parties may define the level of openness in listed sectors either on a positive or negative list basis. In particular, agreements following this approach typically adopt the market access and national treatment provisions of the GATS (see Section 3.B). Schedules of commitments then specify the market access “terms, limitations and conditions” and national treatment “conditions and qualifications”.¹¹ In other words, countries are free to describe either how trade is restricted or what type of services transactions are allowed in a listed sector. As a rule of thumb, an entry in a GATS schedule that takes the form “None, except ...” signifies a negative list of trade-restrictive measures,

¹¹ See GATS Articles XVI.1 and XVII.1.

whereas an entry that takes the form “Unbound, expect ...” signifies a positive list of market-opening concessions.¹²

One clarifying remark is in order. The GATS approach to the scheduling of commitments has frequently been referred to in the literature as a positive list approach. This terminology focuses only on the selection of sectors subject to trade commitments. For the purposes of this paper, we refer to GATS-style agreements as hybrid list agreements, because the fixing of the level of openness under this approach involves elements of both negative and positive listings.¹³ We use the term positive list agreements to describe all agreements that adopt a positive list of sectors subject to trade commitments, encompassing the special case of the Lao PDR-US BTA, the pure positive list agreements, and the hybrid list agreements (see Figure 1).

Several features associated with the GATS-style hybrid list approach are worth pointing out. First, commitments in each listed sector are made with respect to four different modes of supply: cross-border trade (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and movement of natural persons (mode 4).¹⁴ In actual GATS schedules, most entries for modes 1, 2, and 3 set the level of openness on a negative list basis, whereas the great majority of entries for mode 4 are made on a positive list basis.

Eleven of the twelve East Asian hybrid list FTAs follow the structure of the GATS by distinguishing between four modes of supply and between market access and national treatment measures. The only exception is the Australia-Thailand FTA. Commitments under this agreement neither distinguish between modes of supply nor between market access and national treatment measures. To which mode and to which class of measures a particular commitment applies is determined by the nature of the scheduled entry. Compared to the GATS, this scheduling approach appears to reduce difficulties in scheduling measures that may be inconsistent with both market access and national treatment obligations.¹⁵

Second, several GATS-style hybrid list agreements adopt an MFN obligation which is subject to the scheduling of reservations. However, MFN reservations are always inscribed on a negative list basis in relation to both service activities and trade restrictive measures. The precise meaning of MFN in a bilateral or regional agreement will be further discussion in Section 3.B.

Third, GATS-style schedules allow for horizontal commitments. Measures scheduled in these horizontal commitments apply to all listed service sectors, unless the wording of a sectoral commitment unambiguously indicates otherwise. In assessing the level of openness of specific service sectors, it is therefore critical to take these horizontal commitments into account. Sometimes they can be far-reaching—for example, a joint venture requirement with foreign equity participation limited to 49 percent, or an entry that limits the movement of individual service providers to specific types of intra-corporate transferees. In such cases they effectively set a low ceiling to the level of openness in all sectors. As will be further

¹² A negative list of trade-restrictive measures also prevails, when a scheduling member does not explicitly indicate “None, except ...”, but inscribes one or more limitations applying to a listed sector. For further details on the scheduling of GATS commitments, see WTO document S/CSC/W/19.

¹³ Hoekman and Sauvé (1994), OECD (2002), and UNCTAD (1999) also characterize GATS-style agreements as hybrid list agreements.

¹⁴ For a more comprehensive discussion of modes of supply, see Adlung and Mattoo (2006).

¹⁵ The relationship between the GATS market access and national treatment disciplines has been subject to conflicting legal interpretations. See Mattoo (1997).

discussed in Section IV, some East Asian countries have reduced horizontal limitations in their FTA schedules relative to the GATS, whereas others have reproduced entirely what they committed horizontally under the GATS.

Fourth, GATS-style hybrid list agreements typically do not require signatories to make bindings at the level of actual openness. In fact, existing GATS commitments are often characterized as being less liberal than status quo policies—not least because substantial unilateral liberalization has taken place in many countries since the conclusion of the Uruguay Round of Trade Negotiations in 1994. A gap between bound and actual policies—a so-called binding overhang—may introduce uncertainty, because governments at any point can restrict foreign participation in their domestic service markets, as long as they stay within their trade commitments. The East Asian hybrid list FTAs similarly do not impose any requirement to bind at the actual level of actual openness.

However, the Japan-Malaysia EPA introduces an innovation that serves to reduce the uncertainty associated with a binding overhang. This agreement offers parties the possibility to identify in their schedules those service sectors in which a party agrees to bind status quo policies. In addition, the identified service sectors are subject to upward ratcheting: once a party eliminates a trade-restrictive measure, policy will automatically be bound at the more liberal level.¹⁶

Negative list agreements

Seven East Asian FTAs have adopted a negative list approach in scheduling their market opening commitments. Negative listing generally applies to both sectors and measures. In other words, trade is unrestricted across all service activities (except where a sectoral carve-out applies), unless scheduled limitations indicate otherwise.

Historically, one of the first major agreements to adopt the negative list model was the North American Free Trade Agreement (NAFTA) between Canada, Mexico, and the United States, which came into force in 1994. It is interesting to observe how this model found its way to East Asia. Singapore was the first country to adopt a negative list agreement in its FTA with the United States in 2003. Singapore has since pursued the negative list model in four other agreements, including its FTA with Korea. Japan adopted a negative list in the Japan-Mexico EPA in 2003. Finally, Korea's first negative list agreement was concluded with Chile in 2004—after Chile had concluded a negative list FTA with the United States in 2003. It appears that countries that conclude one negative list agreement seek to promote this model in subsequent agreements, an issue to which we return later.

Again, it is useful to review several key features of negative list agreements. First, these agreements typically establish separate disciplines for cross-border trade and investment in services. Cross-border trade in services in the negative list model covers the GATS equivalent of modes 1, 2, and 4, although commitments do not formally distinguish between these three modes of supply. The GATS equivalent of mode 3 is covered by a horizontal investment chapter that applies to both goods and services, though the typical investment disciplines go beyond those established by the GATS. Two agreements depart from this

¹⁶ Article 99.3 of the Japan-Malaysia EPA provides that “[w]ith respect to sectors or sub-sectors where the specific commitments are undertaken [...] and which are indicated with “SS”, any terms, limitations, conditions and qualifications [...] other than those based on measures pursuant to immigration laws and regulations, shall be limited to those based on non-conforming measures, which are in effect on the date of entry into force of this Agreement.”

basic model. The Trans-Pacific EPA does not establish separate investment disciplines, but services supplied through commercial presence are covered under the agreement's services disciplines—reverting to the structure of the GATS. Similarly, the Australia-Singapore FTA covers commercial presence in the services chapter, but in this case separate investment disciplines still apply (see also the discussion in Section 3.C).

Second, trade in financial services receives separate treatment in several of the negative list FTAs. Two agreements—the Panama-Singapore FTA and the Singapore-US FTA—adopt a positive list of sub-sectors for cross-border trade in financial services. Trade restrictive measures continue to be scheduled on a negative list basis. The Korea-Singapore FTA extends the positive list of sub-sectors to investment in financial services and allows parties to determine the level of openness in each sub-sector through a hybrid list approach. In other words, the Korea-Singapore FTA fully adopts the GATS approach for the scheduling of financial services commitments. As illustrated in Table 2, three negative list FTAs—the Japan-Mexico EPA, the Korea-Chile FTA, and the Trans-Pacific EPA—carve out trade in financial services entirely from the scope of the agreement, leaving the Australia-Singapore FTA as the only agreement for which the negative list applies, in principle, to financial services.¹⁷

Third, negative list agreements establish additional classes of measures for the scheduling of specific commitments. Table 4 lists the classes of measures identified by the seven negative list FTAs in East Asia in the three areas subject to trade commitments: cross-border trade in services, investment, and trade in financial services. All seven FTAs provide for the scheduling of national treatment limitations. However, only 5 negative list FTAs establish market access obligations. Interestingly, the Chile-Korea FTA follows the original NAFTA model in requiring that quantitative restrictions be only notified. Four FTAs subject MFN treatment to the scheduling of limitations (see also Section 3.B).¹⁸

For cross-border trade in services, negative list agreements introduce a new class of measures: local presence requirements. This class reflects the fact that negative list agreements do not separately identify the GATS equivalent of mode 1. In hybrid list agreements, local presence requirements are implicitly dealt with by commitments under mode 1.

For investment, there are two new classes of measures: performance requirements and limitations on the nationality or residency of senior managers and boards of directors. These two classes of measures have their origin in bilateral investment treaties, on which the horizontal investment chapters of FTAs are based (see Section 3.C). Finally, for financial services, Singapore's FTAs with Panama and the United States allow for the scheduling of limitations on cross-border purchases of financial services—again, reflecting the absence of a distinction between modes of supply in the scheduling of commitments.

Fourth, negative list agreements allow for the scheduling of two categories of limitations: existing non-conforming measures and future measures. Existing non-conforming measures include all current laws and regulations that a country seeks to maintain, but which would be inconsistent with one or more of the obligations listed in Table 4. By definition, limitations scheduled in this category reflect status quo policies. In addition, all seven negative list

¹⁷ As described further below, however, Singapore scheduled several broad future measures in financial services, substantially limiting the scope and depth of its liberalization undertaking.

¹⁸ As explained in Section 3.B, a negative list of MFN exemptions is also found in several hybrid list agreements.

FTAs provide for upward ratcheting of policy bindings: once a trade-restrictive measure identified in this category is eliminated, policy will automatically be bound at the more liberal level.

Table 4: Classes of measures in negative list agreements

	(Cross-border) trade in services	Investment	Trade in financial services
Australia-Singapore FTA	National treatment, market access	National treatment	(Not treated separately)
Trans-Pacific EPA	National treatment, MFN treatment, market access	(No separate investment disciplines, but investment is covered by commercial presence mode of supply in services chapter)	--
Chile-Korea FTA	National treatment, local presence requirements Quantitative restrictions (notifications only)	National treatment, performance requirements, limitations on senior managers and boards of directors	--
Japan-Mexico EPA	National treatment, MFN treatment, local presence requirements	National treatment, MFN treatment, performance requirements, limitations on senior managers and boards of directors	--
Korea-Singapore FTA	National treatment, market access, local presence requirements	National treatment, performance requirements, limitations on senior managers and boards of directors	National treatment and market access
Panama-Singapore FTA, Singapore-US FTA	National treatment, market access, MFN treatment, local presence requirements	National treatment, market access, MFN treatment, performance requirements, limitations on senior managers and boards of directors	Cross-border trade: national treatment, MFN treatment, limitations on cross-border purchases of financial services Investment: national treatment, market access, MFN treatment, and limitations on senior managers and boards of directors

Future measures are reservations that do not necessarily relate to existing laws and regulations. They allow a country to introduce new measures in the relevant sectors at any point after an agreement enters into effect. The scope of future measures is defined through their sectoral coverage and the description outlining the reserved policy actions. Broad future measures can de facto exclude full sectors from an agreement's market opening obligations—equivalent to not listing a sector or inscribing 'unbound' for one or more modes of supply under a positive list scheduling approach. For example, under the Korea-Singapore FTA, Korea scheduled a future measure under which the government reserves "*the right to adopt*

or maintain any measure with respect to (a) broadcasting services [...] (b) foreign investment in the broadcasting services sector”.

Positive versus negative list scheduling: an assessment

Does an FTA’s approach towards scheduling commitments matter? Some observers have argued that a negative list approach provides for greater transparency and lends greater credibility to services trade policies.¹⁹ Knowing what is not allowed—rather than allowed—may help service providers better understand how they can do business in a foreign country.²⁰ In addition, as described above, non-conforming measures scheduled under a negative list reflect status quo policies. Thus, businesses are better informed about the actual level of openness in an FTA partner and are directly pointed to the laws and regulations affecting their ability to contest the FTA partner’s market. Status quo bindings also maximize the credibility value of trade commitments, as foreign service suppliers are assured that actual policies will not become more restrictive.

The scheduling approach may affect an FTA’s negotiating outcome, too. Under a negative list, governments need to reveal existing non-conforming measures in the course of FTA negotiations and, if they wish to maintain those restrictions, defend their rationale. This process may create greater incentives for eliminating unwarranted restrictions. Another pro-liberalization feature of negative list agreements is that they apply to future service activities, because those activities would not be subject to limitations at the time FTAs are concluded. New service activities may emerge from technological progress or new ways of organizing business and an automatic commitment to free trade may pre-empt protectionist pressures.

Having said this, there are several considerations that question the superiority of negative list agreements along these lines. First, the transparency value of knowing what is not allowed would seem to depend on the level of openness. Where few trade restrictions prevail, a negative list may indeed be more transparent. But where trade-restrictive measures take the size of a ‘telephone book’, knowing what is allowed may equip foreign businesses with a better understanding of how they can do business.

Second, it is in principle possible to replicate every negative list schedule with a positive list schedule. In addition, GATS-style hybrid list agreements allow for the scheduling of measures on a negative list basis, preserving possible transparency benefits associated with negative listing. Theoretically, a positive list of sectors can even apply to future service activities by covering residual service sectors, such as ‘other business services,’ ‘other financial services,’ or ‘other services not included elsewhere.’²¹

Third, benefits associated with status quo bindings are not necessarily limited to negative list agreements. The Japan-Malaysia EPA illustrates that a requirement to schedule at the level of existing policies can also be incorporated into a pure positive list or hybrid list agreement. Conversely, the possibility of scheduling future measures opens the door for excluding certain service activities from liberalization undertakings and binding policy above status quo

¹⁹ For example, see Hoekman and Sauvé (1994) and Stephenson (2002).

²⁰ See OECD (2002).

²¹ In practice, however, commitments with a positive list of sectors do not seem to provide substantial coverage of these residual categories. Negative list agreements therefore appear to be more liberalizing with respect to future service activities.

levels in negative list agreements—diluting the difference between hybrid list and negative list agreements.²²

Some observers have also argued that a positive list of sectors combined with the possibility of binding above status quo policies may provide important breathing room to governments.²³ Such breathing room may be needed in cases where governments have limited administrative capacity to compile an inventory of all trade-restrictive measures, including at the sub-federal level, or in sectors where there are sensitivities towards foreign participation.

In this context, it is interesting to note that three of the East Asian negative list FTAs have partially or fully reverted to a positive list in scheduling commitments for financial services—a sector where regulatory sensitivities towards foreign participation are common. As pointed out above, three of the remaining four negative list FTAs have carved out the financial service sector altogether, leaving the Australia-Singapore FTA as the only agreement in which the negative list applies to financial services. However, Singapore scheduled several broad future measures under this FTA, preserving its freedom to maintain or impose restrictions on the supply of financial services by Australian institutions. For example, one such future measure reserves Singapore’s right “[...]to adopt or maintain any measure affecting the supply of services by foreign full banks or in relation to Qualifying Full Bank licenses.”²⁴

In sum, the structure of negative list agreements may not be conducive to promote market opening in particularly sensitive sectors. In contrast, positive list agreements seem to afford governments the ability to tailor commitments to better accommodate regulatory concerns. They may thus give governments the confidence to embark on some liberalization rather than fully excluding sensitive sectors.

Finally, possible transparency and liberalization benefits of negative list agreements depend crucially on the nature of non-confirming and future measures scheduled. If non-confirming measures do not list all relevant laws and regulations, businesses may not be able to draw an accurate picture of the level of openness of an FTA partner. Reservations that exempt a broad range of measures can seriously reduce the liberalization content of trade commitments. Three examples of non-confirming measures and future measures in East Asian negative list FTAs that are seemingly incomplete and broad are worth pointing out:

- In the Singapore-US FTA, the United States scheduled a non-confirming measure that effectively exempts “[a]ll existing non-confirming measures of all states of the United States, the District of Columbia, and Puerto Rico.”²⁵ No state law or regulation is explicitly listed under this reservation, making it difficult for a Singaporean service provider to assess possible US trade barriers at the state level.²⁶

²² This point is discussed more fully in World Bank (2004).

²³ See UNCTAD (2004) for further elaboration.

²⁴ See Annex 4-II(B) of the Australia-Singapore FTA.

²⁵ See Annex 8A of the Singapore-US FTA.

²⁶ The Japan-Mexico EPA recognizes the burden of collecting information on all trade-restrictive measures applied at the sub-federal level. But instead of scheduling a single reservation like the one described for the US, Mexico committed to list all non-confirming measures applied by Mexican states within one year after entry into force of the FTA.

- In the same FTA, the United States scheduled a non-conforming measure under which it “[...] reserves the right to adopt or maintain any measure that is not inconsistent with the United States’ obligations under Article XVI of the General Agreement on Trade in Services.”²⁷ This limitation appears to nullify all market access concessions that the US offered to Singapore and that go beyond the US GATS commitment.²⁸ Moreover, fully understanding how open US service markets are for Singaporean service providers requires a careful reading of the US GATS commitment. Given that the latter follows a hybrid list approach, the presumed transparency value of the negative list seems seriously undermined.
- In the Japan-Mexico EPA, Mexico scheduled a future measure under which it “[...] reserves the right to adopt or maintain any measure relating to the supply of services in any mode of supply in which those services were not technically feasible at the time of entry of force of this Agreement.” This reservation effectively denies the application of the agreement to future service activities—one of the supposed benefits of negative listings.

In Section 4, we will compare the liberalization content of FTAs with different scheduling approaches in quantitative terms. But from our analysis so far, we can already make two observations. First, benefits associated with greater transparency, enhanced credibility and stronger incentives for committing to liberal trade policies may emerge from rules that require countries to bind status quo policies and that allow for an upward ratcheting of policy bindings once trade-restrictive measures are unilaterally liberalized. These rules exist in all East Asian negative list FTAs. However, the Japan-Malaysia EPA illustrates that they can also be incorporated into positive list FTAs. Second, positive list FTAs may provide breathing room to governments that do not have the capacity to compile an inventory of all non-conforming measures or where governments want to retain the flexibility to introduce trade-restrictive measures at a future point in time—as is illustrated by the treatment of financial services in East Asian FTAs.

These two findings suggest that causality not only runs from the scheduling approach to the transparency, credibility and liberalization outcome, but also the other way around. Trading partners which have limited administrative capacity to take stock of all their existing measures and which are cautious in committing to market opening in services may be more likely to adopt a positive list approach and shun rules requiring status quo bindings and upward ratcheting. By contrast, countries that have a good understanding of all measures affecting trade in services and that are prepared to open up are more likely to adopt negative list agreements and accept status quo binding and ratcheting rules. From this view, it is not surprising that countries such as Japan, Korea, and Singapore that have negotiated at least one negative list FTA, will seek the adoption of negative lists in subsequent FTAs, as they already went through the exercise of identifying all their non-conforming measures.

As a final consideration, the transparency, credibility and liberalization value of any FTA commitment depends crucially on the nature of trade-restrictive measures scheduled—as illustrated by the examples of non-conforming and future measures described above. Indeed,

²⁷ See Annex 8A of the Singapore-US FTA.

²⁸ The transparency of the US commitment in the Singapore-US FTA is reduced by another provision of this agreement. Schedules of non-conforming measures contain both a description of the relevant measures and a reference to the relevant laws and regulations. Article 2(g) of Annex 8 of the Singapore-US FTA provides that “description, for Singapore, sets out the non-conforming aspects of the measure for which the entry is made; and description, for the United States, provides a general, non-binding, description of the measures”.

it can be argued that the scope and nature of scheduled limitations is in the end more significant than the scheduling approach as such.

B. Main disciplines

Trade agreements establish rules that constrain governments from maintaining policies that adversely affect foreign participation in the domestic economy. In the area of trade in services, these rules take the form of disciplines on national treatment, market access, MFN treatment, domestic regulation, dispute settlement, and other matters. In what follows, we briefly review the main disciplines that determine the liberalization content of FTAs—national treatment, market access, and MFN treatment. Other disciplines will be discussed later in this section. For ease of reference, Appendix 1 offers a comprehensive overview of the most relevant disciplines found in the 20 East Asian FTAs analyzed in this paper.

National treatment

National treatment is one the main disciplines that ensures the contestability of services markets by foreign suppliers. It mandates that imported services do not face more restrictive policy measures than domestically supplied services. As discussed in Section 3.A, the Lao PDR-US BTA incorporates a general national treatment obligation, applying to all service activities. All other agreements allow parties to not immediately provide for non-discriminatory treatment of foreign supplied and domestically supplied services. Depending on the scheduling approach of FTAs, departures from national treatment are inscribed in schedules of specific commitments or in lists of non-conforming and future measures. Two agreements—the Mainland-Hong Kong and Mainland-Macao CEPAs—do not expressly establish a national treatment discipline, though China’s market opening schedules under these agreements implicitly allow for departures from national treatment.

Table 5: National treatment provision

Agreements	Standard of likeness
ASEAN Framework Agreement on Services, Australia-Singapore FTA, Australia-Thailand FTA, EFTA-Singapore FTA, India-Singapore ECA, Japan-Malaysia EPA, Japan-Singapore EPA, EFTA-Korea FTA, Lao PDR-US BTA, Jordan-Singapore FTA, New Zealand-Singapore FTA, Vietnam-US BTA	Like services and service suppliers
Panama-Singapore FTA, Singapore-US FTA	In like circumstances, referring to service suppliers
Chile-Korea FTA, Japan-Mexico EPA, Korea-Singapore FTA, Trans-Pacific EPA	In like circumstances, referring to services and service suppliers
Mainland-Hong Kong CEPA, Mainland-Macao CEPA	No explicit national treatment discipline

Note: The standard of likeness indicated here refers to the national treatment provision of FTAs’ services chapter. Different standards may prevail in the investment chapter of FTAs. Appendix 1 offers more details.

The reach of the national treatment obligation depends crucially on whether foreign and domestic services are considered alike. If likeness were defined narrowly such that only few imported services would be considered like domestically supplied services, the reach of

national treatment would be limited. In this context, it is interesting to observe that the standard of likeness in services agreements is not uniform. Table 5 offers an overview of the different standards found in East Asian FTAs.

The hybrid list agreements, the Lao-PDR US BTA, and the Australia-Singapore FTA have adopted the language of GATS Article XVII, which mandates no less favorable treatment to “like services and service suppliers.” By contrast, national treatment in all negative list agreements except the Australia-Singapore FTA applies in “like circumstances”. Within this latter group, a further distinction is made in that the national treatment provision of two agreements—the Panama-Singapore FTA and the Singapore-US FTA—only applies to service suppliers, whereas the other four negative list agreements refer to services and service suppliers.

These seemingly small semantic differences can have non-trivial implications for the level of openness established by trade agreements. Which standard of likeness is narrower or broader raises complex legal issues and will depend on the factual situation in question. For example, where national treatment refers to both services and service suppliers, is likeness met if only services are like but service suppliers are unlike? Or do both services and service suppliers have to be like? Consider a car manufacturer that provides consumer loans to promote the purchase of its automobiles. Would the car manufacturer’s lending service be like a lending service supplied by a bank? Would the car manufacturer and the bank be like service suppliers or acting in like circumstances, if the former is not subject to the same prudential regulations? Finally, does likeness extend across different modes of supply? Are online gambling services supplied from foreign territories like online gambling services supplied domestically? So far, there has been no jurisprudence that could give guidance in answering these types of questions.²⁹

Market access

Market access is the second main discipline that determines the liberalization content of FTAs. The measures covered by the market access discipline fall under an exhaustive catalogue of explicit trade barriers. Under the GATS, the market access provision encompasses four types of quantitative restrictions, limitations on the form of legal establishment, and restrictions on foreign equity participation.³⁰ Measures covered may be discriminatory or non-discriminatory in nature.³¹

All but four East Asian FTAs contain disciplines on market access. As discussed in Section 3.A, market access is subject to the scheduling of specific commitments or non-conforming and future measures, depending on the agreement’s scheduling approach. The catalogue of measures covered by these agreements mirrors the one adopted by the GATS, with one exception. Four negative list agreements—the Korea-Singapore FTA, the Singapore-Panama FTA, the Singapore-US FTA, and the Trans-Pacific EPA—do not cover restrictions on

²⁹ Johnson (2001) discusses the concepts of “like circumstances” and “like service and service suppliers” in the context of NAFTA disciplines on investment. See also Mattoo (1997).

³⁰ See GATS Article XVI.2. The four types of quantitative restrictions are limitations on the number of service suppliers, on the total value of service transactions or assets, on the total number of service operations or on the total quantity of service output, and on the total number of natural persons.

³¹ See WTO document S/CSC/W/19. The overlap between market access and national treatment measures is addressed in GATS Article XX, which specifies that measures inconsistent with both market access and national treatment are to be scheduled under market access and would then be considered as a limitation on national treatment as well.

foreign equity participation under market access. In the case of the Korea-Singapore FTA, market access does not apply to investment in services and the question of foreign equity participation thus does not arise. In the other three cases, foreign equity limitations would likely be covered under the agreements' national treatment obligation, because they are discriminatory in nature. In other words, the absence of foreign equity restrictions in the catalogue of market access measures does not appear to fundamentally alter the scope of measures covered by liberalization undertakings.

As discussed in Section 3.A, China's two CEPAs with Hong Kong and Macao do not establish an explicit market access obligation, though market access-type measures are implicitly covered in China's schedule of specific commitments. The Japan-Mexico EPA and the Chile-Korea FTA also do not establish a market access discipline. In these two FTAs, non-discriminatory market access-type measures are truly excluded from the agreements' liberalization undertakings. The Chile-Korea FTA features a provision that requires parties to set out all quantitative restrictions they maintain. But this provision does not bind governments to the notified measures, as new quantitative restrictions can be listed at any time. The treatment of quantitative restrictions in the Chile-Korea-FTA replicates the original NAFTA model, which also did not establish a binding market access discipline.

Most favored nation treatment

The MFN principle is one of the cornerstones of the multilateral trading system. It obliges WTO members to not discriminate between trading partners. Under the GATS, MFN is a general discipline, applying to all service sectors even if no specific commitments are undertaken.³² However, it is subject to two exceptions: the conclusion of regional trade agreements and certain reservations scheduled by WTO members on a negative list basis.³³ The former will be discussed in greater detail in Section 5. The latter were negotiated as part of the original GATS agreement and were supposed to be temporary, though they have so far not been eliminated.³⁴

What is the role of the MFN principle in bilateral and regional free trade agreements? One can distinguish between two such roles. First, regional trade agreements involving more than two countries may wish to establish an MFN obligation to establish non-discriminatory treatment between service providers from countries within the region. In East Asia, this is the case for the ASEAN Framework Agreement on Services (AFAS), which calls for preferential treatment to be accorded on an MFN basis. Interestingly, a 2003 amendment to the AFAS allows for departure from MFN if two or more members agree to liberalize trade in services faster than the remaining ASEAN members. The rationale for this so-called ASEAN-X formula was to advance negotiations among member countries that are ready and willing to commit to more open service markets. The adoption of this formula is a textbook illustration of the bargaining handicap associated with MFN-based negotiations, as discussed in Section 2.

The second type of MFN provision found in FTAs focuses on the treatment of parties versus non-parties. A number of East Asian services agreements require that trade preferences

³² However, the MFN obligation does not apply to service activities that are carved out from the scope of the GATS, such as core air transport services (see Section 3.A).

³³ A third exception pertains to the conclusion of recognition agreements, as discussed in Section 3.D.

³⁴ GATS Annex II, Art. 6, provides that "[i]n principle, such exemptions should not exceed a period of 10 years". However, that period elapsed on January 1st, 2005 without achieving the elimination of GATS MFN reservations. For a detailed discussion of the MFN principle in the GATS, see Mattoo (1999).

accorded to non-parties are extended to FTA parties. As in the GATS, this extra-regional MFN clause is subject to a negative list of reservations. Several other East Asian services agreements establish a non-binding extra-regional MFN provision, merely requiring countries to favorably consider requests from other parties to extend benefits granted to a non-party.

The bargaining incentives created by an extra-regional MFN obligation are somewhat different from the well-known free-riding handicap discussed in Section 2. For any given FTA, each country has an incentive to ask its trading partner for MFN treatment, as it ensures that domestic service providers benefit from current and future trade preferences extended to non-parties. But a country bound by many extra-territorial MFN obligations becomes a less attractive negotiating partner for future FTAs. Potential new FTA partners know that any negotiated preference will be extended automatically to others. As a consequence, the bargaining advantage offered by FTAs with a small number of players is undermined and incentives to negotiate at the multilateral level are strengthened.

Table 6: MFN provisions

Agreement(s)	Type of MFN provision
ASEAN Framework Agreement on Services	Intra-regional MFN obligation subject to ASEAN-X formula
Japan-Malaysia EPA, Japan-Mexico EPA, EFTA-Korea FTA, EFTA-Singapore FTA, Panama-Singapore FTA, Singapore-US FTA, Trans-Pacific EPA, Vietnam-US BTA	Extra-regional MFN obligation subject to a negative list of reservations
Australia-Thailand FTA, India-Singapore ECA, Japan-Singapore EPA	Non-binding extra-regional MFN provision
Australia-Singapore FTA, Chile-Korea FTA, Korea-Singapore FTA, Lao PDR-US BTA, Mainland-Hong Kong CEPA, Mainland-Macao CEPA, Jordan-Singapore FTA, New Zealand-Singapore FTA	No MFN disciplines

Notes: The type of MFN provision indicated here refers to FTAs' services chapter. Different types may prevail in the investment chapter of FTAs. Appendix 1 offers more details. The MFN obligation of the EFTA-Korea and EFTA-Singapore FTAs does not apply to agreements concluded by one of the parties and notified under GATS Article V.

Table 6 offers an overview of the different type of MFN provisions found in the 20 East Asian FTAs analyzed here. No clear pattern can be discerned: there are almost as many FTAs without an MFN clause as there are with an extra-territorial MFN obligation. In addition, the approach to MFN treatment cannot be associated with the basic structure of the agreement: one finds negative list agreements with and without MFN disciplines, as one finds positive list agreements with and without MFN disciplines. Having said this, one distinguishing feature of MFN clauses can be associated with the basic FTA structure. As in the case of national treatment, negative list agreements provide for MFN in 'like circumstances' whereas the hybrid list agreements have adopted the 'like services and service suppliers' language found in the GATS.³⁵ The interpretive questions raised above on the different standards of likeness thus apply equally to the MFN discipline.

³⁵ In particular, those FTAs that provide for MFN treatment adopt the language on likeness found in the agreements' respective national treatment articles, as shown in Table 4.

C. Investment in services

For historical reasons, many FTAs establish two different sets of disciplines for investment in services. On the one hand, investment is considered a mode of supply in the services chapters of numerous agreements. Given that many services require the physical proximity of suppliers and consumers, the concept of trade in services has typically been defined more broadly than trade in goods to also include services supplied through commercial presence abroad. Under the GATS, commercial presence is one of four modes of supply and FTAs that have adopted the GATS model have followed this approach.

On the other hand, countries have for long time concluded bilateral investment treaties (BITs) that establish horizontal disciplines for investment in goods and services. No such horizontal investment disciplines have so far been established under the WTO.³⁶ But most FTAs negotiated in recent years have included separate investment chapters that are largely based on the BIT model. Indeed, a number of agreements—notably those that strictly follow the NAFTA model—cover investment in services exclusively through horizontal investment disciplines. However, the majority of East Asian FTAs feature both services disciplines covering commercial presence and horizontal investment disciplines.

The dual coverage of investment in services raises several questions about the transparency and depth of liberalization undertakings. In what follows, we first compare the definition of investment and the key obligations established by the two different sets of disciplines. We then describe how FTAs have sought to address possible inconsistencies between services and investment chapters, evaluating the advantages and drawbacks of the different approaches encountered.³⁷

Definition of investment and key obligations

Table 7 provides an overview of the treatment of investment in the 20 East Asian FTAs analyzed in this paper. Sixteen agreements have incorporated horizontal investment disciplines. The definition of investment in most of these sixteen agreements is broad, covering foreign direct investment, portfolio investments, and various forms of tangible and intangible property.³⁸ Only two agreements depart from this broad definition. The Framework Agreement on the ASEAN Investment Area (AIA) and the Australia-Thailand FTA limit the scope of horizontal investment disciplines to foreign direct investment (FDI). The former does not further define FDI, whereas the latter refers to the International

³⁶ WTO members considered the establishment of a multilateral investment agreement in the initial stages of the Doha Development Agenda. But no consensus on launching negotiations in this area could be formed and the topic was removed from the DDA's work programme as part of the July 2004 General Council Decision.

³⁷ See Roy (2003) for a general discussion of the treatment of investment in services under services and investment disciplines.

³⁸ For example, under the Singapore-US FTA “investment means every asset owned or controlled, directly or indirectly, by an investor, that has the characteristics of an investment. Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to applicable domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges” (Article 15.1, para. 13, footnotes omitted).

Monetary Fund's definition of FDI which uses a 10 percent ownership threshold to distinguish FDI from portfolio investment.³⁹

The definition of commercial presence in FTAs' services chapters is substantially narrower. Most FTAs that incorporate commercial presence as a mode of supply subject to services disciplines follow the GATS definition of commercial presence. This definition covers only foreign investments in services where the foreign investor holds more than 50 percent of the equity interest or exercises control over the foreign invested enterprise.⁴⁰ Foreign investments with a minority equity stake and no exercise of control are not covered by the scope of services disciplines, though they would typically be covered by horizontal investment disciplines (either as FDI or portfolio investment).⁴¹

Appendix 1 offers an overview of the most relevant disciplines found in the services and investment chapters of FTAs. The key obligations established by the two sets of disciplines are similar in one respect. Where services or horizontal investment disciplines exist, they always establish a national treatment obligation. At the same time, services chapters provide for a market access discipline, which is not always incorporated into investment chapters. In addition, services chapters often establish service-specific rules on domestic regulation not found in horizontal investment disciplines. By contrast, several obligations are, in principle, unique to investment chapters: prohibitions of performance requirements, bans on residency requirements for senior managers and boards of directors, regulations against direct and indirect expropriation, and guarantees on the free transfer of funds. Having said this, to the extent that measures covered by these obligations are discriminatory, they may also be subject to the national treatment obligation of services chapters. Finally, all horizontal investment disciplines provide for investor-state dispute settlement, which is not available under any of the services chapters (see Section 3.G).

Relationship between services and investment disciplines

In principle, the dual coverage of investment in services can be complementary or overlapping. Complementary coverage occurs whenever an investment transaction is covered by one set of disciplines, but not the other. It can emanate either from the different definitions of investment or from the different obligations established by the two sets of disciplines, as described in the previous section. Governments may specifically seek this type of complementary coverage. A horizontal investment chapter promotes equal treatment of investors in manufacturing and services and may thus promote a more transparent investment regime for multinational enterprises that are engaged in both manufacturing and the provision of services. At the same time, a parallel services chapter allows governments to

³⁹ The IMF's Balance of Payments Manual defines a direct investment enterprise "*as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 percent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise)*" (International Monetary Fund, 1993).

⁴⁰ Three East Asian FTAs—the Trans-Pacific EPA, the Lao PDR-US BTA, and the New Zealand-Singapore FTA—do not provide for a definition of what constitutes a 'juridical person of the other party', along the lines of GATS Article XXVIII(m). There is thus no link between the concept of commercial presence and ownership or control. The range of investments in services covered by these three agreements remains unclear. Since the structure of these FTAs' services chapter follows in many ways the GATS, can one assume that the GATS criteria of majority ownership or control apply? Or does the absence of a definition imply that any level of foreign participation in a juridical person would be covered?

⁴¹ The GATS definition of commercial presence extends to "*the creation or maintenance of a branch or a representative office*" (Article XXVIII). These forms of foreign presence appear to be covered also under the definition of investment adopted by horizontal investment chapters.

establish disciplines specific to the service sector, such as market access and domestic regulation.

Table 7: The treatment of investment in services

Agreement(s)	Definition of commercial presence in services chapter	Definition of investment in horizontal investment disciplines	Relationship between services and horizontal investment disciplines
Mainland-Hong Kong CEPA, Mainland-Macao CEPA	--	--	No substantial disciplines on either services or investment
Lao PDR-US BTA, Trans-Pacific EPA	GATS definition of commercial presence	--	No investment disciplines, only services disciplines apply
Chile-Korea FTA, Japan-Mexico EPA, Korea-Singapore FTA, Panama-Singapore FTA, Singapore-US FTA	--	FDI, portfolio investment and various forms of tangible and intangible property	No services disciplines, only investment disciplines apply
ASEAN Framework Agreement on Services/ASEAN Investment Area (AIA)	Not explicitly defined, but implicitly follows GATS	Foreign direct investment (not further defined)	AIA does not apply to investment in services
Australia-Thailand FTA	GATS definition of commercial presence	Foreign direct investment, as defined by IMF	One single schedule of commitments for services and investment
Australia-Singapore FTA	GATS definition of commercial presence	FDI, portfolio investment and various forms of tangible and intangible property	One single schedule of commitments for services and investment
US-Vietnam BTA, India-Singapore ECA, Japan-Malaysia EPA, Jordan-Singapore FTA	GATS definition of commercial presence	FDI, portfolio investment and various forms of tangible and intangible property	Services chapter prevails in case of inconsistencies
EFTA-Singapore FTA, New Zealand-Singapore FTA, EFTA-Korea FTA	GATS definition of commercial presence	FDI, portfolio investment and various forms of tangible and intangible property	The investment chapter's national treatment and MFN obligations do not apply to commercial presence as governed by services chapter
Japan-Singapore FTA	GATS definition of commercial presence	FDI, portfolio investment and various forms of tangible and intangible property	Relationship not expressly defined. Singapore has scheduled a reservation giving precedence to the services disciplines in case of inconsistencies with the investment chapter's obligations on national treatment and performance requirements.

Overlapping coverage occurs whenever measures affecting foreign investment in services are covered by both sets of disciplines. In principle, such overlaps would not pose a problem if the disciplines and levels of openness under the services and investment chapters were identical. However, suppose that a measure is allowed in one chapter, but prohibited in the other chapter. Which chapter would prevail? Inconsistencies of this type would undermine the transparency of the investment regime and may even give rise to legal conflicts. To remedy such inconsistencies, most East Asian FTAs that provide for dual coverage of investment in services have established rules that define the relationship between the services chapter and the horizontal investment chapter. These rules are described in the last column of Table 7.

The Framework Agreement on the AIA has taken the most drastic approach in simply removing investment in services from the scope of investment disciplines.⁴² This approach avoids any type of inconsistency, but does not provide the benefit of truly horizontal investment disciplines. Four agreements—the India-Singapore ECA, the Japan-Malaysia EPA, the Jordan-Singapore FTA, and the US-Vietnam BTA—have established a rule that gives precedence to the services chapter in case of inconsistencies.⁴³ Investment disciplines still apply insofar they affect matters not covered by the services chapter. This rule again avoids inconsistencies between the two chapters and, at the same time, preserves some of the benefits of horizontal investment disciplines. However, the transparency of the investment regime is reduced, as an understanding of what type of investments are (not) allowed requires joint reading of the two chapters and possible interpretation of what might be considered an inconsistency.⁴⁴

Three agreements—the EFTA-Singapore FTA, the New Zealand-Singapore FTA, and the EFTA-Korea FTA—have adopted a different approach. They provide that the national treatment and MFN obligations of the investment chapter do not apply to measures affecting commercial presence as governed by the services chapter. Since national treatment and MFN are the only two overlapping obligations in these FTAs, direct inconsistencies between the two chapters are avoided. This approach provides for somewhat greater transparency, as the liberalization content related to commercial presence is solely determined by the services chapter and no judgment is necessary about what might be considered an inconsistency. However, a full understanding of the investment regime for services still requires joint reading of the services and investment chapters, as the investment chapter's national

⁴² A 2001 amendment to the Framework Agreement on the AIA increases the scope of the AIA to include services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying. The relationship between ASEAN Framework Agreement on Services and the AIA for these service activities is not further defined.

⁴³ In the case of the Japan-Malaysia EPA, the precedence of services discipline only applies to inconsistencies with the investment chapter's obligations on national treatment, MFN, and performance requirements. The investment chapter takes precedence in the case of inconsistencies with all other investment disciplines. In the case of the US-Vietnam BTA, precedence of services disciplines only applies to inconsistencies between "provisions set forth" in parties' schedule of specific services commitments and the BTA's investment disciplines (see Article VII.6).

⁴⁴ For example, suppose that a sector is not subject to specific service commitments but no investment reservations are listed in that sector. Would this situation be considered an inconsistency, as one could argue that the right to restrict investment is afforded by one set of disciplines and denied by another? A side letter to the Jordan-Singapore BIT on this question makes clear that such a case would indeed be considered an inconsistency. The same conclusion may be drawn for the US-Vietnam BTA, which stipulates that the investment disciplines "shall not be construed or applied in a manner that would deprive a Party of rights" provided for in the schedule of specific services commitments (see Article VII.6). The other two agreements do not explicitly address this question.

treatment and MFN obligations still apply to those forms of investments not covered by the services chapter—notably investments with a minority equity stake and no effective foreign control.⁴⁵

The Australia-Thailand FTA and the Australia-Singapore FTA have adopted yet another approach to avoiding inconsistencies. Liberalization undertakings in these two agreements are inscribed in one single schedule of commitments, which also covers investment in goods. This approach offers the benefit of consulting only one schedule of commitments to determine the level of openness of the investment regime. Among all the agreements with dual coverage of investment in services, it appears to offer the most transparent solution to avoiding potential inconsistencies between services and investment disciplines.⁴⁶

Finally, the Japan-Singapore FTA does not establish any rule defining the relationship between services and investment disciplines. In addition, while services commitments are scheduled on a hybrid list basis, investment reservations are scheduled on a negative list basis and the two commitment schedules do not provide for identical sectoral coverage. In principle, this approach seems to offer the least transparent treatment of investment in services and may even open the door to inconsistencies between services and investment disciplines. Having said this, Singapore has scheduled a reservation which stipulates that (i) the investment chapter's obligations on national treatment and performance requirements do not apply to sectors for which no specific services commitments are undertaken; and (ii) services disciplines take precedence over investment disciplines where sectors are subject to specific services commitments.⁴⁷ This reservation eliminates potential inconsistencies and improves on transparency along the lines discussed above. Interestingly, no such reservation is found in the case of Japan.

D. Movement of natural persons

As in the case of investment, the inclusion of labor movements in trade agreements on services stems from the fact that the provision of many services requires the physical proximity of suppliers and consumers. At the same time, trade agreements typically seek the freeing of only certain labor flows—those directly linked to the provision of services, as distinct from permanent migration.

The supply of services through the movement of natural persons is recognized as the fourth mode of delivery by the GATS. However, many observers have pointed out that WTO members have so far made only limited commitments in this area.⁴⁸ A natural question therefore is whether FTAs have been able to make any progress. In Section 4, we will seek to assess this question empirically. In what follows, we will focus on two issues that escape our empirical analysis.

⁴⁵ However, the EFTA-Singapore FTA extends the non-application of national treatment and MFN to all investments in services.

⁴⁶ Theoretically, the EFTA-Singapore FTA, the New Zealand-Singapore FTA, the EFTA-Korea FTA, the Australia-Thailand FTA and the Australia-Singapore FTA leave the door open to potential inconsistencies between obligations not subject to liberalization undertakings.

⁴⁷ See Annex V.B of the Japan-Singapore FTA.

⁴⁸ See, for example, Mattoo and Carzaniga (2003).

First, we will review the different architectural approaches adopted by the East Asian FTAs towards the movement of natural persons. Even though an evaluation of the depth of liberalization undertakings on mode 4 invariably requires careful reading of all relevant commitments, certain architectural choices influence the transparency and depth of commitments. Second, we will discuss the contribution of East Asian FTAs with respect to the recognition of professional qualifications. For many professional services, trade may only be commercially attractive if trading partners recognize the credentials of foreign professionals. As discussed in Section 2, FTAs may offer a fertile forum for this type of regulatory cooperation and we will evaluate to what extent East Asian FTAs have lived up to this promise.

Architectural considerations

In considering the different architectural approaches towards labor mobility encountered in East Asian FTAs, a natural starting point is the treatment of the movement of natural persons at the multilateral level. The GATS defines mode 4 as the supply of a service “*by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.*” Additional guidance is provided in the Annex on the Movement of Natural Persons, which suggests that ‘service suppliers’ include independent service providers, the self-employed and individuals employed by foreign companies established in the territory of a WTO member. It remains unclear, however, whether individuals employed by domestic companies are covered by mode 4.⁴⁹

Two types of measures are expressly carved out from the scope of the GATS. First, the GATS does not apply to measures affecting access to the employment market of a Member nor to measures regarding citizenship, residence or employment on a permanent basis. Second, it does not prevent WTO members from regulating the entry of natural persons provided that regulations are not applied in such a manner as to nullify or impair the benefits accruing from specific commitments made by WTO members. In this context, the sole fact of requiring a visa for certain members and not for others is not regarded as nullifying or impairing benefits under a specific commitment.⁵⁰

Table 8 summarizes the architectural approaches adopted by the 20 East Asian FTAs. As can be seen, most of the positive list agreements have adopted the GATS definition of mode 4. The only two exceptions are China’s two CEPAs with Hong Kong and Macao, which do not offer any definition of modes of supply. The Lao PDR-US BTA replicates the GATS definition of mode 4, but then limits its scope to services sales persons and intra-corporate transferees. Most positive list FTAs also provide for similar carve-outs with respect to covered measures as the ones established in the GATS. Exceptions again are China’s two CEPAs with Hong Kong and Macao and the Lao PDR-US BTA, for which no comparable carve-outs are found. In addition, the services chapter of the Japan-Singapore EPA does not expressly carve out regulations affecting the entry of natural persons.

⁴⁹ See, for example, WTO Document S/C/W/75 and Nielson (2003).

⁵⁰ In this regard, it could be argued that a consistent practice of denying visas to service providers of a certain WTO Member, or plainly denying the possibility to apply for visas, may entail a nullification of GATS commitments on mode 4.

Table 8: Key architectural choices

Agreement(s)	Definition of mode 4	Separate chapter or agreement related to the movement of natural persons
<i>Positive list agreements</i>		
Jordan-Singapore FTA, New Zealand-Singapore FTA, US-Vietnam BTA	GATS	--
Lao PDR-US BTA	GATS, but limited to services sales persons and intra-corporate transferees	--
ASEAN (AFAS)	GATS	AESAN Framework Agreement on Visa Exemption
Australia-Thailand FTA	GATS	Chapter on movement of natural persons, providing for additional rights and obligations to those set out in the services and investment chapters
EFTA-Korea FTA, EFTA-Singapore FTA, Japan-Malaysia EPA	GATS	Provision on key personnel in investment chapter (or BIT)
India-Singapore ECA	GATS	Chapter on movement of natural persons, commitments subject to reservations scheduled under services chapter
Japan-Singapore EPA	GATS (weaker exception)	Chapter on movement of natural persons, commitments apply only to sectors included in a party's services schedule
Mainland-Hong Kong CEPA, Mainland-Macao CEPA	No definition	--
<i>Negative list agreements</i>		
Australia-Singapore FTA, Panama-Singapore FTA	GATS	Chapter (or annex) on movement of natural persons, commitments subject to reservations scheduled under services and investment chapters
Chile-Korea FTA, Korea-Singapore FTA, Singapore-US FTA	NAFTA	Chapter on movement of natural persons, prevailing over services chapter as far as 'immigration measures' are concerned
Japan-Mexico EPA	NAFTA	Chapter on movement of natural persons, relationship to services chapter not further defined
Trans-Pacific EPA	NAFTA	'Soft-law' chapter on movement of natural persons

Note: The precise title and substantive provisions of chapters on movements on natural persons varies from agreement to agreement.

Two of the seven negative list FTAs—the Australia-Singapore FTA and the Panama-Singapore FTA—have also followed the GATS definition of the movement of natural persons, along with the two familiar carve outs. The other five negative list FTAs—the Chile-Korea FTA, the Japan-Mexico EPA, the Korea-Singapore FTA, the Singapore-US FTA, and the Trans-Pacific EPA—have adopted a definition of the movement of natural persons that can be traced back to the NAFTA. Thus, disciplines on cross-border trade in

services apply to services supplied “*by a national of a Party in the territory of the other Party*” (whereby ‘national’ is essentially equivalent to a natural person). No further guidance is offered on what type of service suppliers are included under this definition. The concept of supply of a service *by* a national—rather than *through presence of* natural persons as in the GATS—may imply a different scope.⁵¹

The five ‘NAFTA-style’ negative list FTAs also provide for a carve-out with respect to measures affecting access to the employment market of a party. In addition, one of the five agreements—the Trans-Pacific EPA—has expressly incorporated the second GATS-style carve-out relating to regulations affecting the entry of natural persons. The Chile-Korea FTA, the Korea-Singapore FTA, and the Singapore-US FTA generally exempt immigration measures from the scope of services disciplines, thus offering a similar carve-out. Therefore, the only negative list agreement not providing for a similar exemption for regulations affecting the entry of natural persons is the Japan-Mexico EPA.

In addition to the disciplines established in the services chapters of trade agreements, a number of East Asian FTAs feature separate rules affecting the movement of natural persons (MNPs). Like for horizontal disciplines on investment, these additional rules mostly take the form of self-standing FTA chapters which establish disciplines for the entry of business persons active in goods and services sectors. The substantive disciplines and depth of commitments established in these MNP chapters varies from agreement to agreement. They typically define categories of business persons eligible for preferential treatment, including business visitors, sales persons, traders and investors, professionals, and intra-corporate transferees. The main benefit then consists of commitments on the temporary entry of natural persons in the various categories, setting out the length of stay, eligibility conditions, applicable numerical quotas, and certain safeguards that parties can invoke. All MNP chapters feature the GATS-style carve-outs regarding access to the employment market of members and the regulation of entry of natural persons.⁵²

Historically, the inclusion of a horizontal chapter on the movement of natural persons can be traced back to the NAFTA. It is thus not surprising that all of the East Asian negative list FTAs contain such a chapter.⁵³ At the same time, the establishment of horizontal rules in this area is not inherently linked to the structure of negative list agreements. Indeed, three positive list agreements—the Australia-Thailand FTA, the India-Singapore ECA, and the Japan-Singapore EPA—have also incorporated a horizontal MNP chapter.

Regardless of the scheduling approach, the dual coverage of this mode of service supply raises the question of how the two sets of disciplines are related. Just as seen in the case of investments, dual coverage can be complementary or overlapping. Complementary exists in both ways. Services disciplines apply to market access and national treatment barriers encountered ‘beyond the border’, whereas MNP chapters focus more narrowly on matters

⁵¹ On the one hand, one may argue that the NAFTA definition does not extend to foreign employees of companies, because services are eventually supplied by a juridical person. On the other hand, the involvement of foreign employees in the production, distribution, and delivery of a service by juridical persons may in itself be considered a supply of a service, so that employees would be covered.

⁵² One exception is the Chile-Korea FTA, which does not feature the second carve-out. However, the commitments on temporary entry make clear that a party may require a business person to obtain a visa in accordance with domestic immigration laws.

⁵³ However, the Chapter on Temporary Entry of the Trans-Pacific EPA is of a ‘soft-law’ nature. It merely commits parties to review the rules and conditions applicable to the movement of natural persons two years after the entry into force of the agreement.

related to the entry of foreign individuals. Conversely, the latter establish certain transparency obligations not available in services chapters and offer horizontal treatment for individuals engaged in trade in goods, trade in services and investment.

The possibility of overlapping coverage emanates from the fact that services disciplines, in principle, also apply to entry measures—to the extent that they fall under the definition of market access, national treatment, or MFN. Unless commitments in the two chapters are identical, overlapping coverage may give rise to inconsistencies. Which chapter would prevail if a measure is allowed by one chapter, but prohibited by the other chapter? Just as we saw in the case of investment, most East Asian FTAs that provide for dual coverage of the movement of natural persons feature rules that define the relationship between the two sets of disciplines (see Table 8).

As pointed out above, the Chile-Korea FTA, the Korea-Singapore FTA, and the Singapore-US FTA make clear that ‘immigration measures’ are exclusively dealt with by the MNP chapter. This rule effectively carves out measures affecting the entry of foreign individuals from the scope of the services chapter, thus providing for a clear delineation of the two sets of disciplines.

The Australia-Singapore FTA, the India-Singapore ECA, and the Panama-Singapore specify that commitments in the chapter on the movement of natural persons are subject to the limitations scheduled under the agreement’s services chapter. In addition, the services schedules of these three FTAs include a horizontal reservation according to which parties are free to adopt any MNP-related measure subject to the provisions of the MNP chapter. Effectively, this rule implies that commitments on the movement of natural persons emanate exclusively from the MNP chapter. However, any commitment in this chapter applies only to sectors covered by services commitments and, even then, may be qualified by limitations for specific service sectors as detailed in the services schedule.

A similar approach is followed by the Japan-Singapore EPA. Commitments under the agreement’s MNP chapter are effectively incorporated into the horizontal section of the two parties’ services schedules. Given the hybrid list scheduling approach of this agreement, these commitments apply only to listed sectors and are further subject to limitations scheduled for specific service sectors.⁵⁴ The Australia-Thailand FTA and Mexico-Japan FTA do not offer a clear rule setting out the relationship between the agreements’ services and MNP chapters.⁵⁵ The absence of such a rule may give rise to inconsistencies between the two chapters, but in any case reduces the transparency of the commitments made.⁵⁶

Finally, four FTAs offer additional benefits for foreign natural persons other than through dedicated chapters on the movement of natural persons. In the case of the EFTA-Korea FTA,

⁵⁴ The MNP chapter of the Japan-Singapore EPA specifies that horizontal MNP commitments apply only where specific services commitments are undertaken. At the same time, for certain service sectors, schedules of specific commitments indicate an ‘unbound’ entry for mode 4. Such situations could well give rise to inconsistencies between the two sets of disciplines.

⁵⁵ The MNP chapter of the Australia-Thailand FTA indicates as an objective the provision of rights and obligations additional to those set out in the services and investment chapters. But this language does not seem to offer any guidance on which chapter would take precedence if a measure was allowed by one chapter, but not the other.

⁵⁶ The Trans-Pacific EPA also does not feature a rule on the relationship between services and MNP disciplines. However, since the MNP chapter of this agreement does not feature any ‘hard’ commitments on the movement of natural persons, the absence of such a rule does not give rise to legal inconsistencies.

the EFTA-Singapore FTA, and the Japan-Malaysia EPA, provisions granting temporary entry for investors and certain key personnel are found in the agreements' investment chapters. These undertakings are subject to immigration laws and regulations relating to entry, stay, and work of natural persons.⁵⁷ ASEAN members, in 2006, concluded a Framework Agreement on Visa Exemption, which establishes guidelines for advancing bilateral arrangements for exempting ASEAN nationals from visa requirements.⁵⁸

Recognition of professional qualifications

For professional services, the absence of explicit trade barriers is only a necessary but not sufficient condition for the entry of foreign service providers. To effectively compete, foreign professionals must either obtain the mandated local qualifications or have their foreign qualifications recognized. For certain professions, the former may require significant educational investments over several years, which may pose a *de facto* barrier to market entry. The recognition of foreign qualifications is an option for those professions with a high degree of generic skills content—for example, doctors, architects, or engineers. Even then, a government would be only willing to consider recognition if it has confidence in the foreign educational system and professional standards applied abroad are comparable to domestic requirements. Thus, recognition is more likely to be feasible where professional standards are harmonized or, for historical reasons, share a common foundation. In such cases, governments often grant recognition on a reciprocal basis, leading to so-called mutual recognition agreements (MRAs).

What is the role of FTAs with respect to the recognition of professional qualifications? One can distinguish two contributions. First, like the GATS, many FTAs exempt recognition agreements from MFN treatment, but attach certain conditions to the conclusion of such agreements. Second, several FTAs facilitate the recognition of professional qualifications and some feature explicit commitments on recognition. We will discuss these contributions in turn.

In principle, an agreement to recognize the professional qualifications of individuals from one particular country may depart from an FTA's MFN obligation. The GATS expressly allows for such a departure provided that the WTO member in question affords adequate opportunity to other interested members to negotiate a comparable arrangement. Most East Asian FTAs that have established a binding MFN obligation (see Section 3.B) feature a similar carve-out. The only exception is the US-Vietnam BTA, for which no such carve-out is found. Under this agreement, a party's recognition agreement with a third country may therefore need to be extended to the other party of the BTA. The Japan-Mexico EPA, while exempting recognition agreements from the MFN principle, does not impose the condition of giving interested parties the opportunity to negotiate a comparable agreement. At the same time, this latter requirement is found in three FTAs that do not feature a binding MFN obligation, namely the India-Singapore ECA, the Japan-Singapore EPA, and the Korea-Singapore FTA.

As discussed in Section 2, FTAs may offer a fertile forum for directly facilitating the recognition of professional qualifications, given the small number of players involved and

⁵⁷ In the case of the EFTA-Korea FTA and EFTA-Singapore FTA, the relationship of the relevant provisions to the agreements' services disciplines is not addressed. In the case of the Japan-Malaysia EPA, the relevant provision takes precedence over services disciplines.

⁵⁸ In addition, the 1998 Framework Agreement on the ASEAN Investment Area commits ASEAN members to promote the freer flow of skilled labor and professionals.

possible similarities in qualification systems. Indeed, the majority of East Asian FTAs contain ‘soft-law’ provisions which encourage parties—or their competent regulatory bodies—to enter into negotiations towards the recognition of professional qualifications.⁵⁹ Some agreements identify specific professions for which such negotiations should take place on a priority basis. In some cases, FTAs have established a negotiating timeframe of 1-3 years after entry into force of the FTA or simply call ‘for an early outcome’.

In the FTAs under review, only five agreements feature binding commitments to recognize foreign qualifications.⁶⁰ ASEAN members concluded in 2005 a mutual recognition agreement for professional engineers, along with a set of minimum qualification requirements that eligible professionals need to meet.⁶¹ Under the Korea-Singapore FTA, again for engineering services, the two parties committed to recognize the professional qualifications obtained from 20 Korean universities (for Singapore) and 2 Singaporean universities (for Korea). The universities were to be selected by each party “*based on mutual trust and common benchmarks*”.⁶² Under the Singapore-US FTA, Singapore committed to recognize the degrees of four U.S. law schools for the purposes of admission into the Singapore Bar. However, recognition is limited to individuals who are Singapore citizens or Singapore Permanent Residents and additional qualifications in Singapore law are necessary for those individuals to be eligible for recognition. The four universities were to be selected through consultations between the two parties.

Finally, a different form of recognition is established by China’s commitments in its two CEPAs with Hong Kong and Macao. For professionals in the fields of law and healthcare, permanent residents from Hong Kong and Macao who meet certain qualification standards in those two territories are allowed to ‘sit’ the Mainland’s qualifying exams. These commitments fall short of full recognition.⁶³ But they still serve to facilitate the mobility of professionals, because they grant permanent residents from Hong Kong and Macao the right to have their qualifications tested in the Mainland without undergoing additional training in the Mainland.

E. Rules of origin

FTAs extend trade benefits to signatory parties, thereby discriminating against trade with non-parties. But what exactly constitutes trade between signatory parties that is eligible for preferential treatment? FTAs resolve this question through so-called rules of origin. In the case of goods trade, rules of origin determine to what extent products with imported intermediate inputs from non-parties qualify for trade preferences. In the case of trade in services, rules of origin are broader, reflecting the fact that services agreements apply to both

⁵⁹ Six FTAs did not feature such provisions, namely the EFTA-Korea FTA, the Japan-Malaysia EPA, the Japan-Mexico EPA, the Lao PDR-US BTA, the Panama-Singapore FTA, and the US-Vietnam BTA.

⁶⁰ Our research was confined to undertakings on recognition that are published alongside trade agreements. It is possible that negotiations between regulatory bodies subsequent to the conclusion of an FTA have led to additional recognition agreements.

⁶¹ See <http://www.aseansec.org/18009.htm>. Negotiations among ASEAN members towards an MRA for nursing professionals are at an advanced stage (see Thanh and Bartlett, 2006).

⁶² See Annex 9D of the Korea-Singapore FTA.

⁶³ In the case of medical and dental services, the Mainland fully recognizes the qualifications of Hong Kong and Macao permanent residents for the purpose of “*short-term practice in the Mainland*”.

services and service suppliers. Suppose countries A and B take part in an FTA to which country C is not a member. In principle, questions of origin arise in three different contexts:

- *Origin of services.* Would a service imported by country A from country B qualify for trade preferences, if the provision of the service relied on intermediate service imports from country C?
- *Origin of service suppliers in the form of juridical persons.* Suppose that a service provider from country C has established a commercial presence in country B. Under which circumstances, if any, would this service provider be allowed to export services to country A—through modes 1, 2, or 3?
- *Origin of service suppliers in the form of natural persons.* Suppose that an individual from country C has certain ties with country B. What kind of ties would allow this individual to export services to country A via mode 4?

As discussed in Section 2, rules of origin determine the degree of trade preferences created by FTAs. From the point of view of economic efficiency, liberal rules of origin minimize trade diversion effects and promote entry of the most efficient service providers. At the same time, they undermine the bargaining advantage that FTAs offer relative to multilateral negotiations.

In what follows, we discuss the rules of origin established by East Asian FTAs. The discussion is divided into three parts, corresponding to the three different contexts outlined above. Notwithstanding certain exceptions and interpretive uncertainties, we conclude that most agreements feature ‘fairly’ liberal rules of origin.

Rules of origin for services

The origin question for services resembles most closely the classical origin question in the case of goods trade. In the latter case, rules of origin define the level of transformation imported goods need to undergo in order for the transformed product to be exported to the FTA partner at a preferential tariff. In the case of services trade, the concepts of imported service inputs and domestic transformation are conceptually and statistically not well-developed. Indeed, it is not clear whether a transformation rule could be meaningfully applied in this area.

Implicitly, most FTAs establish a rule of origin for services through the definition of what constitutes a ‘service of another party’. Thus, services disciplines apply to services that are supplied “*from or in the territory of another party*”—corresponding to modes 1 and 2.⁶⁴ Four agreements—the India-Singapore ECA, the Japan-Singapore EPA, the Jordan-Singapore FTA and the US-Vietnam BTA—expressly allow a party to deny the benefits of the services chapter, if it establishes that the service is supplied from or in the territory of a non-party.⁶⁵ In other words, as long as a service originates within the territory of the exporting party, it would seem to be eligible for preferential treatment.

⁶⁴ The definition of a ‘service of another party’ found in FTAs mirrors the one established by GATS Article XXVIII(f). Several agreements do not provide for a definition of a ‘service of another party’, but the territoriality concept is embedded in the definition of modes 1 and 2. The only two agreements that offer neither a definition of a ‘service of another party’ nor definitions of modes of supply are China’s two CEPAs with Hong Kong and Macao.

⁶⁵ This denial of benefit provisions mirrors GATS Article XXVII(a), which applies in relation to non-members of the WTO.

This rule of origin raises non-obvious interpretive questions. Suppose a firm in country A ‘imports’ call center services from its FTA partner country B. Suppose further that the service supplier in country B subcontracts the answering of telephone calls to a company in country C, but channels the calls between countries A and C through country B and fully manages the business from country B. Would such a service qualify for preferential treatment under the FTA between A and B? Admittedly, such a question may appear theoretical. Cross-border trade in services has so far been largely unrestricted and technological advances may make it increasingly difficult to put in force trade restrictions. However, in view of the rapid growth of cross-border trade in services and associated adjustment pressures, trade protection may not be inconceivable in future and questions about the origin of services may well arise.⁶⁶

Ten East Asian FTAs feature a special rule of origin for maritime transport services.⁶⁷ Thus, maritime transport services are eligible for preferential treatment only if they are supplied by a vessel registered under the law of another party or by a person of that other party which operates and/or uses the vessel with which services are supplied. The four FTAs mentioned above again expressly allow a party to deny the benefits of the services chapter, if similar conditions are not met.⁶⁸ The intent of this special rule of origin is to exclude from preferential treatment maritime transport services which are supplied by transiting vessels which do not have any association with the exporting FTA partner.

Neither the GATS nor the East Asian FTAs establish rules of origin for services supplied through commercial presence or the presence of natural persons. For those modes of supply, services agreements define a ‘service of another member’ as a service supplied *by a service supplier* of that other member. Service suppliers, in turn, are subject to separate rules of origin which we discuss in the remainder of this section.

Rules of origin for juridical persons

FTAs feature provisions that determine to what extent a non-party service supplier established in the territory of an FTA party in the form of a juridical person can benefit from preferential treatment. Such provisions affect services exported by a juridical person on a cross-border basis, via consumption abroad, or through the establishment of a commercial presence in another FTA territory.

Table 9 summarizes the rules of origin for juridical persons established by the 20 East Asian FTAs. These rules are embedded in the definition of a juridical person, denial of benefit clauses, and extension of benefit clauses of FTA services chapters. For FTAs that subject investment in services to separate investment disciplines, additional rules are found in the definition of ‘investors of the other party’ and investor denial of benefit clauses.

⁶⁶ Mattoo and Wunsch (2004) describe that the imposition of trade restrictions on international business process outsourcing has been considered by several US states.

⁶⁷ This special rule of origin is based on GATS Articles XXVII and XXVIII(f). It is not found in the Australia-Thailand FTA, the Chile-Korea FTA, the Japan-Mexico EPA, the Korea-Singapore FTA, the Lao PDR-US BTA, the Mainland-Hong Kong CEPA, the Mainland-Macao CEPA, the Panama-Singapore FTA, the Singapore-US FTA, and the Trans-Pacific EPA.

⁶⁸ The denial of benefit provisions are modelled after GATS Article XXVII(b). However, they apply in respect of non-parties to the FTA.

Most East Asian FTAs have created ‘fairly’ liberal rules of origin, extending FTA benefits to juridical persons that are constituted or otherwise organized under the laws of a party and that have substantial business operations in the territory of that party—regardless of who owns or controls the juridical persons. In other words, service suppliers from non-parties can take advantage of the market opening negotiated under an FTA, as long as they establish a juridical person in one of the FTA member countries and are commercially active in that country. The latter requirement arguably serves to exclude ‘mailbox’ companies that merely seek to exploit an FTA’s trade preferences and that do not have any commercial interest in the country of establishment.

Table 9: Rules of origin for juridical persons

Agreement(s)	Benefits of FTA ...		Other provisions
	... limited to domestically owned or controlled service suppliers	... extended to juridical persons constituted under domestic laws and having substantial business operations in the domestic territory	
Australia-Singapore FTA, Korea-Singapore FTA, Panama-Singapore FTA,	no	yes	--
Mainland-Hong Kong CEPA, Mainland-Macao CEPA	no	yes	Offers in-depth definition of substantial business operations
ASEAN (AFAS), EFTA-Singapore FTA, Japan-Singapore EPA, Jordan-Singapore FTA, Trans-Pacific EPA	no	yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)
New Zealand-Singapore FTA	no	yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only) No substantial business operations test in investment chapter
EFTA-Korea FTA	no	yes	Benefits also extended to juridical persons with substantial business operations in the territory of any WTO member, if service supplier is owned or controlled by person of a party (services chapter only)
US-Vietnam BTA, Lao PDR-US BTA	no	yes	Parties can deny FTA benefits to investors from third country if the denying party does not maintain normal economic relations with the third party (investment chapter only)
Chile-Korea FTA	no	yes	Parties can deny FTA benefits to service providers from non-parties

			with which a party does not maintain diplomatic relations or where certain trade sanctions apply (investment chapter only)
Japan-Malaysia EPA, Japan-Mexico EPA, Singapore-US FTA	no	yes	Parties can deny FTA benefits to service providers from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply The investment chapter of the Japan-Malaysia EPA does not extend benefits to branches of enterprises of third states
Australia-Thailand FTA	yes (for services and main investment disciplines)	yes (for chapter on promotion and protection of investments)	--
India-Singapore ECA	yes (for services supplied through commercial presence and investment disciplines)	yes (for services supplied cross border and through consumption abroad)	Benefits can be denied if juridical person is owned or controlled by persons of the denying party In the case of financial services, several Singaporean banks are expressly listed as beneficiaries

Notwithstanding this liberal picture, there are important exceptions and qualifications. First, two FTAs—the Australia-Thailand FTA and the India-Singapore ECA—have adopted a significantly more restrictive rule of origin, limiting the benefits of FTAs to domestically owned or controlled firms. In countries with substantial ‘non-party’ foreign participation in the service sector, such a requirement can narrow markedly the set of service suppliers eligible for preferences. In the case of the Australia-Thailand FTA, the domestic ownership or control requirement does not apply to the agreement’s chapter on the promotion and protection of investments. In the case of the India-Singapore ECA, this requirement only applies to services supplied through commercial presence and to the agreement’s investment disciplines. It does not apply to services supplied cross-border or through consumption abroad.

Both FTAs define domestic ownership as domestic persons holding a majority equity share in the service supplier and domestic control as domestic persons having the power to name the majority of directors or otherwise directing the service supplier’s actions. Interestingly, the India-Singapore ECA adds a special rule for the supply of audiovisual, education, financial and telecommunications services. For these activities, eligible service suppliers also include juridical persons which are owned or controlled by “*the other Party*”—presumably, referring to state-owned enterprises. In the case of financial services, the agreement explicitly lists several Singaporean financial institutions that are to qualify for preferences and specifies the types and numbers of legal entities through which these institutions can supply financial services in India.

Finally, the India-Singapore ECA has a special clause that allows a party to deny FTA benefits if a juridical person is owned or controlled by persons from the denying party. Since

FTA benefits for services supplied through commercial presence are already limited to domestically owned or controlled juridical persons, this clause applies only to services supplied through modes 1 and 2.

Second, several agreements provide for a more liberal application of the substantial business operations requirement. In particular, the services chapters of the AFAS, the EFTA-Korea FTA, the EFTA-Singapore FTA, the Japan-Singapore EPA, the Jordan-Singapore FTA, the New Zealand-Singapore, and the Trans-Pacific EPA extend FTA benefits to duly constituted juridical persons with substantial business operations in the territory of *any* FTA party—not just the territory of the party in which the juridical person is constituted. The services chapter of the EFTA-Korea FTA goes further in only requiring substantial business operations in the territory of any WTO member, if the service supplier is owned or controlled by a person of a party. Finally, the investment chapter of the New Zealand-Singapore FTA eliminates the substantial business operations test altogether—requiring only establishment or registration under a party’s applicable laws.

Third, a number of agreements have incorporated foreign policy-related exceptions to otherwise liberal rule of origins. In particular, the Chile-Korea FTA (investment chapter only), the Japan-Malaysia EPA, the Japan-Mexico EPA, and the Singapore-US FTA allow a party to deny FTA benefits to a juridical person from a non-party if (i) the denying party does not have diplomatic relations with the non-party, or (ii) the denying party prohibits transactions with the enterprise in question. The Lao PDR-US BTA and the US-Vietnam BTA have incorporated a similar exception that allows the denial of benefits if the denying party does not maintain normal economic relations with the third party.

Fourth, as pointed above, most FTAs require juridical persons to be constituted or otherwise organized under the laws of a party to be eligible for FTA benefits. The concept of ‘constitution or other organization’ arguably encompasses non-incorporated legal entities such as branches and representative offices.⁶⁹ The only exception is the investment chapter of the Japan-Malaysia EPA, which expressly excludes branches of enterprises of third states from the definition of ‘investor of the other party’.

Fifth, most FTAs do not offer a definition of substantial business operations. The only exceptions are China’s two CEPAs with Hong Kong and Macao, which closely circumscribes this concept for service suppliers from Hong Kong and Macao. To qualify for trade preferences, service suppliers must have had substantive business operations for 3-5 years in Hong Kong or Macao for the services they intend to provide in the Mainland; they must have paid profit tax in Hong Kong or Macao; they must own or rent premises for business operations in Hong Kong or Macao; and more than 50 percent of employees must be Hong Kong or Macao residents (or Chinese people staying in Hong Kong or Macao on a one way permit). Additional rules exist for law firms, which require the sole proprietor and all partners of a firm to be registered as practicing lawyers.

The two CEPAs also establish a registration procedure which verifies that interested service suppliers meet the above requirements. In the case of Hong Kong, 1054 service suppliers

⁶⁹ Several negative list FTAs and investment chapters expressly refer to branches in the definition of a juridical person or the definition of an enterprise.

have submitted applications for certificates to be eligible under CEPA, of which 1014 have been approved.⁷⁰

Rules of origin for natural persons

The origin question for natural persons is relatively straightforward. An individual's economic ties with a particular country are closely linked to that individual's nationality or residency. Table 10 summarizes the rules of origin for natural persons found in the 20 East Asian FTAs. All agreements extend trade benefits to the nationals—or 'citizens'—of the signatory parties.⁷¹ In addition, a number of agreements extend benefits to individuals that have the right to permanent residency in an FTA member. In certain cases, permanent residents only qualify for trade preferences, if the importing party accords substantially the same treatment to permanent residents as to nationals in respect of measures affecting services trade.

Provided the nationality or right to permanent residency conditions are met, agreements generally extend FTA benefits regardless of whether individuals actually reside in the territory of an FTA party. The only exception is the US-Vietnam BTA, which requires natural persons to reside in the territory of the 'exporting' FTA party. For example, a US citizen residing in Hong Kong would appear to be ineligible for the trade preferences of this bilateral agreement.

Table 10: Rules of origin for natural persons

Agreement(s)	Benefits of FTA ...		Other provisions
	... extended to domestic nationals (or 'citizens')	... extended to permanent residents	
Australia-Singapore FTA, India-Singapore ECA, Jordan-Singapore FTA, Korea-Singapore FTA, Panama-Singapore FTA, Trans-Pacific EPA	yes	yes	--
Australia-Thailand FTA, Japan-Mexico EPA, Singapore-US FTA,	yes	no	--
Chile-Korea FTA	yes	yes	Benefits of chapter on temporary entry for business persons limited to citizens
AFAS, EFTA-Korea FTA, EFTA-Singapore FTA, New Zealand-Singapore FTA, US-Vietnam BTA	yes	not automatically	Benefits extended to permanent residents only if a party accords substantially the same treatment to permanent residents as to nationals in respect of services measures For US-Vietnam BTA: natural person must reside in the territory

⁷⁰ As of November 30, 2006 (see http://www.tid.gov.hk/english/cepa/statistics/hkss_statistics.html).

⁷¹ The only two exceptions are the Mainland-Hong Kong and Mainland-Macao CEPAs, as these agreements are between separate customs territories within the same nation.

			of 'exporting' party
Japan-Malaysia EPA	yes	no (for Japan) yes (for Malaysia)	--
Japan-Singapore EPA	Yes	no (for Japan) yes (for Singapore)	--
Lao PDR-US BTA	Yes	no	Definition of natural person applies to market access obligation only
Mainland-Hong Kong CEPA	Yes (for Mainland)	no (for Mainland) yes (for Hong Kong)	--
Mainland-Macao CEPA	Yes (for Mainland)	no (for Mainland) yes (for Macao)	--

F. Trade rules

Trade rules in services are generally understood as a set of disciplines designed to complement the core obligations that shape the liberalization content of trade agreements—the latter consisting mainly of national treatment, market access, and MFN. While there is no unique definition of trade rules, most attention usually focuses on four areas: domestic regulation, subsidies, government procurement, and emergency safeguards.⁷² This focus is largely explained by the fact that disciplines in these areas are only incompletely developed under the GATS. No final consensus on such disciplines could be reached during the Uruguay Round, leading the GATS to call for further negotiations to resolve rule-making in these areas. A natural question therefore is whether FTAs have been able to make any rule-making advances.

In principle, the smaller number of countries involved in FTA negotiations may offer a more fertile environment for rule-making innovations. At the same time, bilateral and regional negotiations share many of the technical challenges and regulatory sensitivities that have posed obstacles to progress at the multilateral level.

We divide the discussion of trade rules into two parts. The first part will be exclusively devoted to domestic regulation. As will be seen, this area has seen some innovation in East Asian FTAs. The second part will discuss subsidies, government procurement, and emergency safeguards, where virtually no progress has been made at bilateral and regional levels. For ease of reference, Appendix 1 offers an overview of the disciplines established by East Asian FTAs in all four areas.

Domestic regulation

Most services agreements establish disciplines on domestic regulation. These disciplines are intended to cover measures that are non-discriminatory and qualitative in nature, presumably falling outside the scope of agreements' MFN, national treatment, and market access

⁷² Other areas of trade rules include general exceptions, the treatment of monopolies and exclusive service suppliers, and restrictions to safeguard the balance of payments.

obligations.⁷³ Services agreements often refer to qualification requirements and procedures, technical standards and licensing requirements, though other measures may be covered as well. Governments adopt these types of measures for legitimate regulatory purposes—such as protecting consumers, remedying market failures, and ensuring the quality of services. At the same time, domestic regulatory measures may impose restrictions to trade in services much beyond what is warranted to attain certain policy goals.

Thus, disciplines on domestic regulation seek to ensure that internal government measures do not unnecessarily undermine the market opening offered by the core obligations on national treatment, MFN, and market access. In doing so, these disciplines serve to enhance the credibility of domestic service policies, because foreign service providers are offered some assurance that a government will not seek recourse to domestic regulatory measures to protect domestic service suppliers.

Rules on domestic regulation typically concern three different regulatory aspects:

- the administration of domestic laws, administrative decisions and other rulings;
- the necessity of domestic regulatory measures, to the extent that they impose restrictions on trade in services; and
- the establishment of sectoral regulatory disciplines.

The GATS has provisions in relation to all three aspects. Most East Asian FTAs—except the Lao PDR-US BTA, the Mainland-Hong Kong CEPA, and the Mainland-Macao-CEPA—have established rules covering at least one of them. Some FTAs have even established stronger obligations than what is found in the GATS. In what follows, we describe the key disciplines of the GATS and explore to what extent East Asian FTAs have gone beyond these disciplines.

Administration of regulatory measures

The GATS calls for regulatory measures to be “*administered in a reasonable, objective and impartial manner*.”⁷⁴ However, this requirement is limited to sectors in which WTO members have undertaken specific commitments. East Asian FTAs that have adopted a hybrid listing approach have replicated this requirement either by reproducing the relevant GATS provision in the text of the FTA or by express reference to the GATS. The only exception is the Japan-Malaysia EPA, which does not have any discipline on the administration of regulatory measures.

Negative list FTAs have followed two different routes. The Chile-Korea FTA, the Japan-Mexico EPA, and the Singapore-US FTA do not provide for a requirement to administer regulatory measures reasonably, objectively and impartially—following the original NAFTA model.⁷⁵ The Australia-Singapore FTA, the Korea-Singapore FTA, the Panama-Singapore FTA, and the Trans-Pacific EPA have adopted a requirement mirroring the one found in the GATS. However, the reach of this requirement is different in three respects. First, given the

⁷³ Services agreements typically do not define measures falling under domestic regulation and measures falling under one of the core market opening obligations in a mutually exclusive way. In principle, it is possible for a measure to fall under the scope of both domestic regulation and, say, market access. See Pauwelyn (2005).

⁷⁴ See GATS Article VI.1.

⁷⁵ Interestingly, the Singapore-US FTA has incorporated this requirement only in its financial services chapter.

negative list structure, it applies to all service sectors, rather than only to the sectors in which specific commitments are undertaken. Second, three agreements—the Australia-Singapore FTA, the Korea-Singapore FTA, the Panama-Singapore FTA—exempt all scheduled non-conforming and future measures from any discipline on domestic regulation.⁷⁶ Third, in the case of the Korea-Singapore FTA and the Panama-Singapore FTA the requirement does not apply to commercial presence, as the services chapter of these two agreement does not extend to this mode of supply (see Section 3.A).

Necessity test

The GATS features what may be called a ‘weak’ necessity test for certain regulatory measures. WTO members are required to ensure that licensing and qualification requirements and technical standards are based on objective and transparent criteria and not more burdensome than necessary to ensure the quality of a service. In addition, licensing procedures should not in themselves pose a restriction on the supply of a service. However, these requirements are subject to two important caveats. They can only be invoked if the relevant regulatory measures nullify or impair specific commitments and could not reasonably have been expected when specific commitments were made.⁷⁷

Again, East Asian hybrid list FTAs—with the exception of the Japan-Malaysia EPA—have effectively replicated the weak necessity test of the GATS. Three negative list FTAs—the Australian-Singapore FTA, the Korea-Singapore FTA and the Panama-Singapore FTA—also follow this approach, although the necessity test’s reach is different along the lines described above. The Chile-Korea FTA, the Japan-Malaysia EPA, the Japan-Mexico EPA, and the Singapore-US FTA adopt language similar to the GATS, but the necessity test applies only on a best endeavor basis.⁷⁸ In other words, these agreements provide for an even weaker regulatory discipline than the GATS.

The only East Asian FTA featuring a strong necessity test is the Trans-Pacific EPA. It lists all the requirements found in the GATS, but does not limit regulatory scrutiny to situations where specific commitments have been nullified or impaired and regulatory measures could not reasonably have been expected. The necessity test of the Trans-Pacific EPA is potentially far-reaching. In principle, it applies to all sectors, all four modes of supply, and all measures—even those for which reservations have been listed by the parties.

Sectoral disciplines

In addition to horizontal rules on domestic regulation, trade agreements may also establish regulatory disciplines for specific service sectors. Like horizontal regulatory rules, sectoral disciplines seek to ensure that legitimate regulatory interventions do not lead to unwarranted barriers to trade in services. However, sectoral disciplines can better account for the regulatory environment in which specific services are provided and thereby strengthen the reach of regulatory rules. Ultimately, greater regulatory scrutiny serves to enhance the credibility of market opening commitments in relevant service sectors.

⁷⁶ In contrast to the GATS, these three FTAs thus clearly delineate national treatment, market access, and MFN measures from domestic regulatory measures.

⁷⁷ The GATS also calls for the development of additional disciplines to ensure that qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. See GATS Article VI:4.

⁷⁸ The best-endeavor necessity test has its origins in the NAFTA.

The GATS has established regulatory rules in two service sectors—accountancy services and telecommunications services. In the case of accountancy services, WTO members agreed on a set of disciplines that, among other things, establishes a ‘strong’ necessity test for measures relating to licensing requirements and procedures, technical standards and qualification requirements. In the area of telecommunications, post-Uruguay Round negotiations led to a liberalization package that included a Reference Paper on regulatory principles. Among other things, this reference paper sets rules on network interconnection, universal service, the independence of regulatory agencies, and the allocation of the radio spectrum.⁷⁹

Several East Asian FTAs have introduced new sectoral disciplines, focusing mainly on telecommunications services and electronic commerce-related services (see Table 11).⁸⁰ In the case of the former, dedicated chapters on telecommunications have deepened the obligations of the GATS Reference Paper. In the case of the latter, FTAs have established rules on the electronic supply of services, online consumer protection, data protection, electronic signatures, and other matters. In addition to these two main areas, the Panama-Singapore FTA features certain regulatory disciplines in the maritime transport sector, such as non-discriminatory access to a list of essential port services.

Table 11: New Sectoral disciplines found in FTAs

Agreement(s)	Sector(s) covered
Australia-Singapore FTA, Korea-Singapore FTA, Singapore-US FTA	Electronic commerce and telecommunications
Australia-Thailand FTA, India-Singapore ECA, Jordan-Singapore FTA	Electronic commerce only
Chile-Korea FTA, EFTA-Korea FTA, EFTA-Singapore FTA, Japan-Singapore EPA	Telecommunications only
Panama-Singapore FTA	Electronic commerce, telecommunications, and maritime transport
AFAS, Lao PDR-US BTA, Mainland-Hong Kong CEPA, Mainland-Macao CEPA, New Zealand-Singapore FTA, Trans-Pacific EPA, US-Vietnam BTA	No sectoral disciplines

The scope of regulatory disciplines in these areas varies significantly from agreement to agreement. In addition, some of the regulatory provisions create binding obligations on the matters covered, whereas others establish only ‘soft-law’ or best-endeavor principles. A detailed comparative review of regulatory rules in East Asian FTAs and their valued added relative to the GATS would go beyond the scope of this paper.⁸¹

⁷⁹ See Gamberale and Mattoo (2002) for a detailed review of GATS regulatory rules in these two sectors.

⁸⁰ The Panama-Singapore FTA and the Singapore-US FTA have also established certain regulatory rules for financial services. For example, these FTAs require non-discriminatory access to payment and clearing systems operated by public entities.

⁸¹ See Wunsch-Vincent (2006) for a discussion of provisions on electronic commerce in US FTAs.

Government procurement, subsidies and safeguards

Government procurement of services is largely carved out from the GATS. Specifically, the GATS provides that obligations on national treatment, MFN, and market access do not apply to measures “*governing the procurement by governmental agencies of services purchased for governmental purposes*”.⁸² Most East Asian FTAs have followed the same approach or, even more far-reaching, have carved out government procurement from the scope of services disciplines altogether.⁸³ The services chapters of the Lao PDR-US BTA and the US-Vietnam BTA do not feature a special provision on government procurement. Thus, government purchases of services—like any measure affecting trade in services—are subject to the core market opening obligations of these agreements, especially national treatment.⁸⁴

In the area of subsidies, the GATS does not establish any special discipline. It merely provides for a negotiating mandate to develop necessary disciplines to avoid “trade-distortive” effects of subsidies. In the absence of special rules, subsidies in services are subject to all obligations under the GATS—most importantly, national treatment. In other words, in sectors where specific commitments are undertaken and unless national treatment limitations with respect to subsidies are inscribed, government aid offered to domestic service suppliers has to be extended on a non-discriminatory basis to foreign service suppliers. Like the GATS, East Asian FTAs have not established any dedicated disciplines for subsidies. To the contrary, rules on subsidies in ten East Asian FTAs fall short of multilateral rules as they carve out subsidies from the scope of services disciplines.⁸⁵

Finally, the GATS does not provide for a mechanism by which WTO members can temporarily depart from their commitments in response to an unanticipated surge in services imports with harmful effects on domestic service suppliers. The establishment of such emergency safeguard measures (ESMs)—similar to those provided for in the WTO Agreement on Safeguards for goods trade—was considered during the Uruguay Round, but no consensus could be achieved. The GATS merely calls for negotiations “*on the question of emergency safeguard measures based on the principle of non-discrimination*.”⁸⁶

East Asian FTAs have not established ESMs in services either. Only one agreement—the Japan-Malaysia EPA—foresees the development of guidelines and procedures for the application of ESMs within five years of the entry into force of the agreement. Interestingly, the India-Singapore ECA expressly forbids the initiation of safeguards investigations and the imposition of safeguards measures.

⁸² See GATS Article XIII. At the same time, purchases of services are covered by the disciplines of the WTO Agreement on Government Procurement. However, this agreement is a plurilateral agreement, extending only to 37 WTO members (see http://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm).

⁸³ At the same time, the majority of these FTAs feature self-standing chapters with disciplines on government procurement. Like the WTO Agreement on Government Procurement, these chapters encompass government purchases of services.

⁸⁴ The services chapters of China’s two CEPAs with Hong Kong and Macao also do not feature any provision on government procurement. But these two agreements do not establish a national treatment obligation in the first place (see Section 3.B).

⁸⁵ As shown in Appendix 1, these ten agreements are the Australia-Singapore FTA, the Australia-Thailand FTA, the Chile-Korea FTA, the Japan-Malaysia EPA, the Japan-Mexico EPA, the Korea-Singapore FTA, the New Zealand-Singapore FTA, the Panama-Singapore FTA, the Singapore-US FTA, and the Trans-Pacific EPA.

⁸⁶ See GATS Article X.

Two additional observations in relation to emergency safeguard measures are in order. First, the group of ASEAN countries has been one of the main advocates for the establishment of ESMs at the WTO.⁸⁷ At the same time, ASEAN's own regional trade agreement in services—the AFAS—does not feature an emergency safeguard mechanism.⁸⁸ Second, the lack of ESMs in bilateral and regional agreements may constrain the application of multilateral emergency safeguard measures, if WTO members were ever to agree on such measures. Unless ESMs are also incorporated into FTAs, countries departing from their GATS commitments may run afoul of their FTA liberalization undertakings and may be liable to dispute settlement under these agreements.

G. Dispute Settlement

Rules, rights, obligations, and commitments established in trade agreements are of limited value if they are not supported by an instrument capable of determining when they are being infringed and to compel parties to abide by them. Thus, most East Asian FTAs provide for dispute settlement mechanisms (DSMs) to resolve differences between parties on the interpretation and implementation of the agreements' disciplines.

Effective dispute settlement is central for harnessing the credibility benefit offered by trade agreements. The existence of a sound mechanism for remedying non-compliance with legal obligations assures traders and investors that trade policy will not become more restrictive at the discretion of the 'importing' party. In addition, when trade controversies arise, dispute resolution based on shared principles minimizes the risk of a protectionist backlash. Resort to unilateral retaliatory measures—as observed in extreme forms during the Great Depression of the 1930s—can provoke a vicious cycle of trade protection with adverse economic consequences.

Most East Asian FTAs follow the standard practice in modern FTAs of establishing two distinct dispute settlement procedures: first, a state-to-state DSM that usually applies to all chapters of an agreement—including trade in goods, trade in services, investment and intellectual property; and second, an investor-to-state DSM that applies only to disputes between a private party and a host country government on an agreement's investment disciplines.

The substantive and procedural elements of DSMs embedded in East Asian FTAs vary in important ways. In general, the effectiveness of a DSM can be seen to depend on three factors: the ability of a party to prevent the establishment of arbitral panels; the power of instruments to enforce arbitral rulings; and the mechanism's institutional underpinnings. In what follows, we will review the state-to-state and investor-to-state DSMs found in East Asia and evaluate their effectiveness along these three dimensions.

State-to-state dispute settlement

Table 12 offers an overview of the state-to-state DSMs adopted by East Asian FTAs. Except for China's CEPAs with Hong Kong and Macao and the US-Vietnam BTA, all agreements feature rules governing the resolution of disputes between parties. State-to-state DSMs

⁸⁷ In 2000, ASEAN submitted a concept paper on possible elements of an emergency safeguard mechanism (see WTO Document S/WPGR/W/30).

⁸⁸ ASEAN countries have adopted rules on emergency safeguard measures in the context of the ASEAN Investment Area (AIA). However, the AIA does not apply to investment in services (see Section 3.C).

typically apply to all FTA disciplines covering trade and investment in services. The only exception is the Japan-Mexico EPA, which removes disciplines on financial services from the reach of the agreements' dispute settlement system.

Table 12: State-to-state dispute settlement mechanisms

Agreement(s)	Type of DSM	Can parties block panels?	Remarks
Mainland-Hong Kong CEPA, Mainland-Macao CEPA, US-Vietnam BTA	None	--	--
Lao PDR-US BTA	Unilateral retaliation	--	--
Australia-Singapore FTA, Australia-Thailand FTA, Japan-Malaysia EPA, Korea-Singapore FTA	Ad-hoc arbitration	Yes	Possibility of blocking a panel by failing to appoint arbitrator or chairman.
Singapore-US FTA, Chile-Korea FTA	Ad-hoc arbitration	Yes	If not appointed by a party, panelist drawn by lot from a roster. Possibility of blocking a panel by failing to designate candidates for the roster.
Japan-Singapore EPA	Ad-hoc arbitration	Yes	If not appointed by a party, panelist shall be the Party's legal expert of the Consultative Committee. Possibility of blocking a panel by not designating legal expert to the Consultative Committee.
AFAS	Ad-hoc arbitration	No	Appointment of panelists by ASEAN Secretary-General if parties fail to do so.
New Zealand-Singapore FTA, EFTA-Singapore FTA, Panama-Singapore FTA, Trans-Pacific EPA	Ad-hoc arbitration	No	Appointment of panelist by WTO Director-General if one party fails to do so.
EFTA-Korea FTA	Ad-hoc arbitration	No	Appointment of panelist by WTO Director-General if one party fails to do so, or ultimately drawn by lot from a list submitted by one party only.
Jordan-Singapore FTA	Ad-hoc arbitration	No	Appointment of panelist by WTO Director-General if one party fails to do so.
Japan-Mexico EPA	Ad-hoc arbitration	No	Panelist drawn by lot from a list submitted by one party only. Financial services excluded from DSM.
India-Singapore ECA	Ad-hoc arbitration	No	Panel composed of one single panelist if one party fails to make its appointment. If both parties appoint panelists, chairman can be drawn by lot from a list submitted by one party only.

In many ways, state-to-state DSMs found in FTAs share many of the procedural elements of the WTO Dispute Settlement Understanding (DSU). In particular, they typically foresee three procedural stages: consultations, decision, and implementation. The consultations phase offers a diplomatic forum for discussion, ideally leading to a mutually satisfactory

solution to the dispute between the parties. Even if consultations fail to produce such a solution, they can serve the parties to better understand their respective positions and the measures at issue, providing the basis for well-informed arbitration.

If consultations do not lead to a resolution of the dispute, most FTAs foresee the establishment of an arbitral panel that decides on the consistency of the measures in question with the obligations established in an FTA. It is at this second stage where significant differences between DSMs exist. WTO dispute settlement rules do not require the party complained against—the ‘defending’ party—to consent to the establishment of an arbitral panel. In fact, this feature of the WTO DSU was brought about by the Uruguay Round and has been hailed as one of the most important improvements in multilateral dispute settlement.⁸⁹

Nine East Asian FTAs have followed the WTO DSU in providing for a ‘right to a panel’ (see Table 12). Typically, parties are required to appoint the panelists charged with ruling on the dispute. In case a party fails to do so—or fails to put forward candidates for a list from which panelists are selected—the relevant DSMs have established mechanisms to overcome a possible procedural deadlock. Several agreements have directly followed the WTO DSU in allowing the complaining party to ask the Director-General of the WTO to perform the necessary appointments if the defending party fails to make its appointment(s). Other agreements provide for a missing panelist to be drawn by lot from a list submitted only by the complaining party. The India-Singapore ECA has a unique provision according to which a panel can be composed of a single panelist appointed by the complaining party.

By contrast, the DSMs of seven East Asian FTAs ultimately allow parties to block the establishment of panels. Even though those agreements also require parties to appoint panelists, they do not feature any mechanism to resolve a procedural deadlock if a party fails to make its appointment(s) or fails to put forward candidates for the list from which panelists are to be selected. Experience with dispute settlement under NAFTA has shown that ‘defending’ parties make use of this procedural loophole to prevent the establishment of arbitral panels.⁹⁰

The possibility of blocking the establishment of arbitral panels limits the effectiveness of dispute settlement. Moral suasion and the fact that trade disputes are ‘repeated games’ with reversing roles may still induce the defending parties to agree to the establishment of arbitral panels. But from the point of view of private traders and investors, the absence of an automatic right to a panel introduces uncertainty that ultimately reduces the credibility of FTA liberalization undertakings.

⁸⁹ See, for example, Hoekman and Mavroidis (2000).

⁹⁰ The issue of establishment of a panel under NAFTA Chapter 20 disciplines arose in the context of the Mexico – Soft Drinks dispute at the WTO. In that case, Mexico argued that a complaint against the United States under NAFTA “stalled at the stage of constituting the arbitral panel because of the United States’ refusal to appoint panelists and to agree on the appointment of a chairperson” (response by Mexico to Question 7 from the Panel). On the same matter, the United States expressed that “[u]nlike the DSU, which permits a party to request that the Director-General appoint panelists 20 days after the panel’s establishment if the parties are unable to agree, there is no parallel provision in the NAFTA. As Mexico concedes: ‘NAFTA’s Chapter Twenty lacks the automaticity of the DSU.’ In this regard, the NAFTA Secretariat did not appoint panelists in the NAFTA sugar dispute pursuant to Mexico’s request, because under NAFTA dispute settlement rules the NAFTA Secretariat does not have the authority to appoint panelists” (response by the US to Question 76 of the Panel). See Panel Report on Mexico – Soft Drinks, WTO Document WT/DS308/R, Annex C, pages C-5 and C-87, respectively.

The decision of an arbitral panel determines the consistency of the disputed measures with FTA obligations and, in certain cases, may also provide recommendations to parties on how to best put inconsistent measures into conformity with FTA rules. Most East Asian FTAs follow the WTO's dispute settlement system in allowing the defending party a 'reasonable' period of time to implement the panel's decision. If the complaining party feels that the implementation period proposed by the defending party is excessive, it can seek a further arbitral decision on what timeframe can be considered reasonable. The Chile-Korea FTA has sought to expedite the implementation process by requiring panel decisions to immediately spell out a timeframe for compliance. The ASEAN DSM goes even further in setting a uniform 60-day implementation period from the adoption of the panel decision, unless the parties to the dispute agree otherwise.

If the defending party has not complied with the panel's decision at the end of the implementation period, the complaining party has the right to retaliate. Like under the WTO DSU, retaliation in FTAs takes the form of suspending trade benefits equivalent in value to the damages caused by the defending party's inconsistent measures. The economic drawbacks of this form of 'shoot yourself in the foot' enforcement are well-known.⁹¹ Nonetheless, parties to most FTAs see the suspension of trade benefits as the only effective political economy instrument to induce implementation of panel decisions. One noteworthy innovation is introduced by the DSM of the Singapore-US FTA. Under this agreement, the defending party can avoid the suspension of trade benefits by offering the complaining party the payment of an annual monetary compensation. Unless the parties agree otherwise, the amount of the compensation is equivalent to 50 percent of the level of damages suffered by the complaining party.⁹²

The Lao PDR-US BTA stands out with a unique dispute settlement system. While parties are encouraged to hold consultations on matters relating to the interpretation and implementation of the agreement, the BTA does not provide for arbitral panels if consultations cannot resolve parties' differences. Instead, a party can make a unilateral determination that the other party has failed to implement one or more obligations and request compensation for the damages suffered. If the requested party fails to provide such compensation, the agreement allows the requesting party to unilaterally determine and impose retaliatory measures equivalent in value to the damages suffered. Arguably, the lack of independent arbitration under the Lao PDR-US BTA transforms disputes resolution into a power-driven—rather than law-based—system. As pointed out above, unilateral retaliatory measures can exacerbate trade controversies rather than solve them, especially when non-compliance with BTA obligations is not obvious. In addition, differences in the size of the two parties' economies suggest that the agreement's retaliation mechanism may be effectively used by one party only.

Finally, the credibility of a DSM does not depend only on its procedural rules, but also on the broader institutional framework in which it is embedded. At the multilateral level, the WTO Secretariat provides legal assistance for arbitral panels, drawing on a pool of experienced trade lawyers. In addition, parties have the right to appeal panel decisions in front of a permanent seven-member Appellate Body. Since the establishment of the WTO in 1995, there have been more than 100 panel decisions and more than 70 rulings by the WTO's Appellate Body—forming a substantial body of accumulated case law. The record of WTO

⁹¹ See, for example, Hoekman and Mavroidis (2000) and Pauwelyn (2000).

⁹² In principle, the WTO DSU also allows for "mutually acceptable compensation" if rulings are not implemented within a reasonable period of time (Article 22.2 of the DSU). However, the term "compensation" is generally understood to take the form of trade concessions. In any case, no WTO dispute has so far made use of this option.

members in implementing arbitral decisions is generally considered good, notwithstanding implementation deficiencies in certain cases.⁹³

No comparable institutional underpinnings exist in FTAs. Most agreements establish ad-hoc administrative committees composed of government officials from the parties, but no self-standing secretariats with the mandate and capacity to provide legal support to arbitral panels. In addition, they do not provide for the possibility of appealing the findings of arbitral panels. The only exception is the ASEAN dispute settlement mechanism. It has both an independent secretariat equipped to provide legal support and a permanent Appellate Body, closely following the WTO model. However, to our knowledge, no disputes have led to the adoption of panel or Appellate Body reports under ASEAN, so far. This may, in part, reflect the fact that the ‘enhanced’ ASEAN DSM was only created in 2004.⁹⁴

To the extent that the weaker institutional underpinnings of FTA DSMs lower the real or perceived quality of dispute settlement, parties may be more reluctant to implement adverse panel decisions—thereby reducing the credibility of FTA commitments.

Investor-to-state dispute settlement

As suggested by their name, investor-to-state DSMs afford private investors the ability to invoke an FTA’s (or separate) investment disciplines directly against a government before an international arbitration court. This form of dispute resolution offers certain advantages to foreign investors. They do not need to convince their home governments to challenge non-compliant measures of the host country. In addition, if arbitral tribunals confirm the inconsistency of host country measures with investment disciplines, foreign investors can request monetary compensation for the damages suffered. A government’s acceptance of such scrutiny, in turn, can strengthen the credibility of its investment regime. At the same time, economists disagree about the extent to which the credibility afforded by this form of arbitration is associated with greater foreign investment flows, with some studies suggesting only a small, if any, effect.⁹⁵

It is also worth noting that foreign investors invoke this form of arbitration mostly when a government’s action leads them to exit a market—especially, in the case of asset expropriation. The pursuit of international arbitration implies a rupture in an investor’s relations with the host government, which may be difficult to reconcile with continued business operations. In addition, investor-to-state arbitration decisions do not require governments to bring non-compliant measures into conformity with an agreement’s investment disciplines, thus offering no forward-looking relief for foreign investors. From an investor’s viewpoint, state-to-state and investor-to-state arbitration should therefore be seen as complements, rather than substitutes.⁹⁶ From the viewpoint of defending governments, in turn, some arbitral decisions have been criticized for their ‘expansive’ interpretation of treaty

⁹³ See Hoekman and Mavroidis (2000).

⁹⁴ The original ASEAN DSM was created in 1996, but was perceived as ineffective due to a lack of independent decision-making. See Greenwald (2006).

⁹⁵ Hallward-Driemeier (2003) and Rose-Ackerman and Tobin (2005) find no or only a weak empirical relationship between the existence of a bilateral investment treaty and inflows of foreign investment. However, using a different estimation sample, Neumayer and Spess (2005) find a strong positive relationship.

⁹⁶ For a more detailed discussion of the benefits and drawbacks of state-to-state versus investor-to-state arbitration, see Molinuevo (2006).

provisions, creating more burdensome obligations than those originally intended by the signatory parties.⁹⁷

All of the sixteen East Asian FTAs that have an investment chapter or a separate investment treaty provide for investor-to-state dispute settlement. For agreements with dual coverage of investment in services, the reach of an investor-to-state DSM depends critically on the rules that define the relationship between trade in services and horizontal investment chapters (see Section 3.C). For example, private investors in services may not be able to challenge national treatment violations through investor-to-state arbitration, if an agreement gives precedence to services disciplines in the legal effect of the national treatment obligation.

The ability of a foreign investor to initiate an arbitration claim depends on whether that investor is covered under the rule of origin established by an FTA or investment treaty. In other words, access to investor-to-state arbitration is itself a trade preference. As discussed in Section 3.E, most East Asian FTAs feature liberal rules of origin which include all service providers constituted under the laws of a party and engaging in substantive business operations, regardless of who owns or controls them.

In addition to being a covered investor, the initiation of investor-to-state arbitration proceedings may be subject to the consent of the affected government. Most East Asian FTAs and investment treaties provide for automatic consent to arbitration by the parties. Exceptions are the EFTA-Singapore FTA and the New Zealand-Singapore FTA, which allow parties to block the initiation of arbitration claims. In the case of the EFTA-Korea FTA, a party's consent to arbitration depends on the nature of the dispute. Automatic consent only applies to disputes initiated by foreign investors that already have an investment position in a host country and not to those involving investors that merely seek to make an investment. As in the case of state-to-state dispute settlement, the absence of a right to arbitration may weaken the effectiveness of an investor-to-state DSM and, ultimately, the credibility of the investment regime.

Most East Asian investor-to-state DSMs follow standard international practice in allowing for two types of arbitration procedures. Foreign investors can submit their arbitration claims either to the International Centre for the Settlement of Investment Disputes (ICSID) or to ad-hoc arbitral tribunals established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). Exceptions are the Australia-Thailand FTA, which provides only for the former, and the EFTA-Singapore FTA, Jordan-Singapore FTA, and New Zealand-Singapore FTA, which provide only for the latter.

Finally, some agreements feature special provisions for investor-to-state disputes in the area of financial services. As pointed out in Section 3.A, the provision of financial services raises special regulatory sensitivities, which have led several governments to shun the exposure of measures in this sector to the full scrutiny of an investor-to-state DSM.⁹⁸ Thus, the EFTA-Korea FTA, the Korea-Singapore FTA, and the Singapore-US FTA require authorization

⁹⁷ According to some legal commentators, certain arbitral decisions have interpreted the concept of 'investment' to include transactions that parties did not intend to be covered. Similarly, certain interpretations of obligations relating to 'fair and equitable treatment' and measures 'tantamount to expropriation' have been considered to go beyond parties' original intentions. In response to some of these arbitral decisions, the United States and Canada have included interpretative notes in their BITs and FTA investment chapters, clarifying the scope of the fair and equitable treatment and expropriation provisions. See Sornarajah (2004).

⁹⁸ The Chile-Korea FTA and the Japan-Mexico EPA fully carve out financial services from the scope of the agreements' investment chapter. By design, investor-to-state dispute settlement therefore does not extend to financial services in these cases.

from a joint FTA committee to proceed with investor-to-state arbitration, if the defending government invokes one of the exceptions to financial services disciplines. These exceptions relate to prudential measures, monetary and exchange rate policies, and matters affecting the soundness and integrity of the financial system (see Section 3.F). If the joint FTA committee does not reach a conclusion, the EFTA-Korea FTA allows the investor to proceed with its arbitration claim. The Korea-Singapore FTA and the Singapore-US FTA instead allow the defending party in this case to request the establishment of a state-to-state arbitration panel that makes a binding ruling on the legality of the exceptions defense.

Yet another special provision on investor-to-state arbitration in financial services is found in the Panama-Singapore FTA. The agreement allows arbitration claims based on the breach of certain obligations only—namely, expropriation and compensation, transfer of funds, and denial of benefit. Thus, even though the Panama-Singapore FTA provides for national treatment, MFN and market access in financial services, private investors cannot bring arbitration claims against governments pertaining to breaches of these core market opening obligations.⁹⁹

4. Where and how far have East Asian FTAs gone beyond the GATS?

In this section, we evaluate to what degree the 20 East Asian FTAs with a substantial services component have led to wider and deeper trade commitments relative to the state of play in the GATS. For this purpose, we created a database that identifies the ‘value added’ of FTAs for each of the 154 sub-sectors and four modes of supply identified under the GATS. In particular, we classified the resulting 616 entries per FTA schedule into four categories:

- (i) Sub-sectors and modes for which only a GATS commitment exists or an FTA does not offer any improvement (*GATS only*);
- (ii) Sub-sectors and modes for which a partial GATS commitment exists and an FTA eliminates one or more remaining trade-restrictive measures (*FTA improvements*);
- (iii) Sub-sectors and modes for which no GATS commitment is available, but an FTA commitment is made (*FTA new sectors*); and
- (iv) Sub-sectors and modes for which neither a GATS nor an FTA commitment exists (*Unbound*).

In addition, for categories (i), (ii), and (iii), we further distinguished between partial and full commitments, with the latter defined as not listing any remaining trade-restrictive measures.

Our detailed methodology for classifying commitments into the four categories is described in Appendix 2. Several important methodological elements are worth pointing out here. First, we define trade-restrictive measures as all measures that are inconsistent with GATS-style market access and national treatment disciplines. As further explained in Appendix 2, these two disciplines implicitly capture the additional obligations on local presence, senior managers and boards of directors, and performance requirements found in negative list agreements. In recording trade-restrictive measures, we did not separately identify market

⁹⁹ The purpose of extending application of the investor-to-state DSM to the denial of benefit provision is not clear. One motivation may be to prevent governments from circumventing the expropriation and transfer of funds disciplines by simply denying investors the benefits of the investment chapter. At the same time, the question arises whether investors could challenge violations of national treatment, market access, or MFN as a denial of benefit.

access and national treatment measures. Thus, a partial commitment corresponds to a commitment that maintains at least one trade-restrictive measure in either the market access or national treatment category; a full commitment corresponds to a commitment that does not list any trade-restrictive measure in either of these two categories.

Second, we treated horizontal commitments in ‘hybrid’ GATS-style schedules as if they were inscribed in each scheduled sub-sector. While this approach follows GATS scheduling guidelines, it departs from similar quantification exercises performed in the previous literature.¹⁰⁰ In comparison to those studies, we thus obtain a smaller number of full commitments—especially for Mode 3 where most countries have scheduled horizontal limitations. Third, commitments without any trade-restrictive measures that did not cover the full sub-sector (as defined under the GATS) were classified as partial commitments.

Quantifying services commitments in the way described above allows for meaningful comparisons. At the same time, our approach has a limitation that is inherent to any analysis of services trade policy. Even though we may record that an FTA improves in a certain sub-sector relative to the GATS, we do not measure the depth of the underlying improvement. For example, a country may raise in one FTA the foreign equity ceiling in the banking sector from 40 to 45 percent and in another FTA eliminate a prohibition on branch banking; we would classify both commitments as partial improvements even though the latter is arguably more far-reaching than the former.

Ideally, we would like to measure the tariff-equivalent of services trade liberalization: trade barriers fall from x to y percent of the import value. But trade protection in services is exercised through a variety of non-tariff measures and empirically assessing their *de facto* restrictiveness remains a fundamental challenge.¹⁰¹ To partially remedy this deficiency, Appendix 3 offers descriptive summaries of the key liberalization measures offered by the East Asian FTAs examined. While selective, these summaries are intended to complementing our quantitative findings presented in this section.

A second caveat is that we do not evaluate whether trade commitments imply actual market opening or merely bind services policies at or above the existing status quo. For example, domestic services policy in ASEAN countries is usually more liberal—on an MFN basis—than the commitments negotiated under the ASEAN Framework Agreement on Services.¹⁰² By contrast, the bulk of China’s commitments under the Mainland-Hong Kong and Mainland-Macao Closer Economic Partnership Agreements imply new market opening. For the most part, China’s bilateral liberalization undertakings grant Hong Kong and Macao-based service providers preferential access to the Chinese market, in advance of the liberalization schedule to which China committed when it acceded to the WTO in 2001. Some of the bilateral preferences will be eroded by 2008 once China’s GATS commitments are fully phased in; others will be long-lasting (see Fink, 2005). Carefully evaluating to what extent the East Asian FTAs provide for *de novo* liberalization was beyond the scope of this study.

¹⁰⁰ For example, in quantifying the results of Uruguay Round services commitments, Hoekman (1996) treats horizontal commitments as a separate sub-sector. Marko (1998) ignores horizontal commitments in quantifying the results of the WTO Agreement on Basic Telecommunications Services.

¹⁰¹ Some studies have attempted to refine measurement of trade policy in certain service sectors. See Findlay and Warren (2001) for a review. However, the results of these studies have been mixed and they typically cover only a subset of service sectors.

¹⁰² See Fink (2006) and Stephenson and Nikomborirak (2002).

In what follows, we use our database to analyze the liberalization content of the 20 East Asian FTAs. We first focus on the set of 20 agreements as a whole and then assess their contribution at the level of individual countries.

Aggregate assessment

Thirteen East Asian countries participated in at least one of the 20 FTAs that form the basis of our analysis, for a total of 32 schedules of commitments.¹⁰³ Drawing on our database, Annex A depicts the liberalization content of FTAs relative to the GATS for each of these 32 schedules (in alphabetical order of the scheduling country). The first graph for each schedule presents this information by the 12 main service sectors identified under the GATS. The bars for the four liberalization categories are relative to the total number of sub-sectors and modes in a given sector. (The number of sub-sectors ranges from 4 for environmental services, health-related and social services, and tourism and travel-related services to 46 for business services).¹⁰⁴ The second graph for each schedule breaks the information down by the four modes of supply and depicts an aggregate total (again, all bars are in relative terms).

As can be seen from the figures in Annex A, the ambition of liberalization undertakings varies considerably. At one end of the spectrum, most schedules under the ASEAN Framework Agreement on Services (AFAS) show few improvements over GATS commitments and only a small number of new sub-sectors are listed.¹⁰⁵ Similarly, Malaysia's commitment under the Japan-Malaysia Economic Partnership Agreement and Thailand's commitment under the Australia-Thailand FTA offer limited value added relative to the GATS. At the other end of the spectrum, Laos' commitment under the Lao PDR-US BTA can be considered the most ambitious of all East Asian agreements. As described in Section 3.A, Laos subscribed to full national treatment across all sectors and to full market access in a large number of sectors—including professional, telecommunications, construction, distribution, financial, health and education services.¹⁰⁶ Since Laos is not yet a member of the WTO, its bilateral commitment breaks new ground in binding services policies under international law.

There are other agreements that offer substantial value added vis-à-vis the GATS, notably the commitments made by Japan, Korea, and Singapore in their FTAs.¹⁰⁷ In fact, the GATS commitments of these three high income countries are already among the most liberal in the East Asia region.¹⁰⁸ This point is illustrated in Figure 3, which plots for each FTA schedule the total share of sub-sectors and modes covered by a country's GATS commitment against the equivalent share for the FTA commitment. As can be seen, greater willingness to commit at the FTA level seems to be positively associated with the level of multilateral openness. This finding is not obvious. In principle, the scope for widening and deepening trade commitments in FTAs should be greater for countries with fewer commitments under the

¹⁰³ Hong Kong and Macao did not make specific commitments under their Closer Economic Partnership Agreements with China.

¹⁰⁴ By definition, the residual sector 'Other services not included elsewhere' is not further broken down into sub-sectors.

¹⁰⁵ Thanh and Bartlett (2006) offer a comprehensive analysis of the achievements of AFAS.

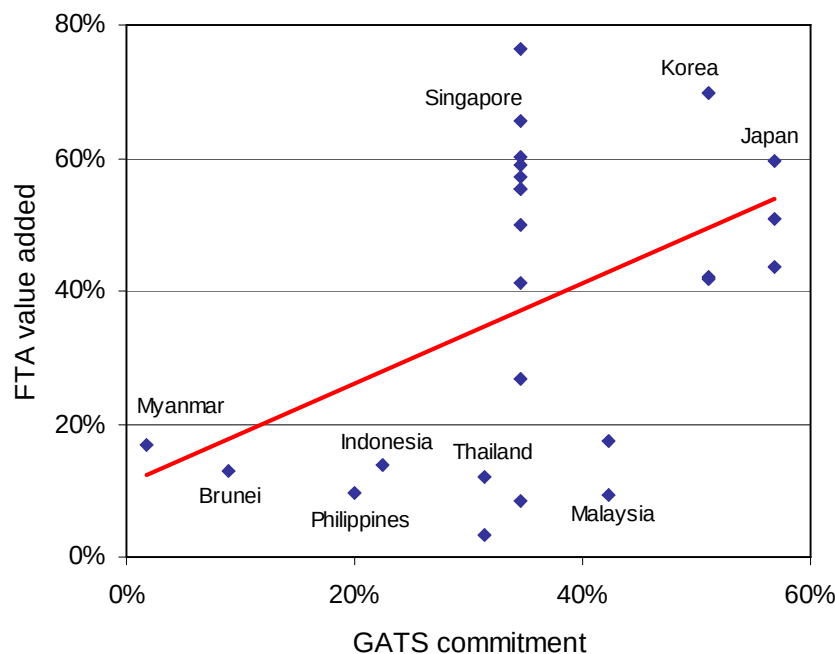
¹⁰⁶ However, the definition of Mode 4 under the Lao PDR-US Bilateral Trade Agreement is limited to services sales persons and intra-corporate transferees.

¹⁰⁷ Having said this, Singapore's commitment under the ASEAN Framework Agreement on Services has limited ambition, mirroring the commitments made by fellow ASEAN members.

¹⁰⁸ We use the World Bank's definition of high income countries here. See World Bank (2005b).

GATS. But it turns out that most of the low and middle income East Asian WTO members have so far used FTAs only in a limited way to widen and deepen their already less ambitious GATS commitments.

Figure 3: Ambition of GATS versus FTA value added



Notes: The dataset used for this figure excludes the commitments of Laos and Vietnam, which are not yet members of the WTO. It also excludes the commitments of Cambodia and China, which acceded to the WTO after the conclusion of the Uruguay Round. Given the non-reciprocal nature of accession negotiations, GATS commitments resulting from accession processes are substantially wider and deeper than those negotiated during the Uruguay Round. The share of GATS commitments is based on all sub-sectors and modes with a partial or full commitment (regardless of subsequent FTA commitments). The share of FTA commitments is based on all sub-sectors and modes for which improved or new partial/full commitments relative to the GATS were made.

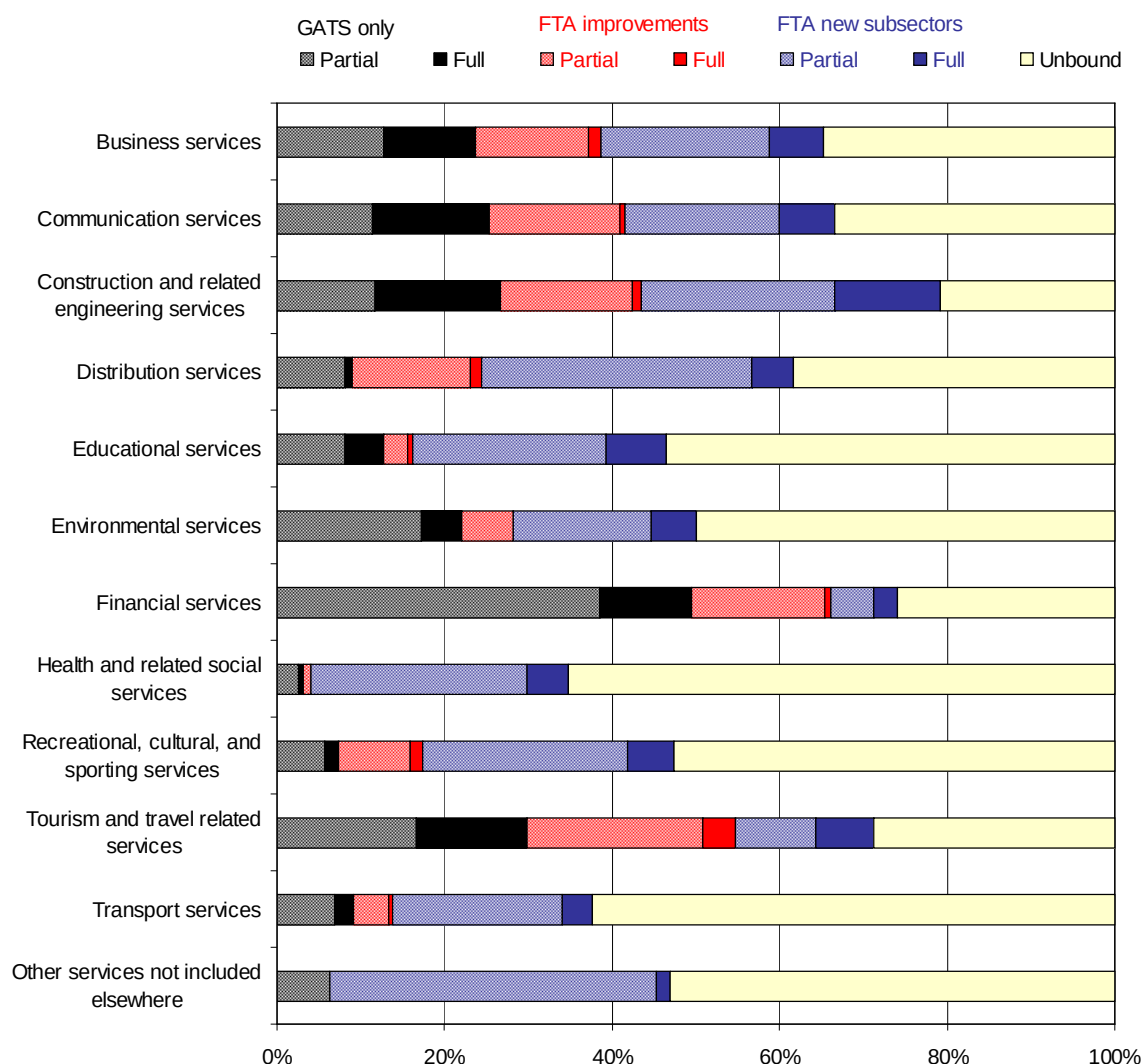
Are the contributions of FTAs evenly spread across sectors and modes of supply or are there specific areas in which FTAs seem more likely to make progress? To answer this question, we computed the aggregate (unweighted) liberalization content of all the 32 schedules in our database. Figure 4 depicts the results of this exercise broken down by the 12 main service sectors. As in the agreement-specific figures, the bars for the four liberalization categories are relative to the total number of sub-sectors and modes in a given sector. Several patterns can be observed. First, the contributions of East Asian FTAs are not limited to particular sectors. FTAs offer improved and new commitments in all of the 12 main service sectors.

Second, construction and distribution services have received the most attention in FTAs, with more than 50 percent of sub-sectors and modes showing improved or new FTA commitments. This is followed by tourism, business, communications, and recreational, cultural, and sporting services, with approximately 40 percent of sub-sectors and modes showing an FTA value added. The smallest contributions have been made in education, environmental, health, transport, and financial services, with only 25 to 31 percent of sub-sectors and modes showing improved or new FTA commitments. This result confirms the

well-known sensitivities towards liberalization in these sectors, even though FTAs were still able to make some inroads towards greater openness. In the case of financial services, the comparatively modest contribution of FTAs may also be due to the already wide coverage of GATS commitments—an outcome of the post-Uruguay Round financial services negotiations in 1997.

Third, the overwhelming share of FTA commitments are still of a partial nature. While this may to some extent reflect our strict criterion for classifying a commitment as ‘full’ (see above), it is apparent that FTAs do not provide for immediate free trade across the board, but only offer a step in that direction.

Figure 4: Aggregate liberalization content by sector

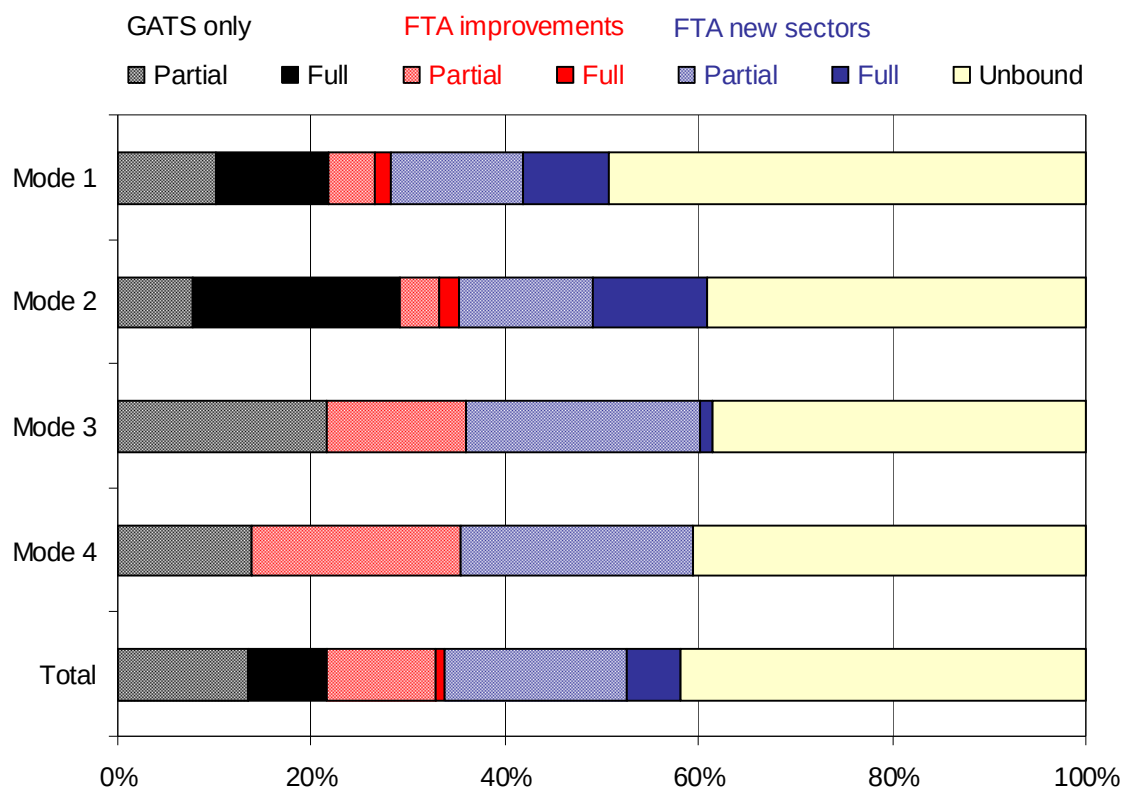


Notes: The commitments shown here are the unweighted aggregate total of the 32 schedules shown in Annex A.

Figure 5 shows the same aggregate liberalization content but this time broken down by the four modes of supply. Again, two patterns bear brief discussion. First, mode 4 has seen the greatest share of improved or new FTA commitments (46 percent), followed by mode 3 (40 percent), mode 2 (32 percent), and mode 1 (29 percent). However, in most cases the value

added offered by FTAs in the area of temporary labor movement is small, consisting mostly of minor expansions in the type of labor flows and measures covered by the agreement. Few of the FTAs provide for expanded quotas for individual service providers or the elimination of economic needs tests. Second, the share of full FTA commitments is substantial for mode 1 (10 percent) and mode 2 (14 percent). As in the GATS, this pattern reflects the absence of horizontal limitations for cross-border supply and consumption abroad in most FTAs and the fact that trade restrictions for these two modes are less pervasive—and, indeed, often not feasible. The share of full commitments for mode 3 is around 2 percent and solely attributable to the commitments made by Laos under the Lao PDR-US BTA.

Figure 5: Aggregate liberalization content by modes of supply

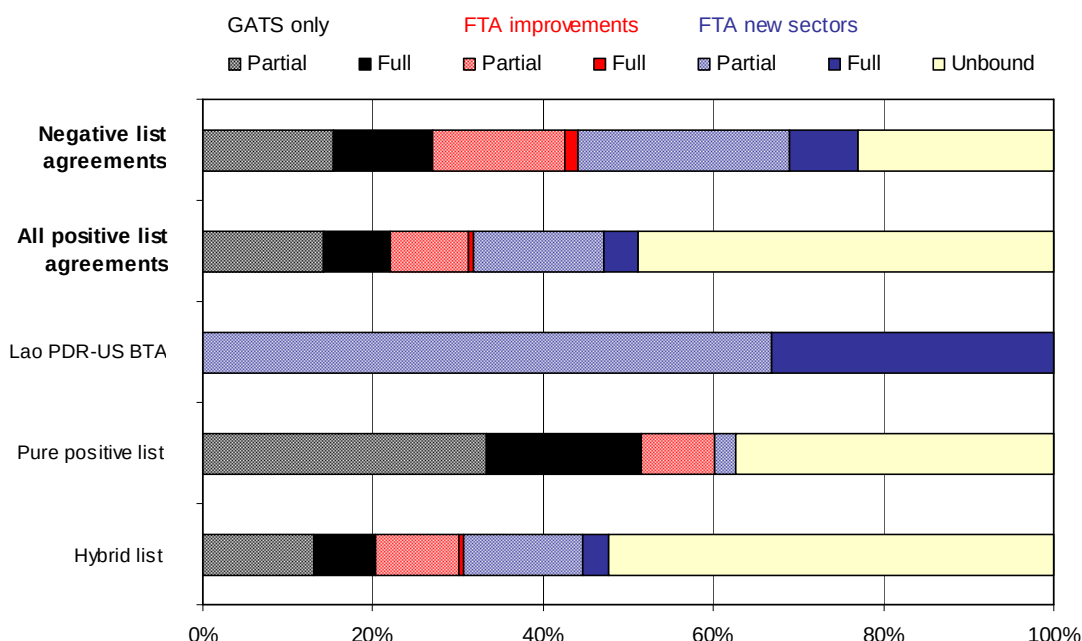


Notes: See Figure 4.

Finally, we can also use our database to investigate whether FTA commitments differ according to the scheduling approach chosen. In Section 3.A, we distinguished between three types of positive list agreements—the Lao PDR-US BTA, pure positive list, and hybrid list—and negative list agreements. As discussed in that section, some observers have argued that a negative list approach offers incentives for the scheduling of more liberal commitments. Is this presumption borne out for East Asian FTAs? At first glance, the answer appears to be ‘yes’. Figure 6 depicts the aggregate liberalization content for all positive list agreements, the three different types of positive list agreements, and negative list agreements. As can be seen, the group of positive list agreements has unleashed a smaller share of improved or new commitments (29 percent) than negative list agreements (50 percent).¹⁰⁹

¹⁰⁹ Within the group of positive list agreements, pure positive list FTAs appear to have unleashed the smallest shares of improved or new commitments (11 percent in total). However, this category is made up of only two

Figure 6: Aggregate liberalization content by scheduling approach



Notes: See Figure 4. For a list of agreements in the various categories shown, see Figure 2. As discussed in Section 3.A, two of the negative list agreements have adopted a hybrid list for cross-border trade in financial services (Modes 1, 2, and 4) and one negative list agreements has adopted a hybrid list for all trade in financial services (Modes 1, 2, 3, and 4). The relevant commitments for these cases were allocated to the hybrid list category.

At the same time, the relationship between the scheduling approach and the ambition of liberalization undertakings is not straightforward. The case of the Lao PDR-US BTA illustrates that far-reaching liberalization can also be achieved through a positive list of sectors. Even comparing FTAs negotiated by the same country, negative list agreements do not always provide wider and deeper coverage. For example, Singapore's schedule under the positive list Japan-Singapore EPA shows more improved and new commitments than Singapore's schedule under the negative list Australia-Singapore FTA (see Figures A19a/b and A22a/b in Annex A).¹¹⁰

In addition, the empirical patterns depicted in Figure 6 do not permit the conclusion that a negative list approach *causes* the scheduling of more liberal commitments. As discussed in Section 3.A, causality may well run in the opposite direction. Countries that are prepared to offer or demand greater openness in services may be more likely to seek a negative list to scheduling commitments.

In Box 1, we describe an econometric investigation that controls for countries' propensity to commit to open service markets using FTA partners' level of economic development. We still find a positive effect of negative list agreements on the FTA liberalization content, but this effect is solely explained by the scheduling of new sub-sectors and modes. FTA

agreements: China's CEPAs with Hong Kong and Macao. As discussed in the text, these two agreements imply substantial actual liberalization, even though the number of sub-sectors covered by them appears modest.

¹¹⁰ Both agreements were concluded around the same time: the Japan-Singapore EPA in 2002 and the Australia-Singapore FTA in 2004.

improvements over existing GATS commitments were not affected by the scheduling approach. However, given the limitations of our database and the fact that other factors are likely to determine countries' 'natural' propensity to liberalize, these findings should be considered as tentative.

Box 1: An econometric evaluation of the contribution of negative list agreements

Our database on East Asian trade commitments allows us to explore the contribution of negative list agreements in an econometric setting. In particular, we investigate what determines the share of commitments with an FTA value added for the 12 main service sectors and 4 modes of supply across the schedules in our database. Our corresponding dependent variables distinguish between three types of FTA value added: (i) improvements relative to existing GATS commitments; (ii) the scheduling of new sub-sectors and modes not listed in the GATS; and (iii) the total contribution of FTAs, defined as the sum of (i) and (ii). In constructing the three dependent variables, we did not make any distinction between partial and full commitments.

The first set of regressions explains the FTA value added by a dummy variable that is 1 if the commitment was scheduled under a negative list and 0 otherwise, and fixed effects for the 12 service sectors and 4 modes of supply. The results are shown in the first three columns of Table 13. Coefficients were estimated by ordinary least squares.¹¹¹ The dummy variable for negative list commitments is always positive and statistically significant at the 1 percent level. This result is not surprising and merely confirms what can be seen in Figure 6: negative list FTAs are associated with deeper and wider commitments.

As explain in the text, this finding does not account for the possibility that trading partners with a greater propensity to commit to open service markets may be more likely to adopt a negative list. To address this possibility, we included two additional variables in our regressions: the GDP per capita of the scheduling country and the GDP per capita of the FTA partner(s).¹¹² Our underlying premise is that countries' 'natural' propensity to commit to liberal trade policies is determined by levels of economic development. The results of the second set of regressions are shown in columns four to six. As before, the dummy variable for negative list commitments is positive and statistically significant at the 1 percent level for new FTA commitments and the total FTA contribution. The value of the estimated coefficients is somewhat smaller than before, suggesting that the GDP per capita variables indeed work to reduce the effect of negative listing. In addition, the negative list dummy variable is not any more statistically significant for improved FTA commitments.

At their face value, our results suggest that negative listings do not hold any advantage in deepening GATS commitments, but that they induce the scheduling of new sub-sectors and modes of supply. This finding accords with intuition. Most positive list agreements included in our analysis are hybrid list agreements, for which the level of openness is to a large extent determined by measures inscribed on a negative basis (see Section 3.A). In other words, the distinguishing characteristic of negative list agreements is the way in which sectors are listed and this seems to have an effect on the negotiating outcome.

As expected, GDP per capita of the scheduling country has a positive effect on improved FTA commitments and the total contribution of FTAs. Interestingly, this variable is found not to be statistically significant for new FTA commitments. GDP per capita of the partner country (or partner countries) was statistically not significant for any of the three dependent variables. This latter result seems surprising. One would expect richer countries to exert stronger pressure on FTA partners to make wider and deeper commitments. But such pressure—if it exists—does not appear to be reflected in the negotiating outcome.

¹¹¹ Since our dependent variable is truncated at values below zero and above one, we also tested a Tobit maximum likelihood estimation technique (with a lower bound of 0 and an upper bound of 1). The results showed higher coefficient estimates, but did not change any of the conclusions described in the text.

¹¹² Where there was more than one FTA partner, we used the population-weighted GDP per capita of all partner countries. Brunei and Myanmar (for ASEAN) and Liechtenstein (for EFTA) were excluded in the calculation of population weighted GDP per capita, because no GDP data were available for these countries.

As a final note, we caution against over-interpreting our econometric findings. As described in the text, our database does not capture the true depth of FTA commitments, but merely records commitments that show some value-added relative to the GATS. In addition, countries' 'natural' propensity to commit to open service markets is likely to be only imperfectly captured by the GDP per capita variables. To the extent that other factors play a role in this respect, our econometric approach over-estimates the contribution of the scheduling approach as such.

Table 13: Results of econometric investigation

	Improved FTA commitment	New FTA commitment	Total FTA contribution	Improved FTA commitment	New FTA commitment	Total FTA contribution
<i>Negative list commitment</i>	0.073* (5.82)	0.294* (15.63)	0.367* (17.91)	0.014 (1.03)	0.279* (13.07)	0.293* (12.82)
<i>GDP per capita of scheduling country</i>				0.036* (9.94)	0.006 (0.99)	0.042* (6.89)
<i>GDP per capita of partner country (or countries)</i>				-0.005 (-1.24)	0.009 (1.36)	0.004 (0.52)
<i>Number of observations</i>	1,440	1,440	1,440	1,440	1,440	1,440
<i>Adjusted R- squared</i>	0.352	0.516	0.626	0.393	0.516	0.639

Notes: Ordinary least squares estimates; t-statistics are in parenthesis; * indicates statistical significance at the 1 percent level. Data on GDP per capita are for 2002, were taken from the World Bank's World Development Indicators, and were converted to natural log values. Brunei and Myanmar were dropped from the analysis, because no GDP per capita data were available. That leaves 30 schedules of commitments with observations for 12 sectors and 4 modes of supply, explaining the total of 1,440 observations.

Country level assessment

Most East Asian countries have concluded more than one FTA. The aggregate liberalization content shown in Figures 3-6 use individual commitment schedules as the unit of analysis. Since countries may make the same or similar commitments to more than one trading partner, it is also interesting to aggregate agreements at the country level. In particular, we identified the most liberal commitment a country has made across all of its FTAs for each of the 154 sub-sectors and 4 modes described above. Of course, this is a hypothetical experiment. By definition, FTAs are preferential agreements, excluding service providers from non-parties (though the degree of exclusion depends on the rule of origin adopted, as discussed in Section 3.E). Even if FTA commitments were implemented on a most-favored nations (MFN) basis, only parties would benefit from the rules and access to dispute settlement provided for in an agreement. Still, our experiment is useful in asking how far a country has been willing to go across all of its FTAs.

The figures presented in Annex B depict the 'maximal' liberalization content for countries with more than one FTA, again broken down by sectors and modes of supply. Table 14 summarizes the information contained in these figures, indicating for each country the number of FTAs and the total 'maximal' liberalization content in the four liberalization categories. Unsurprisingly, Laos remains the country for which FTA commitments have gone farthest. In addition, the figures presented for Korea, Japan, and Singapore reveal that these three high income countries have made extensive use of FTAs to subscribe to greater openness in services. Singapore stands out in this group, with 86 percent of sub-sectors and modes showing improved or new commitments across its 11 FTAs. For Korea and Japan, this share stands at 76 and 71 percent, respectively. They are followed by Vietnam, for

which the share of sub-sectors and modes covered by an FTA commitment is 42 percent. Similar to Laos, Vietnam is not yet a member of the WTO, but has concluded an ambitious—though less far-reaching—BTA with the United States. For the remaining 8 countries that have concluded at least one FTA, the share of sub-sectors and modes with an improved or new commitment lies somewhere between 10 and 20 percent.

Table 14: ‘Maximal’ liberalization content by country

Country	Number of FTAs	GATS only		FTA improvements		FTA new sectors			Variation coefficient (V)
		Partial	Full	Partial	Full	Partial	Full	Unbound	
Brunei Darussalam	1	38	13	2	2	55	21	485	--
Cambodia	1	187	111	44	0	15	4	255	--
China	2	205	112	53	0	16	0	230	0.986
Indonesia	1	72	12	31	23	22	10	446	--
Japan	3	68	85	160	37	131	112	23	0.642
Korea	3	11	70	206	28	202	34	65	0.579
Lao PDR	2	--	--	--	--	410	206	0	0.161
Malaysia	2	142	45	72	1	25	9	322	0.308
Myanmar	1	5	4	2	0	89	12	504	--
Philippines	1	95	25	3	0	39	18	436	--
Singapore	11	12	56	117	28	243	139	21	0.579
Thailand	2	130	25	37	1	32	4	387	0.280
Vietnam	2	--	--	--	--	183	73	360	0.453

Notes: Commitment counts are based on the maximum of commitments across all FTAs concluded by a country. In other words, if an improved commitment or new sub-sector relative to a country’s GATS schedule is found in *at least* one FTA, the relevant sub-sector is classified as ‘improved’ or ‘new’ in the table’s FTA columns. The FTA variation coefficient is calculated as explained in the text.

Finally, it is interesting to ask whether the commitments offered by one country to two or more FTA partners are alike or dissimilar. We investigate this question by calculating a variation coefficient, V , which we define as follows:

$$V = \frac{\sum_{ij} A_{ij}}{\text{Number of subsectors and modes with an improved or new commitment in at least one FTA}},$$

where

$$A_{ij} = \begin{cases} A_{ij} = 0 & \text{if only one FTA shows an improved or new commitment for subsector } i \text{ and mode } j \\ A_{ij} = \frac{\text{Number of FTAs that show an improved or new commitment for subsector } i \text{ and mode } j}{\text{Total number of FTAs}} & \text{otherwise.} \end{cases}$$

Intuitively, our variation coefficient measures the number of matching FTA commitments as a share of all improved or new FTA commitments. It ranges from 0 to 1, with 0 indicating perfect incongruence among a country’s FTAs and 1 suggesting perfectly matching FTAs. In calculating V , we make no distinction between partial and full commitments. We also do not directly compare FTA commitments. Thus, even though two FTAs may show improved or

new commitments for the same sub-sector and mode, the respective commitments may still differ.

The calculated values of our variation coefficient are shown in the last column of Table 1. V is close to one in the case of China, as schedules of commitments under the two CEPAs with Hong Kong and Macao are almost identical. In other words, China's liberalization undertakings seem less the outcome of Hong Kong's or Macao's negotiating demands, but rather by what China was prepared to offer to its two Special Administrative Regions.¹¹³ The lowest value for V is found for Laos, reflecting the low level of ambition in Laos' AFAS commitment relative to the high level of ambition in Laos' commitment under the Lao PDR-US BTA. It is interesting to look at the values of V for Japan, Korea, and Singapore—the countries that have negotiated at least three FTAs and which have used these FTAs to make substantial market opening commitments. We find that the value ranges from 0.579 to 0.642, which could be interpreted as follows: while these countries seem to have a common set of commitments that they are prepared to offer to all negotiating partners, they reserve some commitments for certain trading partners—possibly responding to trading partners' market opening requests.

5. Are East Asian FTAs compatible with WTO rules on economic integration?

The analysis presented so far has shown how much bilateral and regional agreements in services have led to market opening in services beyond existent multilateral commitments. The 20 East Asian FTAs examined feature different degrees of ambition—ranging from agreements with broad sectoral coverage and deep liberalization undertakings to agreements that add only limited value to existing GATS commitments.

These findings are not only of academic interest. The WTO has rules on the conclusion of economic integration agreements (EIAs). Preferential agreements in services entail an exception to the general principle of non-discrimination between WTO Members, enshrined in the MFN obligation of the GATS. Like its goods *alter ego*—GATT Article XXIV—GATS Article V prescribes a series of conditions that treaties on economic integration in services must fulfill in order to constitute a lawful deviation from the MFN principle.

Observance of WTO rules on economic integration is not only a matter of respect for the multilateral trading system. Compliance of an FTA with GATS Article V falls under the jurisdictional capacity of the WTO's dispute settlement system. Thus, should a preferential agreement involving WTO members be found to not comply with the requirements of the GATS, trade preferences under such an agreement would have to be 'multilateralized' to the entire WTO membership.¹¹⁴

The requirements of GATS Article V involve a substantive element and a procedural element. The substantive element establishes obligations on the sectoral coverage and depth of FTAs as well as on the treatment of non-parties. In particular, WTO-consistent EIAs are required to:

¹¹³ The Mainland-Hong Kong and Mainland-Macao CEPAs have to be understood in the context of the 'one country, two systems' formula. For a further discussion, see Fink (2005).

¹¹⁴ For a review of WTO jurisprudence on economic integration—in particular, Article XXIV of the GATT—see Marceau and Reiman (2001).

- have substantial sectoral coverage, in terms of number of sectors, volume of trade affected and modes of supply (understood as not providing for the *a priori* exclusion of any mode of supply);
- provide for the absence or elimination of substantially all discrimination that affects service suppliers from a party to an EIA;
- not raise the overall level of barriers to trade in services for WTO members that are not party to an EIA;
- and provide for a rule of origin that extends trade preference to service suppliers from non-parties that are constituted under the laws of a party and are engaged in substantive business operations in the territory of the parties.

The first and second substantive requirements need to be met either at the entry into force of an EIA or on the basis of a reasonable time-frame.¹¹⁵

The main procedural element is the prompt notification of an EIA—as well as any subsequent enlargement or significant modification—to the WTO Council for Trade in Services (CTS). In addition, where agreements are implemented on the basis of a time-frame, the parties need to report periodically to the CTS on the state of implementation. The CTS may establish a working party to examine the consistency of a notified agreement with the substantive requirements of Article V and issue recommendations to the parties.

Do East Asian FTAs live up to these standards? An authoritative answer can only emerge from WTO dispute settlement. So far, there has been no jurisprudence on GATS Article V. In addition, the CTS has not provided any further clarification on Article V conditions. The precise interpretation of WTO rules in this area remains therefore uncertain. Nonetheless, the analysis presented in the last two sections can shed light on the criteria that might be relevant in assessing compliance with Article V requirements. In what follows, we first document which agreements have been notified to the CTS. We then confront the substantive requirements outlined above with the observed practices in East Asian FTAs.

Notification

Fourteen of the twenty East Asian FTAs have so far been notified to the WTO (see Table 15). Typically, notification occurs within a few weeks or months after entry into force of the FTA, sometimes even shortly before that date. The longest time lag between entry into force and notification has been eleven months (for the Jordan-Singapore FTA). If the “prompt” notification requirement applies from the date of entry into force of an FTA, it appears that notifications have for the most part been made according to GATS Article V obligations.¹¹⁶

Eight of the notified FTAs have undergone a factual examination process. However, the CTS has so far not issued any recommendations to any WTO member on the compliance of FTAs with GATS Article V.

¹¹⁵ Article V bis establishes additional rules for labour market integration agreements. But these rules are of little relevance for our purposes, as none of the East Asian FTAs provides for this form of integration.

¹¹⁶ However, in discussion in the WTO Committee on Regional Trade Agreements, it has also been suggested that a “prompt” notification should occur at least 90 days before an agreement takes effect (see WTO Document WT/REG/W/37).

Table 15: East Asian FTAs notified to the WTO

Agreement	Date of entry into force	Date of notification	Examination process
ASEAN Framework Agreement on Services	December 30, 1998	<i>Not notified</i>	--
New Zealand-Singapore FTA	January 1, 2001	September 19, 2001	Factual examination concluded
US-Vietnam BTA	December 10, 2001	<i>Not notified</i>	--
Japan-Singapore EPA	November 30, 2002	November 14, 2002	Factual examination concluded
EFTA-Singapore FTA	January 1, 2003	January 24, 2003	Factual examination concluded
Australia-Singapore FTA	July 28, 2003	October 1, 2003	Factual examination concluded
Chile-Korea FTA	April 1, 2004	April 19, 2004	Factual examination concluded
Mainland-Hong Kong CEPA	January 1, 2004	January 12, 2004	Factual examination concluded
Mainland-Macao CEPA	January 1, 2004	January 12, 2004	Factual examination concluded
Singapore-US FTA	January 1, 2004	December 19, 2003	Factual examination concluded
Laos PDR-US BTA	February 4, 2005	<i>Not notified</i>	--
Japan-Mexico EPA	April 1, 2005	April 22, 2005	Factual examination not started
Jordan-Singapore FTA	August 22, 2005	July 12, 2006	Examination not requested
Australia-Thailand FTA	January 1, 2005	January 5, 2005	Factual examination not started
EFTA-Korea FTA	September 1, 2006	August 28, 2006	Examination not requested
Korea-Singapore FTA	March 2, 2006	February 24, 2006	Factual examination not started
Japan-Malaysia EPA	July 13, 2006	July 13, 2006	Examination not requested
Trans-Pacific EPA	<i>Not yet in force</i>	<i>Not notified</i>	--
India-Singapore ECA	<i>Not yet in force</i>	<i>Not notified</i>	--
Panama-Singapore FTA	<i>Not yet in force</i>	<i>Not notified</i>	--

Source: WTO (http://www.wto.org/english/tratop_e/region_e/region_e.htm, as of October, 2006).

To date, six East Asian FTAs have not been notified to the WTO. In the case of three agreements—the India-Singapore ECA, the Panama-Singapore FTA, and the Trans-Pacific EPA—non-notification is most likely due to their recent vintage. The US BTAs with Laos and Vietnam have not been notified, probably because they are unlikely to pose any conflict with the MFN principle of the GATS. Laos and Vietnam are not yet Members of the WTO. The United States, in turn, does not extend any trade preference to its BTA partners beyond its current GATS commitment.

Thus, the only FTA where notification has not occurred for an apparent reason is the ASEAN Framework Agreement on Services—the oldest services agreement in the East Asia region.

Substantial sectoral coverage

The first of the four substantive requirements relates to substantial sectoral coverage. GATS Article V spells out that this concept is to be understood in terms of number of sectors, volume of trade affected and modes of supply. However, the precise application of these criteria remains unclear. Several questions immediately arise. What precisely is meant by the ‘volume’ of services trade (as opposed to the ‘value’ of such trade)? At what level of disaggregation should the count of sectors be made? Can entire sectors be excluded from the

agreement? If so, at which point would an exclusion of a sector reduce the volume of trade to a non-substantial level?¹¹⁷ The lack of precise and sufficiently disaggregated data on trade in services further complicates the task of determining whether or not an FTA meets a certain threshold value above which sectoral coverage could be considered substantial.

The analysis presented in the previous section has shown that no East Asian FTA provides for universal sectoral coverage.¹¹⁸ Having said this, the lack of universal coverage does not immediately imply non-substantial coverage. Looking at the number of sub-sectors, we note that some East Asian FTAs, such as the Japan-Singapore FTA or the Chile-Korea FTA, provide for wide sectoral coverage, averaging commitments in well over 70 percent of all services sub-sectors. By contrast, a great number of East Asian FTAs—including the AFAS, the Australia-Thailand FTA, the Mainland-Hong Kong and Mainland-Macao CEPAs, and the Jordan-Singapore FTA—feature commitments in less than half of all 154 sub-sectors.¹¹⁹ Without implying any judgment on the definition of sectors to be counted, it seems fair to conclude that current commitments under FTAs do not manifestly provide for substantial sectoral coverage.

It is beyond the scope of this paper to attempt any quantification of the volume of trade covered by East Asian FTAs. As already pointed out, such an exercise would be severely constrained by the availability of data on trade in services. But it is worth pointing out that certain agreements carve out service activities that are known to be associated with substantial trade flows—air and maritime transport services and financial services (see Table 2).¹²⁰ Again, it is not obvious to what extent the exclusion of such sectors reduces the volume of trade covered to non-substantial levels.

As far as modes of supply are concerned, GATS Article V makes clear that there should be non *a priori* exclusion of any mode of supply. Thus, an agreement that features commitments in all service sectors, but excludes one or more modes of supply would still fail the substantial sectoral coverage test. None of the 20 East Asian FTAs formally excludes any mode of supply from its coverage.¹²¹ As discussed in Section 3.A, most negative list agreements exclude mode 3 from the scope of the services chapter. But commercial presence

¹¹⁷ In discussions in the WTO Committee on Regional Trade Agreements, one WTO member has suggested that excluded sectors should not be of an essential nature—alluding specifically to transport services, but presumably also encompassing services such as finance and telecommunications that form the ‘backbone’ of an economy (See WTO Document WT/REG/M/22). However, an essentiality test is not expressly mentioned in GATS Article V. In addition, such a criterion would seem difficult to apply in practice, as most services—except maybe services such tourism or entertainment—can be argued to be essential in some way.

¹¹⁸ The commitment of Laos under the Lao PDR-US BTA can be considered universal in scope. But the same does not hold for the US commitment under that agreement.

¹¹⁹ See Annex A for a graphical description of the sectoral coverage of FTA commitments.

¹²⁰ Another open question is whether FTAs need to expand coverage to air transport, which has been carved out from the scope of the GATS.

¹²¹ Some WTO Members have argued that certain mode 4 aspects exempted from the GATS through the Annex on the Movement of Natural Persons should be included in EIAs (see WTO documents WT/REG/W7 and WT/REG/M/22). Thus, even FTAs that fully replicate the GATS modes of supply would not meet the substantive sectoral coverage test. However, it is uncertain whether such an expansionist view would be upheld in WTO dispute settlement proceedings.

is covered by the investment chapters of these agreements.¹²² Indeed, all agreements analyzed offer some commitments in each of the four modes of supply (see Annex A).¹²³

Finally, FTAs that do not provide for substantial sectoral coverage when they enter into force can still be consistent with Article V, if further negotiations lead to the achievement of substantial sectoral coverage within a reasonable timeframe. Most East Asian FTAs incorporate provisions that call for further liberalization through successive negotiations. In the case of AFAS and China's two CEPAs with Hong Kong and Macao, several rounds of negotiations have taken place. But as pointed out above, commitments under these agreements cover still less than half of the 154 sub-sectors identified under the GATS. While at current trends these agreements would eventually reach universal coverage, it is an open question whether the pace of liberalization is sufficient for substantial coverage to be achieved within a timeframe that can be deemed 'reasonable'.¹²⁴

Elimination of substantially all discrimination

The second of the four substantive conditions of GATS Article V calls for the elimination of substantially all discrimination, with explicit reference to the national treatment article of the GATS. In other words, EIAs are allowed to maintain all non-discriminatory measures that fall exclusively under the market access discipline, but they are supposed to substantially do away with measures inconsistent with national treatment.¹²⁵

Like above, the requirement to eliminate substantially all discrimination raises a number of interpretative questions. Does this requirement extend to all sub-sectors and modes for which FTA commitments are made? Which measures could still be maintained so that the level of remaining discrimination can be considered non-substantial? Would the volume of trade in a particular sub-sector play a role in this assessment? As discussed in Section 4, quantifying the restrictiveness of trade barriers in services—for example, in the form of tariff-equivalents—is a challenging task. For methodological and data reasons, a rigorous empirical assessment of the depth of FTA liberalization undertakings appears elusive.

Our database of the value added of FTA liberalization undertakings discussed in Section 4 did not separately record market access and national treatment commitments. Still, a few observations are possible based on the qualitative summaries of FTA commitments presented in Appendix 3. First, except Laos' commitment under the Lao PDR-US BTA, none of the East Asian FTAs provide for full national treatment across all sectors and modes. Second, where sub-sectors have been scheduled, modes 1 and 2 are for the most part subject to few explicit discriminatory measures. Having said this, in several FTAs, parties require the establishment of a commercial presence or the registration with local professional bodies as a

¹²² Similarly, several negative list agreements adopt a definition of mode 4 different from the one found in the GATS. It is uncertain, however, whether this definition is necessarily narrower. In addition, the relevant agreements complement services commitments with dedicated MNP chapters. See Section 3.D.

¹²³ The US undertakings under the Lao PDR-US BTA and US-Vietnam BTA do not offer any market opening beyond the US GATS commitment. As pointed out above, however, these commitments are most likely not subject to the disciplines of Article V.

¹²⁴ In discussions in the WTO Committee on Regional Trade Agreements, suggestions about what can be considered a "reasonable" period of time for substantial liberalization of services trade to occur have ranged, for the most part, from 5 to 10 years (see WTO Document WT/REG/W/37).

¹²⁵ Article V offers vaguely formulated flexibility in evaluating whether substantially all discrimination has been eliminated. Thus, "*consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned.*"

prerequisite for supplying services. Even if such restrictions are *de jure* non-discriminatory and are inscribed as market access limitations, they may be considered *de facto* discriminatory and thus be taken into account in an assessment of whether substantially all discrimination is eliminated.

Third, most agreements feature horizontal limitations for mode 3. In several cases, these limitations are relatively far-reaching. For example, in the Korea-Singapore FTA, Korea maintains all discriminatory measures of local governments and reserves the right to maintain or introduce discriminatory measures pertaining to the acquisition and usage of land, capital transactions by non-residents, and performance requirements with respect to employment. Brunei's AFAS commitment exempts all measures concerning foreign equity participation (again, a market access measure that may be considered *de facto* discrimination). In all its FTAs, Singapore maintains horizontal limitations on the nationality of managers and directors of foreign service suppliers.

As described in Section 4, even though there are a significant number of FTA liberalization undertakings that offer wider and deeper commitments under mode 4, the value added of these commitments relative to the GATS is typically minor. Most FTAs commitments, like the GATS, are limited to high-skilled professionals and intra-corporate transferees. Measures affecting low-skilled workers and independent service providers are usually not covered in commitment schedules.

As in the case of substantial sectoral coverage, provisions in East Asian FTAs calling for further liberalization through successive negotiating rounds can help ensure compliance even if remaining discriminatory measures at the entry into force of an FTA are non-substantial.

Overall level of trade barriers

The first two substantive requirements concern the 'internal' breadth and depth of an EIA. The final two conditions focus on the treatment of non-parties. In particular, the third condition calls for an EIA to not raise the overall level of trade "barriers" as faced by WTO members outside the agreement. Once more, a number of interpretative questions emerge. What is meant by "barriers"—national treatment measures, market access measures, or both?¹²⁶ Does the concept of *overall* level of trade barriers allow for higher barriers in certain sectors, as long as some weighted or unweighted average of sectoral barriers is not raised? Even if these questions were answered, it would appear difficult to translate this requirement into practice. Given the quantification challenges outlined previously, it does not seem feasible to calculate the overall level of barriers in effect prior to the formation of an EIA and compare that level to the post-EIA counterfactual.¹²⁷

At the same time, the requirement to not raise the level of protection faced by outsiders applies only to trade policy changes that directly emanate from obligations under an EIA. In analyzing the 20 East Asian FTAs, we did not find any provision that implies the creation of new trade barriers vis-à-vis third parties. From this view, it would appear that all FTAs are compliant with this substantive requirement of GATS Article V.

¹²⁶ The GATS Agreement does not provide for a definition of the term "barrier".

¹²⁷ See also Stephenson (2000) for a discussion of the practical difficulties in applying this requirement.

Rule of origin

The fourth substantive condition also concerns the treatment of non-parties. It requires the establishment of a liberal rule of origin for juridical persons. In particular, trade preferences negotiated under an EIA need to be extended to juridical persons of any other WTO member that are constituted under the laws of a party and are engaged in substantive business operations in the territory of the parties.¹²⁸

Compared to the other three substantive requirements, the rule of origin condition poses the least interpretative difficulties. Still, several uncertainties remain. Does the concept of constitution under the laws of a party encompass non-incorporated entities such as branches or representative offices? What threshold needs to be surpassed for business operations to qualify as substantive?

Notwithstanding these uncertainties, several observations can be made in relation to the East Asian FTAs. As discussed in Section 3.E, most agreements feature a rule of origin that, indeed, entitles non-party service suppliers that are constituted or otherwise organized under the laws of a party and that engage in substantive business operations to the benefits of FTAs. The Mainland-Hong Kong and Mainland-Macao CEPAs are the only agreements that define ‘substantive business operations’ in concrete terms. In all other FTAs, the implementation of this concept is left to domestic laws and regulations.

While most rules of origin thus appear compliant with GATS Article V, several agreements allow parties the denial of trade benefits to at least some service suppliers from other WTO member countries that are legally constituted and engaged in substantive business operations in the territory of the parties (see Table 9):

- the Australia-Thailand FTA allows the denial of benefits when a party “*establishes that the service supplier is owned or controlled by persons of a non-Party*”;
- the Chile-Korea FTA (investment chapter only), the Japan-Malaysia FTA, the Japan-Mexico EPA, and the Singapore-US FTA allow the denial of benefits to service providers from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.¹²⁹

It is not immediately obvious how the denial of benefit provisions of these agreements comply with GATS Article V.¹³⁰

Special and differential treatment for developing countries

WTO rules on economic integration offer special and differential treatment (SDT) for agreements involving developing countries. In the area of goods trade, SDT takes the form

¹²⁸ GATS Article V does not establish any discipline on the rule of origin for services or natural persons.

¹²⁹ The majority of East Asian FTAs limit FTA benefits to juridical persons with substantial business operations in the territory of the party in which the juridical person is legally constituted (see Table 9). To the extent that the language “*territory of the parties*” in GATS Article V.6 is equivalent to ‘territory of either party’, the rule of origin of these FTAs would appear to be inconsistent with GATS rules as well.

¹³⁰ In case an FTA’s rule of origin provision is found to be inconsistent with GATS Article V, WTO members may be able to invoke the general exceptions (Article XIV) and security exceptions (Article XIVbis) provisions of the GATS. Security motivations may apply especially to the denial of benefits clauses of the Chile-Korea FTA, the Japan-Malaysia FTA, the Japan-Mexico EPA, and the Singapore-US FTA.

of the so-called ‘Enabling Clause’ of 1979, which allows for the conclusion of EIAs that provide for less than full liberalization. In the area of services trade, GATS Article V offers two distinct SDT provisions.

First, where developing countries are parties to an EIA, GATS Article V calls for “flexibility” in the application of the two substantive ‘internal’ conditions—substantial sectoral coverage and elimination of substantially all discrimination. Second, agreements involving developing countries *only* may adopt a more restrictive rule of origin which limits trade preferences to service suppliers that are owned or controlled by natural persons of the parties.

The significance of the first provision depends critically on the interpretation of the concept of “flexibility.” GATS Article V does not offer any guidance on how this concept could be applied in practice. As such, it is difficult to evaluate to what extent this provision might bring East Asian FTAs that fall short of the two substantive ‘internal’ requirements closer to compliance.

A second source of uncertainty—relevant for both SDT provisions—stems from the classification of developing countries. The WTO only has an official list of least-developed country (LDC) members, based on United Nations criteria. In principle, non-LDC WTO members can decide for themselves whether they are to be considered ‘developed’ or ‘developing’ countries. However, this decision may be challenged by other members. The question of developing country status is particularly delicate for the ‘emerging’ East Asian economies that have experienced fast growth over the past 10-20 years and are today classified as ‘high income’ countries by the World Bank—notably Hong Kong, Korea, and Singapore. So far, there has been no jurisprudence that could give guidance on what criteria would be used to resolve a disagreement on this question.

Finally, only two agreements have established a rule of origin with an ownership and control criterion—the Australia-Thailand FTA and the India-Singapore ECA. Since Australia is unlikely to be considered a developing country in the WTO, it is not obvious how the rule of origin of the former agreement complies with Article V—as pointed out above. Compatibility of the rule of origin of the latter agreement with GATS requirements seems to depend on whether Singapore would be considered a developing country under WTO law.

6. Conclusion

FTAs involving East Asian countries are proliferating at a mind-boggling pace. In light of their large and fast-growing markets, many countries in the region are seen as attractive partners for an FTA. Most recently, the European Union, which has so far not entered into an FTA with an East Asian country, identified agreements with ASEAN and Korea as priorities in its new trade policy strategy.¹³¹ If current trends continue, the bulk of international commerce in the East Asia region will be governed by the rules and commitments of such agreements. Indeed, many future commercial transactions may be governed by more than one FTA. New Zealand and Singapore, for example, have already entered into two FTAs—a bilateral agreement and a regional agreement involving Brunei and Chile. A third common FTA is under negotiation as part of the ASEAN-New Zealand partnership.

¹³¹ See the Communication from the European Commission “Global Europe: Competing in the World,” Document No. COM(2006) 567, October 4, 2006.

What are the implications of this growing ‘spaghetti bowl’ of overlapping FTAs for the governance of world trade? Most interestingly, will the East Asian FTAs act as ‘building blocks’ or ‘stumbling blocks’ to further multilateral liberalization? This question has been heavily debated by economists.¹³² Even though most of this debate has focused on trade in goods, a number of arguments apply directly to the services context. In particular, proponents of the ‘building blocks’ view advance the following arguments:

- FTAs offer inroads towards more open markets, even if liberalization occurs only with respect to certain trading partners. As such, countries may be more willing to liberalize, for two reasons. First, there may be less resistance from vested interests that already face some foreign competition. Second, if the outcome of preferential liberalization proves successful, the support for multilateral market opening may be strengthened.
- FTAs may spur a process of competitive liberalization. Businesses in countries left out by FTAs may feel that they are harmed by not having preferential access to a foreign market. They may thus lobby their own government to enter the FTA game. The rapid increase in the number of FTAs suggests that this force may be at work in the East Asia region.¹³³ Once a country has concluded FTAs with all of its major trading partner, it might as well ‘multilateralize’ its level of openness.

Followers of the ‘stumbling blocks’ view respond with the following arguments:

- FTAs are discriminatory in nature, leading to the diversion of trade. As such, there may be businesses that would see their preferences eroded from MFN-based liberalization. Those businesses can become a powerful voice against further multilateral integration. Indeed, concerns about preference erosion have been a source of contention in the DDA’s negotiations on non-agricultural market access.
- FTAs divert scarce negotiating resources. Many countries in East Asia are negotiating five or more FTAs at the same (see Table 2). While there are substantial spillovers from negotiating in different trade fora, each individual agreement requires its own share of preparation, consultation, coordination, and travel. There is therefore the risk that devotion of negotiating resources towards FTAs comes at the expense of reduced engagement at the WTO.

Is there anything special about the services component of East Asian FTAs that would strengthen either the ‘building block’ or ‘stumbling block’ forces? Three arguments can be made in support of the ‘building block’ camp. First, as discussed in Section 3.E, most East Asian FTAs have adopted liberal rules of origin, reducing the discriminatory nature of trade preferences in services. Service providers from non-parties that have substantial business operations in the territory of a party typically benefit from the greater levels of openness available under FTAs. While this treatment still falls short of MFN treatment, it arguably generates less resistance to further multilateral liberalization from vested interests worried about preference erosion as in the goods case. From this view, one might argue that the

¹³² See Baldwin (2006a) for a recent review of the rich literature on this topic.

¹³³ Baldwin (2006b) argues that China’s broaching of the idea of an FTA between China and ASEAN in November 2000 triggered a domino effect responsible for the negotiation of many East Asian FTAs, especially by Japan and Korea.

obligation under GATS Article V to provide for liberal treatment of non-party service providers has laid the foundations for ‘WTO-friendly’ FTAs.

Second, a number of East Asian FTAs provide for extra-territorial MFN obligations. As explained in Section 3.B, countries bound by many such MFN obligations become less attractive partners for future FTAs, because potential negotiating parties know that any negotiated preference will be extended automatically to others. As a consequence, the bargaining advantage offered by FTAs with a small number of players is undermined and incentives to negotiate at the multilateral level are strengthened.

Third, positive spillover effects from FTA to WTO negotiations may be more important in services than in goods. Services negotiations are more information-intensive, requiring a resource-intensive stock-take of domestic laws and regulations that might be considered measures affecting services trade. Governments that have carried out a comprehensive stock-take in the course of FTA negotiations may be better prepared for services negotiations at the WTO. In other words, the East Asian services FTAs may play a useful role in overcoming ‘informational’ obstacles to further multilateral integration.

At the same time, there is one important consideration that may lead East Asian FTAs in services to become a stumbling block towards progress at the WTO. The United States, the European Union, Japan, and several other WTO members consider greater engagement in the WTO’s services negotiations as a quid pro quo for committing to trade reforms in agriculture—currently the key sticking point for unlocking the DDA negotiations. As discussed in Section 2, one of the key trade policy measures in agriculture—domestic subsidies—by nature cannot be reduced on a preferential basis. Many East Asian countries would stand to gain from agricultural trade reforms at the WTO and, at the same time, are the targets of liberalization requests in services. If the ‘demandeurs’ in services are able to advance their offensive interests through FTAs, important bargaining chips may be removed from the multilateral negotiating table. By the same token, private sector interests may have less of an incentive to lobby for a successful conclusion of the DDA, if their market opening demands can be fulfilled in FTAs.

As a final point, it is worth emphasizing that East Asian countries arguably have much to gain from engagement in the DDA’s services negotiations. First, important commercial relations are not covered by FTAs—for example, Japan-Korea, China-Japan, or Japan-United States. The negotiation of FTAs between these trading partners cannot be ruled out, but does not appear likely in the foreseeable future. Improved GATS commitments offer the only realistic vehicle for wider and deeper policy bindings in these cases. Second, the WTO offers the most credible mechanism for settling trade disputes between governments. As discussed in Section 3.G, the state-to-state DSMs found in East Asian FTAs do not share the institutional underpinnings and accumulated experience of multilateral dispute settlement.

Finally, from an economic perspective, non-discriminatory liberalization ensures access to the world’s most efficient service providers. Since performance in the service sector has emerged as a critical determinant of a country’s export competitiveness and attractiveness to foreign investment, preferential arrangements may prove costly in the long term. Equally, a non-discriminatory trading system offers the greatest transparency and lowest transaction costs for modern service suppliers that are active in many countries, operate international networks and frequently move staff from one location to another.

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Appendix 1

Overview of key disciplines found in East Asian FTAs

	Services disciplines							Investment disciplines										
	MFN	NT	MA	Domestic regulation	Government procurement	Subsidies	ESM	MFN	NT	F&ET	MA	Domestic regulation	Performance requirements	Board of Directors	ESM	Transfer of funds	Expropriation	Investor-State arbitration
ASEAN (AFAS)	yes ¹	yes ³	yes ¹	yes ⁴	no ²	--	--	yes ¹	yes ¹	yes	--	--	--	--	yes	yes ¹	yes	yes
Australia-Singapore FTA	--	yes ¹	yes ¹	yes ¹	no ²	no ²	--	soft	yes ²	--	--	--	--	--	--	yes ¹	yes	yes
Australia-Thailand FTA	soft	yes ¹	yes ¹	yes ¹	no ¹	no ²	--	yes	yes ²	yes	--	--	--	--	--	yes ¹	yes	yes
Chile-Korea FTA	--	yes ²	soft ³	soft ⁵	no ¹	no ²	--	yes	yes ²	yes	--	--	yes ²	yes	--	yes ¹	yes	yes
EFTA-Korea FTA	yes	yes ¹	yes ¹	yes ⁴	no ¹	--	--	yes	yes ⁴	yes	--	--	--	yes	--	yes ¹	yes	yes ²
EFTA-Singapore FTA	yes	yes ¹	yes ¹	yes ¹	no ¹	soft ¹	--	yes	yes ³	yes	--	--	--	yes	--	yes ¹	yes	yes ¹
India-Singapore ECA	soft	yes ¹	yes ¹	yes ¹	no ²	soft ¹	no ²	soft	yes ²	--	--	--	yes ¹	yes	--	yes ¹	yes	yes
Japan-Malaysia EPA	yes	yes ¹	yes ¹	soft ⁵	no ²	no ²	no ¹	yes	yes ²	yes	--	--	yes ¹	--	--	yes ¹	yes	yes
Japan-Mexico EPA	yes	yes ²	--	soft ⁵	no ¹	no ²	--	yes	yes ²	yes	--	--	yes ²	yes	--	yes ¹	yes	yes
Japan-Singapore EPA	soft	yes ¹	yes ¹	yes ¹	no ¹	--	--	soft	yes ²	yes	--	--	yes ²	--	--	yes ¹	yes	yes
Jordan-Singapore FTA	--	yes ¹	yes ¹	yes ¹	no ²	--	--	soft	yes ²	yes	--	--	yes ¹	yes	--	yes ¹	yes	yes
Korea-Singapore FTA	--	yes ²	yes ²	yes ¹	no ¹	no ²	--	soft	yes ²	yes	--	--	yes ²	yes	--	yes ¹	yes	yes
Lao PDR-US BTA	--	yes ¹	yes ¹	--	--	--	--	no investment disciplines										
Mainland-Hong Kong CEPA	--	--	--	--	--	--	--	no investment disciplines										
Mainland-Macao CEPA	--	--	--	--	--	--	--	no investment disciplines										
New Zealand-Singapore FTA	--	yes ¹	yes ¹	yes ²	no ¹	no ²	--	yes	yes ²	--	--	--	--	--	--	yes ¹	--	yes ¹
Panama-Singapore FTA	yes	yes ²	yes ²	yes ¹	no ¹	no ²	--	yes	yes ²	yes	yes ¹	--	yes ²	yes	--	yes ¹	yes	yes
Singapore-US FTA	yes	yes ²	yes ²	soft ⁵	no ¹	no ²	--	yes	yes ²	yes	yes ¹	--	yes ²	yes	--	yes ¹	yes	yes
Trans-Pacific EPA	yes ²	yes ²	yes ²	yes ³	no ¹	no ²	--	no investment disciplines										
US-Vietnam BTA	yes	yes ¹	yes ¹	yes ¹	--	--	--	yes	yes ³	yes	--	--	yes ¹	yes	--	--	yes	yes

Notes:

- “yes”: FTA features mandatory disciplines
“soft”: FTA features ‘best-endeavor’ or similar soft-law disciplines
“no”: FTA features a provision on the matter which does not impose any obligation on the parties
“--”: FTA does not feature any provision

Services

MFN – Most-favoured-nation treatment

- 1 intra-regional
- 2 extra-regional

NT – National treatment

- 1 refers to “like services and service suppliers”
- 2 refers to “like circumstances”
- 3 refers to “discriminatory measures”

MA – Market access

- 1 substantially reproduces GATS Art. XVII
- 2 substantially reproduces GATS Art. XVII, excluding paragraph e)
- 3 substantially reproduces NAFTA Art. 1207

Domestic regulation

- 1 substantially reproduces GATS Art. VI:1,2,3,5
- 2 substantially reproduces GATS Art. VI:1,5
- 3 substantially reproduces GATS Art. VI:1,3 and features an effective necessity test
- 4 fully reproduces GATS Art. VI
- 5 provides for a ‘best-endeavor’ necessity test

Government procurement

- 1 carved-out from the scope of the services disciplines
- 2 excluded from the scope of national treatment, MFN, market access obligations

Subsidies

- 1 consultations between parties foreseen in case of adverse effects of subsidies
- 2 expressly carved-out from services disciplines

ESM – Emergency Safeguard Measures

- 1 features a built-in agenda for negotiations on an ESM
- 2 expressly prohibits safeguards measures

Investment

MFN – Most-favoured-nation treatment

- 1 intra-regional

F&ET – Fair and equitable treatment

MA – Market access

- 1 by reference to services chapter reproduces GATS Art. XVII, excluding paragraph e)

NT – National treatment

- 1 refers to “like investors”
- 2 refers to “like circumstances”
- 3 refers to “like situations”
- 4 refers to “treatment that is not less favourable than that it accords to its own investors”

Performance requirements

- 1 substantially reproduces TRIMs obligations
- 2 substantially expands on TRIMs obligations

Transfer of funds

- 1 allows for current and capital transactions

ESM – Emergency Safeguard Measures

Investor-state arbitration

- 1 No automatic consent given by the states
- 2 No automatic consent for pre-establishment disputes

Appendix 2

Methodology for quantifying services commitments

This appendix describes the methodology for compiling the database of services commitments that forms the basis of the analysis in Section 4.

Our database identifies the ‘value added’ of FTAs for each of the 154 sub-sectors and four modes of supply identified under the GATS. In particular, we classified the resulting 616 entries per FTA schedule into four categories:

- (v) Sub-sectors and modes for which only a GATS commitment exists or an FTA does not offer any improvement (*GATS only*);
- (vi) Sub-sectors and modes for which a partial GATS commitment exists and an FTA eliminates one or more remaining trade-restrictive measures (*FTA improvements*);
- (vii) Sub-sectors and modes for which no GATS commitment is available, but an FTA commitment is made (*FTA new sectors*); and
- (viii) Sub-sectors and modes for which neither a GATS nor an FTA commitment exists (*Unbound*).

For categories (i), (ii), and (iii), we further distinguished between partial and full commitments, with the latter defined as not listing any remaining trade-restrictive measures.

Trade-restrictive measures

We defined trade-restrictive measures as all measures that are inconsistent with GATS-style market access and national treatment disciplines. The additional classes of measures found in negative list agreements—local presence, performance requirements, and senior managers and boards of directors—are implicitly captured by these two disciplines. Local presence requirements are limitations on the provision of services through Mode 1 of the GATS (non-conforming and future measures in negative list agreements do not distinguish between different modes of cross-border trade in services). Performance requirements and limitations on the nationality or residency of senior managers and boards of directors are discriminatory measures that would otherwise be covered by the national treatment discipline.

In recording trade-restrictive measures, we did not separately identify market access and national treatment measures. Thus, a partial commitment corresponds to a commitment that maintains at least one trade-restrictive measure in either the market access or national treatment category; a full commitment corresponds to a commitment that does not list any trade-restrictive measure in either of these two categories. In adopting this approach, we avoided classifying measures into the national treatment or market accesses domains—an issue for which FTAs establish different rules and which has been subject to conflicting legal interpretations (see Mattoo, 1997).¹³⁴

¹³⁴ Exceptions to MFN treatment were not considered in our quantification exercise.

Horizontal commitments

We treated horizontal commitments in GATS-style schedules as if they were inscribed in each scheduled sub-sector. In doing so, we adopted the following rules, following GATS scheduling guidelines:¹³⁵

- If a sectoral commitment indicates ‘unbound’, the relevant sector is fully excluded from a country’s schedule and the horizontal commitment does not apply.
- If there is a partial sectoral commitment which can be read harmoniously with the horizontal commitment, both commitments apply.
- If there is a partial sectoral commitment which is mutually contradictory with the horizontal commitment, the former overrides the latter.
- If the sectoral commitment indicates ‘none’, horizontal limitations still apply unless expressly mentioned otherwise.

Definition of sectors

Our definition of sectors corresponds to the GATS Services Sectoral Classification List—also known as the W120 list.¹³⁶ In allocating commitments to the 154 sub-sectors, we adopted the following conventions:

- Commitments without any trade-restrictive measures that did not cover the full sub-sector (as defined under the GATS) were classified as partial commitments. In line with this approach, all commitments applying to residual categories—“other services” within a particular sector or the overall “other services not included elsewhere” category—were recorded as partial commitments, unless a whole residual category was expressly scheduled.
- Where a commitment covered two or more sectors, it was separately recorded in the relevant W120 categories.
- Where two or more commitments applied to the same W120 sector, we read the commitments jointly. A partial commitment was recorded whenever at least one of the relevant commitments listed remaining trade-restrictive measures.
- In selected cases, the description of service activities did not correspond to the W120 sector identified in the commitment. In those cases, we allocated the commitment to the W120 sector that we saw as most appropriately matching the description of activities.

These conventions apply equally to positive and negative list agreements. However, for negative list agreements, we started by assuming full commitments across all 154 sub-sectors and then reduced or eliminated commitments in line with the non-conforming and future measures listed.

¹³⁵ See WTO document S/CSC/W/19.

¹³⁶ See WTO document MTN.GNS/W/120.

Recording of commitments

In determining whether to record commitments as partial or full commitments, we ignored superfluous entries in commitments that did not constitute a limitation on market access or national treatment. These include, for example, references to non-discriminatory licensing requirements or non-discriminatory prudential measures, often found in the horizontal section of GATS-style commitment schedules.

As described above, we only counted an FTA commitment as an improvement over an existing GATS commitment if at least one trade-restrictive measure was relaxed or eliminated. In a number of cases, an entry in an FTA schedule was identical to—or effectively the same as—the corresponding GATS entry. In principle, the replicated FTA commitment still offers value added—for example, by making a policy binding subject to the FTA’s dispute settlement understanding. But since the focus of our analysis was on the liberalization content of FTAs, we allocated the relevant sub-sectors and modes to the ‘GATS only’ category.

Finally, in selected cases, we felt that there was legal ambiguity on the sectoral allocation or the level of openness. We resolved those cases by adopting the most liberal interpretation of the description of service activities or the trade-restrictive measures. For example, consider Japan’s GATS commitment for certain legal services under mode 1. In the market access column, Japan’s entry includes the limitation “*Commercial presence is required*”. At the same time, Japan has a “none” entry under national treatment. Since the cross-border supply of legal services, by definition, cannot take the form of commercial presence in Japan, one may interpret Japan’s commitment as a full prohibition of the supply of legal services under mode 1. In this case, Japan’s national treatment commitment would seem irrelevant. However, we still recorded a partial commitment in this case. Even if Japan’s commitment were to amount to a de facto prohibition, the actual policy regime in Japan could be—or could become—more liberal. If some cross-border supply of legal services was allowed, the guarantee of full national treatment would be of value to foreign service providers.

Fortunately, the number of cases with legal ambiguity was small and a more restrictive interpretation would not alter any of the conclusions drawn in Section 4.

Appendix 3

Summary of country-specific liberalization undertakings

This appendix offers a brief summary of the liberalization undertakings of the East Asian countries considered in this paper. It is intended to complement the quantitative analysis of GATS and FTA commitments presented in Section IV. The comments provided for each country are based on our subjective impressions of the value added of FTAs, trying to identify the nature and depth of liberalization undertakings as well as the commonalities among different agreements negotiated by one country. While these comments offer a first guide to the achievements of FTAs, they may hide important details—such as deep commitments in selected services sub-sectors or liberalization undertakings that go beyond status quo policies.

Country	FTA(s)	Summary comments
Brunei	ASEAN Framework Agreement on Services (AFAS)	For the most part, Brunei's AFAS commitment replicates the country's GATS schedules. The value added relative to the GATS consists primarily of commitments in selected sub-sectors not listed under the GATS. Overall, Brunei's liberalization undertakings are limited in depth, particularly with respect to Mode 3. Horizontal limitations under both AFAS and GATS remove measures affecting foreign equity participation from Brunei's schedules of specific commitments. Under AFAS, Brunei has made commitments on foreign equity participation in certain sub-sectors, but allows foreign majority equity participation (up to 55 percent) only in the case of construction services.
Cambodia	ASEAN Framework Agreement on Services (AFAS)	Cambodia's AFAS commitment provides only limited value added compared to the country's GATS commitment. This is largely explained by Cambodia's ambitious GATS offer (with the exception of financial services), which reflects the unique circumstances of WTO accession negotiations. In the area of Mode 3, Cambodia's AFAS commitment is even 'GATS-minus,' as they feature a 49 percent foreign equity limitation for joint venture enterprises that is not found in Cambodia's GATS schedule. This outcome is most likely due to the AFAS commitment having been finalized before the conclusion of the WTO accession negotiations. Key GATS-plus commitments found in Cambodia's AFAS schedule include the absence of a national treatment limitation for subsidies and a permission to provide deposit services extending to all foreign banks.

Country	FTA(s)	Summary comments
China	Mainland-Hong CEPA, Mainland-Macao CEPA	The Mainland-Hong Kong and Mainland-Macao CEPAs offer the two Special Administrative Regions a number of specific preferences. Some of these preferences are time-bound and will expire once China's WTO accession commitments are fully phased in at the beginning of 2008. Other preferences will last beyond 2008. Many of China's CEPA commitments facilitate access of professional service providers to the Chinese market, including lawyers and medical practitioners from certain Macao and Hong Kong universities. The Mainland explicitly recognizes qualifications for certain professional services (e.g., short term medical practice in the Mainland) and waives residency requirements for Macao and Hong Kong technical and managerial staff. In respect of Mode 3, the agreements reduce total asset requirements for setting up bank branches in the Mainland. The Mainland-Hong Kong and Mainland-Macao CEPA are almost identical, except that the former allows the establishment of representative offices of Hong Kong securities companies.
Indonesia	ASEAN Framework Agreement on Services (AFAS)	Indonesia's AFAS commitment offers only limited value added relative to the GATS. A number of new sub-sectors are scheduled, especially in the area of business services. GATS commitments are deepened in three ways. First, certain foreign equity restrictions are relaxed, especially for maritime transport and telecommunications services. Second, Indonesia has undertaken full AFAS commitments for modes 1 and 2 in sub-sectors where these modes are 'unbound' under the GATS. Third, Indonesia's AFAS commitment increases the number of service suppliers allowed for travel agency and tour operator services.
Japan	Japan-Malaysia EPA, Japan-Mexico EPA, Japan-Singapore EPA	Japan's FTAs offer value added relative to the GATS in a large number of sub-sectors and modes. Having said this, the depth of FTA liberalization undertakings is sometimes modest. This partly reflects the already liberal commitment by Japan under the GATS. New FTA commitments cover, in particular, certain professional service categories. In the area of telecommunications, Japan's FTAs offer greater foreign equity ownership (though this liberalization measure was already anticipated under the GATS). Japan's FTA schedules also provide for full liberalization in a number of sub-sectors and modes that were categorized as "unbound due to lack of technical feasibility" under the GATS.
Korea	Chile-Korea FTA, EFTA-Korea	Korea's FTAs significantly improve on GATS commitments by eliminating a broad horizontal

Country	FTA(s)	Summary comments
	FTA, Korea-Singapore FTA	restriction on ownership and control of Korean companies. In addition, Korea has made FTA commitments for modes 1 and 2 in a significant number of sub-sectors which remain “unbound” under the GATS (though certain limitations still apply). Having said this, FTA commitments in key service sectors—including financial and telecommunications services—offer only modest value added relative to the GATS. The Korea-Chile FTA carves out financial services altogether; the two other FTAs feature only few new liberalization undertakings. In the area of telecommunications, all Korean FTAs maintain important restrictions.
Lao PDR	ASEAN Framework Agreement on Services (AFAS), Lao PDR-US BTA	Laos’ FTAs have the particularity of featuring one of the least ambitious agreements (AFAS) and one of the most ambitious agreements (Lao PDR-US BTA) in services. The former offers only few commitments in selected sectors, mainly construction services, tourism and maritime transport. In these sectors, Laos has undertaken liberal market access commitments—for example, allowing full foreign ownership—but less liberal national treatment commitments. By contrast, the Lao PDR-US BTA is probably the world’s most liberal trade agreement in services (for Laos at least, as the United States is only bound by its GATS commitment). Laos has committed to full national treatment across all sectors and full market in a large number of sectors (including telecommunications, financial services, distribution, professional services, audiovisual, construction, health, tourism). Only Mode 4 commitments are narrow in scope, as they are limited to services sales persons and intra-corporate transferees.
Malaysia	ASEAN Framework Agreement on Services (AFAS), Japan-Malaysia EPA	Malaysia’s commitments in its two FTAs offer only modest value added over the country’s GATS commitment. While some FTA commitments raise foreign equity limitations (e.g., from 30 to 35 percent), they do not allow for majority foreign ownership. Only the Japan-Malaysia EPA includes commitments for new sub-sectors and modes of supply, but the ambition of those commitments is modest. Malaysia’s AFAS commitment offers minor improvements in the area of mode 4, consisting mostly of a small quota increases—usually between one and three—for certain types of foreign natural persons.
Myanmar	ASEAN Framework Agreement on Services (AFAS)	Myanmar’s commitments under AFAS are significantly wider than those under the GATS, but the overall level of ambition of its FTA commitment is still low. Myanmar has not scheduled any horizontal limitations under the GATS or under AFAS. In several sectors, Myanmar’s

Country	FTA(s)	Summary comments
		AFAS undertaking offers full foreign ownership under mode 3.
Philippines	ASEAN Framework Agreement on Services (AFAS)	The Philippine's commitment under AFAS offers only limited value added relative to the country's GATS commitment. New sectors scheduled under AFAS include construction services, telecommunications, tourism, and selected professional services. Modes 1 and 2 in these sectors are fully liberalized (except where trade is not considered feasible under these modes). Commitments on Mode 3 are substantial for certain high-end hotel services, for which full foreign ownership is allowed. In all other sectors, important restrictions remain, including foreign ownership limitations of less than 50 percent. AFAS commitments do not cover financial services. In telecommunications, they are limited to basic telecommunications services with foreign ownership limited to 40 percent and managers and directors required to be Philippine citizens. In the area of mode 4, AFAS expands coverage to certain professional services (e.g., engineering and architectural services), although economic needs tests and reciprocity requirements still apply.
Singapore	ASEAN Framework Agreement on Services (AFAS), Australia-Singapore FTA, Brunei-Chile-New Zealand-Singapore (Trans-Pacific) EPA, EFTA-Singapore FTA, India-Singapore ECA, Japan-Singapore EPA, Jordan-Singapore FTA, Korea-Singapore FTA, New Zealand-Singapore FTA, Panama-Singapore FTA, Singapore-United States FTA	Singapore's FTA commitments vary markedly from agreement to agreement. Commitments under AFAS and the Jordan-Singapore FTA offer only limited value added relative to Singapore's GATS schedule. Both agreements mostly replicate GATS entries, with only few sub-sectors added. GATS horizontal measures—including a nationality requirement for managers and directors under mode 3—are maintained, limiting deeper liberalization undertakings. Other agreements are more ambitious. They offer wider coverage, extending to a large number of services sub-sectors that have not been included in Singapore's GATS schedules, with few restrictions maintained. Relative to the GATS, a number of restrictions on modes 1 and 2 are lifted under these FTAs. Otherwise, there are few improvements over GATS commitments. This outcome partly reflects the maintenance under FTAs of horizontal limitations inscribed found in the GATS. Commitments in financial services are marginal for all of Singapore's FTAs, except for the Singapore-US FTA. The latter inscribes a phase-out commitment under which Singapore would open its market to US banks within 18 months from the entry into force of the agreement. The Singapore-US FTA also offers deeper market

Country	FTA(s)	Summary comments
		opening in the area of telecommunications. In summary, the main value added of Singapore's FTAs is the widening of GATS commitments to additional sub-sectors. With the exception of the Singapore-US FTA, there are few improvements relative to existing GATS entries. At the same time, Singapore's GATS commitment is already relatively liberal—the only major restriction being a nationality requirement for managers and directors of foreign invested enterprises. Finally, FTA commitments in the area of Mode 4 are limited in scope. The only improvement relative to Singapore's GATS schedule consists of extended periods of stay for business visitors and intra-corporate transferees.
Thailand	ASEAN Framework Agreement on Services (AFAS), Australia-Thailand FTA	Thailand's FTA commitments do not substantially expand on sectoral coverage relative to the country's GATS commitment. In addition, AFAS offers hardly any improvement over the GATS. All sectors listed face a horizontal foreign equity limitation of 49 percent. By contrast, the Australia-Thailand FTA offers certain improvements in distribution and construction services (for which full foreign ownership is allowed) as well as hotel and restaurant services (for which majority ownership is allowed). In the area of Mode 4, Thailand extends residency and work permits to Australians to up to 5 years, compared to six months under the GATS.
Vietnam	ASEAN Framework Agreement on Services (AFAS), US-Vietnam BTA	Vietnam's two FTAs feature different degrees of ambition. While Vietnam's AFAS commitment has limited sectoral scope, the US-Vietnam BTA covers the vast majority of service sectors (except transport services). Where commitments exist, they are subject to deep liberalization undertakings in both agreements. In the area of Mode 3, Vietnam's AFAS commitment does not impose any foreign equity limitations but inscribes certain licensing requirements. Under the US-Vietnam BTA, Vietnam maintains certain foreign equity restrictions, but these are phased out over time (within 3 to 10 years after entry into force of the BTA).



INVESTMENT

**APEC Workshop on FTAs
Hanoi February/March 2006**

Jane Drake-Brockman



Investment does not (yet?) fully figure on the WTO negotiating agenda

- Most OECD economies have relatively open foreign investment regimes and offensive investment interests in developing economies
- Developing economies, despite their obvious and overwhelming economic interests in attracting foreign investment, typically operate more restrictive regimes
- So it is inevitable that developed economies will see FTAs as potentially useful mechanisms for addressing bilateral investment irritants
- Developing countries need to be ready to discuss ways of covering investment issues in FTAs and to respond to demands from bilateral partners to make investment related commitments that go “beyond the WTO”

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Remember

A potential bilateral offer of investment liberalisation is very valuable negotiating coin – it may be enough to bring a reluctant major trading partner to the negotiating table.....

A faint world map is visible in the background of the slide, showing the continents in a light blue color against a darker blue gradient background.

***In a globalising world economy,
the interactive relationship between
Investment and Trade is extremely
complex & evolving
Trade Negotiators need to understand
this better***

Trade and Investment ? -Goods-

- In protected goods sectors, inward flows of foreign direct investment can act a **SUBSTITUTE** for trade. Foreigners are motivated to invest overseas in order to get around tariff barriers in the host country by servicing the host market from inside. “Pre-establishment” barriers to investment limit this option.
- Foreign investment also acts as a **COMPLEMENT** to trade
 - Investment may be focused on exploiting comparative advantages in the host economy, boosting bilateral or global **EXPORT** from the host economy
 - Investment also seems to stimulates **EXPORT** growth from the home economy, of both goods and services, including via intra-industry trade

Trade and Investment -Services-

- When their domestic clients invest offshore, services providers try to follow those domestic clients abroad. Often they require a commercial presence in the offshore market to service those customers effectively, so they also invest. **If the policy regime is sufficiently open, foreign investment in goods can breed foreign investment in services.**
- Services providers look for foreign clients in their own right - & to service them effectively, they need to pursue their own offensive investment interests to achieving **commercial presence** in that market.
- As services activities which traditionally have been government-owned & operated enter the realm of the private market place, they also become attractive to the international market. Foreign participation in these activities requires inward direct investment.

Although we don't fully understand it yet, we do know that the relationship between Trade and Investment is increasingly seamless.....but

- Investment policy tends to be in the realm of Finance Ministries, Treasuries and Investment Authorities
- The idea of investment negotiations, in any forum, is still a bit of a mystery to trade negotiators – and trade negotiations, in any forum, still remain a bit of mystery to Finance Departments and Treasury officials
- Disciplines on Investment have proved elusive to date in the multilateral fora, including the OECD

So how should we handle Investment in FTAs?

There is more than one way to draft an FTA chapter on Investment

- All of them are potentially confusing for private sector investors!
- The US approach is gaining in ascendency?
- Typically, the Investment Chapter will aim to cover investment in both **goods sectors & services sectors**.
- Typically, the Investment Chapter will aim to pull together into 1 chapter
 - the key elements of the usually pre-existing **Bilateral Investment Protection and Promotion Agreement**
 - along with reaffirmation of various relevant **WTO disciplines** (eg TRIPS)
 - plus commit, where possible, to more liberal conditions for **market entry &**
 - extend **National Treatment** post-establishment
 - commit perhaps to a “minimum standard of treatment”?

Defining Investment

- Investment means every asset that an investor owns or controls, directly or indirectly, involving eg the commitment of capital or other resources, the expectation of gain or profit or the assumption of risk.
- **FDI** (involving direct participation by the investor in the management of the investment)
- **Portfolio Investment** (minority holding of shares, bonds or other securities)

Treatment of Investors and their Investments

- *Pre-Establishment Disciplines*
- *Post-Establishment Disciplines*
- *Non Discrimination*
 - National Treatment*
 - Most-Favoured-Nation Treatment*
- *Minimum Standard of Treatment*
- *Performance Requirements*
- *Transfers and Payments*
- *Expropriation & Compensation*
- *Senior Personnel*

Scheduling Commitments

- *Horizontal Commitments*
 - foreign investment approval mechanisms
 - land purchases
 - foreign exchange regulations
 - eligibility for government subsidies
- *Sectoral Schedules of Non Conforming Measures (Negative List?)*
- *Sectoral Schedules of Reserved Sectors (Negative List?)*
- *Combined Schedules (Negative Lists) of both Services and Investment Commitments*

Non Conforming Measures

A schedule containing a list of all those measures that are not fully in conformity with the liberalising provisions of the Agreement

Reserved Sectors (Sensitive Carve Outs)

A schedule listing the sectors in which future “policy space” is preserved ie in which the parties may unilaterally introduce policy changes without contravening the provisions of the Agreement.

Dispute Settlement

Benefits to developing economies of negotiating a deal on Investment

In addition to all the other important “non – trade” public policy objectives you may be seeking to preserve, remember that the overriding objective in negotiating an Investment Chapter in an RTA/FTA, should be to send a positive and **welcoming message to (desperately needed) private sector foreign investors.**

Implementing Investment Liberalisation

- Whatever one thinks about the bilateral preferential approach to trade, there is much less question that a discriminatory approach to investment liberalisation makes no economic sense
- Wherever possible, pre-establishment investment liberalisation which is negotiated bilaterally should be implemented multilaterally as soon as possible

A world map in a lighter blue shade, centered on the Atlantic Ocean, serving as a background for the text.

SERVICES

APEC Workshop on FTAs
Hanoi February/March 2006

Jane Drake-Brockman

A world map in a lighter blue shade, centered on the Atlantic Ocean, serving as a background for the text.

Point no.1

***Services issues are by far the
most dominant issues on the
FTA negotiating agenda***

Why?

1. Trade in Services takes place in several ways

- *Cross Border (eg via the internet)***
- *Temporary movement of customers (eg tourism, education)***
- *Temporary movement of service providers into the foreign market (eg foreign insurance agents, consultants)***
- *Setting up a local office (investment)***

This complexity means it takes more than 1 Chapter of an FTA to deal with all the relevant issues

2. The services sector includes major infra-structural industries affecting the entire economy

- Financial services usually need to be dealt with in a separate chapter**
- Telecommunications is also often dealt with in a separate chapter**
- E-Commerce is often dealt with in a separate chapter**
- Business mobility needs to be handled separately**

- 
3. *Services account for more than 50% on average of GDP & employment (over 75% in the developed economies) & is often the major contributor to innovation & productivity growth & the fastest growing export sector*

Services industries are beginning to mobilise & to demand commercial outcomes from trade negotiations

4. The GATS is moving too slowly.....

- And FTAs offer an opportunity for the pursuit of other “new” issues which do not figure fully on the current WTO negotiating agenda but which are closely related to Trade in Services such as E Commerce, Investment and Competition Policy
- It is inevitable that developed economies will view FTAs as potentially constructive mechanisms for addressing all of these interrelated issues

5. Reform in the Services sectors has the greatest relative power to deliver economic benefits

Most modelling work assessing the economic impact of any particular FTA will show, despite the problems of measurement, that the potential gains from liberalising services tend to outweigh the gains from liberalising trade in goods.

(This is generally due to the positive impact of domestic reform in the services sector rather than due to gains from new access to trading partners' markets.)

***So there are at least 5 good
reasons why an OECD country
trading partner will want an FTA to
focus closely and deliver results
on Services related issues***

Lets look at a Table of Contents....



Goods (Agriculture/ Manufactured Goods/Textiles)
Tariff Schedules and Rules of Origin
Sanitary and Phytosanitary Barriers
Cross Border Trade in Services
Positive List - Schedule of Commitments
or Negative List Approach
List A (Non Conforming Measures)
List B (Sensitive Carve Outs)
Financial / Telecommunications / Professional Services
E Commerce / Other Sectors?
Mode 4 / Temporary Movement of Business Personnel
Competition Policy
Investment
Government Procurement
Intellectual Property
Standards and Technical Barriers
Dispute Settlement

Point no.2

***Services issues are also proving to
be the slowest and most difficult to
negotiate, especially for developing
countries***

negotiators seem unprepared

- 
- A faint world map is visible in the background of the slide, showing the continents in a light blue color against a darker blue gradient.
- Services issues can not be avoided in any FTA negotiation with a developed economy
 - It is inefficient to try to avoid them also in any FTA/RTA among less developed economies
 - But the issues are complex and there are many pitfalls for developing economy negotiators
 - How to get better prepared?

Steps to take

- 
- A faint world map is visible in the background of the slide, showing the continents in a light blue color against a darker blue gradient.
- **Step Number 1: Do your Homework.** Improve your understanding of your services sectors, including potential export interests & competitive threats. Enhance the transparency of the domestic regulatory framework
 - **Step Number 2: Get your Own House in Order.** Identify outdated & stifling red tape and get ready to implement pro-competitive regulatory reforms so that new domestic firms will be able to enter the market & allow the domestic industry to develop & grow
 - **Step 3:** You are now ready to negotiate with confidence. Steps 1 & 2 will ensure that your trade negotiating strategy is **home-grown and development driven.**

Food for Thought

- Your FTA partner will probably seek to remove discrimination by achieving maximum concessions on **National Treatment**.
- (And the WTO rules on FTAs require removal of substantially all discrimination)
- But remember that unless you also do Step 2 above ie pro-competitive regulatory reform (which the GATS does not insist upon), you risk transferring any existing monopoly profits to foreigners.

Food for Thought

- Remember also that any concessions you agree to make on **Market Access** (consistent with Step 2 above) will boost productivity and deliver net gains for economic development, including to your own domestic service providers. Remember this is in your own best interest. Take advantage, from a political perspective, of the external pressure of trade negotiations to pave the way for necessary regulatory reforms of this kind.
- The FTA negotiation provides an excellent opportunity for ongoing policy dialogue (& perhaps for receiving technical assistance) on best regulatory practices in the services sectors.

The basic concepts in a sample chapter on Cross Border Trade in Services

- A sample FTA chapter would contain principles drawn from the WTO/GATS
- But it also contains some new concepts
- Let's focus on the aspects which are different from the GATS ie not necessarily familiar to WTO or APEC negotiators

Important Concepts

- **Most Favoured Nation**
- **Denial of Benefits (rules of origin for services - generally more liberal than for goods)**
- **Positive List approach (like the GATS) and/or the more deeply liberalising Negative List approach (list it or liberalise it)**
- **2 Schedules of Non Conforming (Sensitive) Measures**
 - **Ratchet Mechanism**
- **Absence of an Emergency Safeguards clause?**

Negative List Approach

Non Conforming Measures Annex 1

- Existing measures which do not conform with the principles set out in the chapter, but which are “grandfathered” in Annex 1 ie you want to retain them
- If you don’t list them in Annex 1, you are obliged to liberalise them.
- In a Federal system, it is typical to “grandfather” all existing measures at State and local level.
- No new measures which are inconsistent with the Chapter can be introduced

Negative List Approach

Non-Conforming Measures Annex 2

- List of measures with respect to which you wish to retain even greater flexibility ie retain the right to increase the level of protection in the future
- These are the most domestically sensitive policy areas
- There will always be considerable negotiating pressure to keep this list short.

Implementing services preferences

- It is worth noting that, unless the barriers to trade are quantitative in nature (eg numbers of foreign universities that can establish locally) it is probably harder, than it is for goods, to implement services sector market liberalisation on an exclusive discriminatory basis
- Many services sector reform measures agreed in the context of a bilateral FTA could readily be multilateralised and it would generally add to the domestic economic benefit to do so.

How much services sector liberalisation is taking place via FTAs?

- In general, services liberalisation seems no easier in small groups than it is in the WTO
- Where the negative list approach is used, there have been significant WTO plus strides forward in terms of National Treatment
- Progress is less evident in terms of Market Access, at least from developed economy partners
- There is some progress on Temporary Movement of Business Persons and there are attempts underway to deal with Recognition of Professional Qualifications
- There is deeper commitment on the part of developing countries to Regulatory Transparency and there is incremental progress in the direction of regulatory harmonisation, including on telecoms and banking.

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APEC 2007

**Investment Experts Group
Group on Services**

**Workshop on the Relationship between
Investment and Services
in RTAs**

Adelaide 18 April 2007

Presentation by Jane Drake-Brockman

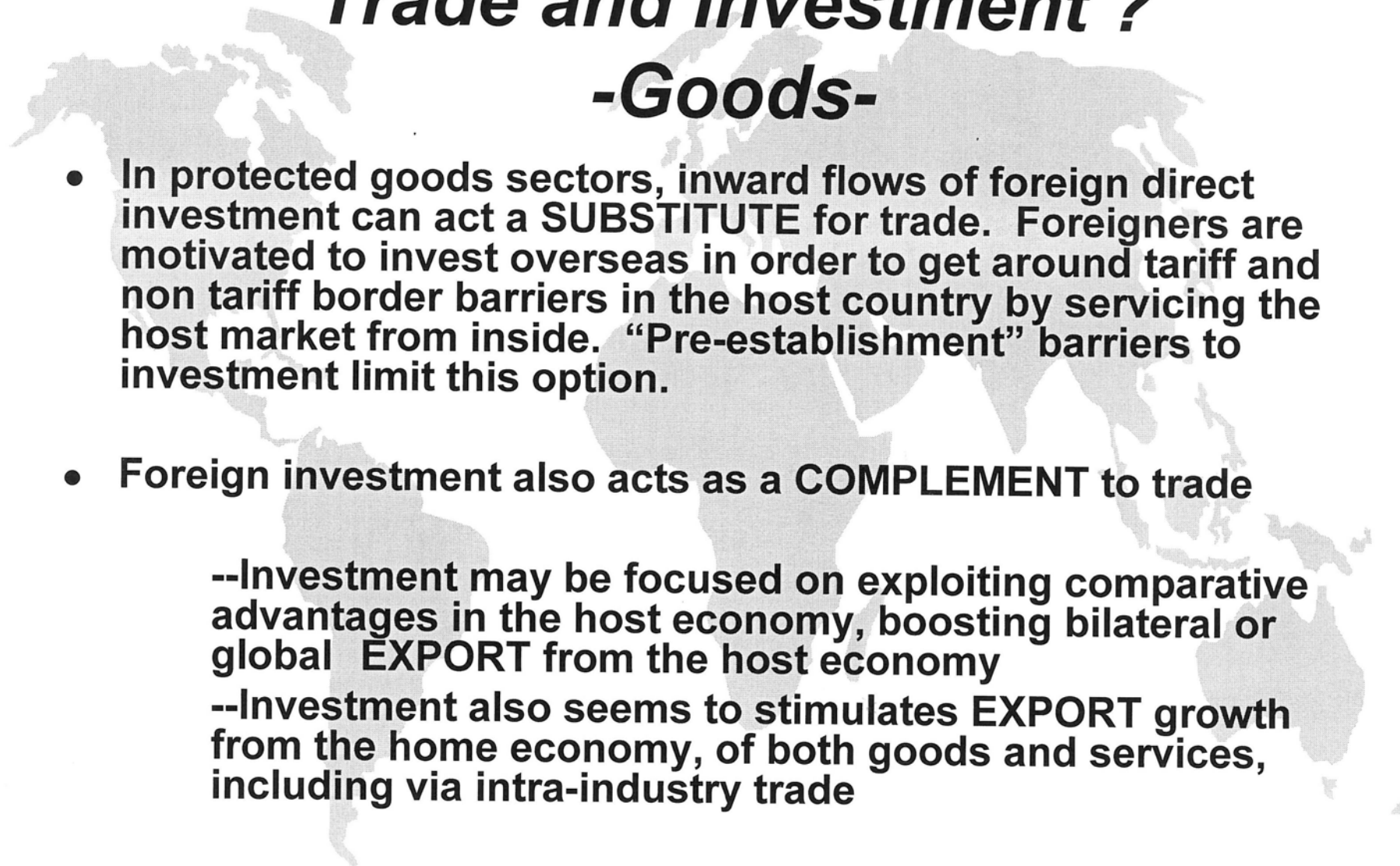


Why is Investment a Trade Issue?

In a globalising world economy, the relationship between investment flows and trade flows is complex and evolving

The policy divide has become blurred

Trade and Investment officials need to understand this better



Trade and Investment ?

-Goods-

- In protected goods sectors, inward flows of foreign direct investment can act a **SUBSTITUTE** for trade. Foreigners are motivated to invest overseas in order to get around tariff and non tariff border barriers in the host country by servicing the host market from inside. “Pre-establishment” barriers to investment limit this option.
- Foreign investment also acts as a **COMPLEMENT** to trade
 - Investment may be focused on exploiting comparative advantages in the host economy, boosting bilateral or global **EXPORT** from the host economy
 - Investment also seems to stimulates **EXPORT** growth from the home economy, of both goods and services, including via intra-industry trade

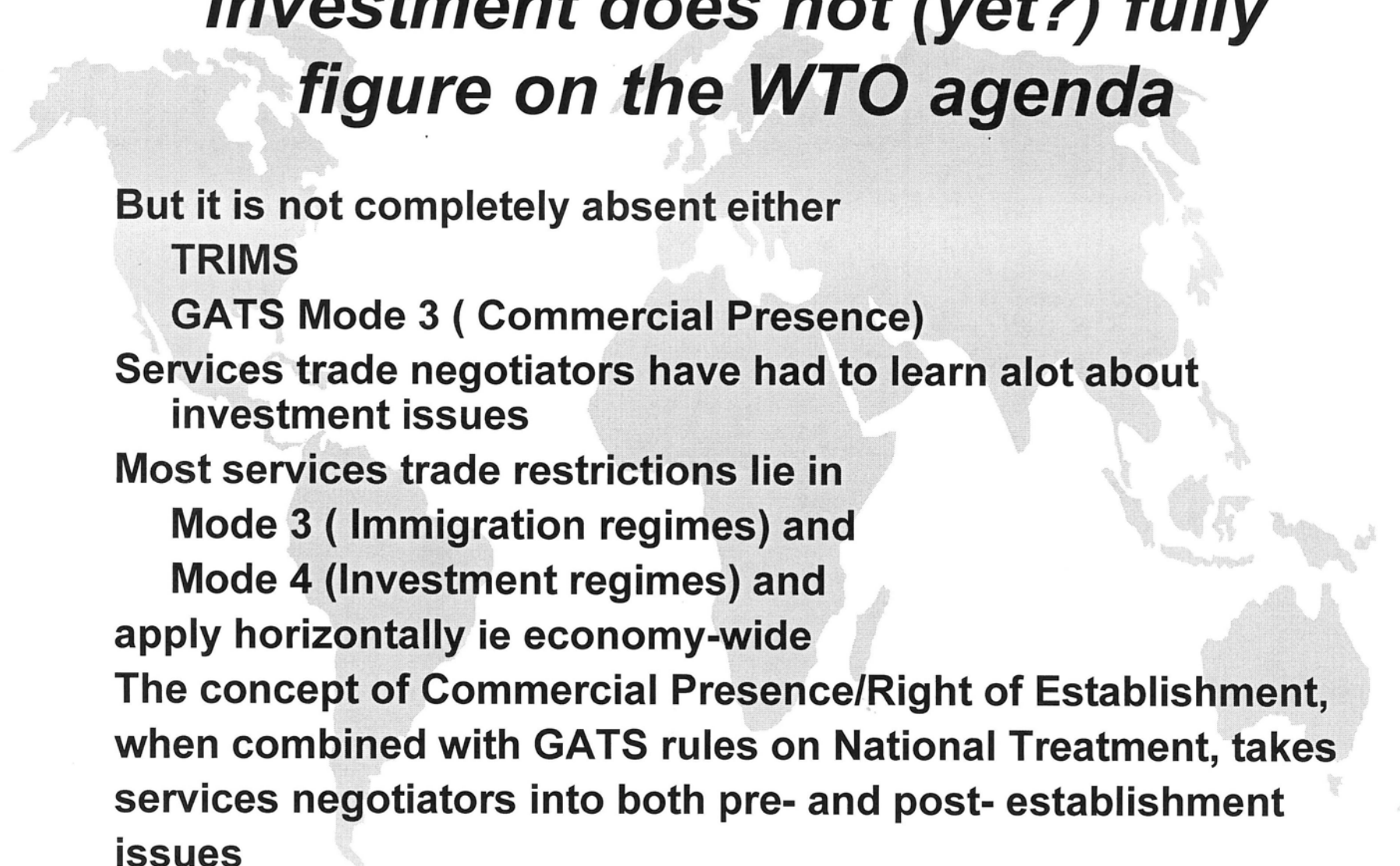
Trade and Investment

-Services-

- **When their domestic clients invest offshore, services providers try to follow them abroad. Often they require a commercial presence in the offshore market to service them effectively, so they also invest. If the policy regime is sufficiently open, foreign investment in goods can breed foreign investment in services.**
- **Services providers look for foreign clients in their own right - & to service them effectively, they need to pursue their own offensive investment interests to achieving commercial presence in that market.**
- **As services activities which traditionally have been government-owned & operated enter the realm of the private market place, they also become attractive to the international market. Foreign participation in these activities requires inward direct (and portfolio) investment.**

The relationship between Trade and Investment is increasingly seamless.....but

- **Investment policy tends to be in the realm of Finance Ministries, Treasuries and Investment Authorities**
- **The idea of investment negotiations, in any forum, is still a bit of a mystery to many trade negotiators – and trade negotiations, in any forum, still remain a bit of mystery to Finance Departments and Treasury officials**
- **Disciplines on Investment have proved elusive to date in the multilateral fora, including the OECD**



Investment does not (yet?) fully figure on the WTO agenda

But it is not completely absent either

TRIMS

GATS Mode 3 (Commercial Presence)

Services trade negotiators have had to learn alot about investment issues

Most services trade restrictions lie in

Mode 3 (Immigration regimes) and

Mode 4 (Investment regimes) and

apply horizontally ie economy-wide

The concept of Commercial Presence/Right of Establishment, when combined with GATS rules on National Treatment, takes services negotiators into both pre- and post- establishment issues



Will negotiation of Investment rules eventually appear on the WTO agenda?

Does it, meanwhile, make any logical sense in a “WTO plus” RTA to discipline investment in services industries alone?

Even if your answer to the first question is “no” your answer to the second question is very unlikely to also be “no”.

So how should we handle Investment issues in RTAs?

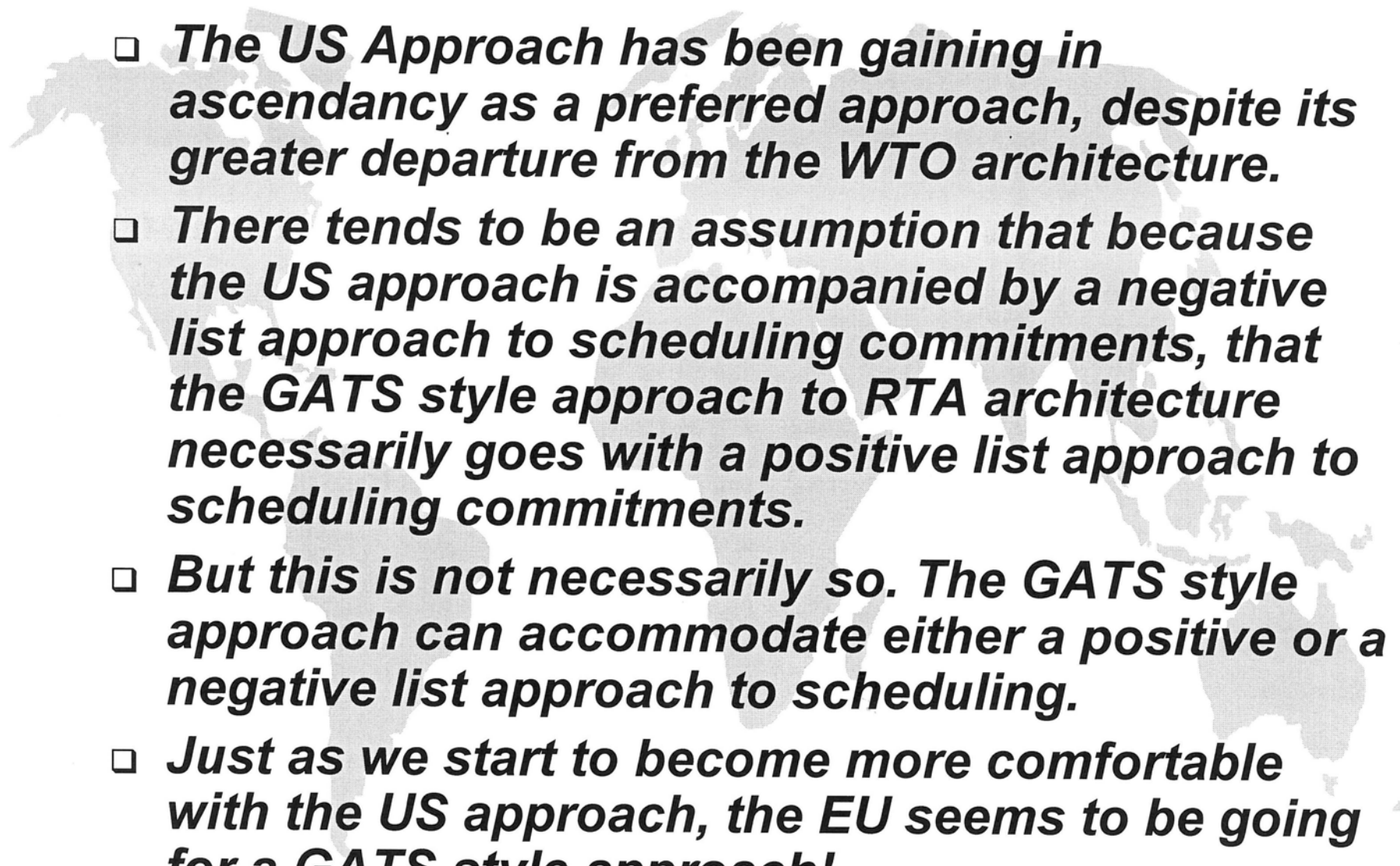
RTA Architectural Issues

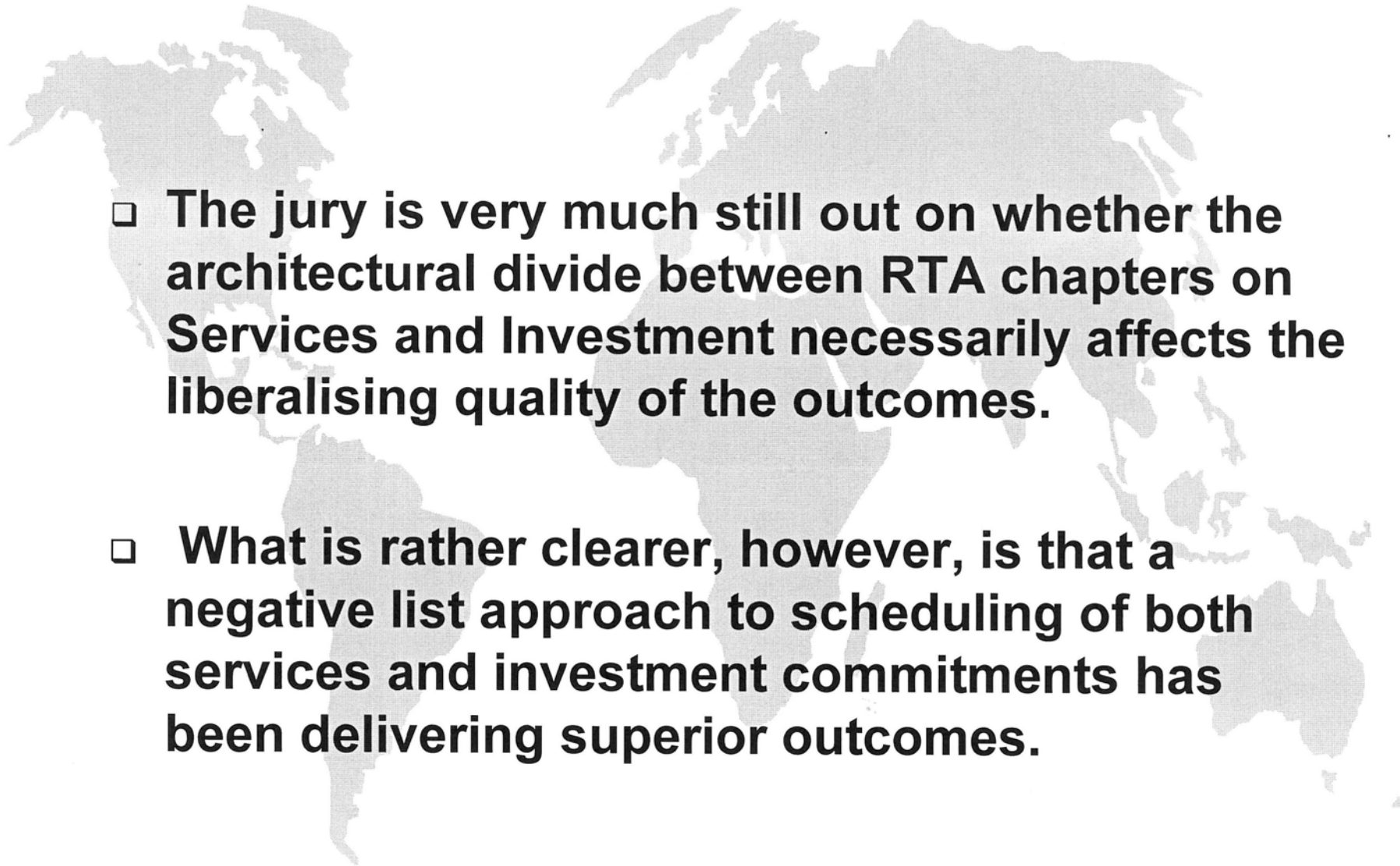
There is more than one way to draft an RTA Chapter on Services or an RTA Chapter on Investment

All of them are confusing for the private sector

Two basic models;

- 1. A GATS style Chapter (or set of Chapters) on Services which covers Mode 3 plus a Chapter on Investment which updates/replaces the BIT***
- 2. A NAFTA style Chapter on Services Modes 1 and 2 alone, extracting Mode 3 and putting it into what then looks like a more ambitious Investment Chapter***

- 
- A faint, light gray world map is visible in the background of the slide, centered behind the text.
- ❑ ***The US Approach has been gaining in ascendancy as a preferred approach, despite its greater departure from the WTO architecture.***
 - ❑ ***There tends to be an assumption that because the US approach is accompanied by a negative list approach to scheduling commitments, that the GATS style approach to RTA architecture necessarily goes with a positive list approach to scheduling commitments.***
 - ❑ ***But this is not necessarily so. The GATS style approach can accommodate either a positive or a negative list approach to scheduling.***
 - ❑ ***Just as we start to become more comfortable with the US approach, the EU seems to be going for a GATS style approach!***

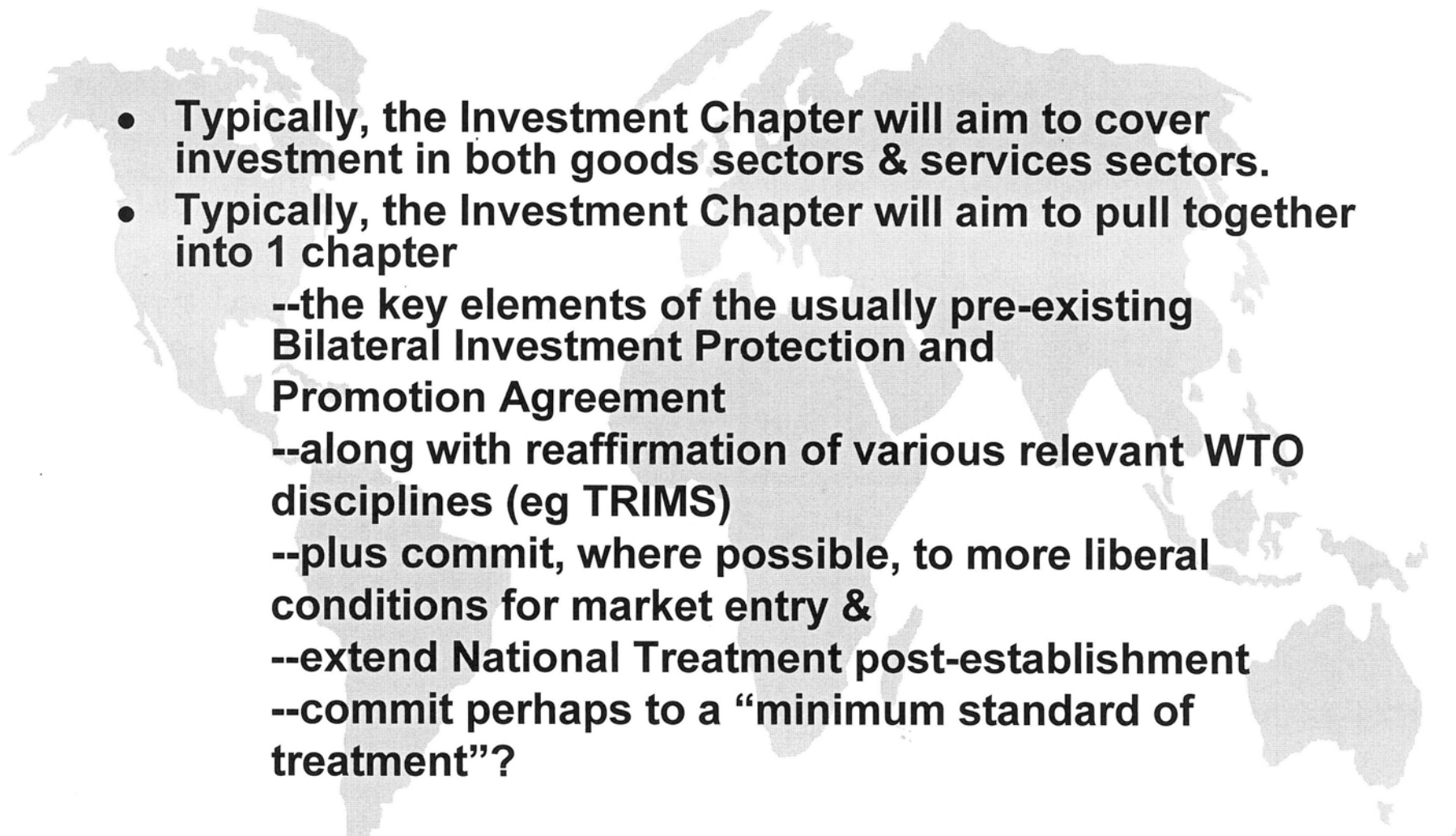
- 
- ❑ **The jury is very much still out on whether the architectural divide between RTA chapters on Services and Investment necessarily affects the liberalising quality of the outcomes.**
 - ❑ **What is rather clearer, however, is that a negative list approach to scheduling of both services and investment commitments has been delivering superior outcomes.**

Improving Transparency

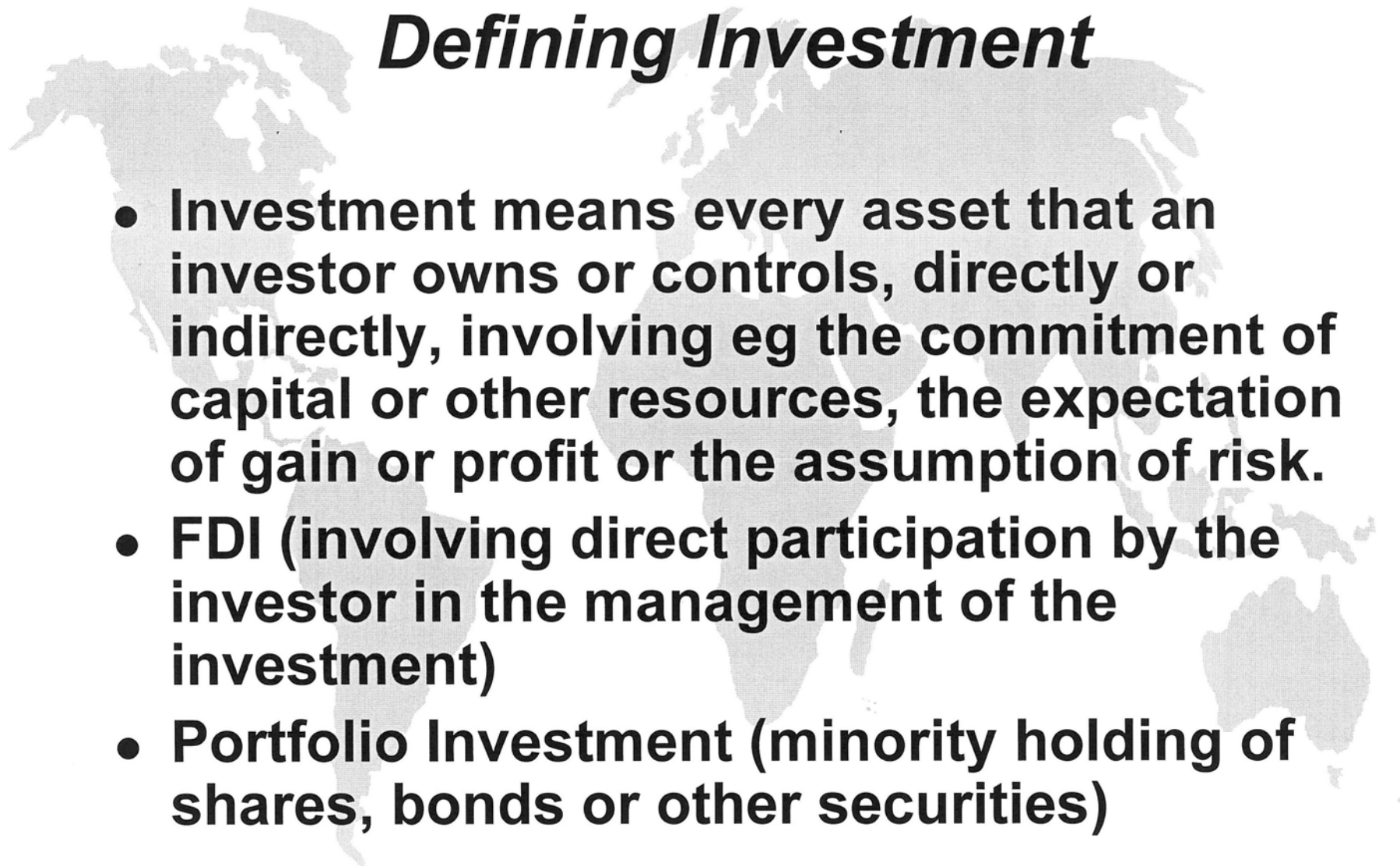
- ❑ **RTA negotiations on services issues necessitate a deeper look than the WTO requires at whether one's regulatory house is in order.**
- ❑ **Very importantly for the business community, even where no regulatory reform results, this regulatory stocktake can lead to a significant improvement in transparency.**
- ❑ **This is true for both a Negative and a Positive list approach to scheduling of commitments.**

The Positive List approach (or even uncertainty over which approach will finally be agreed) tends to shift the burden of undertaking the stocktake to the demandeur

Lets look at the US approach

- 
- Typically, the Investment Chapter will aim to cover investment in both goods sectors & services sectors.
 - Typically, the Investment Chapter will aim to pull together into 1 chapter
 - the key elements of the usually pre-existing Bilateral Investment Protection and Promotion Agreement
 - along with reaffirmation of various relevant WTO disciplines (eg TRIMS)
 - plus commit, where possible, to more liberal conditions for market entry &
 - extend National Treatment post-establishment
 - commit perhaps to a “minimum standard of treatment”?

There are still some unresolved problems of definition.



Defining Investment

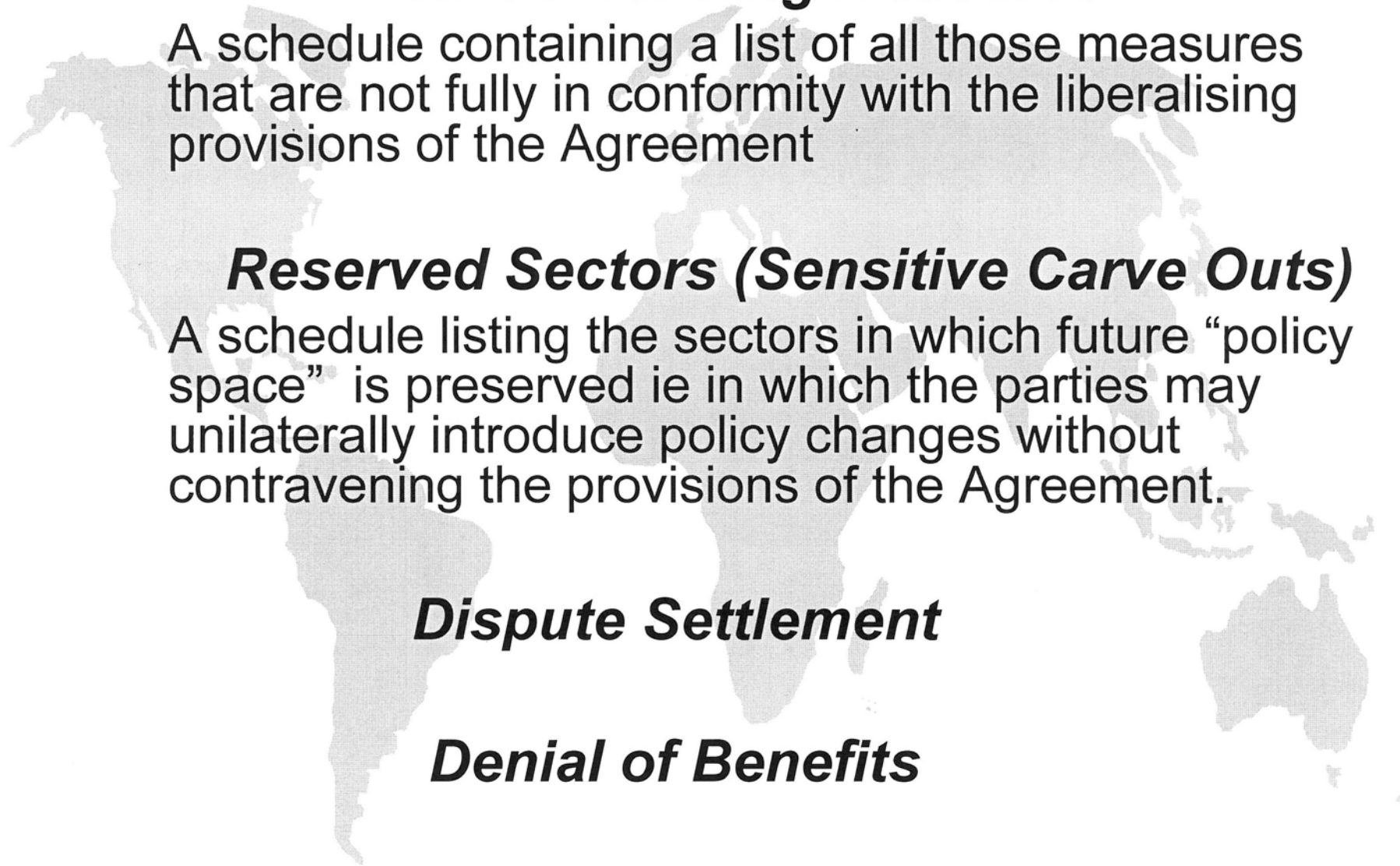
- **Investment means every asset that an investor owns or controls, directly or indirectly, involving eg the commitment of capital or other resources, the expectation of gain or profit or the assumption of risk.**
- **FDI (involving direct participation by the investor in the management of the investment)**
- **Portfolio Investment (minority holding of shares, bonds or other securities)**

Treatment of Investors and their Investments

- ***Pre-Establishment Disciplines***
- ***Post-Establishment Disciplines***
- ***Non Discrimination***
 - National Treatment***
 - Most-Favoured-Nation Treatment***
- ***Minimum Standard of Treatment***
- ***Performance Requirements***
- ***Transfers and Payments***
- ***Expropriation & Compensation***
- ***Senior Personnel***

Scheduling Commitments

- ***Horizontal Commitments***
 - foreign investment approval mechanisms***
 - land purchases***
 - foreign exchange regulations***
 - eligibility for government subsidies***
- ***Sectoral Schedules of Non Conforming Measures (Negative List?)***
- ***Sectoral Schedules of Reserved Sectors (Negative List?)***
- ***Combined Schedules of both Services and Investment Commitments?***
- ***Positive Schedules, separate or combined for Services and for Investment?***
- ***If separate schedules exist, where should Mode 3 Services commitment be scheduled?***



Non Conforming Measures

A schedule containing a list of all those measures that are not fully in conformity with the liberalising provisions of the Agreement

Reserved Sectors (Sensitive Carve Outs)

A schedule listing the sectors in which future “policy space” is preserved ie in which the parties may unilaterally introduce policy changes without contravening the provisions of the Agreement.

Dispute Settlement

Denial of Benefits

Policy Questions?

**Unanswered Questions with respect to Definitions;
eg securities trading is a financial service but is not
fully covered in the GATS definitions of financial
services? In an RTA, should we redefine financial
services - or might barriers in this industry be better
handled under the heading of Portfolio investment in
an Investment Chapter.**

**How does the text have to change if you start out
negotiating with a NAFTA style chapter but end up
with a positive list approach to scheduling
commitments**

**Is GATS being undermined by innovative approaches
to investment in RTAs ? Does it matter?**

A faint, light gray world map is visible in the background, centered behind the text. The map shows the continents of North America, South America, Europe, Africa, Asia, and Australia.

Benefits to developing economies of negotiating a deal on Investment

In addition to all the other important “non – trade” public policy objectives you may be seeking to preserve, remember that the overriding objective in negotiating an Investment Chapter in an RTA/FTA, should be to send a positive and welcoming message to (badly needed) private sector foreign investors.

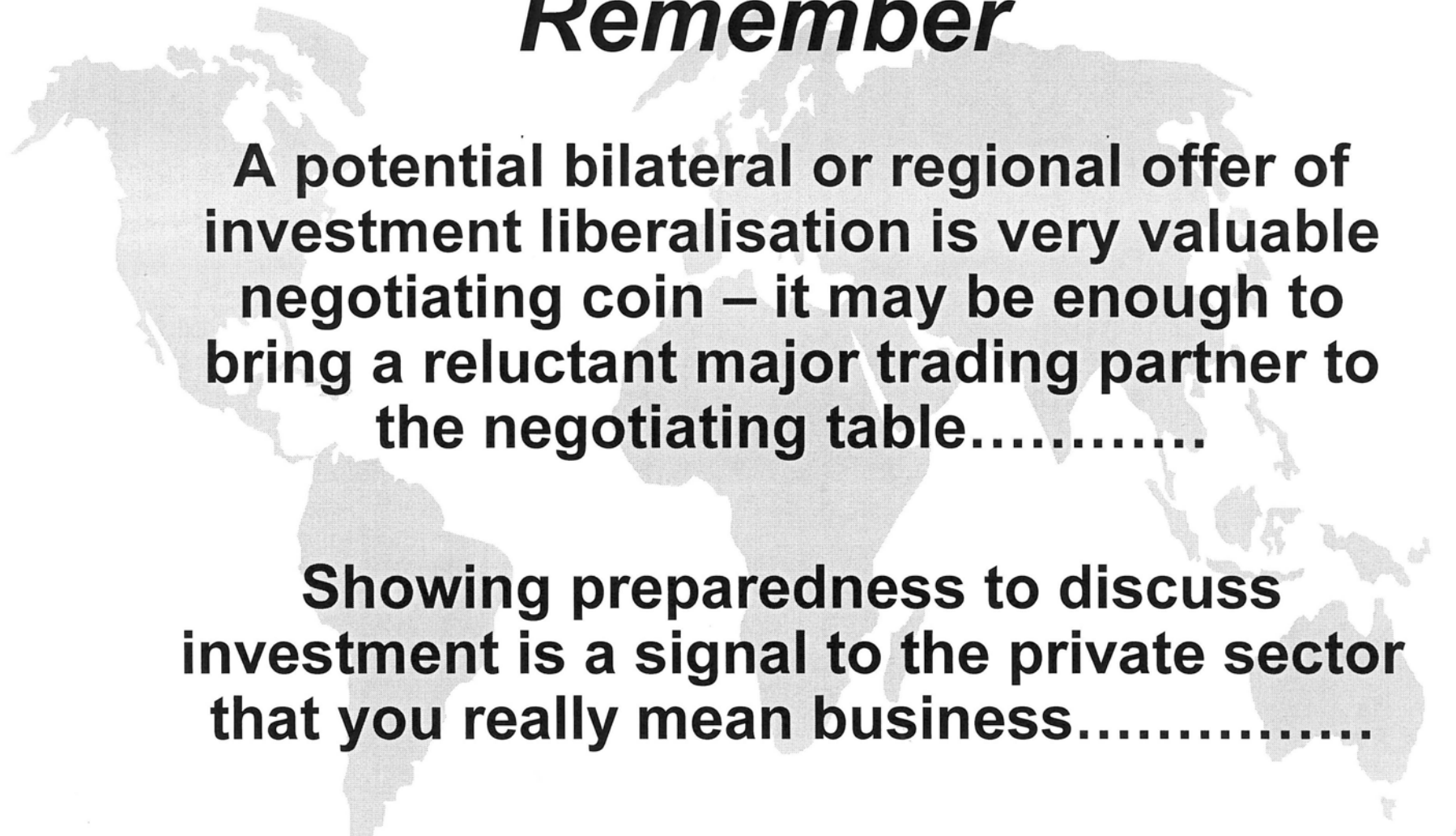


Implementing Investment Liberalisation

- **Does a preferential approach to investment liberalisation make economic sense?**
- **Wherever possible, pre-establishment investment liberalisation which is negotiated bilaterally should be multilateralised as soon as possible.**

What does this mean for APEC economies

- ❑ **Most developed economies in the region have relatively open foreign investment regimes.**
- ❑ **Most developing economies, despite their overwhelming economic interests in attracting foreign investment, and despite the considerable progress which has been made in recent years towards the Bogor goals, still typically operate more restrictive regimes.**
- ❑ **Given their interests in trade in services, the developed economies will have strong offensive investment interests in developing economies**
- ❑ **Developed economies will see RTAs as potential mechanisms for addressing investment irritants**
- ❑ **Developing countries need to be ready to discuss ways of covering investment issues in RTAs and to respond to requests that go well “beyond the WTO”**



Remember

A potential bilateral or regional offer of investment liberalisation is very valuable negotiating coin – it may be enough to bring a reluctant major trading partner to the negotiating table.....

Showing preparedness to discuss investment is a signal to the private sector that you really mean business.....

And in APEC we do really mean business

MARYSE ROBERT

9

Investment

Trade rules governing foreign investment in the Americas have begun to converge in the 1990s. After years of imposing controls excluding or restricting the entry of foreign firms, Latin American and Caribbean countries embarked on a series of ambitious economic reforms in the mid-1980s and early 1990s. They abandoned the import-substitution model and undertook to liberalize trade and ease restrictions on foreign investment. At the beginning of the twenty-first century, most countries in the Western Hemisphere are now seeking to attract investment from abroad both to foster economic growth and development and to stimulate transfer of technology and competition. In 1999 foreign direct investment (FDI) in Latin America and the Caribbean reached a new record. The total of \$90 billion in inflows was a twelve-fold increase over the annual average from 1984 to 1989. The region has become as attractive to investors as developing Asia, which received \$106 billion in FDI inflows in 1999.¹ Market-oriented policies, including privatization programs, have played a significant role in the investment surge experienced by the region in the 1990s.

1. Several Latin American countries experienced a significant increase in foreign direct investment (FDI) inflows in 1999. Overseas investment into Brazil totaled \$31 billion, while FDI flows into Argentina jumped more than three-fold to \$23 billion, due in large part to the \$13 billion takeover of

Approaches to Investment: Protection and Liberalization

In addition to laws and regulations that are more investment friendly, governments of the Western Hemisphere have entered into binding obligations to improve their investment climate. Traditionally, investment agreements have set standards for the treatment and protection of the investment and investor; have included an admission clause, which refers to the laws and regulations of the host state for the admission of investments; and have provided an effective dispute settlement mechanism between the investor and the host state. In the 1990s a growing number of countries in the Americas concluded agreements that go beyond this traditional approach. These new agreements include a right of establishment (right to establish a new business or to acquire an existing one) with no admission provision but with a list of country-specific exceptions; these agreements therefore add a “market access” component to the “protection element” of a traditional investment agreement. Investment agreements do not themselves attract investment, but they complement the main determinants of FDI flows. Countries that have locked in the liberalization achieved at the domestic level have gained from the signaling effects of such binding agreements.

Bilateral Investment Treaties and Regional Trade Agreements

Since the early 1990s more than sixty bilateral investment treaties (BITs) have been signed between countries of the hemisphere. Although the first BITs originated in Europe in the late 1950s, it took more than thirty years before countries of the Americas started negotiating bilateral investment treaties among themselves. The first BIT concluded within the region was between the United States and Panama in 1982. During the 1980s only the United States was active in entering into bilateral investment treaties with other countries of the region, signing a BIT with Haiti in 1983 and one with Grenada in 1986. An overwhelming majority of the countries in the Americas have now signed at least one bilateral investment treaty. In fact, only two countries (the Commonwealth of the Bahamas and St. Kitts and Nevis) have not yet done so, while twenty-four have concluded at least one

YPF, Argentina's largest oil company, by the Spanish-based company Repsol. Mexico (\$11 billion), Chile (\$9 billion), and Peru (\$2 billion) also saw higher inward investment in 1999. However, Venezuela (\$2.6 billion) and Colombia (\$1.3 billion) suffered a decrease. See UNCTAD (2000) and *Financial Times*, “Latin America Sees Investment Surge,” February 2, 2000, p. 7.

BIT with another country of the region. Of all these bilateral investment treaties, those signed by the United States and Canada include a right of establishment and a list of reservations.² At the regional level the North American Free Trade Agreement (NAFTA), the free trade agreement among members of the Group of Three (Colombia, Mexico, and Venezuela), and the bilateral free trade agreements signed by Mexico with Bolivia, Chile, Costa Rica, Nicaragua, and the Northern Triangle (El Salvador, Guatemala, and Honduras), and by Chile with Canada embrace this new approach. They incorporate a protection element and a market access component. The investment chapter of the free trade agreement between the Central American countries and the Dominican Republic includes an additional element, an admission clause, which suggests that the entry of investors and investments of one party into the territory of another party is subject to the laws of that other party. The Colonia Protocol for MERCOSUR (Common Market of the South) also includes an admission clause. The Buenos Aires Protocol for non-MERCOSUR members follows the traditional approach adopted in bilateral investment treaties, and so does the investment agreement between the Caribbean Community and Common Market (CARICOM) and the Dominican Republic. Other arrangements such as the Andean Community Decision 291 and CARICOM Protocol II contain a few investment provisions. Protocol II establishes that members shall not introduce in their territories any new restrictions relating to the right of establishment of nationals of other member states except as otherwise provided in the agreement.³ Finally, the bilateral investment treaties signed by each Central American country with Chile are incorporated as an integral part of the chapter on investment in the free trade agreement between Chile and these countries.⁴

2. In contrast to a general exception, which has the effect of exempting a party from the whole set of obligations contained in the agreement, a reservation is applicable only in relation to specific provisions. States usually take reservations regarding national treatment, most-favored-nation treatment, performance requirements, and senior management and boards of directors. A reservation identifies the sector in which the reservation is taken and the obligation against which the reservation is taken, and it often also refers to the specific measure (laws, regulations, or other measures) for which the reservation is taken.

3. The Protocol of Colonia for the Reciprocal Promotion and Protection of Investment in MERCOSUR was signed on January 17, 1994. MERCOSUR's Protocol for the Promotion and Protection of Investment of Third States (Buenos Aires Protocol) was signed on August 5, 1994. Protocol II of CARICOM entered into force provisionally on July 4, 1998. Decision 291 of the Andean Community was signed in Lima on March 21, 1991.

4. Article 10.02 of the free trade agreement between Chile and Central American countries, signed on October 18, 1999, states that parties may at any time decide—and must within two years of the entry into force of the agreement analyze the possibility—to broaden the coverage of the investment rules in the bilateral investment treaties between Chile and each Central American country.

Investment at the WTO

Several agreements resulting from the Uruguay Round include investment provisions, but there is no comprehensive agreement on investment. The WTO Agreement on Trade-Related Investment Measures (TRIMs) addresses the issue of performance requirements for goods, whereas the General Agreement on Trade in Services (GATS), as explained in chapter 8, covers investment in two of its four modes of supply—commercial presence (mode 3) and movement of natural persons (mode 4). The TRIMs Agreement establishes an illustrative list of prohibited performance requirements, those contrary to the principle of national treatment (Article III of GATT 1994), such as local content and trade-balancing requirements, and those inconsistent with the general obligation of eliminating quantitative restrictions (Article XI of GATT 1994), such as trade and foreign exchange—balancing restrictions and domestic sales requirements. Member countries had ninety days from the date of entry into force of the WTO agreement to report all inconsistent TRIMs to the Council for Trade in Goods. Developed countries had to eliminate their performance requirements within two years of the date of entry into force of the WTO agreement. Developing countries had a deadline of five years (January 1, 2000), and least-developed countries had seven years. The Council for Trade in Goods may extend the transition period for developing and least-developed countries, and a few countries have requested extension of their deadline.

The GATS provisions regarding national treatment (Article XVII) and market access (Article XVI) are conditional, a clear departure from common practice in investment agreements with respect to the national treatment provision.⁵ They are granted according to specific commitments listed in members' schedules indicating to which sectors and modes of supply these provisions apply. GATS thus makes use of what is known as a "positive list" by identifying those sectors that are covered by the agreement. More specifically, this approach means that new discriminatory measures are allowed in sectors not included in a member's schedule. Moreover, in sectors where commitments have been made, existing measures inconsistent with the agreement do not have to be eliminated as long as they are listed in a member's schedule.⁶ In fact, once a sector is listed in a member's schedule, it is bound in full by the market access and national treatment obligations for the four modes of supply, unless a limitation to this treatment (the

5. WTO (1996, p. 71).

6. Sauvé (1994).

negative list approach) is specified for one or several modes in the columns entitled "limitations on market access" and "limitations on national treatment." Schedules include a number of "unbound" entries for each mode of supply, which means that a WTO member is not bound by any commitment in GATS for a particular mode in a particular sector with respect to either national treatment or market access. When commitments are unbound, countries are not obliged to maintain the same level of openness or to liberalize further. Commercial presence is the mode with the lowest percentage of unbound commitments; it has been scheduled for full liberalization by about 20 percent of WTO members. Liberalization of mode 4, movement of natural persons, was much less common, with full liberalization by less than 1 percent of WTO members.

Unlike the NAFTA-type agreements, GATS does not contain a right of nonestablishment promoting services trade along lines of comparative advantage. Such right ensures that no party may require a service provider of another party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border provision of a service. A right of nonestablishment prohibits regulators from requiring establishment as a condition for delivery of a service.

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is the first ever comprehensive multilateral agreement to set minimum standards protecting all areas of intellectual property rights (copyright and related rights, trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and trade secrets), to include domestic enforcement measures, and to be covered by a dispute settlement mechanism. Its impact on investment issues, although indirect, is nonetheless significant. The TRIPS Agreement contributes to strengthening the protection afforded to foreign investment by reinforcing the protection of intellectual property rights, one of the key elements often listed in the definition of investment found in most recent BITs and free trade agreements currently in force worldwide.

The Agreement on Subsidies and Countervailing Measures (ASCM) contains disciplines covering investment-related issues. Some examples of investment incentives (fiscal, financial, or indirect) fall under the meaning of subsidy, as defined in the ASCM. Except as provided in the Agreement on Agriculture, such investment incentives are prohibited if they are conditioned upon export performance or use of domestic over imported goods (Article 3). Other incentives that may not be prohibited but that are found to cause adverse effects are subject to compensation. However, as noted by

the WTO, “the underlying concepts of the ASCM are oriented toward trade in goods, and as such may not in all cases be easily applied to investment incentives.” For example, an investment incentive is usually granted *before* any production begins, which means that “neither a recommendation to withdraw or modify a subsidy, nor a countervailing duty applied to the exported goods, will be able to ‘undo’ or to change an investment that already has been made.”⁷

Convergence and Divergence

The 1990s have seen the emergence of a new consensus in the Americas over the rules governing foreign investment. On issues that once seemed controversial, common approaches have been adopted in investment agreements signed between countries negotiating the Free Trade Area of the Americas (FTAA). This section analyzes the convergence and divergence on the following issues: scope and coverage (including definitions of *investment* and *investor*); general standards of treatment; performance requirements; key personnel; compensation for losses; transfers; expropriation; and dispute settlement.

Scope and Coverage

The scope of an investment agreement has three essential components (table 9-1). The substantive scope consists of the disciplines and the definition of key terms such as *investment* and *investor*. The territorial scope refers to the territory of the parties that falls under the agreement, including the application of the provisions at the subnational level. In free trade agreements, this issue is generally dealt with in an article that covers the whole agreement. The temporal scope informs on whether the agreement applies to investments made, and disputes that arose, before the agreement entered into force. The provision on scope may also include economic activities reserved to the state that parties choose to exclude from the agreement. This is the case for the NAFTA-type agreements.

definition of investment. With the exception of CARICOM's Protocol II, which does not define investment, and Decision 291 of the Andean Community, which covers only FDI, all investment agreements in the

7. WTO (1996, pp. 72–73).

Table 9-1. *Scope and Coverage of Investment Agreements*

<i>Agreement</i>	<i>Definition of investment</i>	<i>Definition of investor</i>	<i>Temporal scope</i>
MERCOSUR			
Colonia	Yes	Yes	Yes
Buenos Aires	Yes	Yes	Yes
CARICOM			
Protocol II	No	Yes	No
Andean Community			
Decision 291	Yes, FDI only	Yes	No
NAFTA	Yes	Yes	Yes
Group of Three	Yes	Yes	Yes
Bolivia-Mexico	Yes	Yes	Yes
Costa Rica-Mexico	Yes	Yes	Yes
Mexico-Nicaragua	Yes	Yes	Yes
Mexico-Northern Triangle	Yes	Yes	Yes
Canada-Chile	Yes	Yes	Yes
Chile-Mexico	Yes	Yes	Yes
Central America-Dominican Republic	Yes	Yes	Yes
CARICOM-Dominican Republic	Yes	Yes	No

Americas have adopted a broad, open-ended, asset-based definition of the term *investment*. Such definition is more encompassing than the traditional definition of foreign direct investment because it also includes portfolio investment and intangible assets such as intellectual property rights. Modern definitions typically use phrases such as “every kind of asset,” “any kind of asset,” or “every kind of investment,” accompanied by an illustrative but nonexhaustive list of examples. The list commonly includes the following five components: movable and immovable property and any related property rights, such as mortgages, liens, or pledges; shares, stock, bonds, debentures, or any other form of participation in a company, business enterprise, or joint venture; money, claims to money, claims to performance under contract having a financial value, and loans directly related to a specific investment; intellectual property rights; and rights conferred by law (such as concessions) or under contract.

Although the objective of using such a comprehensive definition is to guarantee protection to as many forms of investment as possible, there has been an attempt to avoid coverage of purely monetary or speculative flows

not related to an investment. Thus, recent agreements include qualifications of their coverage. For example, a few recent agreements exclude “real estate or other property, tangible or intangible, not acquired in the expectation or used for the purpose of economic benefit or other business purposes” from the definition of covered investment. This exception is built into the definition of investment in NAFTA, the Group of Three, and the Canada-Chile, Mexico-Nicaragua, and Mexico-Northern Triangle free trade agreements. Their “asset-based” definition covers a broad list of assets that are expressly linked with the activities of an enterprise. It excludes, for example, those transactions that might occur in capital or money markets with no connection to a specific investment and claims to money that arise solely from commercial contracts.

definition of investor. The definition of *investor* covers natural and juridical persons (or other legal entities). In most investment instruments citizenship is the only criterion used to determine whether a natural person should be considered an investor under the agreement. In a few agreements—for example, those signed by Canada—the definition is broadened to include permanent residents. Residency is also sometimes used to exclude natural persons from coverage of the agreements.

With respect to juridical persons, three different criteria have been commonly used to define the nationality of a company or legal entity: incorporation, seat, and control. Countries with common law tradition, such as Canada, the United States, and the CARICOM members, use the place of incorporation of a company to determine its nationality. Other investment instruments such as NAFTA and the Canada-Chile free trade agreement follow the same approach. Under NAFTA, to be an “investor of a Party” an enterprise (and a branch of an enterprise) must be constituted or organized under the law of that party. There is no requirement that the enterprise be controlled by nationals of a NAFTA country. If the enterprise is controlled by investors of a nonparty, however, benefits can be denied if the enterprise has no substantial business activities in the territory of the party under whose laws it is constituted. The denial-of-benefits clause also provides that the host state may deny benefits of the agreement if it does not maintain diplomatic relations with the nonparty or if it adopts or maintains measures with respect to the nonparty that prohibit transactions with the enterprise.

The incorporation criterion has also been used between countries with civil law traditions (Group of Three, and the free trade agreements signed

by Mexico with Bolivia, Chile, Costa Rica, Nicaragua, and the Northern Triangle). But civil law countries have traditionally relied instead on the place where the management or seat of the company is located. The two MERCOSUR protocols on investment have elected that criterion. In the case of BITs signed between Latin American countries, this criterion is often combined with the place of incorporation and, in some cases, with the requirement that the company actually must have effective economic activities in the home country. In other cases, BITs use the control of the company by nationals of a party as the sole criterion to determine its nationality. This is the case of the Colombia-Peru BIT. Finally, some agreements combine the above criteria or use them as alternatives. In general, it can be said that the combination of different criteria is used in those cases where governments are interested in restricting the benefits of the agreement to those legal entities that effectively have ties with the home country. In contrast, when the objective is to broaden the scope of application, agreements provide for the possibility of applying alternative criteria.

temporal scope. All investment agreements that address this issue make clear that all investments, including those made before the investment agreement has entered into force, are covered by the agreement. In a few cases, for example, the Costa Rica-Mexico and the Central America-Dominican Republic free trade agreements, the agreement stipulates that it does not apply to disputes that arose before the entry into force of the agreement.

General Standards of Treatment

There is a broad consensus in the region on the treatment that applies to investments once they have been made by an investor of a party in the territory of another party. States have incorporated a number of standards of treatment in their investment agreements, including fair and equitable treatment, national treatment, and most-favored-nation (MFN) treatment (table 9-2).

fair and equitable treatment. Fair and equitable treatment is a general concept without a precise definition. It provides a basic standard unrelated to the host state's domestic law and serves as an additional element in the interpretation of the provisions of an investment agreement. Almost all agreements incorporate a provision on fair and equitable treatment. Notable exceptions include the free trade agreements concluded by Mexico

Table 9-2. *General Standards of Treatment in Investment Agreements*

<i>Agreement</i>	<i>Fair and equitable treatment</i>	<i>National treatment</i>	<i>Most-favored-nation treatment</i>
MERCOSUR			
Colonia	Yes	Yes	Yes
Buenos Aires	Yes	Yes	Yes
CARICOM	No	Right of establishment	No
Protocol II			
Andean Community			
Decision 291	No	Yes	No
NAFTA	Yes	Yes	Yes
Group of Three	Yes	Yes	Yes
Bolivia-Mexico	No	Yes	Yes
Costa Rica-Mexico	No	Yes	Yes
Mexico-Nicaragua	No	Yes	Yes
Mexico-Northern Triangle	Yes	Yes	Yes
Canada-Chile	Yes	Yes	Yes
Chile-Mexico	Yes	Yes	Yes
Central America-Dominican Republic	Yes	Yes	Yes
CARICOM-Dominican Republic	Yes	Yes	Yes

with Bolivia, Costa Rica, and Nicaragua. This standard is generally combined with the principle of full protection and security or that of nondiscrimination. Full protection and security traces its origins in the modern Friendship, Commerce, and Navigation treaties signed by the United States until the 1960s. Although it does not create any liability for the host state, full protection and security “serves to amplify the obligations that the parties have otherwise taken upon themselves” and provides a general standard for the host state “to exercise due diligence in the protection of foreign investment.”⁸ In a few cases, these three standards are combined together. In other cases, it is clear that fair and equitable treatment shall be in accordance with the principles of international law. Most treaties also require some form of protection, albeit not necessarily full protection and security.

8. Dolzer and Stevens (1995, p. 61). These treaties provided for “the most constant protection and security.”

national treatment and mfn treatment. Two different approaches have been adopted with respect to the entry of investments and investors of a party into the territory of another party. Newer instruments such as NAFTA, the Group of Three, and the bilateral free trade agreements concluded by Mexico with Bolivia, Chile, Costa Rica, Nicaragua, and the Northern Triangle and by Chile with Canada create a right of establishment for investors and investments of the other party. In fact, these instruments have been designed with the purpose of assuring the free entry of such investments—albeit with country-specific reservations—into the territory of the host country. They require national treatment and most-favored-nation treatment and prohibit specific performance requirements as a condition for establishment. They indicate that such treatment shall be for investments made in “like circumstances.” As mentioned at the beginning of this chapter, the Central America-Dominican Republic agreement adds an admission clause, which refers to the laws of each party. The Colonia Protocol for the MERCOSUR countries also includes an admission clause but does not refer to the laws and regulations of the parties. Other agreements require that the national treatment and MFN standards be applied to investments of investors *after* admission of these investments.

National treatment is a relative standard that prohibits discriminatory treatment. The intent is to avoid cases in which investments—and investors—of other parties cannot compete on equivalent terms with those of the host state. All investment agreements in the Americas provide that once the investment has been made, the host state must accord national treatment to investments or investors of other parties, that is, treatment no less favorable than that granted to its investments and investors. The Andean Community Decision 291 stipulates that national treatment can be regulated according to the national laws of each member. Although the CARICOM Protocol II does not include a national treatment provision per se, as mentioned earlier, it does establish that members shall not introduce in their territories any new restrictions relating to the right of establishment of nationals of other member states except as otherwise provided in the agreement.

With respect to MFN treatment, most investment agreements in the region require that, once the investment is established, each party must grant investments of investors of other parties treatment no less favorable than that it accords to investments of investors of third countries. The Andean Community and CARICOM do not include an MFN provision. Therefore, members of these two arrangements are not required to extend

to the other members more favorable treatment granted to nonmembers. It is also worth noting that the NAFTA-type agreements require that the investment and investor of another party be granted the better of national treatment and MFN treatment.

National treatment and MFN treatment are rarely accorded without limitations. The agreements that follow the NAFTA model and the CARICOM-Dominican Republic agreement state that these two standards must be granted in "like circumstances." U.S. and Canadian BITs refer to "like situations" or "like circumstances." The NAFTA-type agreements, which provide for a right of establishment, include a list of reservations to national treatment and MFN treatment. This list includes nonconforming measures at the federal and subfederal levels. The Colonia Protocol for MERCOSUR members includes a list of temporary sectoral reservations.

A few investment agreements incorporate an exception to the MFN treatment in the case of the privileges deriving from membership or association in a free trade agreement, customs union, common market, or regional agreement. The two MERCOSUR protocols on investment, the free trade agreements concluded by Mexico with Bolivia, Costa Rica, Nicaragua, and the Northern Triangle, as well as those signed by the Dominican Republic with Central America and CARICOM do include such provision. The two MERCOSUR protocols, the Group of Three, and the CARICOM-Dominican Republic agreement also stipulate that the MFN treatment does not apply to preferences or privileges resulting from an international agreement relating wholly or mainly to taxation. The NAFTA and the free trade agreements concluded by Chile with Canada and Mexico have a general exception for taxation treaties that covers not only the investment chapter but the entire agreement.

Performance Requirements

The majority of bilateral investment treaties signed between developing countries in the Americas do not address performance requirements. The exceptions are the BITs between the Dominican Republic and Ecuador and between El Salvador and Peru. Free trade agreements do include provisions on performance requirements, however. Whereas those signed by the Dominican Republic with Central America and CARICOM refer to the WTO TRIMs Agreement, the others (NAFTA; those signed by Mexico with Bolivia, Chile, Costa Rica, Nicaragua, and the Northern Triangle; and the Canada-Chile agreement) go further, as does the Colonia

Protocol of MERCOSUR. The TRIMs Agreement only covers goods and clearly states that no member shall apply any TRIM that is inconsistent with the provisions of Article III (principle of national treatment) or Article XI (general obligation of eliminating quantitative restrictions) of GATT 1994.

The NAFTA-type agreements prohibit specific performance requirements for both goods *and* services. For example, NAFTA and the Chilean free trade agreements with Canada and Mexico require that performance requirements to achieve a particular level or percentage of local content, to purchase local goods and services, to impose trade- or foreign exchange-balancing requirements, to restrict domestic sales of goods or services, to export a given level or percentage of goods or services, to transfer technology, and to act as exclusive supplier of goods and services be prohibited as a condition of the establishment, acquisition, expansion, management, conduct, or operation of a covered investment. The first four requirements are also prohibited as a condition for receiving an advantage (that is, a subsidy or an investment incentive). There is, however, no such limitation on requirements to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development. Moreover, there are some exceptions to the performance requirement prohibition. For instance, NAFTA Article 1106 (6) provides that requirements to achieve given levels of domestic content or to purchase local goods and services are allowed, provided that they are not applied in an arbitrary or unjustifiable manner or do not constitute a disguised restriction, if these measures are necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of the agreement; to protect human, animal or plant life or health; or to conserve exhaustible natural resources. Finally, the prohibition on performance requirements does not apply to some of the above requirements with respect to export promotion and foreign aid programs, procurement by a state enterprise, and the content of goods necessary for an importing party to qualify for preferential tariffs or tariff quotas.

The Andean Community, in contrast, establishes particular provisions for the performance of contracts for the license of technology, technical assistance, and technical services and for other technological contracts under the national laws of each member.

Key Personnel

Most free trade agreements and a few bilateral investment treaties (essentially those signed by the United States and Canada) in the Americas

provide for the temporary entry of managers and other key personnel relating to an investment. Some agreements allow investors of another party to hire top managerial personnel of their choice, regardless of nationality. Other agreements state that a party may not require that an enterprise of that party appoint to senior management positions individuals of any particular nationality. These agreements also mention that a party may require that a majority of the board of directors of an enterprise that is an investment under the agreement be of a particular nationality, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment.

Moreover, most free trade agreements grant temporary entry to a business person to establish, develop, administer, or provide advice or key technical services to the operation of an investment as long as the business person or his enterprise has committed, or is in the process of committing, a substantial amount of capital. The business person must comply with existing immigration and labor laws and work as a supervisor or executive or in a job that involves essential skills.

Compensation for Losses

No investment agreement requires compensation for losses due to war or other armed conflict, civil disturbances, or other *force majeure* (including natural disasters, as mentioned in the Costa Rica-Mexico agreement). Most agreements, however, provide for national treatment and MFN treatment in respect to any measure a party adopts or maintains related to those losses. This issue is either covered in a specific provision on compensation for losses or by the national treatment and MFN provisions. It is worth noting that the CARICOM-Dominican Republic free trade agreement grants only the MFN treatment in such cases (table 9-3).

Transfers

All investment agreements state that the host country must guarantee the free transfer of funds related to investments to investors of the other party. Most include an illustrative list of types of payments that are guaranteed such as returns (profits, interests, dividends, and other current incomes); repayments of loans; and proceeds of the total or partial liquidation of an investment. In addition, other types of payments are often listed; these include additional contributions to capital for the maintenance or development of an investment, bonuses and honoraria, wages and other

Table 9-3. *Investment Protection and Dispute Settlement Provisions*

<i>Agreement</i>	<i>Compensation for losses</i>	<i>Transfers</i>	<i>Expropriation</i>	<i>Dispute settlement</i>
MERCOSUR				
Colonia	Yes	Yes	Yes	Yes
Buenos Aires	Yes	Yes	Yes	Yes
CARICOM	Yes, under			Yes, other
Protocol II	national treatment	Yes	No	protocol
Andean Community	Yes	Yes	No	Yes, Andean
Decision 291				Court
NAFTA	Yes	Yes	Yes	Yes
Group of Three	Yes	Yes	Yes	Yes
Bolivia-Mexico	Yes	Yes	Yes	Yes
Costa Rica-Mexico	Yes	Yes	Yes	Yes
Mexico-Nicaragua	Yes	Yes	Yes	Yes
Mexico-Northern Triangle	Yes	Yes	Yes	Yes
Canada-Chile	Yes	Yes	Yes	Yes
Chile-Mexico	Yes	Yes	Yes	Yes
Central America-Dominican				
Republic	Yes	Yes	Yes	Yes
CARICOM-Dominican				
Republic	Yes, only MFN	Yes	Yes	Yes

remuneration accruing to a citizen of the other party, compensation or indemnification, and payments arising out of an investment dispute (see table 9-3).

Most agreements stipulate that the transfer shall be made without delay in a freely convertible currency or freely usable currency at the normal exchange rate applicable on the date of the transfer.⁹ Some agreements allow for limitations or exceptions to transfers, such as balance of payments difficulties and prudential measures, as long as these restrictions are exercised for a limited period of time in an equitable way, in good faith, and in a nondiscriminatory manner. Chile reserves the right to maintain requirements and adopt measures for the purpose of preserving the stability of its currency.¹⁰

9. There are five currencies, as defined by the International Monetary Fund, as freely usable: U.S. dollar, yen, deutsche mark, French franc, and pound sterling.

10. These measures are explained in Annex G-09.1 of the Canada-Chile free trade agreement. In BITs signed by Chile, transfers of capital are restricted for a period of one year.

Expropriation

An important concern of foreign investors is to ensure that their interests are protected in the event that the host country expropriates their investment. Investment agreements generally refer to either expropriation or nationalization (or both) without differentiating between these terms. In fact, the language is broad enough to allow for coverage of “indirect” or “creeping” expropriations, that is, measures having equivalent effects to expropriation or nationalization. Under customary international law, states are allowed to expropriate foreign investment as long as it is done on a nondiscriminatory basis (that is, under principles of national treatment and MFN treatment), for a public purpose,¹¹ under due process of law, and with compensation. With the exception of the Andean Community Decision 291 and CARICOM Protocol II, which do not cover this issue, all investment agreements discussed in this chapter prohibit the expropriation of investments except when these conditions are met.

Most agreements use the Hull formula, which stipulates that compensation should be “prompt, adequate, and effective.”¹² Only in a very few cases is the more general expression “just compensation” used. In relation to the value of the expropriated investment, most agreements use the term “market value” or “fair market value,” while others use expressions such as “genuine value,” immediately before the expropriatory action was taken or became known, thus protecting the investor from any reduction in value that may result as a consequence of the expropriation. Agreements also stipulate that compensation shall include interest and, in most cases, specify that it should be calculated at a normal commercial rate from the date of expropriation. In general, payments must be fully realizable, freely transferable, and made without delay. In some instances, payments must be transferable at the prevailing market rate of exchange on the date of expropriation. In most cases, however, exchange rates are not dealt with in the context of expropriation. Instead, general transfer provisions are applicable (see table 9-3).

11. Some treaties add expressions such as “national interest,” “public use,” “public interest,” “public benefit,” “social interest,” or “national security.” Notwithstanding the fact that “public purpose” is difficult to define in precise terms, there is a general consensus that a state can adopt expropriatory measures only when there is a collective interest that justifies it.

12. This standard was formulated by U.S. Secretary of State Cordell Hull, who declared in 1938, in correspondence to the Government of Mexico, that “under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose without provisions for prompt, adequate and effective payment thereof.” See Dolzer (1981).

Dispute Settlement

Following traditional treaty practice, provisions for the settlement of disputes between parties are included in both bilateral investment treaties and in regional trade arrangements containing provisions on investment. In the free trade agreements, investment disputes between parties fall under the general dispute settlement mechanism included in these agreements. This mechanism is based on consultation and, failing resolution through consultation, panel review. In the Andean Community, state-to-state disputes are referred to the Andean Court of Justice. MERCOSUR's Colonia protocol provides for disputes concerning its interpretation or application to be resolved through the dispute settlement procedures established in the Brasilia Protocol of December 17, 1991. When disputes involve a third state, the Buenos Aires Protocol refers them to ad hoc arbitration. Protocol IX of CARICOM addresses the issue of disputes among members. In Central America there is no regional agreement on investment, but there is a new state-to-state dispute settlement agreement approved on September 27, 2000, which means that should members of the Central American Common Market (CACM) sign an investment agreement, their state-to-state investment disputes would most likely be covered by this new agreement.

Almost all investment instruments include separate provisions for the settlement of investor-state disputes. This constitutes a departure from traditional practice in this field where no such mechanism was provided. Thus, a foreign investor was limited to bringing claim against the host state in a domestic court or having its home state assume his claim against the host state (diplomatic protection). Investment agreements include a reference to a specific institutional arbitration mechanism. They normally refer to arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) or under ICSID Additional Facility Rules where either the host or home state of the foreign investor is not an ICSID contracting party.¹³ Following an increasingly common practice in modern investment agreements, most agreements include alternative forms of arbitration such as UNCITRAL (United Nations Commission on International Trade Law) rules.¹⁴ These

13. The ICSID Convention came into force in 1966. On the ICSID Convention, see ICSID (1985); on the ICSID Additional Facility Rules, see ICSID (1979).

14. Only in the case of the Haiti-United States BIT is a reference made to arbitration under the International Chamber of Commerce. On UNCITRAL, see United Nations Commission on International Trade Law (1976).

might prove particularly relevant where ICSID arbitration is unavailable due to jurisdictional constraints.

Most agreements require that the investor and the host state seek to solve the dispute amicably through consultations and negotiations before taking it to arbitration. In some cases, a certain period of time has to elapse before the dispute can be submitted to arbitration. Evidently, investors also have the right to bring disputes to local courts of the host state, although agreements differ in the way recourse to local remedies is treated. The most common approach is to allow the investor to choose between referring the dispute to local courts or resorting to arbitration. When following this approach, a number of BITs signed between Latin American countries as well as the Colonia Protocol state that election by the investor of either international arbitration or domestic remedies “shall be final.” Other agreements provide for arbitration only when the case has previously been submitted to local courts *and* a certain period of time (usually eighteen months) has elapsed without a final decision being made or the decision is inconsistent with the agreement or the decision is “manifestly unjust.” A different approach is taken in recent U.S. BITs. To avoid inconsistent decisions in different forums, the agreements do not allow recourse to international arbitration if the investor has already submitted the dispute to local courts or administrative tribunals (see table 9-3).

Other Issues

Other issues are also covered in some investment agreements. Two are mentioned here: general exceptions, and environmental concerns.

general exceptions and other derogations. General exceptions allow countries to exempt from the obligations of an agreement all actions related to such exceptions; that is, they often—but not always—apply to all obligations and also to all parties to an agreement. They are generally invoked for reasons of maintenance of national security, international peace and security, and public order. In the Americas, the free trade agreements, U.S. BITs, and the Peruvian bilateral investment treaties with Bolivia, Paraguay, and Venezuela permit such general exceptions. Other exceptions to treaty obligations include a carve-out for taxation matters found in almost all investment agreements; exceptions to the MFN principle when a party is a member of a preferential trade agreement; country-specific reservations with respect to national treatment, MFN treatment, performance

requirements, and senior management and boards of directors; temporary derogation in case of balance of payments problems; and prudential measures to protect the rights of creditors and the stability of the financial system.

environmental concerns. The free trade agreements and most post-NAFTA BITs signed by Canada mention that nothing is to be construed so as to prevent a party from adopting, maintaining, or enforcing any measure otherwise consistent with the agreement that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to domestic health, safety, and environmental concerns. The parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety, or environmental measures. Accordingly, a party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion, or retention in its territory of an investment of an investor. If a party considers that another party has offered such an encouragement, it may request consultations with the other party and the two parties shall consult with a view to avoiding any such encouragement.

Investment in the FTAA Negotiations

In March 1998 in the San José Declaration, trade ministers agreed upon the objective of the new Negotiating Group on Investment (NGIN): to establish a fair and transparent legal framework to promote investment through the creation of a stable and predictable environment that protects the investor, the investment, and related flows without creating obstacles to investments from outside the hemisphere. A few months later, in June 1998, the Trade Negotiations Committee defined the mandate of the Negotiating Group on Investment as being the development of a framework incorporating comprehensive rights and obligations on investment, taking into consideration the substantive areas already identified by the FTAA Working Group on Investment, and the development of a methodology to consider potential reservations and exceptions to the obligations.

During the first phase of the negotiations, the negotiating group discussed twelve issues identified by the working group as possible elements for inclusion in an investment chapter. The discussions have focused on basic definitions of investment and investor; scope; national treatment; most-favored-nation treatment; fair and equitable treatment; expropriation and compensation; compensation for losses; key personnel; transfers;

performance requirements; general exceptions and reservations; and dispute settlement. During the second phase of the FTAA negotiations in 2000, the negotiating group began to prepare a draft investment chapter, as instructed by trade ministers at their Fifth Ministerial Meeting held in Toronto in November 1999.

The Tripartite Committee, particularly through the Organization of American States, is providing expertise and analytical support to the NGIN. The Negotiating Group on Investment requested the Tripartite Committee to update the two compendiums that were prepared under the guidance of the working group: the Organization of American States's "Investment Agreements in the Western Hemisphere: A Compendium," and the Inter-American Development Bank's "Foreign Investment Regimes in the Americas: A Comparative Study." The Negotiating Group has also discussed the statistical studies prepared by the UN Economic Commission for Latin America and the Caribbean on investment flows in the region.¹⁵

Challenges for the Future

A first challenge is to determine how a hemispheric investment agreement would be a commitment to go beyond the status quo. Most countries of the region have either accepted the notion of a right of establishment accompanied by a list of reservations or have substantially liberalized their investment regime. Bound commitments that minimally reflect the status quo would help the Western Hemisphere gain in credibility and confidence. A related issue is whether the FTAA investment chapter would go beyond a standstill commitment and aim at progressive liberalization with, for instance, a built-in agenda and a ratchet mechanism, which would ensure that all liberalization that occurs is automatically bound in the agreement.

A second challenge is the linkages with services. One of the four modes of supply defined in GATS—commercial presence—is entirely about investment, which means that the negotiating modality of both the FTAA investment and services chapters must be compatible.

But the central question is the role the FTAA investment chapter should have. Should it aim at providing for nondiscrimination treatment and investment protection with an effective dispute settlement mechanism and also at locking in the status quo, and how should it ensure progressive liberalization?

15. These studies are available on the official FTAA home page (www.ftaa-alca.org).

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Asia-Pacific
Economic Cooperation

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Session 3

GATS + Liberalization in East Asian FTAs: Architectural Aspects and Achievements

Submitted by: World Bank



**Workshop on the Relationship Between
Investment and Trade in Services in Regional
Trade Agreements and Other International
Investment Agreements
Adelaide, Australia
18 April 2007**

Joint IEG/GOS Workshop on the Relationship Between
Investment and Services in International Agreements

Adelaide, 18 April 2007

GATS+ liberalization in East Asian FTAs:
Architectural aspects and achievements

Martín Molinuevo
World Bank /
World Trade Institute

Carsten Fink
World Bank

1

Overview

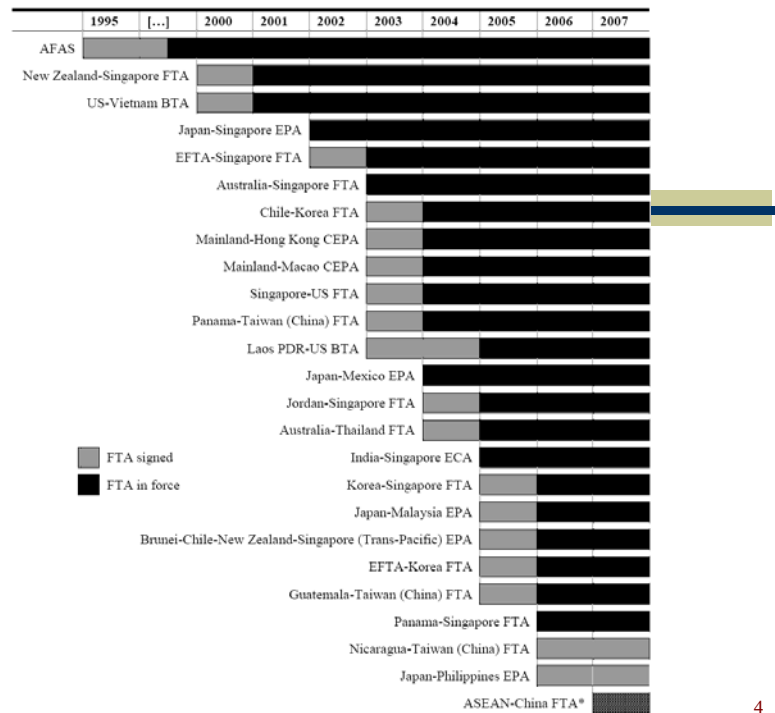
- ❖ Background
- ❖ Architecture of East Asian FTAs
- ❖ Services liberalization in East Asian FTAs
- ❖ Negative list agreements and services liberalization
- ❖ Rules on relation between services and investment
- ❖ Conclusion

2

FTAs in services in East Asia in figures

- ◆ 25 agreements
 - 3 'regional' agreements (AFAS, AFAS-China, TransPacific SEP)
 - 22 bilaterals
- ◆ 16 East Asian countries*
- ◆ 11 other countries
- ◆ 1 non-WTO Member
- ◆ 40+ agreements currently under negotiations

3



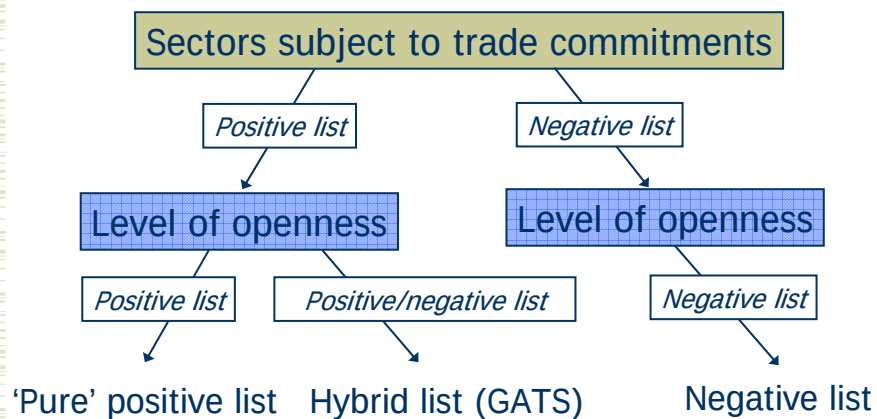
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Architecture of East Asian FTAs

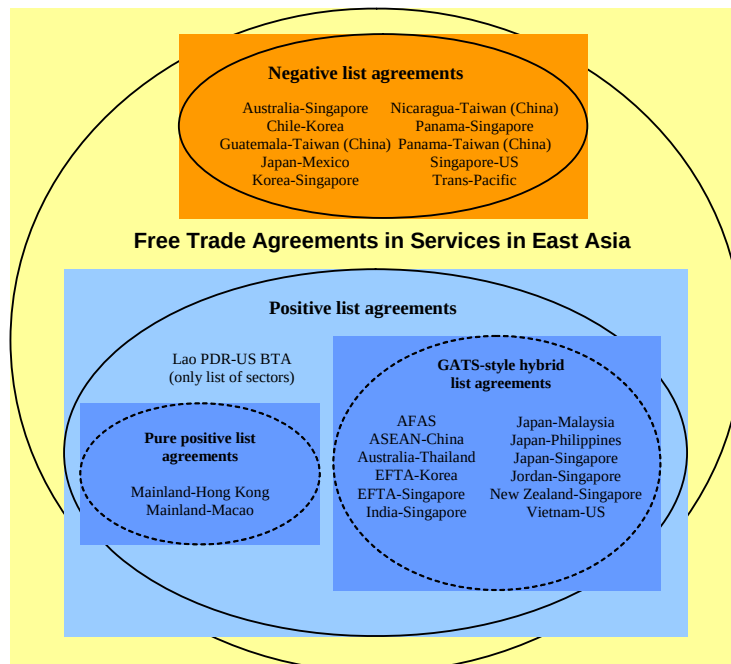
- [Background on bilateral / regional services agreements in East Asia](#)
- [Architecture of East Asian FTAs](#)
- [Services liberalization in East Asian FTAs](#)
- [Negative list agreements and services liberalization](#)
- [Rules on investment and services chapters](#)
- [Conclusion](#)

5

Architecture of FTAs: liberalization approach



6



7

Key features of hybrid list FTAs

- ♦ **Four modes of supply** (with separate investment chapter in some cases)
- ♦ **Main obligations:**
 - **Market access**
 - **National treatment**
 - + additional commitments
- ♦ Generally, no mechanism to bind at actual levels of openness,
 - except in Japan-Malaysia and Japan-Philippines ('SS' entries)

8

Key features of negative list FTAs

- ♦ **Three modes of supply** (except Trans-Pacific and Australia-Singapore)
- ♦ Investment in services treated in separate chapter (except Trans-Pacific)
- ♦ **Additional obligations** (e.g. performance requirements), but sometimes no binding market access discipline (Japan–Mexico, Chile – Korea)
- ♦ Non-conforming measures versus ‘future’ measures
- ♦ **Varying approaches to financial services**, partly/fully reverting to hybrid list

9

Positive vs. Negative: an architectural assessment

- ♦ **Transparency: depends on level of openness**
 - Lots of restrictions: positive list
 - Few restrictions: negative list
 - But drafting is crucial!
- ♦ **Liberalization**
 - **Same outcome can be achieved with either model**
 - Status quo binding: in principle, negative lists
 - but “future measures” de facto prevent status quo binding
 - and positive lists also have this potential (Japan – Malaysia, Japan - Philippines)
- ♦ From an architectural perspective, there seems to be **nothing inherent to either approach in terms of transparency or liberalization**
 - ==> Empirical question.

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Services liberalization in East Asian FTAs

- [Background on bilateral / regional services agreements in East Asia](#)
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- [Services liberalization in East Asian FTAs](#)
- [Negative list agreements and services liberalization](#)
- [Rules on investment and services chapters](#)
- [Conclusion](#)

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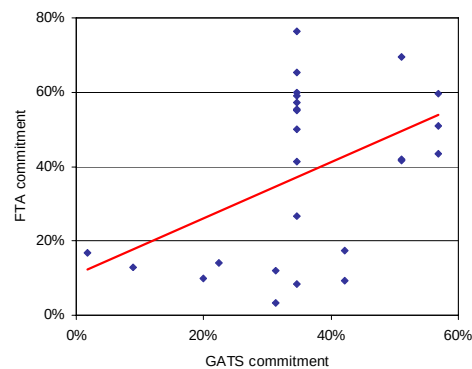
GATS + liberalization in East Asian FTAs

- ♦ Evidence is **mixed**.
- ♦ Many agreements show **few commitments beyond GATS level**
 - AFAS
 - Thailand – Australia
 - Singapore – Jordan
- ♦ Others entail **broad / deep commitments**:
 - US – Lao PDR
 - Mainland – Hong Kong CEPA
 - Japan – Singapore
 - US – Singapore

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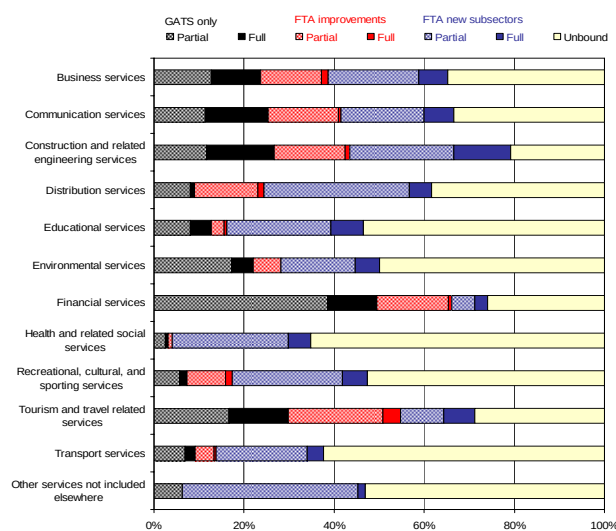
Who gives more at bilateral / regional level?

- ◆ ...those who have given more at multilateral level.
- ◆ ...albeit other countries have greater potential for improvement.



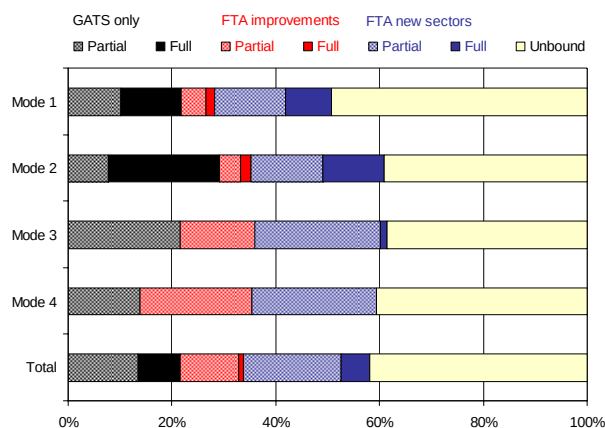
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In what sectors?



14

In what modes of supply?



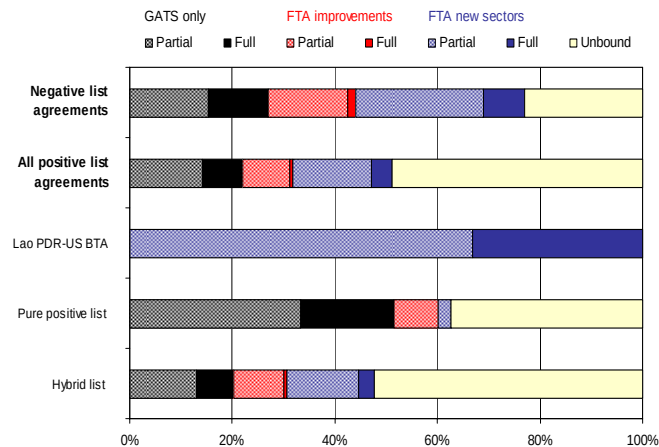
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Negative list FTAs and liberalization commitments

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What kind of agreement provides more liberalization?



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Do negative list FTA ensure broader / deeper liberalization?

- ◆ **Broader:** negative list FTAs show a statistically significant effect on the amount of new scheduled sectors
- ◆ **No deeper liberalization:** no statistically significant effect of negative list FTA on the improvement of existent multilateral liberalization commitments (once GDP per capita is controlled for)

	Improved FTA commitment	New FTA commitment	Total FTA contribution	Improved FTA commitment	New FTA commitment	Total FTA contribution
Negative list commitment	0.073* (5.82)	0.294* (15.63)	0.367* (17.91)	0.014 (1.03)	0.279* (13.07)	0.293* (12.82)
GDP per capita of scheduling country				0.036* (9.94)	0.006 (0.99)	0.042* (6.89)
GDP per capita of partner country (or countries)				-0.005 (-1.24)	0.009 (1.36)	0.004 (0.52)
Number of observations	1,440	1,440	1,440	1,440	1,440	1,440
Adjusted R-squared	0.352	0.516	0.626	0.393	0.516	0.639

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The devil is the details...

- ♦ Singapore reserves the right to “[...]to adopt or maintain any measure affecting the supply of services by foreign full banks or in relation to Qualifying Full Bank licenses.” (Australia-Singapore)
- ♦ United States effectively exempts “[a]ll existing non-conforming measures of all states of the United States, the District of Columbia, and Puerto Rico.” (Singapore-US)
- ♦ United States “[...] reserves the right to adopt or maintain any measure that is not inconsistent with the United States’ obligations under Article XVI of the General Agreement on Trade in Services.” (Singapore-US)
- ♦ Mexico “[...] reserves the right to adopt or maintain any measure relating to the supply of services in any mode of supply in which those services were not technically feasible at the time of entry of force of this Agreement.” (Japan-Mexico)

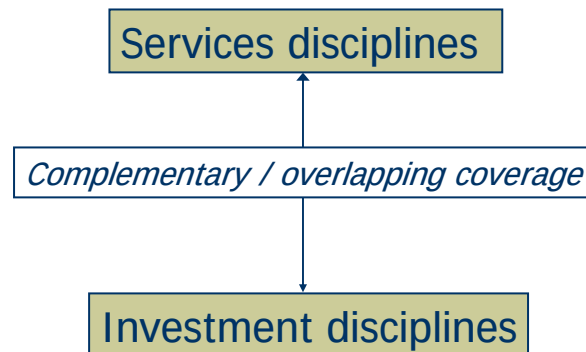
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Rules on investment and services chapters

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- ♦ [Architecture of East Asian FTAs](#)
- ♦ [Rules in services FTAs](#)
- ♦ [Services liberalization in East Asian FTAs](#)
- ♦ [Negative list agreements and services liberalization](#)
- ♦ [Conclusion](#)

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Investment in services



21

Rules addressing dual coverage: an informal ranking

1) Market access and domestic regulations provision of services chapter apply to investment in services	Nicaragua-Taiwan (China), Panama-Singapore, Singapore-US
2) Services chapter prevails in case of inconsistencies	India-Singapore, Japan-Malaysia, Jordan-Singapore, US-Vietnam, Japan-Singapore (for Singapore)
3) One single schedule of commitments, also covering investment in goods	Australia-Singapore, Australia-Thailand
4) Core liberalizing obligations in investment chapter do not apply to investment in services	EFTA-Singapore FTA, Japan-Philippines (for the Philippines)
5) Core liberalizing obligations (NT, MFN) in investment chapter do not apply to commercial presence	New Zealand-Singapore, EFTA-Korea
6) Relationship not defined	Japan-Singapore, Japan-Philippines (for Japan)

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Concluding remarks

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Conclusions

- ♦ Different architectural approaches have **no inherent benefits of disadvantages in regard to transparency and liberalization**
- ♦ Negative lists, however, provide incentives for **broader –but not deeper– commitments**.
- ♦ East Asian FTAs present **mixed liberalization achievements**
 - Developing countries in East Asia seem reluctant to services liberalization commitments –both multilaterally and regionally/bilaterally
 - East Asia richer countries (Japan, Korea, Singapore) have taken advantage of FTAs to expand on already significant multilateral commitments

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Thank you for your attention.

Martín Molinuevo
martin.molinuevo@wti.org



The interaction between investment and services chapters in RTAs

Degree of liberalisation achieved by the
GATS-inspired and NAFTA-inspired approach

Sébastien Miroudot

Trade Policy Linkages and Services Division

Joint IEG/GOS APEC workshop

Adelaide, 18 April 2007

OECD Trade & Agriculture Directorate

What is exactly investment liberalisation?

- “Liberalisation” is more of a “trade” concept: the removal of barriers.
- “Liberalisation” in the context of investment agreements is about:
 - establishment / market access
 - non-discrimination
 - national treatment
 - most-favoured-nation (MFN) treatment
- Some RTAs do not “liberalise” investment in the sense that their commitments correspond to the statu quo or to a guarantee that any new liberalisation effort is covered by the disciplines of the agreement.
 - All agreements analysed in the OECD study were however found to be “GATS plus”. There are additional non-discrimination and market access commitments at the regional level.
 - RTAs include provisions on future liberalisation.
 - NAFTA-inspired agreements have a “ratchet mechanism”.

Why investment liberalisation matters

- For a long time, investment agreements were only about the protection of investors and promotion of investment.
- Investment provisions are now often in *trade* agreements and deal with investment liberalisation
 - Around 230 RTAs with investment provisions
- At the origin of this:
 - NAFTA (entered into force in 1994)
 - GATS (1995)
- Trade and investment are intertwined:
 - Global value chains and new MNEs strategies (outsourcing, offshoring, fragmentation of production, vertical specialisation)
 - FDI in services



3

What are in practice barriers to investment?

- We don't know much about actual barriers to FDI. Most of the studies look at non-discrimination and market access *commitments*.
- But do countries' commitments match actual practices?
 - Barth & al. (2006) on WTO commitments in foreign banking.
- The OECD index of FDI restrictiveness: Golub and Koyama (2006).



4

Analysis of the economic impact of investment provisions in RTAs

Leshner and Miroudot (2006)

- An analysis of 58 RTAs with substantive investment-related provisions.
 - RTAs in force as of November 2005
 - 24 North-South RTAs, 7 North-North, 27 South-South
 - The dataset covers the period 1990-2004.
- The study aims at:
 - Understanding how « new regionalism » has impacted trade and FDI flows.
 - Designing a new tool—an index measuring the extensiveness of provisions on investment—to analyse investment provisions in RTAs.
 - Developing a gravity model to test the impact of regionalism on trade and investment flows.
- In the index created, no distinction is made between positive lists of commitments and negative lists of reservations.



5

Results from the econometric analysis

- RTAs with substantive investment provisions are positively associated with trade and, to an even greater extent, investment flows
 - A RTA with substantive investment provisions is associated with a 21% increase in exports and a 57% increase in FDI.
 - A 10% increase in the RTA index is associated with a 0.34% increase in FDI and a 0.14% increase in exports.
- There does not appear to be a quantitative relationship between BITs and FDI flows, but the joint effect of a BIT and a RTA with substantive investment provisions may positively impact FDI.
- The results suggest that trade and investment complement, more than they substitute for, each other.
- Such analysis does not provide evidence of a difference between GATS-inspired and NAFTA-inspired agreements



6

A comparison between the GATS-inspired and NAFTA-inspired approach (OECD 2007, forthcoming)

- For provisions related to the liberalisation of investment in services, the architecture of the agreements matters
- The difference between the GATS-inspired and NAFTA-inspired approaches cannot be reduced to the positive/negative list of commitments and reservations (or the bottom-up and top-down approach).
 - GATS “hybrid” approach: a positive list of sectors where commitments are made (but limitations to market access and national treatment are listed negatively); negative list for MFN exemptions (when applicable)
 - Also part of the GATS approach: further liberalisation is foreseen.
 - NAFTA approach: not only the negative list of non-conforming measures but also provisions on performance requirements, certain types of nationality requirements, a broader definition of “investment” and the “ratchet” mechanism.



7

Sectoral coverage for investment in services

- Different methods to assess the degree of investment liberalisation achieved
 - Index
 - Percentage of sectors and sub-sectors where commitments are made
- Very few limitations to investment in manufacturing sectors.
- A simple graphical/numerical analysis (OECD, 2007 forthcoming): a “mapping” exercise.



8

Commitments and reservations in 5 NAFTA-inspired agreements

Investment commitments	All sectors H			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5			Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN			
US-Australia FTA	4	n/a	2	1	n/a	1	5	n/a	3	n/a	n/a	n/a	1	n/a	n/a	n/a	n/a	n/a	3	n/a	2	n/a	1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	8	n/a	n/a	n/a	n/a	n/a			
Australia	3	n/a	4	1	n/a	1	2	n/a	3	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	10	11	5	1	n/a	3	n/a	n/a	n/a	n/a	n/a	4	n/a	3	n/a	n/a	n/a	n/a			
United States																																							
NAFTA																																							
Canada	8	n/a	2	2	n/a	1	n/a	n/a	1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1	10	12	1	n/a	1	n/a	n/a	n/a	n/a	n/a	2	n/a	2	n/a	n/a	n/a	n/a			
Mexico	1	n/a	3	3	n/a	2	10	n/a	2	1	n/a	3	n/a	1	n/a	n/a	n/a	n/a	1	10	12	1	n/a	1	n/a	n/a	n/a	10	n/a	2	n/a	n/a	n/a	n/a	n/a	n/a			
United States	4	n/a	5	2	n/a	2	3	n/a	2	1	n/a	3	n/a	n/a	n/a	n/a	n/a	n/a	7	4	1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	7	n/a	4	n/a	n/a	n/a	n/a			
US-Morocco FTA																																							
Morocco	2	n/a	1	10	4	5	3	6	n/a	n/a	n/a	2	n/a	2	n/a	n/a	n/a	1	7	11	n/a	7	4	5	1	n/a	n/a	n/a	3	4	2	n/a	n/a	n/a	n/a	n/a			
United States	3	1	4	1	n/a	1	1	n/a	3	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	10	11	5	1	n/a	1	n/a	n/a	n/a	4	n/a	3	n/a	n/a	n/a	n/a	n/a	n/a			
Japan-Mexico Economic Partnership*																																							
Mexico	8	n/a	1	9	n/a	2	8	n/a	4	1	n/a	1	n/a	n/a	1	n/a	n/a	n/a	GATS & OECD	1	n/a	n/a	n/a	n/a	n/a	3	n/a	1	18	n/a	1	n/a	n/a	n/a	n/a				
Japan	4	n/a	1	5	n/a	1	4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	GATS & OECD	3	n/a	n/a	n/a	n/a	n/a	n/a	n/a	11	n/a	4	n/a	n/a	n/a	n/a	n/a				
Chile-Korea FTA*																																							
Chile	5	n/a	n/a	8	n/a	n/a	11	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	24	n/a	n/a	n/a	n/a	n/a				
Korea	8	n/a	n/a	5	n/a	28	n/a	n/a	n/a	n/a	n/a	3	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	3	n/a	n/a	9	n/a	n/a	n/a	n/a	n/a	n/a				

* Financial services are not in the agreement yet (a negotiation is scheduled four years after the entry into force of the agreement)

No commitments in the sector - sector excluded
Commitments in a limited number of sub-sectors
Commitments in most of the sector
Commitments across the entire sector

Horizontal limitations (affect all sectors) * first column only *

Number of limitations

2

None applicable



Example: US-Australia FTA

Investment commitments	All sectors H			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN
US-Australia FTA																		
Australia	4			2	1	n/a	1	5	n/a	3		n/a	1	n/a		1	n/a	
United States	3			4	1	n/a	1	2	n/a	2		n/a		n/a			n/a	

Investment commitments	Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN
		n/a		3			2	n/a	1	n/a			n/a			6	n/a			n/a	
	n/a	10	11	5	1	n/a	1	n/a	1	n/a			n/a	1	n/a	1	n/a	1		n/a	

No commitments in the sector - sector excluded
Commitments in a limited number of sub-sectors

Commitments in most of the sector
Commitments across the entire sector

Horizontal limitations (affect all sectors) * first column only *

Number of limitations



Commitments and reservations in 5 GATS-inspired agreements

Investment commitments	All sectors H			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5			Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN			
Japan-Singapore New Age Economic Partnership Agreement																																							
Japan	2			8	14		1	1		10	5		3			1						1	2										7	7					
Singapore	3			5	5			2						1			1						15	34		2	2							1	1				
Thailand-Australia FTA (TAFTA)																																							
Australia	4	9		2	3				5													2	13			1								1	2				
Thailand	1	12		32					15	10		3			2				4	1		9				8	29		1	5	4		2	4		15	9		
EU-Chile Association Agreement																																							
Chile	5	5		7	8		1	4														1	25									1	1		6	7			
EU*	2*	1*		4*	3*			1					*		*				*	*			2*	3*			*		*		*	*	*		3	3*			
* Limitations that apply in specific EU Member States are not reported but an asterisk signals their presence																																							
EFTA-Singapore FTA																																							
Singapore	3			3	3								3		1	1						7	22		2	2								2	2				
Switzerland	3			7	2								3									2	2					2	1					3	4				
India-Singapore Comprehensive Economic Co-operation Agreement																																							
India	7	2		9	13		8	19		1	1		2									3	30		1	2							1	1	2				
Singapore	3			4	6			5					5			1						42	45		1	2								1	1				
No commitments in the sector - sector excluded																																							
Commitments in a limited number of sub-sectors																																							
Commitments in most of the sector																																							
Commitments across the entire sector																																							
Horizontal limitations (affect all sectors) * first column only *																																							
Number of limitations																																							
2																																							

No commitments in the sector - sector excluded
 Commitments in a limited number of sub-sectors
 Commitments in most of the sector
 Commitments across the entire sector
 Horizontal limitations (affect all sectors) * first column only *
 Number of limitations



Example: Japan-Singapore EPA

Investment commitments	All sectors 11			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN
Japan-Singapore New Age Economic Partnership Agreement																		
Japan	2			8	14		1	1		10	5		3					1
Singapore	3			5	5			2					1					1

Investment commitments	Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN
Japan				1	2											7	7				
Singapore				15	34		2	2								1	1				

No commitments in the sector - sector excluded
 Commitments in a limited number of sub-sectors
 Commitments in most of the sector
 Commitments across the entire sector
 Horizontal limitations (affect all sectors) * first column only *
 Number of limitations

Sectors covered: conclusions of the analysis

- The NAFTA-inspired approach has the advantage when looking at the number of sectors and sub-sectors where commitments are made, as well as the number of limitations listed.
- The comparison has a certain number of caveats
 - GATS-inspired agreements cover non-discriminatory quantitative restrictions
 - “market access” vs. “national treatment” (pre-establishment)
 - Counting limitations does not provide a good assessment of the extensiveness and importance of barriers to FDI.

Transparency

- In GATS-inspired agreements:
 - Transparency is a general obligation under the GATS.
 - Schedules of commitments based on a positive list are sometimes found to be less transparent in the sense that not all limitations to market access or national treatment are known (nothing regarding sectors where no commitments are made).
 - Transparency can be improved in GATS-inspired agreements (some countries have improved the way they list commitments and reservations as compared to GATS).
- In NAFTA-inspired agreements:
 - The negative list can be considered as more transparent because:
 - All reservations are in principle listed
 - NAFTA-like lists of non-conforming measures are more detailed.
 - The transparency of certain NAFTA-inspired agreements can however be nuanced when for example not all reservations are listed.
 - The case of sub-federal non-conforming measures in NAFTA.

Flexibility

- The GATS-inspired approach is often preferred for its “flexibility”:
 - Allows countries to conduct a selective liberalisation of investment and to keep options in sectors where there are on-going reforms
 - When no commitment is scheduled in a sector, there is no ratchet effect
 - But to what extent is it realistic to remove market access or national treatment once a sector has been liberalised (and foreign investors are in the domestic economy)?
- Flexibility is also possible in NAFTA-inspired agreements
 - List of reservations (in particular on future measures)
 - Phasing out of non-conforming measures

Future liberalisation

- In GATS-inspired agreements
 - Objective of free and open trade in services often stated (or deepening liberalisation and reducing the remaining restrictions).
 - Review of commitments
- In NAFTA-inspired agreements
 - All sectors already covered (with some exceptions): further liberalisation = elimination of non-conforming measures
 - Ratchet mechanism

Concluding remarks

- Countries are not constrained by one approach or the other
- The choice between the GATS-inspired and NAFTA-inspired approach depends on several factors
 - The willingness to liberalise investment and the pace of liberalisation
 - Administrative capacity and “path dependency”
 - A matter of negotiation between the Parties
- Investment liberalisation relies on future liberalisation and the implementation of the agreements (autonomous liberalisation and review of commitments).
 - A limited role for the MFN rule in extending liberalisation commitments.

Thank You!

sebastien.miroudot@oecd.org

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**BILATERAL INVESTMENT TREATIES
1995–2006:
TRENDS IN INVESTMENT RULEMAKING**



UNITED NATIONS
New York and Geneva, 2007

NOTE

As the focal point in the United Nations system for investment and technology, and building on 30 years of experience in these areas, UNCTAD, through DITE, promotes understanding of key issues, particularly matters related to foreign direct investment and transfer of technology. DITE also assists developing countries in attracting and benefiting from FDI and in building their productive capacities and international competitiveness. The emphasis is on an integrated policy approach to investment, technological capacity-building and enterprise development.

The term "country" as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row.

A hyphen (-) indicates that the item is equal to zero or its value is negligible.

A blank in a table indicates that the item is not applicable.

A slash (/) between dates representing years (e.g. 1994/1995) indicates a financial year.

Use of a dash (–) between dates representing years (e.g. 1994–1995) signifies the full period involved, including the beginning and end years.

References to "dollars" (\$) are to United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Because of rounding, details and percentages in tables do not necessarily add up to totals.

The material contained in this study may be freely quoted with appropriate acknowledgement.

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PREFACE

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a programme on international investment arrangements. It monitors the trends in IIAs and analyzes the emerging issues and development implications. It seeks to help developing countries participate as effectively as possible in international investment rulemaking. The programme embraces policy research and development, including the preparation of a series of issues papers; human resources capacity-building and institution-building, including national seminars, regional symposia, and training courses; and support to intergovernmental consensus-building.

The programme is implemented by a team led by James Zhan. The members of the team include Victoria Aranda, Amare Bekele, Anna Joubin-Bret, Hamed El-Kady, Joachim Karl, Marie-Estelle Rey and Jörg Weber. The members of the Review Committee are Mark Koulen, Peter Muchlinski, Antonio Parra, Patrick Robinson, Karl P. Sauvant, Pierre Sauvé, M. Sornarajah and Kenneth Vandevelde. Khalil Hamdani provides overall guidance to the programme.

This paper is part of the programme's research and policy analysis on international investment policies for development. This research builds on, and expands, UNCTAD's *Series on Issues in International Investment Agreements*. Like that series, the paper is addressed to government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers.

The main objective of this paper is to update UNCTAD's 1998 study entitled *Bilateral Investment Treaties in the Mid-1990s* and to identify trends in the normative developments of each of the elements typically addressed in BITs since this last stocktaking in 1998. The study traces and explains the new issues that have emerged in recent BITs and also sets out the implications of those developments for developing countries.

The study was prepared by Roberto Echandi and Anna Joubin-Bret. Joachim Karl, Amare Bekele, Bertram Boie, Hamed El-Kady and Jörg Weber finalized the paper. Comments at various stages were provided by Victoria Aranda, Rudolf Dolzer, Marie-France Houde, Mark Kantor, Karl P. Sauvant, M. Sornarajah, Ken Vandevelde and Christopher Wilkie. Desktop published by Teresita Ventura.

Supachai Panitchpakdi
Secretary-General of UNCTAD

Geneva, February 2007

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ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation
BIT	bilateral investment treaty
BoP	balance of payments
CARICOM	Caribbean Common Market
DR–CAFTA	Dominican Republic–Central American Free Trade Agreement
DSU	Dispute Settlement Understanding
DTT	bilateral treaty for the avoidance of double taxation (or double taxation treaty)
EIAs	economic integration agreements
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IIA	international investment agreements
ILO	International Labour Organization
IMF	International Monetary Fund
ISDS	investor–State dispute settlement
MAI	Multilateral Agreement on Investment
MFN	most favoured nation
NAFTA	North American Free Trade Agreement
NT	national treatment
REIO	regional economic integration organization
TNC	transnational corporation
TRIMs	Agreement on Trade-Related Investment Measures
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

EXECUTIVE SUMMARY

Following up on a similar project in the mid-1990s (UNCTAD, 1998), the present study provides an overview of the main developments in the negotiation of bilateral investment treaties (BITs) between 1995 and 2006. In that period, not only did the number of BITs increase substantially, but also there were significant qualitative developments, as agreements tended to become more complex and cover a broader set of issues.

The main objective of this study is to identify trends in the normative developments of each of the elements typically addressed in BITs, as well as to trace and explain new issues that have started to be covered by recent agreements. The study contains three substantive sections. After an introduction, the main part analyses in detail the various approaches in BITs related to the substantive treaty provisions and traces and explains the new issues that have emerged in recent BITs. This is followed by a conclusion that provides an assessment of the main trends and sets out implications for developing countries.

Since the early 1990s, the number of BITs has increased significantly. A considerable degree of conformity has emerged in terms of the main contents of BITs, although with significant differences concerning their substantive details. On the other hand, the surge in BITs has been accompanied by a degree of normative evolution. This development presents new challenges for policymakers. While all BITs limit the regulatory flexibility within which contracting parties can pursue their economic development policies, more recent BITs include a wider variety of disciplines affecting more areas of host country activity in a more complex and detailed manner. At the same time, these treaties put more emphasis on public policy concerns, in particular through, inter alia, the inclusion of safeguards and exceptions relating to public health, environmental protection and national security. Furthermore, the interaction of BITs with other agreements at different levels, including the bilateral, regional, plurilateral and multilateral levels, becomes more complicated. As global economic integration deepens, managing the impacts of integration on the domestic economy becomes more demanding and the challenges involved in concluding BITs are correspondingly greater.

Developments with regard to main BIT provisions

Against the background of more investment disputes, the negotiation of *preambles* has gained importance. Increasingly, these not only emphasize the objectives of investment promotion and protection, but also underline that this goal must not be pursued at the expense of other public interests, such as health, safety, environment and labour.

Most countries continue to conclude BITs with a broad asset-based definition of "*investment*". However, there is a trend towards excluding certain assets or transactions from the definition. Recently, Canada adopted a "closed-list" definition, enumerating in an exhaustive manner the assets that may constitute an investment. Concerning the definition of an "*investor*", various approaches continue to be used to determine the nationality of a legal entity. There has been a tendency in recent BITs to combine the criterion of incorporation with the requirement of also having the seat or the controlling interest in that country. "*Control*" by an investor of an investment is sometimes explicitly defined; one approach is to understand it as the power to appoint the majority of the board of directors or otherwise to legally direct the operations of the investment.

BITs that leave the contracting parties with discretion concerning the *admission and establishment* of foreign investors remain dominant. Nonetheless, treaties that include a "right of establishment" are becoming more frequent. This right is provided either through the granting of national treatment and most-favoured-nation (MFN) treatment or through the latter treatment only. It is subject to exceptions and reservations.

While most BITs include the standard of *fair and equitable treatment* — sometimes combined with the principle of *full protection and security* and/or the *international minimum standard* — only a small fraction of them clarify the meaning of this provision. Different approaches are in use — for instance, a statement that "fair and equitable" treatment does not mean more than what is prescribed by customary international law, a reference to international law, or the linkage of the fair and equitable treatment principle to non-discriminatory treatment.

Most recent BITs provide for *national treatment* in the post-establishment phase. Some agreements falling into this category make the national treatment standard subject to the domestic law of the host country.

All BITs under review contain the MFN principle. In most cases, there are exceptions to this rule with regard to privileges granted under treaties on the avoidance of double taxation and regional economic integration agreements. Despite some recent inconsistent arbitral awards on the scope of the MFN clause, BITs have not so far attempted to clarify its scope any further.

BITs of the last decade show a remarkable convergence concerning the legal preconditions for *expropriation or nationalization*. They require that the measure be non-discriminatory, for a public purpose, against payment of prompt, adequate and effective compensation, and with respect for the due process of law. BIT provisions differ on the degree of specificity with regard to the calculation and payment of compensation. Both direct and indirect expropriations are covered. The majority of BITs, however, do not explicitly deal with the newly emerging issue of regulatory takings.

A large number of BITs provide protection in the event of *war and civil disturbance*. Contracting parties are obliged to grant MFN and national treatment in such situations. Some treaties also specify the amount of compensation to be paid.

Most BITs include a clause on the *transfer of funds*, which gives foreign investors the right to transfer funds related to an investment without delay, and to use a particular currency at a specified exchange rate. There are differences regarding whether the provision covers both inbound and outbound transfers, whether any kind of transfer is protected or only those explicitly mentioned, and whether the transfer right is subject to national law. A significant number of BITs contain exceptions, mainly to ensure compliance with specific laws (e.g. on bankruptcy) or to safeguard flexibility for host countries to properly administer financial and monetary policies. The majority of BITs do not contain an exception clause dealing with a balance-of-payments crisis.

In the last 10 years an increasing number of BITs have included explicit provisions on the prohibition of certain *performance requirements*. The prohibitions tend to include service-related performance requirements and therefore go beyond the obligations in the TRIMs Agreement of the World Trade Organization (WTO).

Only relatively few BITs deal with the *entry and sojourn of foreign nationals*. They do not establish legally binding obligations, but only a "best efforts" commitment of contracting parties concerning the issuing of visas and work permits for nationals of the other contracting party engaged in activities associated with the investment. An increasing number of BITs explicitly deal with key personnel. The most common approach is to establish the right of foreign investors to employ key personnel of their choice, subject to domestic legislation.

Some BITs concluded since 1995 contain a *denial-of-benefits* clause. It allows contracting parties to deny treaty protection to those companies that are controlled by investors of a non-party and that have no substantial business activity in the territory of the party under whose laws they are constituted. In some cases, the clause is also meant to avoid granting treaty protection to investors of countries with which a contracting party does not maintain diplomatic relations or with regard to which an economic embargo exists.

A minority of BITs include *transparency* provisions. However, gradual yet significant qualitative progress has been made with regard to the rationale and content of such rules. While there has been a trend towards viewing transparency as an obligation imposed on countries to exchange information, new approaches also deem it to constitute a reciprocal obligation involving host countries and foreign investors. Transparency obligations are also no longer exclusively geared towards fostering exchange of information; rather, they relate to transparency in the process of domestic rulemaking aimed at enabling interested investors and other stakeholders to participate in that process.

Most BITs under review include *reservations* to one or more of the specific obligations in the agreement. In addition, there is a trend towards making it clear that investment promotion and protection must not be pursued at the expense of other key policy objectives. One technique used in this respect is to provide for general treaty *exceptions*. They may cover a broad range of issues, including taxation, essential security interests and public order, protection of human health and natural resources, protection of culture and prudential measures for financial services. Other BITs have included positive language to underline the responsibilities of contracting parties to safeguard society's core values. A small number of agreements contain a clause prohibiting or discouraging a lowering of environmental or core labour standards in order to attract foreign investment.

A group of BITs have undertaken to address *investor-State dispute settlement* procedures in greater detail, providing more guidance to the disputing parties concerning the conduct of arbitration and strengthening the rule orientation of adjudication mechanisms. However, the majority of BITs have continued with the traditional approach of only sketching out the main features of investor-State dispute settlement, relying on specific arbitration conventions to regulate the details. Some new BITs have incorporated various innovative provisions directed at fostering several objectives, such as to provide greater predictability, promote judicial economy, ensure consistency of awards and promote the legitimacy of arbitration procedures within civil society.

Conclusions

Most BITs concluded in the last decade have a similar basic structure and content. However, this does not mean that agreements would be more or less identical or that there would not have been any normative developments. On the contrary, by looking into the details of each treaty one can distinguish a broad variety of approaches with regard to individual provisions. Differences exist with regard to the underlying rationale of the BITs, the degree of protection and the number of qualitative innovations.

Most recent BITs follow the traditional approach of establishing binding obligations only with regard to the post-establishment phase. However, the number of agreements also including pre-establishment rights is on the rise. Such BITs have predominantly been concluded by Canada, the United States and, more recently, Japan.

As a result, a growing number of developing countries actually apply two different BIT models, depending on who their treaty partners are: the "admission clause" model (mostly in BITs with European countries) and the "right of establishment" model (in treaties mainly with Canada and the United States). More than others, developing countries are therefore confronted with the challenge of keeping their BIT universe coherent.

Likewise, there is an emerging trend towards introducing treaty innovations, namely with the objectives of clarifying the scope of the definition of "investment" and the meaning of several key obligations, providing greater transparency in rulemaking, spelling out that investment protection should not be pursued at the expense of other essential public policy concerns, and improving the transparency and predictability of dispute settlement procedures. As in the case of pre-establishment treatment, these innovations have so far been basically limited to BITs concluded by a few countries, including Canada, Colombia, Japan, the Republic of Korea and the United States. It remains to be seen whether more countries will adopt this approach in the future.

Current BIT practice does not, in general, expressly deal with development matters beyond the inherent objective of BITs of investment protection. There is a need for further clarification of the interrelationship between existing standards of investor protection and investment promotion, on the one hand, and the best means by which development concerns can be (or should be) expressed in the future evolution of BITs, on the other hand.

INTRODUCTION

In the absence of a global investment treaty, most international legal disciplines on the relationship between host countries and international investors have been developed at a bilateral level. Treaties establishing minimum guarantees regarding the treatment of foreign investment have existed for more than two centuries.¹ In the latter half of the 20th century, bilateral investment treaties (BITs) emerged as the first international agreements exclusively focusing on the treatment of foreign investment. In view of their similar legal structure, as well as the fact that BITs have burgeoned, these agreements rank among the most important pillars in international law on foreign investment.

Bilateral treaties on the promotion and protection of investments of investors of one contracting party in the territory of the other contracting party date back to 1959, when the first BIT was signed between the Federal Republic of Germany and Pakistan. Since that time, BITs had a relatively uniform content that had not changed markedly, apart from the introduction of provisions on national treatment and investor–State dispute resolution in the 1960s. Since the mid-1990s, however, the inclusion of investment protection provisions within larger trade agreements and the submission of a growing number of investment disputes to arbitration under investor–State dispute settlement provisions have led to some innovations in BIT practice, resulting in greater variation among these agreements than in the past.

The number of BITs continued to rise throughout the entire review period, reaching almost 2,500 at the end of 2005. However, since 2001 the number of BITs concluded annually has shown a constant downward trend; in 2005, 70 new agreements were concluded. This development contrasts with the surge in free trade agreements and other treaties on economic cooperation containing investment provisions. Whereas only 80 such treaties existed at the beginning of the review period, their number stood at 232 at the end of 2005 (UNCTAD 2006a, 2006b).

Mainly owing to the emergence of the latter kind of agreements, the scope of issues covered by investment-related treaties is expanding. They are no longer limited to investment issues per se, but also deal with related matters such as trade, services, competition, intellectual property and industrial policy (UNCTAD 2006c).

A growing number of BITs contain liberalization commitments. BITs are also becoming more sophisticated and complex in content (UNCTAD 2006d). Some countries have started to clarify individual treaty provisions and to make dispute settlement procedures more detailed. Treaties also emphasize in a stronger manner public policy concerns, such as those related to health, safety, security and environmental protection.

The evolution of the BIT universe is also due to the increase in BITs concluded between developing countries. In 2005 alone, 20 such treaties were concluded; this brought their total number to 644, whereas ten years before only 161 had existed. This development partially reflects the stronger role of some developing countries as capital exporters, which makes them actively seek the conclusion of BITs (UNCTAD 2005a).

Another element that contributed to the evolution of BITs is the surge in investor–State disputes over the last decade. While only six such cases were known in 1995, the number was almost 38 times higher at the end of 2005 (226 cases). This development is one of the main reasons why some countries seek to clarify individual BIT provisions with a view to reducing the risk of disputes in the future (UNCTAD 2005b, 2005c).

In 1998, UNCTAD published a comprehensive study entitled *Bilateral Investment Treaties in the Mid-1990s* (UNCTAD 1998). This document was one of the first studies ever published explaining the nature and content of BIT provisions. In addition, UNCTAD has published the *Series on Issues in International Investment Agreements*. That series addresses the basic conceptual framework and issues related to BITs. The present study neither purports to reiterate what has been explained in greater detail in those documents, nor does it intend to propose “best practices” in BIT negotiations. Rather, it attempts to present the diversity and the wide range of options, which can be observed from the BITs under review, and to identify major trends in the evolution of international investment rulemaking.

Note

- ¹ The first Friendship, Commerce and Navigation Treaty signed between the United States and France in 1788 contained provisions regulating treatment of foreign investment.

MAIN PROVISIONS OF BILATERAL INVESTMENT TREATIES: RECENT DEVELOPMENTS IN RULEMAKING

A. Preamble

Most BITs are prefaced with a preamble, in which the contracting parties state their intentions and objectives when concluding the agreement.

Often, the preamble does not attract as much attention as the substantive BIT provisions since it does not establish legally binding rights and obligations. However, this does not mean that the wording of preambles is irrelevant.

The importance of the preamble stems from the fact that, as stated in Article 31 of the 1969 Vienna Convention on the Law of Treaties (hereinafter “the Vienna Convention”), it constitutes part of the context of the agreement. Consequently, the preamble is relevant for the interpretation of the treaty.¹ Contracting parties therefore need to ensure that the preamble is consistent with the substantive provisions of the BIT. Given the substantial increase in investor–State disputes, the specific language used in preambles might play a more significant role in the interpretation of BITs in the future.

From a political perspective, the preamble contains key messages of Governments to both national and international constituencies. They become more relevant as IIAs are critically looked at by some parts of civil society, both at a domestic and an international level. Thus, during the review period, an increasing number of countries have opted to include specific language in their BITs, aimed at making it clear that the objective of investment promotion and protection must not be pursued at the expense of other key public policy goals, such as the protection of health, safety, the environment and the promotion of internationally recognized labour rights. This trend has been reflected not only in the preambles, but also in the wording of substantive BIT provisions.

Two broad categories of preambles can be distinguished: the first group, which is by far the more numerous, includes those that focus on the importance of fostering economic cooperation among the contracting parties, promoting favourable conditions for reciprocal investments and recognizing the impact that such investment may have in generating prosperity in the host countries. An example is the preamble of the BIT between Mongolia and Singapore (1995). It states that:

*“DESIRING to create favourable conditions for greater economic co-operation between them and in particular for investments by nationals and companies of one State in the territory of the other State based on the principles of equality and mutual benefit;
RECOGNIZING, that the encouragement and reciprocal protection of such investments will be conducive to stimulating business initiative and increasing prosperity in both States [...]”.*

Other BITs falling into this category include additional elements, such as the agreement between Brunei Darussalam and the Republic of Korea (2000), which also recognize *the importance of technology transfer and human resources development*. Furthermore, Australian BITs usually highlight issues such as *mutual respect for sovereignty*. These preambles also emphasize that investments are made within the framework of the *laws of the host country*. Some BITs highlight in the preamble the importance of *specific substantive obligations* included in the main body of the agreement. This is the case of the agreement between China and Djibouti (2003) (table 1).

Table 1. Examples of traditional preambles

BIT between China and Djibouti (2003)	BIT between Australia and Egypt (2001)	BIT between Brunei Darussalam and the Republic of Korea (2000)
“The Government of the People’s Republic of China and the Government of the Republic of Djibouti, Intending to create favorable conditions for investment by investors of one Contracting Party in the territory of the other Contracting Party; Recognizing that the reciprocal encouragement, promotion and protection of such investment will be conducive to stimulating business initiative of the investors, flow of capital and technology, and will increase prosperity and economic development and that fair and equitable treatment of investments is desirable in both States; Desiring to intensify the cooperation of both States on the basis of equality and mutual benefits; Have agreed as follows:”	“The Government of Australia and the Government of the Arab Republic of Egypt (“the Parties”) Recognising the importance of promoting the flow of capital for economic activity and development and aware of its role in expanding economic relations and technical co-operation between them, particularly with respect to investment by investors of one Party in the territory of the other Party; Considering that investment relations should be promoted and economic co-operation strengthened in accordance with the internationally accepted principles of mutual respect for sovereignty, equality, mutual benefit, non-discrimination and mutual confidence; Acknowledging that investments of investors of one Party in the territory of the other Party would be made within the framework of the laws of that other Party; and Recognising that pursuit of these objectives would be facilitated by a clear statement of principles relating to the protection of investments, combined with rules designed to render more effective the application of these principles within the territories of the Parties, Have agreed as follows:”	“The Government of the Republic of Korea and the Government of His Majesty The Sultan and Yang Di-Pertuan of Brunei Darussalam (hereinafter referred to as “the Contracting Parties”), Desiring to create favourable conditions for greater economic co-operation between the two countries and, in particular for investments by investors of one Contracting Party in the territory of the other Contracting Party on the basis of equality and mutual benefit, Recognising that the encouragement and reciprocal protection under international agreements of such investments will be conducive to the stimulation of business initiatives and will increase prosperity in both countries, Recognising the importance of the transfer of technology and human resources development arising from such investments, Have agreed as follows:”

A second category of preambles additionally make it clear that investment promotion and protection need to respect other key public policy objectives. Such objectives may include the protection of health, safety, the environment and consumers, or the promotion of internationally recognized labour rights. It should be noted that this group of BITs also comprises agreements that follow the traditional approach of applying only to established investment and that do not contain specific provisions addressing issues such as labour or environmental standards (table 2).

Regardless of the specific content of the preambles, two trends can be identified. First, as the use of investor–State dispute settlement procedures increases, it is likely that countries will pay more attention to the specific wording of the preambles when negotiating a BIT. Second, an increasing number of preambles indicate that BITs do not purport to promote and protect investment at the expense of other key values such as health, safety, labour protection and the environment.

B. Scope of application

The scope of application of a BIT has different dimensions. There is the subject matter to which the agreement applies — typically the investment made by investors of the other contracting party — the geographical coverage of the agreement and the temporal scope of application of the BIT.

Table 2. Examples of non-traditional preambles

BIT between the Republic of Korea and Trinidad & Tobago (2002)	BIT between the United States and Uruguay (2005)
“The Government of the Republic of Korea and the Government of the Republic of Trinidad and Tobago (hereinafter referred to as “the Contracting Parties”), Desiring to intensify economic cooperation between both States, Intending to create favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party, based on the principles of equality and mutual benefit, Recognizing that the promotion and protection of investments on the basis of this Agreement will be conducive to the stimulation of individual business initiative and will increase prosperity in both States, Respecting the sovereignty and laws of the Contracting Party within whose jurisdiction the investments fall, and Convinced that these objectives can be achieved without relaxing health, safety and environmental measures of general application, Have agreed as follows:”	“The Republic of Uruguay and the United States of America (hereinafter the “Parties”); Desiring to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party; Recognizing that agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties; Agreeing that a stable framework for investment will maximize effective utilization of economic resources and improve living standards; Recognizing the importance of providing effective means of asserting claims and enforcing rights with respect to investment under national law as well as through international arbitration; Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of consumer protection and internationally recognized labor rights; Having resolved to conclude a Treaty concerning the encouragement and reciprocal protection of investment; Have agreed as follows:”

Traditionally, most BITs have not included a specific clause to comprehensively address these different aspects in one single provision (UNCTAD, 1999a). Instead, the overwhelming majority have dealt with these issues in separate definitions of the terms “investment”, “investor” and “territory”, while clarifying the duration of the agreement in the “final clauses” of the BIT (UNCTAD, 1998). A number of BITs reviewed include, however, a specific clause to determine *ab initio* the scope of application of the BIT.

1. Scope of application clause

Specific clauses on the scope of application of the agreements are no substitute for the use of definitions as a means to delimit the subject matter of the BITs.² Rather, there are several reasons for using such a clause. In some agreements, it responds to considerations of legal drafting, aiming to clarify the *different dimensions* of the scope of application of the agreement in *one single* provision. Examples of BITs using this technique are those of Australia. The BIT between Australia and Uruguay (2001) states the following:

“Article 2 Application of Agreement

1. *This Agreement shall apply to investments whenever made but shall not apply to disputes which have arisen prior to the entry into force of this Agreement.*

2. Where a company of a Party is owned or controlled by a citizen or a company of any third country, the Parties may decide jointly in consultation not to extend the rights and benefits of this Agreement to such company.
3. A company duly organised under the law of a Party shall not be treated as an investor of the other Party, but any investments in that company by investors of that other Party shall be protected by this Agreement.
4. This Agreement shall not apply to a company organised under the law of a third country within the meaning of paragraph 1(d)(ii) of Article 1 where the provisions of an investment protection agreement with that country have already been invoked in respect of the same matter.
5. This Agreement shall not apply to a permanent resident of one Party where:
 - (a) the provisions of an investment protection agreement between the other Party and the country of which that person is a citizen have already been invoked in respect of the same matter; or
 - (b) the permanent resident is a citizen of the other Party.”

A common trend among a number of recent BITs is to include an article emphasizing *one particular key aspect*, for instance the *temporal application* of the BIT. An example is the BIT between Austria and the Philippines (2002). It states that although the agreement is not retroactive, it applies to all existing investments of investors of one contracting party in the territory of the other once it enters into force:

“Article 11
Application of the Agreement

*This Agreement shall apply to investments made in the territory of one of the Contracting Parties in accordance with its legislation by investors of the other Contracting Party **prior to as well as after the entry into force** of this Agreement.”* (emphasis added)

Other BITs emphasize that the host country retains full discretion and control over the admission of the investment into its territory, stressing the fact that the BIT does not grant any right of establishment to the foreign investor. Such discretion and control may entail formal requirements included in the host country’s domestic legislation, compliance with which may be crucial for determining whether the agreement applies to a particular investment. This clarification may be important for dispute settlement purposes.³ An example is the BIT between India and Thailand (2000).

“Article 2
Scope of the Agreement

*The benefit of this Agreement shall apply to all investments made by investors of one Contracting Party in the territory of the other Contracting Party, which have been admitted in accordance with the laws and regulations and, where applicable, **specifically approved in writing by the competent authorities concerned of the other Contracting Party**, whether made before or after coming into force of this Agreement.”* (emphasis added)

As a result, the BIT would not cover an investment made in contravention of a formal requirement for written approval.⁴

Another category of agreements focuses on the *measures* relating to investments or investors rather than on the investment or investors of the other party, that is to laws and regulations existing at the date of entry into force of the agreement or adopted thereafter. An illustration is the new Canadian model BIT, which states:

“Article 2
Scope

1. This Agreement shall apply to measures adopted or maintained by a Party relating to:
 - (a) investors of the other Party; and
 - (b) covered investments. [...]

To limit the scope of application of the BIT in this manner may have significant practical effects for determining the universe of measures that could be challenged for purposes of dispute settlement procedures.

This issue was discussed in the initial disputes invoking the application of NAFTA's Chapter 11 on investor-State dispute settlement procedures.⁵ In several cases, such as *Pope & Talbot* and *S.D. Myers*, Canada sought to have the arbitral tribunal decline jurisdiction on the basis that the measures challenged dealt with trade in goods, and as such, were governed by chapters of NAFTA other than the investment chapter. Consequently, the argument was that measures concerning trade in goods were not subject to arbitration under the investment provisions of Chapter 11.⁶

Arbitral tribunals established pursuant to NAFTA's Chapter 11 consistently held that measures concerning trade in goods can also be measures that "relate to" an investor or an investment. The tribunals have drawn on similar reasoning regarding the application of the WTO Agreements, in particular the GATT and GATS. In that context, the WTO Appellate Body has ruled that these agreements apply to measures that "affect" trade in goods or "affect" trade in services and, consequently, should not be read as applying only to measures concerning "goods" or "services".⁷

On the basis of the NAFTA experience, BITs applying to measures that "relate to" investors of the parties and their investments thus extend the scope of the agreement to any kind of measure affecting the investor or the investment concerned. Therefore, a broad range of regulations in the host country could potentially fall under the scope of application of the BIT. The subject matter to which the measures were primarily directed would be irrelevant.

2. Definition of terms

The purpose of definitions in legal instruments such as BITs is to determine the object to which the rules of the agreement shall apply and the scope of their applicability (UNCTAD, 1999a). The typical BIT protects investments made by investors of one contracting party in the territory of the other contracting party. The scope of the subject matter of the treaty thus depends on the definitions of certain key terms, particularly "*investment*" and "*investor*".

a. Investment

Traditionally aimed at investment protection, most BITs define "*investment*" in a broad and open-ended manner, covering not only the capital that has crossed borders, but also practically all other kinds of assets of an investor in the territory of the host country. A significant number of BITs have included a standard definition of "*investment*", covering "*every kind of asset*" owned or controlled by an investor of another party. This is typically complemented by an illustrative list of assets included within the definition.

Given that different kinds of investment may have different economic implications and a different impact on development, the parties to a BIT may not wish to promote and protect all investment flows in the same manner. Thus, many BITs have narrowed the definition of "*investment*" in various ways. While some agreements have complemented the broad asset-based definition with a list of clarifications aimed at excluding certain kinds of investments, other countries have opted to use "closed-list" definitions — an approach that defines "*investment*" in terms of listing an ample but yet finite list of assets.

Among the BITs concluded since 1995, one can distinguish several kinds of definitions. There is the traditional "*asset-based*" definition, which, with several variations, has continued to be the most common approach. A second kind of definition, the use of which has diminished recently, is related to a "*circular*" or "*tautological*" approach, which focuses on the features of an investment rather than conceptualizing it. A third approach is a "*closed-list*" definition of investment. Fourth, there are techniques that exclude certain assets and transactions from the definition.

(i) Asset-based definition of investment

Most BITs of the last 10 years have continued to adopt a broad “asset-based” definition of “investment”, the scope of which goes beyond covering only foreign direct investment. The definition covers “every kind of asset” or “any kind of asset”, accompanied by a list of examples. Such lists usually include five categories of assets: first, movable and immovable property and any related property rights such as mortgages, liens or pledges; second, various types of interests in companies, such as shares, stock, bonds, debentures or any other form of participation in a company, business enterprise or joint venture; third, claims to money and claims under a contract having a financial value and loans directly related to a specific investment; fourth, intellectual property rights; and fifth, business concessions, that is rights conferred by law or under contracts (UNCTAD, 1998, 1999a) (table 3).

Table 3. Examples of “asset-based” definitions of investment

BIT between Ghana and Guinea (2001)	BIT between Azerbaijan and Finland (2003)
“Article 1 Definitions “Investments” means every kind of asset and in particular, though not exclusively, includes: (i) movable and immovable property and any other property rights such as mortgages, liens or pledges; (ii) shares in and stocks and debentures of a company and any other form of participation in a company; (iii) claims to money or to any performance under contract having a financial value; (iv) intellectual property rights, goodwill, technical processes and know-how and all similar rights recognized by the national laws of both Contracting Parties ; (v) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract, or exploit natural resources; A change in the form in which assets are invested does not affect their character as investments, provided such change is not contrary to the laws of the Contracting Party in whose territory the investment has been made. The term “investment” includes all investments, whether made before or after the date of entry into force of this Agreement.”	“Article 1 Definitions The term “Investment” means every kind of asset established or acquired by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party including, in particular, though not exclusively: (a) movable and immovable property or any property rights such as mortgages, liens, pledges, leases, usufruct and similar rights; (b) shares, stocks, debentures or other form of participation in a company; (c) titles or claims to money or rights to performance having an economic value; (d) intellectual property rights, such as patents, copyrights, technical processes, trade marks, industrial designs, business names, know-how and goodwill; and (e) concessions conferred by law, by administrative act or under a contract by a competent authority, including concessions to search for, develop, extract or exploit natural resources. Any alteration of the form in which assets are invested or reinvested does not affect their character as investments.”

A variation of an asset-based definition is the approach used in some agreements of the Russian Federation, such as the BIT with Japan (1998), which applies to “capital investments”. This concept is defined as follows:

“Article 1

- (1) The term “capital investment” means all kinds of valuables, in particular:
- a) the rights relating to movable and immovable property;
 - b) shares and other forms of interest in companies;
 - c) investment related right of claim of monetary means or any contractual obligation of financial value;

- d) *the rights to intellectual property including patents, trademarks, industrial designs, integrated circuit designs, brand names, references to sources or origin marks and non-disclosable information; and*
- e) *concession rights including the right to prospect and use natural resources; Variations in the form of valuables investment do not affect their nature as capital investments."*

At first glance, the use of the term "*capital investment*" in this definition suggests that the intent of the parties was to apply the BIT not to all kinds of investments, but only to those entailing a commitment of capital. However, it appears that the use of this particular term responds more to considerations of drafting than to such intent. "*Capital investment*" is defined as comprising "*all kinds of valuables*", a notion that is clarified with the illustrative list comprising the five categories of assets usually included in asset-based definitions. Furthermore, to the extent that every asset has a value, the example cited above is only a variation of the typical asset-based definition.

The main objective of an asset-based definition is to guarantee protection of as many forms of investment as possible. However, a significant number of BITs have also included certain limitations on the scope of investment covered. During the review period, this trend has continued. An example is the BIT between Chile and New Zealand (1999), which defines "investment" as follows:

*"investment" means any kind of asset or rights related to it **provided that the investment has been made in accordance with the laws and regulations of the Contracting Party receiving it, including, though not exclusively [...]***" (emphasis added)

Conditioning the coverage of an asset on compliance with local laws has several purposes. It confirms that both foreign and domestic investors have to observe the laws of the land, thereby establishing a "level playing field". Moreover, this limitation implies that investment is covered only if consistent with the host country's development policy, and other policies, as expressed in its domestic legislation (UNCTAD, 1999b).

Some recent BITs include the qualification that the assets must be invested by an investor of one party *in the territory* of another party. An example of this approach is the BIT between Algeria and Indonesia (2000), which defines "investment" as follows:

*"The term "investment" shall mean any kind of asset **invested by investors of one Contracting Party in the territory of the other Contracting Party**, in conformity with the laws and regulations of the latter, including, but not exclusively [...]*" (emphasis added)

Similarly, other BITs also establish the link between the asset and the territory of the host country by stating that for the former to be a covered investment, it has to be owned or controlled in the territory of the host country. That is the case of the BIT between Belgium–Luxembourg and Saudi Arabia (2002), which defines "investment" in the following terms:

*"[...] the term "investment" means every kind of asset, **owned or controlled by an investor of a Contracting Party in the territory of the other Contracting Party** according to its legislation and in particular, but not exclusively includes: [...]*" (emphasis added)

If the investment is an intangible asset, for example a debt or a right under contract, it may not be easy to determine whether an investor of contracting party A has in fact invested an asset in the territory of contracting party B. The SGS arbitration cases provide an example of such a difficulty.⁸

In those cases, the Governments of Pakistan and the Philippines respectively entered into contracts with SGS whereby SGS agreed to provide "pre-shipment inspection" services with respect to goods to be exported from certain countries to Pakistan and the Philippines. SGS undertook to inspect such goods partially abroad through its offices and affiliates. Accordingly, the two Governments argued that the investment in question was not made in their territories as required by the BITs. In the end, the tribunal did

not have to deal with this objection, because it considered it sufficient that according to the contract SGS had to make certain expenditures in the territory of Pakistan and the Philippines. These expenditures then constituted the investment.

(ii) Tautological element in the definition of investment

The definition of “investment” not only requires a concept ample enough to cover the wide range of forms that investment can take, but also must be flexible enough to apply to new types of investment that might emerge in the future.

Some countries have responded to this need by introducing a tautological — or circular — definition of “investment”.⁹ Numerous BITs concluded by the United States illustrate this approach, such as the BIT with Bahrain (1999). It defines an “investment” as “every kind of investment”. The definition reads as follows:

“Investment” of a national or company means every kind of investment owned or controlled directly or indirectly by the national or company, and includes, but it is not limited to, [...]

During the last decade, this tautological approach has not been very widespread, and virtually limited to those BITs of the United States during the first part of the period. However, in the BIT with Uruguay (2005), as well as in the negotiation of investment chapters of several free trade agreements, the United States has adopted a still broad, but more precise asset-based definition of investment (see subsection (iii) below). Such evolution in rulemaking might stem from the United States’ experience in the context of NAFTA’s Chapter 11 on investor–State disputes, where the definition of “investment” has been crucial in determining the jurisdiction of arbitral panels. Using a tautological approach implies that the contracting parties leave a significant degree of discretion to arbitral tribunals to interpret this concept.

(iii) Closed-list definition of investment

A third approach that has emerged to avoid an excessively broad definition of “investment” is what is called a “closed-list” definition. This method differs from the broader “asset-based” definition in that it does not contain a conceptual chapeau to define “investment”, but rather consists of an ample, but finite list of tangible and intangible assets to be covered by the treaty. Originally envisaged as an “enterprise-based” definition used in the context of the United States–Canada Free Trade Agreement, this approach evolved towards the definition used in Article 1139 of NAFTA. It was not until the last decade that this approach began to be also used in BITs. It has been incorporated into the 2004 Canadian BIT model, which defines “investment” in the following terms:

“Article 1 Definitions

Investment means:

- (I) *an enterprise;*
- (II) *an equity security of an enterprise;*
- (III) *a debt security of an enterprise*
 - (i) *where the enterprise is an affiliate of the investor, or*
 - (ii) *where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;*
- (IV) *a loan to an enterprise*
 - (i) *where the enterprise is an affiliate of the investor, or*
 - (ii) *where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;*
- (V) (i) *notwithstanding subparagraph (III) and (IV) above, a loan to or debt security issued by a financial institution is an investment only where the loan or debt security is treated as regulatory capital by the Party in whose territory the financial institution is located, and*

- (ii) *a loan granted by or debt security owned by a financial institution, other than a loan to or debt security of a financial institution referred to in (i), is not an investment;*

for greater certainty:

- (iii) *a loan to, or debt security issued by, a Party or a state enterprise thereof is not an investment; and*
- (iv) *a loan granted by or debt security owned by a cross-border financial service provider, other than a loan to or debt security issued by a financial institution, is an investment if such loan or debt security meets the criteria for investments set out elsewhere in this Article;*
- (VI) *an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;*
- (VII) *an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraphs (III) (IV) or (V);*
- (VIII) *real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and*
- (IX) *interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under*
 - (i) *contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or*
 - (ii) *contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;*

but investment does not mean,

- (X) *claims to money that arise solely from*
 - (i) *commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of the other Party, or*
 - (ii) *the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraphs (IV) or (V); and (XI) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (I) through (IX)"*

In addition to being finite, the list contains a series of specific clarifications to avoid applying the BIT to certain kinds of assets. This is an emerging trend among recent BITs. While countries following this approach intend to maintain the broad concept of investment, they include clarifications and additional language to make the definition of "investment" more precise. This point is developed below.

(iv) Limiting the scope of the definition of "investment"

A limited number of recent BITs, regardless of whether they use an asset-based or a closed-list definition of "investment", exclude certain assets and transactions from the scope of the definition of "investment". The specific exclusions vary among the different treaties. However, it is possible to distinguish two broad categories of excluded assets. The first group comprises real estate or other property not acquired for the purpose of economic benefit or other business purposes. The second type relates to certain financial assets or transactions, which are perceived as not entailing real acquisitions of interests by a foreign investor in the host country.

1. Assets used for non-business purposes

Although not very numerous, some BITs under review exclude from the definition of "investment" all real estate or other property, tangible or intangible, not acquired in the expectation or used for the purpose of economic benefit or other business purposes (table 4). A typical example of an asset falling into this category is the vacation home.

Table 4. Examples of language variations used to exclude assets for personal use from the definition of investment

BIT between Belarus and the Czech Republic (1996)	BIT between Mauritius and Swaziland (2000)
“Article 1 Definitions The term "investment" shall mean every kind of asset invested in connection with economic activities by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter ...” (emphasis added)	“Article 1 Definitions "Investment" means every kind of asset admissible under the relevant laws and regulations of the Contracting Party in whose territory the respective business undertaking is made, ...” (emphasis added)

Another technique to exclude certain kinds of assets is to insert the qualification that for an asset to be a covered “investment” it must have the “characteristics of an investment”, such as “the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk”. This approach contains once again a tautological element; it gives, however, some general indications as to the meaning of the term “investment”. This concept, which was first considered in the stillborn negotiations of the Multilateral Agreement on Investment (MAI) (UNCTAD, 1999c), has more recently been applied in the BIT between the United States and Uruguay (2005). The definition reads as follows:

“Article 1
Definitions

“investment” means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. [...]”

This definition does not list all the characteristics that an asset must have in order to be considered an investment. However, it does include three minimum parameters.

2. *Financial transactions that do not entail a real acquisition of interests*

The second category of assets that a few BITs have begun to exclude from the definition of “investment” are those related to transactions that do not entail a real acquisition of interests by an investor in the territory of the host country.

A first group of excluded transactions are debt instruments with short-term maturity periods. Some agreements, such as the new United States model BIT, do not specify the term “short-term maturity period” and leave its determination to a case-by-case basis.¹⁰ Other BITs state that the excluded debt instruments are those with a maturity of less than three years. The purpose of this policy is to prevent volatile or short-term portfolio investment from being considered a covered investment. The requirement of a three-year maturity does not apply when the loan is made to an enterprise that is an affiliate of the investor. This exception has usually been included in the definition of “investment” used in BITs of Mexico.¹¹ An example is the BIT between Greece and Mexico (2000):

“Article 1
Definitions

1. *“Investment” means every kind of asset acquired or used for economic purposes and invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party and, in particular though not exclusively, includes: [...]*

- c) *claims to money, to other assets and to any performance having an economic value, except for:*
 - i) *claims to money that arise solely from commercial contracts for the sale of goods and services,*
 - ii) *the extension of credit in connection with a commercial transaction, such as trade financing;*
 - iii) ***credits with a maturity of less than three years, by an investor in the territory of a Contracting Party to a natural or legal person in the territory of the other Contracting Party. However, the exception concerning credits with a maturity of less than three years, shall not apply to credits granted by an investor of a Contracting Party to a legal person of the other Contracting Party that is an affiliate of that investor; [...]*** (emphasis added)

A second group of transactions excluded in some agreements, such as the BITs of Canada, Mexico and the United States, are claims to money that arise solely from commercial contracts for the sale of goods and services by nationals in the territory of a Party to a national in the territory of another Party. For example, the BIT between the United States and Uruguay (2005) states that “*for purposes of this Treaty, claims to payment that are immediately due and result from the sale of goods or services are not investments*”.

The third sub-category of transactions is *public debt* in the form of payment obligations — loans or securities — of the State or a State enterprise. A reason justifying this exclusion could be that Governments do not want to establish in a BIT international obligations in relation to public debt, which could interfere with debt rescheduling in the framework of the “Paris Club”.

In conclusion, two trends can be observed with regard to the definition of “*investment*” in BITs. The overwhelming majority of treaties have continued to use the traditional broad asset-based definitions of investment. However, a growing number of BITs define the term “*investment*” with greater precision and exclude certain assets from the definition.

b. Investor

BITs apply to investments made by *investors* of one contracting party in the territory of the other contracting party. Most BITs have traditionally included a definition of “*investor*”, which covers both natural and legal persons. There is the question of what kind of link a particular investor — either a natural or a legal person — needs to have with the contracting parties to justify protection under the agreement. The answer usually depends on whether the investor is a natural person or a legal entity; that is why BITs address those two categories of investors separately.

(i) Natural person

With respect to natural persons, most BITs protect persons who have the nationality of one of the contracting parties. Thus, the typical definition of a national of a party is a natural person recognized by that party’s internal law as a national or citizen. This approach has not varied during the review period. Examples are the BITs between Angola and the United Kingdom (2000) and between Bangladesh and Japan (1998) (table 5).

In some cases, the definition of “*investor*” is even broader to include not only citizens but also individuals, who qualify as permanent residents under domestic law. For example, the BIT between Armenia and Canada (1997) states the following:

“Investor” means in the case of Canada any natural person possessing the citizenship of or permanently residing in Canada in accordance with its laws. (emphasis added)

Table 5. Examples of definitions of nationals

BIT between Angola and the United Kingdom (2000)	BIT between Bangladesh and Japan (1998)
“Article 1 Definitions [...] (c) “nationals” means: (i) in respect of the United Kingdom: physical persons deriving their status as United Kingdom nationals from the law in force in the United Kingdom; (ii) in respect of the Republic of Angola: physical persons deriving their status as nationals of the Republic of Angola from the law in force in Angola;”	“Article 1 [...] (3) the term “nationals” means, in relation to one Contracting Party, physical persons possessing the nationality of that Contracting Party;”

A few BITs concluded some decades ago required, in addition to nationality, the person to reside or be domiciled in the country of nationality.¹² However, among the BITs under review, that kind of requirement seldom exists.

There is also the issue of the coverage of natural persons having the nationality of both BIT parties under their respective laws. One possibility, following the international law principle of an effective link, is to consider a person with dual nationality as a national of the country of his/her dominant and effective nationality. This is, for instance, the approach in the BIT between the United States and Uruguay (2005), which defines “*investor of a Party*” in the following way:

“Article 1
Definitions

“investor of a Party” means a Party or state enterprise thereof, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party; provided, however, that a natural person who is a dual citizen shall be deemed to be exclusively a citizen of the State of his or her dominant and effective citizenship.” (emphasis added)

Another method is to consider a person who is a national under the laws of both BIT parties as a national of each country in their respective territories.¹³ This approach has the effect of excluding such persons from the coverage of the agreement. An example is the BIT between Canada and Lebanon (1997). It states:

“Article 1
Definitions

*“investor” means:
any natural person possessing the citizenship of or permanently residing in one Contracting Party in accordance with its laws; ... who makes the investment in the territory of the other Contracting Party. In the case of persons who have both Canadian and Lebanese citizenship, they shall be considered Canadian citizens in Canada and Lebanese citizens in Lebanon.”*

Another method having the same legal effect is exemplified by the 2004 Canadian model BIT that defines “*investor*” as follows:

“Article 1
Definitions

*investor of a Party means:
in the case of Canada:
(i) Canada or a state enterprise of Canada, or*

(ii) a national or an enterprise of Canada, that seeks to make, is making or has made an investment;
in the case of _____:

_____;
that seeks to make, is making or has made an investment and **that does not possess the citizenship of Canada.**" (emphasis added)

This approach has the effect of denying treaty protection to Canadian individuals making an investment in Canada.

(ii) Legal entities

Different criteria — in various combinations — have been used in BITs to define the nationality of a legal entity. These are the place of incorporation, the location of the company's seat — also referred to as the *siège social*, *real seat* or *principal place of business* — and the nationality of ownership or control.¹⁴ As has been explained in greater detail elsewhere, each of these different criteria has its advantages and disadvantages.¹⁵

Numerous BITs concluded since 1995 use the place of incorporation or constitution as the sole criterion (table 6).

Table 6. Examples of definitions of the term "investor" using the criterion of place of incorporation or constitution

BIT between Sierra Leone and the United Kingdom (2000)	BIT between Belgium - Luxembourg and Pakistan (1998)
"Article 1 [...] (d) companies" means: (i) in respect of the United Kingdom: corporations, firms and associations incorporated or constituted under the law in force in any part of the United Kingdom or in any territory to which this Agreement is extended in accordance with the provisions of Article 12; (ii) in respect of the Republic of Sierra Leone: corporations, firms and associations incorporated or constituted under the law in force in any part of the Republic of Sierra Leone; (emphasis added)	"Article I. [...] 1. The term "Investor" means: [...] b) any legal entity, including companies, association of companies, trading corporate entities and other organizations which is incorporated or, in any event is properly organized under the law of the Islamic Republic of Pakistan, the Kingdom of Belgium or the Grand-Duchy of Luxembourg." (emphasis added)

Unlike in the case of place of constitution or incorporation, it is not very common for BITs to use the criteria of the company's seat or the ownership or control as the *sole* condition for defining the nationality of a legal entity. An exception is, for example, the BIT between Peru and Venezuela (1996), which focuses exclusively on the control of a company by nationals of a party. The Agreement defines the term "enterprises" as follows:

"Article 1

[...]

(3) "Company" applies to all judicial persons, including civil and commercial corporations and other associations which exercise an economic activity comprised within the ambit of this Agreement and that are effectively controlled, directly or indirectly, by nationals of one of the Contracting Parties." (non-official translation from Spanish)

A significant number of BITs under review follow a different approach and combine several criteria. For instance, they require a company both to be incorporated in the territory of a contracting party and to have its seat or controlling interests in that country (table 7).

Table 7. Examples of definitions of the term “investor” combining different criteria to ascribe nationality to legal entities

BIT between France and Uganda (2002)	BIT between Argentina and Thailand (2000)	BIT between Chile and Turkey (1998)
“Article 1 [...] 3. The term “company” means any legal person constituted on the territory of one Contracting Party in accordance with the legislation of that Party and having its head office on the territory of that Party, or controlled directly or indirectly by the nationals of one Contracting Party or by legal persons having their head office in the territory of one contracting Party and constituted in accordance with the legislation of that Party.” (emphasis added)	“Article 1 1. The term “investor” shall mean: ... (b) any juridical person incorporated or constituted under the law in force in the territory of either Contracting Party whether or not with limited liability and whether or not for pecuniary profit and having its seat in the territory of that Contracting Party.” (emphasis added)	“Article 1 1. The term “investor” means the following subjects who invest in the territory of the other Contracting Party in accordance with this Agreement: [...] (b) any legal person including companies, corporations, or business associations incorporated or constituted under the law in force of either of the Contracting Parties and having their headquarters together with effective economic activities in the territory of that Contracting Party.” (emphasis added)

In general, different criteria are combined in cases in which Governments intend to limit the benefits of the agreement to those legal entities that have genuine ties with the home country. Vice versa, if the objective is to broaden the scope of application, agreements provide for alternative criteria.

Recent BITs do not show a significant evolution regarding the problems that could arise in the determination of the nationality of a legal entity. Thus, they do not address issues such as how to deal with companies having interests in both parties to a BIT, and what legal effects changes in the nationality of an investor during the duration of a BIT might have (UNCTAD, 1999a; Dolzer and Stevens, 1995).

(iii) Clarifying the link between the investment and the investor: The issue of direct and indirect ownership and control

The description of a particular asset as foreign — as opposed to domestic — investment depends on the link of ownership between that asset and the investor. Thus, at least in principle, the determination of whether a particular asset is a foreign investment should be very simple: if the asset is owned by a foreign natural or legal person it would be deemed to be foreign, and would therefore be a covered investment for the purposes of the agreement. However, the apparent simplicity of this formulation is misleading since a foreign investor may exercise rights of ownership in a direct or indirect manner. Foreign investment is often carried out through complex mechanisms entailing multiple layers of ownership. A huge number of shareholders may be co-owners of multinational enterprises, which have a vertical structure extending over several countries. How does international investment law deal with the legal issues derived from such complex business realities?

BITs often deal with this issue by perceiving “control” as the link between the investor and the investment. An example is the BIT between Austria and the United Arab Emirates (2001), which defines “investment” in the following manner:

*“Article 1
Definitions*

[...]

(2) “investment by an investor of a Contracting Party” means every kind of asset in the territory of one Contracting Party, **owned or controlled, directly or indirectly**, by an investor of the other Contracting Party, [...]

The incorporation of the notion of control into BITs may be better understood in the light of the decision of the International Court of Justice (ICJ) in the *Barcelona Traction, Light and Power Co., Ltd. Case*.¹⁶ In this dispute, the Court held that a company has the nationality of the country in which it is incorporated and that only the latter has the right of diplomatic intervention on behalf of the enterprise.¹⁷ Thus, the ICJ held that the Belgian Government was not entitled to protect the Spanish interests of a company incorporated in Canada but owned principally by Belgians.¹⁸

The practical implication of this decision was that it did not permit diplomatic protection of shareholders whose nationality was different from that of the country of incorporation of the company. According to this ruling, much foreign investment would have had to be made without the possibility of diplomatic protection of the home countries of the foreign investors. This was avoided by incorporating the notion of “*control*” into the definitions of “*investment*” or “*investor*”. This approach renders the “Barcelona Traction” award inapplicable. Thus, assets indirectly owned or controlled by investors of the other contracting party are covered, regardless of the country in which the company directly owning the assets has been incorporated.

All BITs incorporating the notion of “*control*” into their definitions refer to “*direct*” and “*indirect*” control or ownership. This method highlights an important aspect of these treaties — namely, that they protect investments of nationals or companies of a contracting party, no matter how many corporate layers exist between the national or company and the investment. Consequently, more than one home country may exercise diplomatic protection (Vandeveld, 1992).

Incorporating the notion of direct and indirect ownership or control into the definition of “*investment*” or “*investor*” results in another challenge: to establish objective criteria to determine whether in a particular case an investor actually owns or controls an investment, either directly or indirectly.

Most agreements use the term “*own and control*” jointly and without distinction. Others draw a thin but distinct line between ownership, on the one hand, and control, on the other.¹⁹ Definitions of ownership attempt to convey the idea that when an investor owns an investment — for instance, a company — it is because the investor owns a substantial part of the equity in it. Thus, definitions of ownership are often quantitative, requiring a particular percentage of ownership in the capital of an enterprise.²⁰ Definitions of control, instead, are qualitative.²¹

This distinction stems from the fact that control generally does not require majority or any specific quantum of ownership. Neither is it necessary that the investors *actually exercise* control.²² Rather, it is sufficient that they have the power to legally conduct or direct the business of the company. In this respect, shareholders owning less than half of its stock may effectively control an enterprise. A single investor may control a company by holding as little as 5 per cent or even less of the total stock, provided that the remaining ownership is widely dispersed. In this regard, BITs often define the term “control” as the power to exercise decisive influence over the management and operation of the subsidiary. The BIT may further specify that this criterion is fulfilled if the investor owns at least 51 per cent of the shares or has the ability to exercise decisive control over the selection of the majority of members of the board of directors of the subsidiary.²³

3. Geographical application

The geographical scope of application of a BIT depends on the definition of the term “territory”. The purpose of defining this term is not to delimit the territory of the Contracting Parties; that is an aspect normally dealt with in national constitutions. Rather, the rationale derives from the objective of investment protection, in particular to provide that investments located in maritime areas beyond the boundaries of the territorial waters are deemed to be within the parties’ territory for the purposes of the agreement (UNCTAD, 1999a).

The typical definition includes within the term “*territory*” those maritime areas over which the contracting parties exercise sovereign rights or jurisdiction in accordance with international law. This generally includes the continental shelf and the exclusive economic zone.

Notwithstanding minor differences in wording, most BITs of the last decade include a definition of “*territory*” and explicitly make reference to those areas over which the contracting parties exercise sovereign rights or jurisdiction under international law. An example is the BIT between Australia and India (1999), which contains the following definition:

“Article 1

[...]

f) “*territory*” means:

- (i) *in respect of India the territory of the Republic of India including its territorial waters and the airspace above it and other maritime zones including Exclusive Economic Zone and continental shelf over which the Republic of India has sovereignty, sovereign rights or jurisdiction in accordance with its laws in force and international law, including the 1982 United Nations Convention on the Law of the Sea;*
- (ii) *in respect of Australia the territory of Australia includes the territorial sea, maritime zone, Exclusive Economic Zone or continental shelf where Australia exercises its sovereignty, sovereign rights or jurisdiction in accordance with international law;“* (emphasis added)

Other BITs state that the rights granted under international law are for purposes of exploration and use of natural resources. An illustration is the BIT between the Republic of Korea and Tajikistan (1995):

“Article 1

[...]

4. “*Territory*” means the territory of the Republic of Korea or the territory of the Republic of Tajikistan respectively, as well as those maritime areas, including the seabed and subsoil adjacent to the outer limit of the territorial sea of the above territories over which the State concerned exercises, in accordance with international law, sovereign rights **for the purpose of exploration and exploitation of the natural resources of such areas.**” (emphasis added)

Despite having important practical implications, not all recent BITs address the issue of sovereign rights in maritime areas. In some cases, BITs include a definition of “*territory*” but simply make reference to the area where countries exercise jurisdiction — without specifying the relevant criteria. A case in point is the BIT between Egypt and Thailand (2000):

“Article 1

[...]

The term “*territory*” means the territory over which a Contracting Party has sovereignty and/or jurisdiction.”

Not all BITs define the term “*territory*”. This is, for instance, the case of the BIT between Austria and Egypt (2001).

On the other hand, there is a group of recent BITs that define “*territory*” in a more comprehensive manner. This definition does not exclusively aim at clarifying the extent of the jurisdiction beyond territorial waters, but also makes reference to the air space and even artificial islands, installations and structures on the continental shelf. An example is the 2004 Canadian model BIT, which envisages the possibility for each party to include its own definitions of “*territory*”. However, with respect to Canada, and for the purposes of clarifying the geographical application of the agreement, it explicitly states the following:

“Article 1

[...]

“*territory*” means

- (i) *in respect of Canada:*

- (a) the land territory of Canada, air space, internal waters and territorial sea of Canada;
 - (b) those areas, including the exclusive economic zone and the seabed and subsoil, over which Canada exercises, in accordance with international law, sovereign rights or jurisdiction for the purpose of exploration and exploitation of the natural resources; and
 - (c) artificial islands, installations and structures in the exclusive economic zone or on the continental shelf over which Canada has jurisdiction as a coastal state.
- (ii) in respect of _____”

Similarly, Uruguay included the air space and continental shelf in the definition of “territory” in its 2005 BIT with the United States.

4. Application in time

Regarding the issue of application in time, two main questions have traditionally arisen in BIT negotiations. The first is whether treaty protection should be extended to investments made before the entry into force of the agreement. The second issue relates to the determination of the period of application of the agreement, namely its duration and termination.

a. Application to existing investments

In accordance with the Vienna Convention, BITs — like any other international agreement — do not in general have retroactive effects.²⁴ The rights and obligations derived from a BIT apply only after the treaty has entered into force and with respect to acts or facts occurring thereafter.

There is the issue of whether BITs should apply after their entry into force to investments already existing at that time. Recent BITs have followed different approaches.

The prevailing trend is to provide protection to both future investments and investments already established at the date of entry into force of the agreement. Furthermore, it is stated that the agreement shall not apply to any investment-related dispute or claim that arose or was settled before the entry into force of the BIT.²⁵ A typical example of this approach is the BIT between the Republic of Korea and Nigeria (1998):

“Article 12 Application

*This Agreement shall apply to all investments, **prior to as well as after** its entry into force, but shall not apply to any dispute concerning investments which was settled before its entry into force.”* (emphasis added)

Not all BITs, however, apply to existing investments.²⁶ A case in point is the BIT between Cyprus and Egypt (1998):

“Article 12 Application

*This Agreement shall apply to all investments made by investors of either Contracting Party in the territory of the other Contracting Party **after its entry into force.**”* (emphasis added)

A variation of this method is to explicitly provide that the treaty shall apply only to investments made after a specific date. The BIT between Egypt and the Russian Federation (1997) illustrates this technique:

“Article 13 Application of the Agreement

*The present Agreement shall be applied with respect to all capital investments, carried out by the investors of one of the Contracting Parties on the territory of the other Contracting Party, **beginning in January 1, 1987.**”* (emphasis added)

A third approach, although less common among the BITs concluded since 1995, is to not address the issue at all. This is the case of the BIT between the Philippines and Turkey (1999), and the agreement between Tonga and the United Kingdom (1997). In this situation, Article 28 of the Vienna Convention would apply.²⁷

b. Duration and termination

Unlike other international agreements, BITs usually specify that they shall remain in force for a minimum fixed period. The rationale for this approach is to provide investors of the contracting parties with a high level of certainty and predictability regarding the international legal framework applicable to their investments, which thereby establishes a stable environment in which they can conduct their businesses.

Among the BITs under review, the prevailing trend has been to specify that the initial period for which the treaty shall be in force will be 10 years. Among the agreements following this approach is the BIT between Argentina and New Zealand (1999). However, a significant number of agreements provide for a longer initial period of application (15 years), such as the BIT between Finland and the Philippines (1998). Other treaties provide in principle that the BIT shall remain in force indefinitely until one contracting party notifies the other of its intention to terminate it. An example is the BIT between the Democratic People's Republic of Korea and Thailand (2002) (table 8).

Most BITs provide that after the initial fixed period has ended, each party may terminate the treaty, usually with one year's written notice (table 8). However, some agreements, such as the BIT between Costa Rica and Spain (1997), provide for a different period of notice, for example six months. Most BITs also state that if the agreement is not terminated at the end of the initial fixed term, it shall continue to be in force.

Table 8. Examples of final provisions

BIT between Argentina and New Zealand (1999)	BIT between Finland and the Philippines (1998)	BIT between the Democratic People's Republic of Korea and Thailand (2002)
“Article 14 Final provisions (1) The Contracting Parties shall notify each other in writing when the constitutional requirements for the entry into force of this Agreement have been fulfilled. This Agreement shall enter into force on the thirtieth (30th) day from the date of the later notification. (2) This Agreement shall remain in force for a period of ten years. It shall remain in force thereafter until one of the Contracting Parties gives one year's written notice of termination through diplomatic channels of its intention to terminate. (3) In respect of investments made prior to the date when the notice of termination of this Agreement becomes effective, the provisions of Articles 1 to 13 shall remain in force for a further period of fifteen years from that date.” (emphasis added)	“Article 12 Final clauses 1) The Contracting Parties shall notify each other when the constitutional requirements for the entry into force of this Agreement have been fulfilled. The Agreement shall enter into force on the thirtieth day after the latter notification. 2) This Agreement shall remain in force fifteen years. Thereafter, it shall remain in force until one of the Contracting Parties gives one year's prior written notice of termination through diplomatic channels.” (emphasis added)	“Article 14 Entry into force, duration and termination 1. Each Contracting Party shall notify the other in writing of the completion of the procedures required in its territory for the entry into force of this Agreement. This Agreement shall enter into force on the date of the latter of the two notifications for an initial period of ten years. 2. Thereafter, this Agreement shall remain in force indefinitely unless either Contracting Party notifies the other Contracting Party in writing of its intention to terminate it. The termination of this Agreement shall become effective one year after notice of termination has been received by the other Contracting Party. In respect of investments made prior to the date when the termination of this Agreement becomes effective, the provisions of this Agreement shall remain in force for a period of fifteen years.” (emphasis added)

Among the BITs examined, one can discern two different approaches regarding the specification of the duration of the treaty after the initial fixed term has expired. While some BITs state that the treaty shall continue to be in force indefinitely — always subject to the right of either party to terminate the agreement by prior written notice — others provide that the treaty shall continue to be in force for additional fixed terms. In this regard, there has been a shift in the prevailing trend between the BITs of the last decade and those concluded until the mid-1990s. In the earlier period, most BITs used to establish fixed terms for renewal of the agreements, most commonly 10 years. During the review period, however, the prevailing trend has been to allow the agreements to remain in force indefinitely.

Regardless of whether BITs follow the fixed-term or indefinite approach to delimit the duration of the treaty, a significant number of agreements provide that investments covered under the BIT shall continue to be protected for a specific time even after the treaty has been terminated. The BIT between Argentina and New Zealand (1999) is an example of this approach (table 8). Once again, the rationale is to provide investors of the contracting parties with a predictable legal environment for their investments.

* * *

In conclusion, BITs concluded in the review period have consolidated the traditional approaches to delimit the scope of application of the agreement; as in the past, they use separate definitions of “investment”, “investor” and “territory” for that purpose, and also specify their application in time. The most important new development has to do with the definition of an “investment”. Whereas most BITs of the last decade continue to use a broad, asset-based definition, some more recent agreements have made an effort to delimit its scope more precisely.

C. Admission and establishment of investment

The issue of admission and establishment refers to the entry of investments of investors of a contracting party into the territory of another contracting party. According to customary international law, countries have the right to regulate the admission of foreign investors and their investments in their territories. Most countries refrain from granting foreign nationals and companies an unrestricted right to invest in their economies (UNCTAD 1999b).

Access limitations imposed on foreign investment have been justified on economic, social, political or national security grounds. The negotiation of BITs has evolved within this context. Two basic models are currently used. One makes the admission and establishment of foreign investment subject to the domestic laws of the host country (called the “admission clause” model), and the other grants foreign investors a right of establishment, although not in an absolute manner (hereinafter called the “right of establishment” model).²⁸

As will be explained below, most BITs have not been conceived as instruments to provide foreign investors with a right of establishment. Rather, these agreements only impose a duty on the contracting parties to admit foreign investment in accordance with their national legislation. However, as will be explained below, recent BITs have applied different techniques and modalities to deal with the issue of admission and establishment of foreign investment.

1. The use of the “admission clause”

The overwhelming majority of BITs concluded since 1995 admit investments of investors of the other contracting party only if such investments conform to the host country's legislation. This is the so-called admission clause. It allows the host country to apply any admission and screening mechanism for foreign investment that it may have in place and therefore to determine the conditions on which foreign investment will be allowed to enter the country.

Another implication of the admission clause is that, regardless of whether the host country maintains any admission and screening mechanism for foreign investment — and unless the BIT states otherwise — there is no obligation on the part of the host country to eliminate discriminatory legislation affecting the establishment of foreign investment. For example, if the domestic legislation reserves certain economic activities to national investors or even to foreign investors of a particular nationality, this is part of the legal context that foreign investors have to respect when admitted to the host country.

The language used in the drafting of admission clauses varies among treaties. For example, some BITs, such as the one between Ethiopia and the Russian Federation (2000), specify only that investments of investors of the parties “*shall be admitted in accordance with their laws and regulations*”. Other BITs, such as the one between Bahrain and Thailand (2002), address the issue of admission by delimiting the scope of application of the agreement and specifying that, for the investment to be admitted into the host country, written approval may be required. Other BITs, for example the one between Australia and Egypt (2001), stress the fact that the host country is not binding its legislation regarding investment entry — legislation which may vary “*from time to time*” — and indicate that the admission may be contingent on the investment policies adopted by the host country (table 9).

Table 9. Examples of admission clauses

BIT between Ethiopia and the Russian Federation (2000)	BIT between Bahrain and Thailand (2002)	BIT between Australia and Egypt (2001)
“Article 2.1. Promotion and Protection of Investments 1. Each Contracting Party shall encourage and create favourable conditions for Investors of the other Contracting Party to invest in its territory and admit such investments in accordance with its laws and regulations.” (emphasis added)	“Article 2. Scope of Application 1. The benefits of this Agreement shall apply to the investments by the investors of one Contracting Party in the territory of the other Contracting Party which is specifically approved in writing by the competent authority in accordance with the laws and regulations of the latter Contracting Party.” (emphasis added)	“Article 3 Promotion and protection of investments 1. Each Party shall encourage and promote investments in its territory by investors of the other Party and shall, in accordance with its laws and investment policies applicable from time to time, admit investments.” (emphasis added)

In a recent arbitration case, the issue was raised whether the reference to the domestic laws and regulations in the admission clause allows the host country to condition the basis on which a foreign investment enters its market. In particular, it was argued that this reference could serve to place an investment within the exclusive jurisdiction of the host country. The arbitration tribunal rejected this reasoning. It held that such an interpretation would defeat the purpose of the BIT with regard to establishing a neutral and independent forum for dispute resolution.²⁹

2. Right of establishment

Besides those BITs containing an admission clause, there is a second category of agreements that grant certain rights of entry to investors of the other contracting party.

a. The granting of national treatment and most-favoured nation treatment

This approach consists in providing foreign investors with national treatment and MFN treatment not only once the investment has been established, but also with respect to the establishment. This means that investors of one party will receive treatment not less favourable with regard to investing in the territory of the other party than domestic investors and investors of any other third country (UNCTAD 1999d). These treaties therefore also aim at liberalizing investment flows.

BITs designed for the purpose of ensuring the free entry of foreign investment into the territory of the host country may contain country-specific reservations. The contracting parties thus retain some degree of flexibility to control the admission of foreign investment from the other party, usually by allowing for the inclusion of a list of industries, activities or laws and regulations to which the obligations to grant national treatment and MFN treatment in the pre-establishment phase do not apply.

The use of this approach was traditionally limited to BITs concluded by the United States and, after the mid-1990s when the NAFTA had entered into force, to agreements concluded by Canada.³⁰ However, during the last 10 years other nations, such as Japan, have adopted this method. As a result, a growing number of developing countries actually apply two different BIT models, depending on who their treaty partners are: the “admission clause” model (mostly in BITs with European countries) and the “right of establishment” model (mainly in treaties concluded by the United States and Canada).

Within the category of agreements granting establishment rights, different techniques have been used to deal with host country measures that do not conform to the national treatment and MFN obligations. BITs negotiated by the United States and Canada during the end of the 1990s and during the beginning of this century often used to have only one annex listing the sectors where the host country reserves the right not to grant national treatment and MFN treatment in the pre-establishment phase. In those agreements, once a sector is included in the annex, the contracting party concerned is free to maintain or adopt new non-conforming measures. It should be noted that some agreements, such as the BIT between Canada and Costa Rica (1998), provide for the possibility of making reservations only with respect to the investor or the investment in the pre-establishment phase, while other agreements, such as the BIT between Azerbaijan and the United States (1997), also allow the contracting parties to refrain from granting national treatment or MFN treatment to established investments, unless this amounts to a full or partial forced disinvestment (table 10).

Table 10. Examples of provisions granting NT and MFN treatment in the pre-establishment phase subject to an annex of reservations

BIT between Azerbaijan and the United States (1997)	BIT between Canada and Costa Rica (1998)
“Article II 1. With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favorable than that it accords, in like situations, to investments in its territory of its own nationals or companies (hereinafter “national treatment”) or to investments in its territory of nationals or companies of a third country (hereinafter “most favored nation treatment”), whichever is most favorable (hereinafter “national and most favored nation treatment”). Each Party shall ensure that its state enterprises, in the provision of their goods or services, accord national and most favored nation treatment to covered investments. 2. (a) A Party may adopt or maintain exceptions to the obligations of paragraph 1 in the sectors or with respect to the matters specified in the Annex to this Treaty. In adopting such an exception, a Party may not require the divestment, in whole or in part, of covered investments existing at the time the exception becomes effective [...]” (emphasis added)	“Article III Establishment of Investment 1. Each Contracting Party shall permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors of the other Contracting Party on a basis no less favorable than that which, in like circumstances, it permits such acquisition or establishment by: investors or prospective investors of any third State; its own investors or prospective investors. For the purpose of this Agreement, “prospective investor” means any natural person or enterprise of one Contracting Party who actually has carried out concrete steps toward making an investment in the territory of the other Contracting Party. 2. A Contracting Party may adopt or maintain exceptions to the obligation stated in paragraph (1) above, in the sectors, measures, or with respect to the matters specified in Sections I, II, III and VI of Annex I of this Agreement.” (emphasis added)

More recently, BITs providing for national treatment and MFN treatment in the pre-establishment phase have used a more sophisticated approach to deal with reservations to those obligations.

One annex includes a list of *existing laws and regulations* which are inconsistent with one or several of the obligations in respect of which the contracting parties may adopt reservations. This is an annex of non-conforming measures, the effect of which is to allow the contracting parties to maintain the level of non-conformity existing between the domestic legislation of the contracting parties and the obligations of the BIT. Thus, once the BIT enters into force, parties may amend any of the non-conforming measures included in this annex, provided that the amendment does not decrease the conformity of the measure with the obligation concerned as it existed immediately before the amendment. An example is the 2004 Canadian model BIT:

“Article 9
Reservations and Exceptions

1. Articles 3, 4, 6 and 7 shall not apply to:
 - (a) **any existing non-conforming measure** that is maintained by
 - (i) a Party at the national level, as set out in its Schedule to Annex I, or
 - (ii) a sub-national government;
 - (b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a);
 - (c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 3, 4, 6 and 7. ” (emphasis added)

Recent BITs of Canada, Japan and the United States also envisage a second kind of annex, which comprises a list of economic activities or sectors where the contracting parties may maintain or *adopt new measures* inconsistent with one or several of the obligations of the BIT. Thus, in the areas or sectors included in this annex, parties are not only allowed to maintain any existing non-conforming laws or regulations, but also reserve their right to adopt new non-conforming measures, which may not have existed at the time of negotiations. This kind of annex is often known as annex of “future measures” or “precautionary reservations”. An example is the 2004 Canadian model BIT:

“Article 9
Reservations and Exceptions

[...]

2. Articles 3, 4, 6 and 7 shall not apply to any measure that a Party adopts or maintains with respect to sectors, sub sectors or activities, as set out in its schedule to Annex II.”

Other BITs, such as the one between Japan and Viet Nam (2003) include much more detailed provisions and allow new non-conforming measures only in “exceptional circumstances”.

“Article 6

1. Notwithstanding the provisions of Article 2 or 4, each Contracting Party may maintain any exceptional measure, which exists on the date on which this Agreement comes into force, in the sectors or with respect to the matters specified in Annex II to this Agreement.
2. Each Contracting Party shall, on the date on which this Agreement comes into force, notify the other Contracting Party of all existing exceptional measures in the sectors or with respect to the matters specified in Annex II. Such notification shall include information on the following elements of each exceptional measure:
 - (a) sector and sub-sector or matter;
 - (b) obligation or article in respect of the exceptional measure;
 - (c) legal source of the exceptional measure;
 - (d) succinct description of the exceptional measure; and
 - (e) purpose of the exceptional measure.

3. *Each Contracting Party shall endeavour to progressively reduce or eliminate the exceptional measures notified pursuant to paragraph 2 above.*
4. ***Neither Contracting Party shall, after the entry into force of this Agreement, adopt any new exceptional measure in the sectors or with respect to the matters specified in Annex II.***
5. *The provisions of paragraph 4 above shall not be construed so as to prevent a Contracting Party from amending or modifying any existing exceptional measure, provided that such amendment or modification does not decrease the conformity of the exceptional measure, as it existed immediately before the amendment or modification, with the provisions of Article 2 or 4.*
6. *In cases where a Contracting Party makes such amendment or modification, the Contracting Party shall, prior to the entry into force of the exceptional measure or, in exceptional circumstances, as soon thereafter as possible:*
 - (a) *notify the other Contracting Party of the elements of the exceptional measure as set out in paragraph 2 of this Article; and*
 - (b) *provide, upon request by that other Contracting Party, particulars of the exceptional measure to that other Contracting Party.*
7. ***Notwithstanding the provisions of paragraph 4 of this Article, each Contracting Party may, in exceptional financial, economic or industrial circumstances, adopt any exceptional measure in the sectors or with respect to the matters specified in Annex II, provided that such Contracting Party shall, prior to the entry into force of the exceptional measure:***
 - (a) *notify the other Contracting Party of the elements of the exceptional measure as set out in paragraph 2 of this Article;*
 - (b) *provide, upon request by that other Contracting Party, particulars of the exceptional measure to that other Contracting Party;*
 - (c) *allow that other Contracting Party reasonable time to make comments in writing;*
 - (d) *hold, upon request by that other Contracting Party, consultations in good faith with that other Contracting Party with a view to achieving mutual satisfaction; and*
 - (e) *take an appropriate action based upon the written comments made pursuant to subparagraph (c) of this paragraph or the results of the consultations held pursuant to subparagraph (d) above.” (emphasis added)*

From the perspective of the investor, BITs providing for national treatment and MFN treatment in the pre-establishment phase are more advantageous than those including an admission clause, and thus provide these rights only to established investment. Within this context, a question of interaction of BITs arises. In a hypothetical scenario, country A negotiates with country B a BIT providing for a right of establishment. Considering that most BITs contain an MFN clause, would this right need to be extended to all other investors of third countries with which country A has concluded a BIT limited to post-establishment protection? The relevance of this question becomes more pertinent as the number of countries negotiating BITs providing protection in both the pre- and post-establishment phases of the investment increases. Since the scope of legal obligations in those BITs with only an admission clause is confined to post-establishment treatment, the MFN clause included therein could not have the effect of “importing” a right of establishment from another treaty.

b. The granting of most-favoured nation treatment only

There are BITs that, despite containing an admission clause, also provide some rights to investments in the pre-establishment phase. An illustration of this approach is the BIT between Bangladesh and Japan (1998):

“Article 2

1. *Each Contracting Party shall, subject to its rights to exercise powers in accordance with the applicable laws and regulations, encourage and create favorable conditions for investors of the other Contracting Party to make investment in its territory, and, subject to the same rights, shall admit such investment.*

2. *Investors of either Contracting Party shall within the territory of the other Contracting Party be accorded treatment no less favorable than that accorded to investors of any third country in respect of matters relating to the admission of investment.*" (emphasis added)

Paragraph 1 of this provision does not provide investors with any right of entry into the host country beyond the rights included in the domestic legislation of the parties. However, paragraph 2 grants investors of the contracting parties the right to receive the best treatment regarding admission that each of them grants to investors of any third country — that is, foreign investors receive MFN treatment in the pre-establishment phase. In the above example, considering that Japan has concluded BITs providing for national treatment and MFN treatment in the pre-establishment phase with countries such as the Republic of Korea and Viet Nam, Bangladeshi investors would be entitled to the guarantees that Japan provides to Republic of Korea or Vietnamese investors pursuant to the respective BITs.

* * *

Summarizing the recent trends in BITs, the prevailing approach is to make the question of entry and establishment subject to national laws. However, an increasing number of BITs provide national treatment and MFN treatment in the pre-establishment phase — perhaps as a response to the fact that the protection provided by traditional BITs is becoming commonplace. In the global economy, where more goods and services are delivered to foreign markets through international production than through international trade, and where patterns of international production of manufactures as well as international trade in services — most of which need commercial presence in order to be effectively provided — are increasing in importance, it is not surprising that international investors seek better market access for their investments.

D. Investment promotion

Most of the BITs reviewed do not specify any promotional activities that should be undertaken by the Governments of the BIT partners to encourage investment flows between the two countries, either as host or home countries. The approach to promotion of foreign investment taken by BITs is mainly indirect, relying in the first place on their protection provisions to create a favourable investment climate. This in turn is expected to deliver FDI flows (UNCTAD, 1998).³¹ Thus, as in earlier practice, and in spite of BITs' clearly stated objective of promoting FDI flows between the countries, there is only a vague and general commitment of the contracting parties to "encourage" or "promote" investment, usually formulated in connection with the preamble, where the language tends to be hortatory in nature, or with the admission provisions (table 11) (see also sections A and C above).

Table 11. Examples of investment promotion provisions

BIT between Australia and Egypt (2001)	BIT between Spain and Uzbekistan (2003)	BIT between Hungary and India (2003)
"Preamble Considering that investment relations should be promoted and economic co-operation strengthened in accordance with the internationally accepted principles of mutual respect for sovereignty, equality, mutual benefit, non-discrimination and mutual confidence; [...]" (emphasis added)	"Article 2 Promotion and Admission of Investments 1. Each Contracting Party shall in its territory promote, as far as possible, investments by investors of the other Contracting Party. Each Contracting Party shall admit such investments in accordance with its laws and regulations. " (emphasis added)	"Article 3 Promotion and Protection of Investments 1. Each Contracting Party shall encourage and create favourable conditions for investors of the other Contracting Party to make investments in its territory and admit such investments in accordance with its laws and regulations." (emphasis added)

Occasionally, a few recent BITs go a step further to require the parties to exchange information on investment opportunities in each country with a view to increasing investment flows. This language can be

found in the provisions related to transparency (see section J below) and in the institutional mechanism creating a joint commission to follow up on the application and interpretation of the treaty. However, in a few BITs, separate provisions on the exchange of information have been included. An example is the BIT between Mexico and Argentina (1996), which provides as follows:

“Article 7: Exchange of Information

With the intention to increase significantly the reciprocal participation in investments, the Contracting Parties will inform each other in a detailed manner concerning especially

- a. **investment opportunities;***
- b laws, regulations and decrees that directly or indirectly concern foreign investments, including, among others, exchange controls, monetary and fiscal regimes; and*
- c. performance of foreign investments in their respective countries.” (emphasis added) (non-official translation from Spanish)*

Similarly, some BITs include requirements to facilitate the granting of work permits, visas, licences and authorizations in connection with investment activities under the investment promotion provisions. An example is the BIT between Bolivia and the Republic of Korea (1996), which states that:

“Article 2: Promotion and Reception of Investments

When a Contracting Party shall have admitted an investment on its territory, it shall grant the necessary permits in connection with such an investment and with the carrying out of licensing agreements and contracts for technical, commercial or administrative assistance. Each Contracting Party shall, whenever needed, issue, as far as possible, the necessary authorizations concerning the activities of consultants and other qualified persons of foreign nationality related to investment.”

In other BITs, this language is included under a separate article on the entry and sojourn of personnel (see subsection I.2 below).

Moreover, a few BITs mention the granting of incentives as a way to encourage and to promote investments between the contracting parties. The BIT between Finland and Kuwait (1996), for example, states:

*“Article 2:
Promotion of Investments*

*Each Contracting State shall endeavour to take the necessary measures **for granting of appropriate facilities, incentives and other forms of encouragement** for investments made by investors of the other Contracting State.” (emphasis added)*

Other BITs go even further by prescribing the establishment of representation offices in the other contracting party. For example, the BIT between Croatia and Denmark (2000) states as follows:

*“Article 2
Promotion and Protection of Investments*

- 1. Each Contracting Party shall admit investments by investors of the other Contracting Party in accordance with its legislation and administrative practice and encourage such investments, **including facilitating the establishment of representative offices.**” (emphasis added)*

Some of these investment promotion efforts can also be seen in the context of home country measures, namely the proactive engagement of home countries to promote and facilitate outward investment by their firms, especially in developing countries (UNCTAD 2000b). Most of the BITs reviewed do not specify any

promotional activities, beyond the ones described above, that should be undertaken by Governments to encourage outward investment flows between the two BIT partners.

E. General standards of treatment

Investment agreements contain obligations specifying the treatment that the contracting parties are required to provide to the investment once it has been established. One can distinguish between general treatment standards, that is standards relating to all aspects of the existence of a foreign investment in a host country, and specific treatment standards addressing particular issues (Vandeveld, 1992).

Within the category of general standards of treatment, a further differentiation can be made. First, there are “absolute standards” of treatment, so called because they are non-contingent. They establish the treatment to be accorded to the investment without referring to the manner in which other investments are treated. Examples of absolute standards are the provisions on fair and equitable treatment, full protection and security, expropriation and the transfer of funds.³²

A second category relates to “relative standards” of treatment. They define the required treatment to be granted to investment by reference to the treatment accorded to other investment. National treatment and MFN treatment are the relative standards par excellence. Thus, in the case of national treatment, reference must be made to the treatment of nationals of the host country. Similarly, in determining the content of the MFN standard, reference must be made to the treatment granted to investments from the “most favoured nation” (UNCTAD 1999d, 1999e, 1999f).

Continuing with the traditional trend, most BITs under review provide both categories of standards, albeit with significant variations.

1. Absolute standards: Fair and equitable treatment, full protection and security, and the minimum standard of treatment according to customary international law

BITs usually include one or several general principles that, together or individually, are intended to provide overall criteria by which to judge whether the treatment given to an investment is satisfactory, and to help interpret and clarify how more specific provisions should be applied in particular situations (UNCTAD 1998). Fair and equitable treatment is one of those general principles. It provides a basic standard, detached from the host country’s domestic law, against which the behaviour of the host country vis-à-vis foreign investments can be assessed.

Numerous investment instruments combine the fair and equitable treatment standard with other legal principles that may have their own specific content and historical origin, such as the principles of *full protection and security* and *non-discrimination*.³³ While some treaties guarantee only fair and equitable treatment, other BITs bundle the three standards — or sometimes only two of them — and include them in one single article (table 12).

Although clauses providing foreign investment with fair and equitable treatment are widespread in IIAs, the standard itself lacks a precise meaning. Consequently, this principle has raised important questions, mostly in the context of the application of NAFTA’s Chapter 11, but — more recently — also in connection with BITs. The discussion has focused on the issue of the nature and content of the commitment.³⁴

According to some scholars, the obligation to grant foreign investment “*fair and equitable treatment*” is not different from the obligation to treat the investment in accordance with the international minimum standard. The latter, so it is argued, is part of customary international law, which in turn comprises a bundle of international legal principles (see below).³⁵ According to other scholars, however, “*fair and equitable treatment*” means something different from the international minimum standard. On this view, the term “fair and equitable treatment” should be given its plain meaning. This results in a case-by-case application of a test based on equity in order to determine whether the standard has been infringed.³⁶

Table 12. Examples of provisions on absolute standards of protection

BIT between Algeria and Indonesia (2000)	BIT between Brazil and the Netherlands (1998)	BIT between China and Qatar (1999)
“Article II Promotion and Protection of Investment [...] 2. Investments of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and security in the territory of the other Contracting Party.” (emphasis added)	“Article 3 1) Each Contracting Party shall ensure fair and equitable treatment of the investments of investors of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors. Each Contracting Party shall accord to such investments full security and protection.” (emphasis added)	“Article 3 1. Investments and activities associated with investments of investors of either Contracting Party shall be accorded fair and equitable treatment and shall enjoy protection in the territory of the other Contracting Party.” (emphasis added)

The practical implications of following one approach rather than the other could be significant.³⁷ If the fair and equitable standard were part of the international minimum standard of treatment, the test whether this principle has been violated would entail an objective test. The standard may have to be based on the existing body of customary international law of State responsibility for injury to aliens.

It is argued that under customary international law, for a country to violate the minimum standard of treatment of aliens requires a conduct by the Government amounting to gross misconduct, manifest injustice, an outrage, bad faith or wilful neglect of duty.³⁸ Consequently, a breach of this obligation will probably be found in fewer cases than if fair and equitable treatment is associated with higher standards. From the perspective of the host countries, this would mean that the obligation to grant foreign investment fair and equitable treatment would not significantly impair the flexibility and discretion of Governments to regulate and to pursue their public policy objectives. On the other hand, the three NAFTA contracting parties have accepted that the standard evolves and is not frozen in application to the types of circumstances contemplated in the “Neer” case.³⁹

The outcome of applying the fair and equitable standard under the semantic approach could be very different. In this view, fair and equitable treatment would be understood as a standard of equity or fairness based on the “plain meaning” of the term. The test whether a country has breached the obligation would therefore be to a greater extent subjective than in the case of the international minimum standard — at least as long as there is not yet enough case law that would give the “plain meaning” approach a more precise content.

Following this semantic interpretation of the standard could entail establishing a low threshold for breaching the obligation. It would, in principle, suffice that the host country commits an action found to be *unfair* or *non-equitable* in the view of the arbitral tribunal. This approach therefore has the potential to make numerous governmental regulatory actions inconsistent with the obligations of the BIT, regardless of whether those measures are being adopted and implemented on a non-discriminatory basis.

Interpreting the fair and equitable treatment standard according to its plain meaning has another significant implication. Given that the violation of any other obligation included in the BIT would mean that the host country has somehow mistreated the foreign investor, it could also constitute a violation of the fair and equitable treatment standard.⁴⁰

During the review period, the content of the fair and equitable treatment standard has been mostly contested in NAFTA’s Chapter 11 arbitrations, where arbitral tribunals were called upon in several cases to address the scope and content of NAFTA’s Article 1105.⁴¹ Tribunal interpretations varied, which added to the fact that some of the interpretations of this provision were strongly opposed by all NAFTA contracting

parties. This prompted the intervention of the NAFTA Free Trade Commission. On 31 July 2001, this commission, which is composed of the trade ministers of the three contracting parties, issued a Note of Interpretation stating, among other aspects, that the fair and equitable treatment standard as set out in NAFTA's Article 1105 did not entail any treatment beyond that established by customary international law.⁴²

Potential controversies as to the content of the standard can be minimized through the specific text in the BIT. Some BITs contain more precise language than others, and thus the room allowing for different interpretations of the content of the fair and equitable treatment standard may vary significantly among agreements. A survey of the BITs concluded during the last decade makes it possible to distinguish seven different categories.⁴³

First, there are a significant number of BITs that grant covered investments "*fair and equitable treatment*" without making any reference to international law or to any other criteria to determine the content of the standard. An example of this trend is the BIT between Cambodia and Cuba (2001):

*"Article II
Promotion and Protection of Investments*

[...]

2. Investments of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and security in the territory of the other Contracting Party."

In this category of BITs, the specific content of the obligation remains open. Clarifications would have to be made on a case-by-case basis.

A second group of BITs explicitly state that such treatment shall not be less favourable than national treatment or MFN treatment granted to the investment or the investor concerned. The BIT between Bangladesh and the Islamic Republic of Iran (2001) demonstrates this approach:

*"Article 4
Protection of Investments*

*Investments of natural and legal persons of either Contracting Party effected within the territory of the other Contracting Party, shall receive the host Contracting Party's full legal protection and fair treatment **no less favourable than that accorded to its own investors or to investors of any third State, whichever is more favorable.**"* (emphasis added)

This approach merges in one single clause the fair and equitable treatment principle — an absolute standard of protection — with the national treatment and MFN treatment standards, which are relative parameters of treatment. Furthermore, by linking these two kinds of standards and by providing that the fair and equitable treatment shall in no case be less favourable than national treatment or MFN treatment, the contracting parties indicate that they do not wish to see the fair and equitable treatment standard limited to the international minimum standard.

A third group of BITs add to the obligation to grant fair and equitable treatment the duty to abstain from impairing the investment through unreasonable or discriminatory measures. The BIT between Hungary and Lebanon (2001) illustrates this frequently used approach:

*"Article 2
Promotion and Protection of Investments*

[...]

*2. Investments and returns of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Each Contracting Party **shall refrain from impairing by unreasonable or discriminatory measures** the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments."* (emphasis added)

A fourth category of BITs links the fair and equitable standard to the principles of international law. Among the agreements following this method is the BIT between France and Mexico (1998):

*“Article 4
Protection and treatment of investments*

*1. Either Contracting Party shall extend and ensure fair and equitable treatment **in accordance with the principles of International Law** to investments made by investors of the other Contracting Party in its territory or in its maritime area, and ensure that the exercise of the right thus recognized shall not be hindered by law or in practice [...].”* (emphasis added)

Linking the fair and equitable treatment standard to the principles of international law removes the possibility of interpreting the provision using the semantic approach. Furthermore, this link implies that the fair and equitable treatment standard cannot be applied separately from the principles of international law, which would include customary international law on State responsibility in respect of aliens.

A fifth category of BITs also links the fair and equitable treatment standard to the principles of international law. However, this group of agreements includes additional language so broad that it appears to go beyond the international minimum standard of treatment. An example is the BIT between France and Uganda (2002), which states:

*“Article 3
Fair and equitable treatment*

*Either Contracting Party shall extend **fair and equitable treatment in accordance with the principles of International Law** to investments made by nationals and companies of the other Contracting Party on its territory or in its maritime area, and shall ensure that the exercise of the right thus recognized shall not be hindered by law or in practice. **In particular, though not exclusively, shall be considered as de jure or de facto impediments to fair and equitable treatment any restriction to free movement, purchase and sale of goods and services, as well as any other measures that have a similar effect** [...].”* (emphasis added)

In this example, the clause states that fair and equitable treatment is not equivalent to a plain fairness standard, but rather is a commitment that has to be interpreted within the framework of the principles of international law. Nevertheless, in its second sentence, the article states that “*any restriction*” — without any qualification of arbitrariness — affecting the free movement and trade of goods and services shall be considered an infringement of the fair and equitable treatment standard. This language is so broad that it allows practically any regulatory measure in these areas having a restrictive effect to be considered a violation of the fair and equitable treatment standard. In addition, the wording of the clause leaves very little discretion to a potential arbitral tribunal and explicitly states that if measures of the kind referred to are adopted, it “*shall*” be considered a violation of the standard.

If this approach can be deemed to provide a very extensive scope to the fair and equitable treatment standard, it is also true that among recent BITs one can find methods at the other end of the spectrum. A sixth approach used to address the fair and equitable standard is to make the guarantee contingent on the domestic legislation of the host country. A case in point is the BIT between the countries of the Caribbean Common Market (CARICOM) and Cuba (1997):

*“Article IV
Fair and equitable treatment*

*Each Party shall ensure fair and equitable treatment of Investments of Investors of the other Party **under and subject to national laws and regulations.**”* (emphasis added)

A seventh group of agreements provides for a more precise approach regarding the scope of the fair and equitable treatment standard. It comprises some recent BITs of the United States, and the 2004 Canadian model BIT. These agreements contain a provision on the minimum standard of treatment, establishing the obligation of the contracting parties to accord covered investments treatment in accordance with customary international law. They include within the latter the notions of fair and equitable treatment and full protection and security, and define each of these terms within the same article.

Drafters of this kind of agreement have taken into account the issues discussed in recent NAFTA arbitrations. Elaborating on the Note of Interpretation issued by the Free Trade Commission, this new approach not only sets out the provision to focus on the "*customary international law minimum standard of treatment of aliens*", but also defines the content of more specific standards of treatment subsumed within the former, such as fair and equitable treatment and full protection and security. An illustration of this trend is the BIT between the United States and Uruguay (2005):

"Article 5:
Minimum Standard of Treatment"¹

1. Each Party shall accord to covered investments treatment **in accordance with customary international law**, including fair and equitable treatment and full protection and security.
2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
 - (a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
 - (b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.
3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.

¹ Article 5 shall be interpreted in accordance with Annex A.

Annex A
Customary International Law

The Parties confirm their shared understanding that "customary international law" generally and as specifically referenced in Article 5 and Annex B results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens." (emphasis added)

The language of this clause is self-explanatory. The debate regarding the fair and equitable treatment clause in the context of Chapter 11 of NAFTA has shown the risks of including language in BITs providing for unqualified fair and equitable treatment of foreign investment. The wording of this clause might be broad enough to be invoked in respect of virtually any adverse treatment of an investment, thus making the fair and equitable treatment provision among those most likely to be relied upon by an investor in order to bring a claim under the investor-State dispute settlement proceedings.

It is therefore not surprising that some countries have begun to consider redrafting their BIT models to clarify the scope and content of the fair and equitable treatment standard. This fact, in turn, may also become a precedent for current and future BIT negotiations, as well as for the application of those other existing BITs that provide for unqualified fair and equitable treatment. The clarification example might lead some to argue that those BITs providing for unqualified fair and equitable treatment follow the "plain meaning" approach. The basis for such an argument could be that if the contracting parties had intended something different, they

would have explicitly stated that the fair and equitable treatment standard does not grant investment protection beyond customary international law, assuming that such law exists in this area. Thus, it is likely that the fair and equitable treatment standard will continue to be a focal point of debate on international investment law.

2. Relative standards: Most-favoured-nation treatment and national treatment

In addition to the absolute standards of treatment discussed in the previous section, BITs provide for relative standards of treatment, namely national treatment and MFN treatment. BITs concluded since 1995 address these principles in multiple ways, raising a number of issues both for developing and developed countries.

a. National treatment

National treatment in a BIT context means the obligation of contracting parties to grant investors of the other contracting party treatment no less favourable than the treatment they grant to investments of their own investors. The effect is to create a level playing field between foreign and domestic investors in the relevant market (UNCTAD 1999e).

Two different sets of questions arise regarding this standard. The first relates to the scope of the national treatment obligation — that is, to what should national treatment apply? As will be explained below, BITs approach this issue in different ways. The second set of questions relates to the manner in which the national treatment standard is to apply in practice.

(i) Scope of the national treatment standard

Not all BITs concluded during the review period address the scope of the national treatment standard in the same manner. A first group does not deal with the issue at all. The second category of BITs — which comprises by far the majority — does provide national treatment, but limits its coverage to established investments only. A third group comprises those agreements that provide national treatment to the investors in the pre- and post-establishment phase. Each of these approaches has different implications and raises other, more specific issues.

1. Agreements with no national treatment standard

As mentioned before, a group of BITs refrains from granting the national treatment standard to any covered investments or investors.⁴⁴ These agreements usually limit their general protection standards to fair and equitable treatment and MFN treatment. This might allow contracting parties to treat their domestic investors more favourably.

Most countries that have subscribed to this kind of agreement have concluded at least one other BIT containing the national treatment standard. Consequently, given that all BITs refraining from granting national treatment nevertheless contain an MFN clause, the question arises whether investments covered by the former agreements might nevertheless be entitled to national treatment.⁴⁵

2. Agreements with national treatment applying to established investment

A second category of BITs includes the national treatment standard, but grants non-discriminatory treatment only after the investment has entered the host country. Focused on investment protection rather than on liberalization of investment flows, most BITs under review fall within this group. The typical formulation is to provide national treatment to investments covered by an agreement once it has been admitted into the host country according to the latter's domestic laws and regulations. To achieve this result, all BITs falling within this category contain an admission clause limiting the scope of the protection standards in the agreements.⁴⁶ Furthermore, those BITs providing for national treatment usually also include the MFN principle — the other relative protection standard (table 13).

Table 13. Examples of national treatment provisions

BIT between Mauritius and Zimbabwe (2000)	BIT between the Russian Federation and Thailand (2002)
“Article 4 Treatment of Investments [...] (2) Each Contracting Party shall accord to the investments of investors of the other Contracting Party made in its territory a treatment which is no less favourable than that accorded to investments of its own investors or of investors of any third country, if the latter is more favourable.” (emphasis added)	“Article 3 Treatment of Investments 1. Each Contracting Party shall accord in its territory to investments made in accordance with its laws by investors of the other Contracting Party treatment no less favourable than that it accords to investments of its own investors or to investments of investors of any third State, whichever is more favourable. 2. Each Contracting Party shall in its territory accord investors of the other Contracting Party, as regards management, maintenance, use, enjoyment or disposal of their investments, treatment no less favourable than that which it accords to its own investors or investors of any third State, whichever is more favourable.” (emphasis added)

Within this group of BITs, some agreements apply the standard only to the *investments*, while other agreements provide that national treatment shall also apply to the *investors* of the other party. An example is the BIT between the Russian Federation and Thailand (2002) in table 12. This BIT includes a further distinctive element as it also enumerates the kind of investment activities covered by the provision.

Some BITs go even one step further and define these investment or business activities in more detail. A case in point is the BIT between Bangladesh and Japan (1998):

“Article 1

[...]

6. “The term “business activities in connection with the investment” includes:
- (a) the maintenance of branches, agencies, offices, factories and other establishments appropriate to the conduct of business activities;
 - (b) the control and management of companies established or acquired by investors;
 - (c) the employment of accountants and other technical experts, executive personnel, attorneys, agents and other specialists;
 - (d) the making and performance of contracts; and
 - (e) the use, enjoyment or disposal, in relation to the conduct of business activities, of investment and returns.”

Another group of BITs take a very different approach. They allow the host country to discriminate against foreign investment not only at the stage of entry, but also afterwards. These BITs therefore make the national treatment standard *contingent on the domestic legislation of the host country*. This gives host countries ample discretion to enact new legislation in favour of domestic investment. Examples of this approach can be found in the BITs between India and Indonesia (1999), and between Hong Kong (China) and New Zealand (1995) (table 14).

There is another method that constitutes an intermediary approach between the two alternatives. This approach allows all legislation non-consistent with the national treatment obligation to remain applicable after the BIT enters into force, but at the same time prohibits new non-conforming measures that would increase the degree of discrimination. An example is the BIT between China and the Netherlands (2001). It contains a protocol to the non-discrimination provision (Article 3), which reads as follows:

“[...] *Ad Article 3, paragraph 2 and 3*

In respect of the People’s Republic of China, Paragraphs 2 and 3 of Article 3 do not apply to:

- a) any existing non-conforming measures maintained within its territory;*
- b) the continuation of any non-conforming measure referred to in subparagraph a);*
- c) an amendment to any non-conforming measure referred to in subparagraph a) **to the extent that the amendment does not increase the non-conformity of the measure**, as it existed immediately before the amendment, with those obligations.*
It will be endeavoured to progressively remove the non-conforming measures.” (emphasis added)

Table 14. Examples of provisions illustrating national treatment granted in the post-establishment phase and conditioned to domestic laws and regulations

BIT between India and Indonesia (1999)	BIT between Hong Kong (China) and New Zealand (1995)
“Article 4 Treatment of Investments [...] 3. Each Contracting Party shall, subject to its laws and regulations, accord to investment of investors of the other Contracting Party treatment no less favorable than that which is accorded to investments of its investors.” (emphasis added)	“Article 4 Treatment of Investments 1. Neither Contracting Party shall in its area subject investments or returns of investors of the other Contracting Party to treatment less favourable than that which it accords to investments or returns of investors of any other State or, subject to its laws and regulations, that which it accords to investments or returns of its own investors. 2. Neither Contracting Party shall in its area subject investors of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favourable than that which it accords to investors of any other State or, subject to its laws and regulations, that which it accords to investments or returns of its own investors.” (emphasis added)

In addition to the general application of the national treatment standard in the post-establishment phase, some BITs consider it necessary to emphasize this principle with regard to a particular topic. This is the case of several BITs of Japan, which contain a clause underlining the application of the national treatment standard regarding access to courts and other administrative agencies. The BIT between Japan and the Russian Federation (1998) demonstrates this point.

“Article 4

*The investors of each Contracting Party shall be accorded on the territory of the other Contracting Party treatment not less favourable than the one accorded for the investors of such other Contracting Party or investors of any third country **in terms of access to the courts, administrative tribunals and agencies of any level of jurisdiction for the purpose of protecting and exercising their rights.**” (emphasis added)*

3. Agreements with national treatment applying in the pre- and post- establishment phase

BITs pursuing the liberalization of investment flows in parallel with investment protection usually extend the scope of the national treatment obligation – albeit with country-specific reservations – to the pre-entry phase. This means that foreign investors are entitled to be treated with regard to the making of

investment no less favourably than domestic investors in the host country. Section C.2. above explained in detail the different approaches used in recent BITs to address this issue.

(ii) Application of the national treatment standard

The application of the national treatment standard raises two main questions, which may be clarified *ex ante* in BITs. First, what are the content and the meaning of this non-discrimination standard? And second, how should the standard apply in those contracting parties that have a federal system of government and thus different jurisdictions that might treat investors differently?

1. Content and meaning of the national treatment standard

For the application of the national treatment standard, it does not matter whether the difference in treatment is specifically provided for in a law or regulation of the host country — *de iure discrimination* — or is the consequence of a measure ostensibly non-discriminatory, but resulting in different treatment in fact — *de facto discrimination*.

Being a contingent standard of treatment, the specific content of the national treatment obligation is determined in relation to the treatment granted to domestic investments or investors. Thus, the application of the national treatment standard necessarily entails a comparative analysis between, on the one hand, the treatment granted by the host country to its domestic investments or investors and, on the other hand, the treatment granted by the same host country to the investments or investors of the other contracting party. Such analysis does not aim at determining whether the treatment is *identical*, but rather whether foreign investments or investors receive a treatment *no less favourable* than domestic investments or investors.

Among the BITs of the last decade, some explicitly state that the obligation to grant no less favourable treatment shall apply only when the investments or investors are "*in like circumstances*". An example is the BIT between Japan and Viet Nam (2003):

"Article 2

1. Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment no less favourable than the treatment it accords **in like circumstances** to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments (hereinafter referred to as "investment activities") [...]" (emphasis added)

This specification provides greater guidance for the application of the national treatment standard. The wording makes it clear that providing different treatment to foreign investments and investors, which in fact are not in the same circumstances as domestic investments or investors, would not violate the national treatment standard.

The inclusion of "*in like circumstances*" has led arbitral panels to adopt a "two-step" approach when determining whether a particular measure violates the national treatment standard. Several arbitral tribunals followed an analysis in which the tribunal first verified whether there were in fact differences in treatment between domestic and foreign investors or their investments. If a difference was found, the tribunal then addressed the issue of whether investors or investments were "*in like circumstances*". Such determination requires a factual analysis undertaken on a case-by-case basis.⁴⁷

The application of the national treatment standard in the context of BITs entails different dynamics from the application of the same principle in connection with international trade in goods. Concerning the latter, a significant body of jurisprudence regarding the objective, nature and content of the national treatment standard has evolved under GATT and WTO dispute settlement procedures. In numerous cases, allegations that a country had not treated foreign goods as favourably as "*like*" domestic goods have been considered. One of the main avenues to address this question has been to determine whether the products

produced by the domestic industry and those manufactured by foreign suppliers are, in fact, substitutes in the marketplace. The processes and production methods to create a product, including their impact on the environment, have often been considered irrelevant for the determination of whether the products subject to comparison are in fact “like products”.⁴⁸

Unlike in trade in goods, where tradable products in two or more different jurisdictions are produced, production facilities operate within the jurisdiction of the same host country in the case of inward foreign investment. Consequently, the nature of the foreign investor's production and business processes are much more likely to attract attention than in trade because of their direct impact in the host country. This difference has already been taken into consideration in several arbitral awards addressing national treatment claims.⁴⁹

In several cases under NAFTA's Chapter 11, arbitral tribunals have adopted an approach that provides scope for legitimate regulatory initiatives even if they treat domestic and foreign investors differently.⁵⁰ In determining whether foreign and domestic investors who were treated differently were in like circumstances, arbitral tribunals have asked whether the difference in treatment has been justified by a rational policy objective that is not based on a preference for domestic over foreign investors and whether it unduly undermines the investment-liberalizing objectives of NAFTA. If the difference in treatment could be justified on this basis, arbitral tribunals have found that foreign and domestic investors are not in like circumstances.⁵¹

2. Application of the national treatment standard in federal systems of government

Under Article 29 of the Vienna Convention, a BIT — like any other treaty — is binding upon each party in respect of its entire territory, unless a different intention appears from the text of the agreement or is otherwise established. As explained in section B.3 above, most BITs provide that these agreements are applicable in the whole territory of the contracting parties, regardless of the particular political structure existing in the country concerned.

Thus, when a country assumes the obligation to grant national treatment, it applies not only at the national level, but also to subnational jurisdictions. However, in countries with federal systems of government, subnational jurisdictions may enact laws and regulations granting preferential treatment to investments or investors of that particular State, even when compared with out-of-State investments or investors from the same country. This raises the question as to whether, when a contracting party of a BIT having a federal system of government grants national treatment, the investments or investors of the other contracting party are entitled to national treatment entailing “best-in-State treatment” or only “best-out-of-State treatment”.

Most national treatment clauses in BITs do not indicate what should be understood by a party's “own” investment or investors. However, among the BITs examined, some specify that national treatment be granted in one way or the other. For instance, the BIT between the United States and Uruguay (2005) provides that in the case of the United States, the national treatment standard does not consist in the best “in-State” treatment, but in the treatment granted by the State concerned to investment and investors of any other State part of the United States:

“Article 3 National Treatment

- 1. Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.*
- 2. Each Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.*
- 3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a sub-national government, treatment no less favourable than the treatment accorded, in like*

circumstances, by that sub-national government to investors, and to investments of investors, of the Party of which it forms a part.” (emphasis added)

The 2004 Canadian model BIT takes a similar approach. It provides, at least in principle, that the national treatment standard shall apply on an “out-of-State” basis.

The scope of the national treatment standard in countries with a federal system of government is an aspect to which attention should be paid, especially if the other contracting party has only a national jurisdiction. Otherwise, there is a risk of having a national treatment clause with an asymmetrical scope of application.

b. Most-favoured-nation treatment

The MFN treatment standard means that investments or investors of one contracting party are entitled to treatment by the other contracting party that is no less favourable than the treatment the latter grants to investments or investors of any other third country.

The MFN standard ensures that investments or investors of contracting parties to a BIT receive the best treatment that each of them has granted to the investments or investors of any other third country. Thus the MFN standard establishes, at least in principle, a level playing field between all foreign investors protected by a BIT (UNCTAD 1999d). The MFN standard is also one of the key tools that smaller developing countries have at their disposal to benefit from the stronger bargaining power of third countries.

Most issues and questions relating to the MFN standard are the same as have arisen regarding the scope and application of the national treatment principle (see subsection (a) above).

As in the case of national treatment, not all recent BITs address the MFN standard in the same manner. However, unlike in the case of national treatment, all these BITs include, at least in principle, the MFN standard.

Regarding the scope of the clause, two groups can be distinguished. One category of BITs grants MFN treatment only after the investment has been admitted into the host country.⁵² Another group provides MFN treatment in both the pre- and the post-establishment phase.⁵³

Among the BITs granting MFN treatment *only in the post-establishment phase*, one can distinguish several categories.

There are BITs that, once the investment has been admitted, grant MFN treatment to all covered investments, with, however, some important exceptions (see below).⁵⁴ A second category of agreements limit MFN treatment to established investment permitted by domestic legislation. However, while there are a number of agreements that follow this approach with respect to national treatment, BITs conditioning MFN treatment on domestic legislation are very rare.⁵⁵ The BIT between Malaysia and Saudi Arabia (2000) is a case in point:

“Article 3

Most-Favoured Nation Provision

1. *In accordance with its laws and regulations, each Contracting Party shall in its territory accord investments and returns of investors of the other Contracting Party treatment not less favourable than that which it accords to investments and returns of its own investors, or to investments and returns of investors of any third State whichever is the more favourable. [...]* (emphasis added)⁵⁶

Another group of BITs grants established investments MFN treatment, and provides that no new non-conforming measures must be taken which did not exist at the date the BIT entered into force (“standstill clause”).⁵⁷

As in the case of national treatment, the BITs under review follow different approaches regarding what is covered by the MFN clause once the investment has been admitted into the host country. Some BITs provide that MFN treatment applies only to investments of investors,⁵⁸ while others extend it to investors. In the latter case, the BITs state that the non-discrimination guarantee applies with respect to the management, maintenance, use, enjoyment and disposal of the investments.⁵⁹ As in the case of national treatment, the wording of practically all BITs suggests that the MFN standard applies to both *de iure* and *de facto* discrimination.

(i) The MFN standard in relation to dispute settlement

The MFN standard has generated controversy in the wake of the *Maffezini v. the Kingdom of Spain* case.⁶⁰ It is related to the scope of the MFN standard, in particular whether the MFN clause in a BIT applies only to substantive obligations or also to dispute settlement procedures. The significant analysis of this standard in international jurisprudence until recently focused on its application in respect of substantive rights.⁶¹ The Maffezini case has shown the importance of clearly delimiting the scope of application of the MFN standard. It caused some countries to adjust the text of the MFN clause in BIT negotiations. This aspect leads to the second issue, namely how recent BITs address the question of exceptions to the MFN principle.

The Maffezini case concerned a dispute relating to the alleged treatment by Spanish authorities of Emilio Agustin Maffezini, an Argentine national who invested in an enterprise for the production and distribution of chemical products in Galicia, Spain. Mr. Maffezini invoked the BIT between Argentina and Spain (1991) and initiated an international arbitral procedure before ICSID. According to the provisions of this BIT, the investor had to submit the claim first to domestic courts. The possibility of settling the dispute through international arbitration existed only if domestic tribunals had failed to resolve the dispute on its merits within an 18-month period. Given that Mr. Maffezini did not submit his claim to Spanish courts, Spain objected to the jurisdiction of the arbitration tribunal, arguing that Mr. Maffezini had failed to comply with the BIT between Argentina and Spain.

Mr. Maffezini admitted that he had not presented his claim to Spanish courts prior to its submission to ICSID. Nevertheless, he argued that the MFN clause in article 4 of the BIT between Argentina and Spain allowed him to invoke the dispute settlement provisions in the BIT between Chile and Spain (2003), which permits the investor to submit the dispute to ICSID arbitration without having to involve the domestic courts first. The MFN clause in the BIT between Argentina and Spain reads as follows:

“Article 4 Treatment

[...]

2. ***In all matters subject to this Agreement***, this treatment shall be no less favourable than that extended by each Party to the investments made in its territory by investors of a third country. [...]" (non-official translation from Spanish, emphasis added)

Since this MFN clause explicitly refers to “*all matters subject to this Agreement*”, the tribunal found after elaborate reasoning that Mr. Maffezini was allowed to “import” the dispute settlement provisions of the BIT between Chile and Spain (2003) and thus avoid the requirement to submit his dispute to Spanish courts prior to initiating the case under ICSID.

The Maffezini case shows that the MFN standard does not apply automatically. Furthermore, additional important limitations to the application of the MFN clause became clear.

One is the *eiusdem generis* principle, according to which the MFN principle can cover only issues belonging to the same subject matter or the same category of subject matter to which the clause relates. Thus, for example, an advantage granted between two contracting parties in the framework of a transportation agreement cannot automatically be “imported” into the framework of a BIT.

Second, while recognizing that the MFN clause can be used for purposes of “importing” dispute settlement provisions from other investment agreements, the tribunal reasoned that the MFN standard cannot override public policy considerations envisaged by the contracting parties as crucial to their acceptance of the agreement:

“62. Notwithstanding the fact that the application of the most favoured nation clause to dispute settlement arrangements in the context of investment treaties might result in the harmonization and enlargement of the scope of such arrangements, there are some important limits that ought to be kept in mind. As a matter of principle, the beneficiary of the clause should not be able to override public policy considerations that the contracting parties might have envisaged as fundamental conditions for their acceptance of the agreement in question, particularly if the beneficiary is a private investor, as will often be the case. The scope of the clause might thus be narrower than it appears at first sight.”⁶²

Since *Maffezini* there have been three more major cases dealing with the applicability of the MFN standard to dispute settlement before ICSID (*Salini*, *Siemens*, and *Plama*).⁶³ While *Maffezini* and *Siemens* are in favour of it, *Salini* and *Plama* say, at least in principle, the opposite, focusing on the intention of the parties as the decisive factor. In this view, incorporating dispute settlement provisions from other treaties via the MFN clause is only possible if the parties to the BIT have a clear and unambiguous intention to do so.

Therefore, if the Contracting Parties do not wish to extend MFN treatment to dispute settlement matters, it might be better for the BIT to explicitly say so. BITs concluded since 1995 address this issue in different ways. While a first category of BITs extends MFN treatment to dispute settlement matters, a second group expressly avoids this outcome. Most BITs, however, do not take up this matter directly.

Among the first group of BITs explicitly providing for the application of MFN treatment in dispute settlement is the agreement between Austria and Saudi Arabia (2001):

“Article 3

[...]

3. Each Contracting Party shall accord the investors of the other Contracting Party in connection with the management, operations, maintenance, use, enjoyment or disposal of investments or **with the means to assure their rights to such investments** like transfers and indemnification or with any other activity associated with this in its territory, treatment not less favourable than the treatment it accords to its investors or to the investors of a third State, whichever is more favourable.” (emphasis added)

This approach grants covered investors MFN treatment regarding any “means to assure their rights” to the investments. Dispute settlement is the means par excellence to achieve this purpose.

Other BITs use a different technique by making explicit reference to the provisions to which MFN treatment applies. The BIT between Armenia and Egypt (1995) illustrates this trend:

”Article 3

National Treatment and Most-Favored-Nation Provisions

- (1) Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favourable than that which it accords to investments or returns of its own nationals or companies or to investments or returns of nationals or companies of any third State.
- (2) Neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regard their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favorable than that which it accords to its own nationals or companies or to nationals or companies of any third State.

(3) *In the avoidance of doubt it is confirmed that the treatment provided for the paragraphs (1) and (2) above shall apply to the provisions of Articles 1 to 11 of this Agreement.*"

Investor–State dispute settlement is addressed in article 8 of the BIT between Armenia and Egypt (1995). Consequently, the MFN standard would apply for purposes of investor–State dispute settlement.

A second category of BITs limits MFN treatment to the “*establishment, management, conduct, operation and sale or other disposition*” of an investment in the territory of the host contracting party. In this case, it seems that the MFN clause protects only substantive rights relating to the treatment of investments. The BITs between Canada and Thailand (1997), between Brunei Darussalam and the Republic of Korea (2000), and between Jordan and the United States (1997) are examples of this approach (table 15).

Table 15. Examples of MFN provisions limiting their scope to substantive rights

BIT between Canada and Thailand (1997)	BIT between Brunei Darussalam and the Republic of Korea (2000)	BIT between Jordan and the United States (1997)
“Article III Most-Favoured-Nation (MFN) Treatment after Establishment and Exceptions to MFN (1) Investments of investors of one Contracting Party in the territory of the other Contracting Party, or returns therefrom, shall receive treatment from the latter Contracting Party which, in like circumstances, is no less favourable than that accorded in respect of the investments or returns of investors of any third State. (2) Each Contracting Party shall, in its territory, accord to investors of the other Contracting Party, as regards their management, use, enjoyment or disposal of their investments or returns, treatment no less favourable than that which, in like circumstances, it grants to investors of any third State.” (emphasis added)	“Article 3 Treatment of Investments 1. Each Contracting Party shall in its territory accord to investments and returns of investors of the other Contracting Party, treatment no less favourable than that which it accords to investments and returns of its own investors or to investments and returns of investors of any third State, whichever is more favourable to investors of the other Contracting Party. 2. Each Contracting Party shall in its territory accord to investors of the other Contracting Party as regards, operation, management, maintenance, use, enjoyment or disposal of their investments, treatment no less favourable than that which it accords to its own investors or to investors of any third State, whichever is more favourable to investors of the other Contracting Party.” (emphasis added)	“Article II Treatment and Protection of Investment 1. With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Contracting Party shall accord treatment no less favorable than that it accords, in like situations, to investments in its territory of its own nationals or companies (hereinafter “national treatment”) or to investments in its territory of nationals or companies of a third country (hereinafter “most favored nation treatment”), whichever is more favorable.” (emphasis added)

A third category of BITs simply states that MFN treatment applies to covered investments. An example is the BIT between Algeria and Indonesia (2000):

“Article III
Most-Favoured-Nation Provisions

[...]

2. *More particularly, each Contracting Party shall accord to such investments treatment which in any case shall not be less favourable than that accorded to investments of investors of any other third State [...].*”

Unlike in the *Maffezini* case, where the applicable BIT specified that the MFN standard applied with respect to *all matters* covered by the agreement, these BITs do not contain such a qualification. Thus, it is not clear that the MFN clause could be interpreted in a manner that led to the same outcome as in *Maffezini*. Furthermore, as recognized by the arbitral tribunal in that particular dispute, it is equally important whether

the dispute settlement provisions agreed in the original BIT reflect public policy considerations that the contracting parties might have envisaged as fundamental conditions for their acceptance of the agreement in question.

Notwithstanding the limitations previously referred to, there are strong arguments both for and against applying the MFN clause to dispute settlement. In the end, this issue may need further clarification by international investment jurisprudence.

(ii) Exceptions to the MFN standard

In addition to exceptions of general applications, most recent BITs contain specific exceptions applicable to the MFN standard. The approaches taken depend on whether the particular BIT applies only to established investments or also to investors in the pre-establishment phase.⁶⁴

Those BITs providing protection only in the post-establishment phase normally include two MFN exceptions. One permits the contracting parties to deny investors of the other contracting party more favourable treatment resulting from membership of regional economic integration organizations. The rationale for this REIO exception stems from the nature of regional economic integration, which purports to grant privileges to the member countries in exchange for a reciprocal preferential treatment. The REIO exception prevents these privileges from being extended to those contracting parties of BITs with which such a reciprocal integration relationship does not exist (UNCTAD 2005d).

The second exception excludes any advantage granted to a third country under a double-taxation treaty (DTT) from the application of the MFN clause. The reason for this exception is once again the inherent reciprocal nature of these kinds of agreements and the complexity involved in dealing with tax matters.

There are variations in the wording and scope of these exceptions. For instance, the REIO exception may apply only with respect to agreements of regional economic integration, such as free trade areas, customs unions, common markets or similar arrangements. The BIT between Belgium–Luxembourg and Pakistan (1998) is an illustration:

“Article 4 Treatment

[...]

3. *However, this treatment shall not extend to the privileges that one Contracting Party may grant to investors of a third country by virtue of its membership or association with any existing or future free trade area, customs union, common market or similar international agreement to which any of the Contracting Parties is or may become a Party.”*

Other BITs exempt from the MFN obligation any preference derived from a wider group of agreements, and include also other forms of regional cooperation. The BIT between Ethiopia and Malaysia (1998) demonstrates this method:

“Article 3 Most-Favoured-Nation Treatment

[...]

2. *The provisions of this Agreement relative to the granting of treatment not less favourable than that accorded to investors from any third State shall not be construed so as to oblige to extend to the investors of the other the benefit of any treatment, preference or privilege resulting from:*
 - (a) *any existing or future customs area or free trade area or a common market or a monetary union or similar international agreement or other forms of regional cooperation to which either of the Contracting Parties is or may become a party; or to the adoption of an agreement designed to lead to the formation or extension of such union or area within a reasonable length of time; [...].” (emphasis added)*

Also with regard to taxation matters, BITs reviewed differ concerning the scope of the MFN exception. While some agreements, such as the BIT between Bahrain and China (1999), exclude only those advantages derived from existing or future double taxation agreements, other BITs, such as the agreement between Honduras and the Republic of Korea (2000), exempt any advantage resulting from any international agreement dealing with taxation in general. Other BITs go even further and exclude from the scope of the MFN clause not only any international agreement but also any other matter pertaining to taxation. The BIT between Austria and India (1999) shows the latter trend (table 16).

BITs providing for MFN treatment both in the pre- and post-establishment phases follow a different approach regarding the exceptions to this obligation. They include general exceptions applicable with respect to any of the obligations contained in the agreement. However, as far as MFN treatment is concerned, these BITs do usually not include specific exceptions in the body of the agreement.⁶⁵ Rather, contracting parties negotiate the reservations that will apply to this obligation as these instruments are often based on a negative list approach. Contracting parties may not only exempt all existing non-conforming measures from the application of the MFN treatment, but also exclude whole sectors or economic activities through the annex on “future measures” usually included in this kind of BIT.⁶⁶

Table 16. Examples of MFN provisions excluding taxation

BIT between Bahrain and China (1999)	BIT between Honduras and the Republic of Korea (2000)	BIT between Austria and India (1999)
“Article 3 [...] 3. The treatment and protection as mentioned in Paragraphs 1 and 2 of this Article shall not include any preferential treatment accorded by the other Contracting Party to investments of investors of a third Party based on customs unions, free trade zones, economic unions, or agreements relating to avoidance of double taxation or for facilitating frontier trade.” (emphasis added)	“Article 3 Treatment of investments [...] 3. The provisions of paragraphs 1 and 2 of this Article shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege resulting from any international agreement or arrangement relating wholly or mainly to taxation, customs or economic union, a free trade area or regional economic organization.” (emphasis added)	“Article 3 Treatment of investments [...] (3)The provisions of paragraph (1) shall not be construed as to oblige one Contracting Party to extend to the investors of the other Contracting Party and their investments the present or future benefit of any treatment, preference or privilege resulting from: [...] (b) any matter, including international agreements, pertaining wholly or mainly to taxation.” (emphasis added)

* * *

To sum up, BITs concluded in the review period contain absolute and relative standards of protection. Among the first category are the principles of fair and equitable treatment, full protection and security, and the minimum standard of treatment according to international law; BITs of the last decade usually include at least one of these standards. A remarkable new approach — hitherto limited to a small number of BITs — is to clarify the meaning of the minimum standard of treatment in more detail, including its relationship to the principles of fair and equitable treatment and full protection and security.

The vast majority of BITs under review contain — in a variety of ways — the relative protection standards of national treatment and most-favoured-nation treatment. While most BITs continue to limit the application of these two principles to the post-establishment phase, the number of countries extending these treaty standards to the entry of foreign investment is increasing. An important new development is the interpretation of the scope of the MFN principle by arbitration tribunals, which has not always been consistent. While conflicting awards have so far been limited to the issue of the application of the MFN principle with regard to dispute settlement, it appears that the question at stake is of a more general nature. Up to now, only a few BITs have addressed this issue in more detail.

F. Expropriation

Historically, one of the main drivers of BITs has been foreign investors' concern to protect their investments against the risk of unlawful expropriation.⁶⁷ In general, BITs allow countries to expropriate foreign investments on a non-discriminatory basis, for a public purpose and against the payment of compensation (UNCTAD, 2000a).

Expropriation has continued to rank high in BIT negotiations. As will be explained below, the most significant trend has been a shift in the legal debate. Traditionally, it focused on the conditions for lawful expropriation. The overall level of convergence on this issue among BITs of the last decade is remarkable, except on the details concerning compensation. However, the discussion now concentrates on the question of indirect expropriations.

1. Definition of expropriation: From nationalizations to regulatory takings

Following the traditional trend, BITs under review recognize the right of host countries to expropriate or nationalize foreign private property subject to certain conditions.⁶⁸ Most expropriation clauses apply to *expropriations* and *nationalizations*, and they generally avoid defining these terms as well as clarifying the distinction between the two.⁶⁹

Although the specific wording may vary, most expropriation clauses have continued with the traditional approach of extending protection to those measures of the host country that may have *an effect equivalent* to expropriation or are *tantamount* to expropriation. Other agreements use the term *indirect expropriations*.⁷⁰

The BIT between Chile and Tunisia (1998) is an example of an expropriation clause used in numerous investment agreements:

“Article 6
Expropriation and compensation”

*(1) Neither Contracting Party shall nationalize, expropriate or **subject the investments of an investor of the other Contracting Party to any measures having an equivalent effect** (hereinafter referred to as “expropriation”) unless the following conditions are complied with: [...]”* (emphasis added)

Expropriation clauses such as this one do not define the terms *expropriation* or *nationalization*. They also do not define or establish any criteria to identify *measures having an effect equivalent* to expropriation or nationalization. One of the aspects that has generated controversy is a lack of clarity regarding the degree of interference with the rights of ownership required for an act or series of acts to constitute an indirect expropriation.

Countries frequently enact regulations to pursue a wide range of public policy objectives. A broad concept of indirect expropriation could have the effect of converting a country's routine regulatory acts into a potential indirect taking, and, consequently, entailing compensation in favour of the affected foreign investor. On the other hand, recent arbitral awards have emphasized the extraordinary nature of an indirect taking, meaning that normal regulatory activity of a country does usually not amount to an expropriation.⁷¹

A number of issues contribute to the concern about a possible over-expansive interpretation of the concept of indirect expropriation.

Not all legal systems apply the same criteria to determine whether an indirect expropriation has occurred. This has generated apprehension in some countries, which see BITs as vehicles for introducing notions about expropriation that are alien to, and contradict, domestic legal traditions.

It has been argued that BIT provisions on expropriation should apply to those actions that *substantially impair the value* of an investment. The problem with this view is that a myriad of routine regulatory actions by a country may have this effect. Some countries, including parts of civil society, have strongly opposed international investment disciplines being interpreted in this manner. They argue that, otherwise, BITs could be perceived as instruments tipping the balance in favour of foreign investors at the expense of the freedom that countries should have to fully exert their regulatory powers to pursue the public good.⁷²

It has been recognized that an investment can be expropriated not only in its entirety, but also in respect of its individual components (e.g. management rights, export rights, licences) (Sornarajah, 2004, pp. 239–246). While this *unpacking* of property rights improves the legal protection of foreign investors, it may become more difficult to determine when an expropriation has taken place and what amount of compensation is due.

Another reason for concern has been the language of expropriation clauses. Numerous BITs have expropriation provisions broad enough to suggest that every measure substantially impairing the value of an investment could be challenged as an indirect expropriation. This is the case of some agreements, which not only oblige host countries to refrain from directly or indirectly expropriating or nationalizing an investment, but also include a clause stating that the host country should abstain from adopting any *measure or measures having equivalent effect*. A case in point is the BIT between China and Jordan (2001):

“Article 5
Expropriation

1. A Contracting Party shall not **expropriate or nationalize directly or indirectly** an investment in its territory of an investor of the other Contracting Party **or take any measure or measures having equivalent effect** (hereinafter referred to as “expropriation”) [...]” (emphasis added)

Since this provision explicitly prohibits the host country from taking *any measure or measures having an equivalent effect*, the question arises as to whether, in addition to direct and indirect expropriation, the clause recognizes a third category of measures as covered by the expropriation provision. Although this issue has already been addressed in other contexts, the potential effects of this specific treaty language are yet to be explored. Similar doubts exist with regard to the term “tantamount to expropriation”.⁷³

A survey of recent BITs shows that not all agreements address the issue of indirect expropriation in the same manner. In addition to the group of treaties that follow the “double reference” approach explained above, the BITs can be divided in several categories.

A first group comprises those expropriation provisions that do not include a specific reference to indirect expropriations.⁷⁴ There is the question of whether under this kind of provision an investor of a contracting party could invoke treaty protection in the case of an indirect expropriation.⁷⁵

A second category comprises the BITs that protect investments from direct and indirect expropriation. The BIT between Kuwait and Lithuania (2001) is an example:

“Article 6
Expropriation

- (1) (a) Investments of either Contracting State or any of its investors **shall not be nationalized, expropriated or subjected to direct or indirect measures having effect equivalent to nationalization or expropriation** (hereinafter collectively referred to as “expropriation”) by the other Contracting State [...]” (emphasis added)

While this provision makes reference to direct and indirect takings, it does not provide any guidance regarding the criteria to be used in order to determine whether an indirect expropriation has in fact occurred.

A third category of BITs comprises those agreements that additionally include an implicit guidance regarding the level of interference that would be required for a measure to constitute an indirect expropriation. These BITs suggest that the expropriation clause is not intended to deem any impairment of the value of the investment to be an indirect expropriation. Rather, the language indicates that an expropriation — either direct or indirect — may occur only where the measure has the effect of a *taking* of private property by the State. The BIT between France and Uganda (2002) demonstrates that concept:

“Article 5
Dispossession and indemnification”

[...]

2. Neither Contracting Party shall take any measures of expropriation or nationalization **or any other measures having the effect of dispossession**, direct or indirect, of nationals or companies of the other Contracting Party of their investments on its territory and in its maritime area, except in the public interest [...]" (emphasis added)

Other BITs, such as those of Hong Kong (China), use the term *deprivation* when making reference to indirect expropriations. An illustration is the BIT with the United Kingdom (1998):

“Article 5
Expropriation”

- (1) Investors of either Contracting Party shall not be deprived of their investments nor be subjected to measures having effect equivalent to such **deprivation** in the area of the other Contracting Party except [...]" (emphasis added)

Some BITs take into consideration issues that have arisen in the context of recent investment disputes. They include explicit criteria in order to determine on a case-by-case basis whether a particular measure amounts to an indirect expropriation. The 2004 Canadian model BIT and recent BITs of the United States fall within that category. Annex B of the BIT between the United States and Uruguay (2005) exemplifies this approach:

“Annex B
Expropriation”

The Parties confirm their shared understanding that:

1. Article 6(1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.
2. An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.
3. Article 6(1) addresses two situations. The first is known as direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.
4. The second situation addressed by Article 6(1) is known as indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
 - (a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
 - (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
 - (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
 - (iii) the character of the government action.”

The language of this annex is self-explanatory. It shows the intention of the contracting parties to increase the clarity of BIT provisions to prevent an arbitral tribunal from having broad discretion in interpreting the expropriation clause in the context of a potential dispute.

2. Conditions for lawful expropriation

As mentioned at the beginning of this section, the international debate on the law on expropriation originally focused on the prerequisites for lawful expropriation (Sornarajah, 2004). Some countries — mostly capital-exporting economies — argued that under customary international law, countries were allowed to expropriate foreign investors provided that the expropriation measure met four conditions: it had to be taken for a public purpose, on a non-discriminatory basis, under due process of law and based upon the payment of prompt, adequate and effective compensation. As a number of developing countries denied that such conditions were part of customary international law, capital-exporting economies turned to conventional international instruments — mostly BITs — to specifically provide for investment protection against unlawful expropriations.

A survey of the BITs concluded since 1995 reveals a remarkable degree of convergence with respect to the conditions required to make expropriations lawful. Most agreements include the four substantive requirements mentioned above (table 17).

Table 17. Examples of requirements for lawful expropriations

BIT between Angola and the United Kingdom (2000)	BIT between Belarus and Croatia (2001)
“Article 5 Expropriation (1) Investments of nationals or companies of either Contracting Party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for a public purpose related to the internal needs of that Party on a non-discriminatory basis and against prompt, adequate and effective compensation. [...] The national or company affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of his or its case and of the valuation of his or its investment in accordance with the principles set out in this paragraph. [...]" (emphasis added)	“Article 5 Expropriation 1. A Contracting Party shall not, in its territory, expropriate or nationalise directly or indirectly an investment of an investor of another Contracting Party or take any measure or measures having equivalent effect (hereinafter referred to as "expropriation" except: a) for a purpose which is in the public interest, b) on a non-discriminatory basis, c) in accordance with due process of law, and d) accompanied by payment of prompt, adequate and effective compensation. [...]" (emphasis added)

However, some important differences remain among BITs. They mainly relate to the content given to the concept of due process, and the degree of specificity with which the issue of compensation is dealt with.

a. The concept of due process

Most BITs under review include a reference to some sort of due process concept that has to be respected by a contracting party when taking an expropriation measure. One group of treaties refers to the principle of legality, requiring that the expropriation procedure comply with domestic legislation. An example of this model is article 4.1 of the BIT between the Russian Federation and Thailand (2002), which provides that the expropriation measures, to be lawful, must be “[...] *taken for the public interests in accordance with the procedure established by the laws of the Contracting Party* [...]”.

Other agreements focus on the due process concept understood as the right of the affected investor to an audience and an impartial hearing to review the case. An illustration of this approach is the BIT between Canada and Trinidad and Tobago (1995):

*“Article VIII
Expropriation*

[...]

2. *The investor affected shall have a right, under the law of the Party making the expropriation, to **prompt review, by a judicial or other independent authority of that Party**, of its case and of the valuation of its investment in accordance with the principles set out in this Article.”* (emphasis added)

Regardless of whether an expropriation has to comply with the legal procedures established in the domestic legislation or whether an investor has the explicit right to an independent review of the expropriation, both concepts have something in common. Neither of them gives the host Government total discretion in determining whether an expropriation may be undertaken or in choosing the applicable procedures.

b. Compensation

The determination of what kind of compensation has to be paid in the case of an expropriation once ranked among the most debated issues between developed and developing countries (Sornarajah, 2004). Capital-exporting countries advocated that compensation should be *prompt, adequate and effective*, while some developing countries promoted other standards existing in their domestic legislations.⁷⁶

Today, however, there is an increasing level of convergence among IIAs regarding the standard of compensation. One of the most salient trends among recent BITs is that most agreements include language that has the effect of applying the standard of prompt, adequate and effective compensation. Furthermore, most provide that the compensation has to reflect the actual price of the investment (table 18). For this purpose, reference is made to the market value, the fair market value or the genuine value of the taken assets.

Table 18. Examples of clauses on compensation within expropriation provisions

BIT between Brunei Darussalam and the Republic of Korea (2000)	BIT between Egypt and Thailand (2000)
“Article 5 Expropriation 1. Investments of investors of one Contracting Party shall not be nationalised, expropriated or otherwise subjected to any other measures having an effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for public purpose and against prompt, adequate and effective compensation. The expropriation shall be carried out on a non-discriminatory basis in accordance with legal procedures. 2. Such compensation shall amount to the fair market value of the expropriated investments immediately before expropriation was taken or before impending expropriation became public knowledge, whichever is the earlier, shall include interest at the applicable commercial rate or LIBOR rate, whichever is higher, from the date of expropriation until the date of payment and shall be made without undue delay, be effectively realisable and be freely convertible and transferable.” (emphasis added)	“Article 5 Nationalization or Expropriation 1. [...] (b) Investments of investors of either Contracting Party or any of its natural or juridical persons shall not be directly or indirectly nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation, in the territory of either Contracting Party except for a public purpose, and against payment of compensation. Such compensation shall be adequate, effectively realizable, made without delay and freely transferable in freely convertible currencies. Such measures are taken on a non-discriminatory basis and subject to review by due process of law. (c) Such compensation shall amount to the market value of the investment expropriated on the date the measure was taken.” (emphasis added)

Thus, rulemaking regarding expropriation has evolved towards a more sophisticated stage. The differences among BITs now focus on the level of specificity with which concrete issues related to compensation are addressed.

Compensation clauses may specify the amount of compensation, the currency in which it is to be paid and the period for payment. However, some BITs contain compensation provisions drafted with greater detail, and address several additional issues. There is the question of whether compensation should include interest and what should be the criteria to determine it. Second, should compensation be paid in a freely convertible or freely usable currency? And who should bear the risk of devaluation?

c. Applicable interest

Expropriations usually entail administrative procedures that take some time to be completed. Although most BITs provide that payment of compensation shall be “prompt” or “without delay”, there may be a time lag between the date the investor is dispossessed from its investment and the date of payment. This raises a number of questions. Should compensation be based only on the market value of the taken investment or also include interest? If interest has to be paid, what should be the applicable rate? Finally, what should be the period during which interest has to be paid?

Regarding the first question, one can distinguish several approaches. A number of BITs do not address this issue at all. Among this group are, inter alia, the treaties between Japan and Pakistan (1998), Argentina and Thailand (2000), and Cambodia and Indonesia (1999). Conversely, other BITs do provide for the possibility of including interest within the compensation, but only in those situations when payment is delayed. The BIT between the Russian Federation and Thailand (2002), and the agreement between Jordan and Morocco (1998), are examples of this concept. The latter treaty states as follows:

“Article 4 Expropriation

[...]

3. *These measures shall be accompanied with allocations for prompt and effective payment of compensation provided that the compensation shall be equal to the value of the investment prevailing in the market at the time of expropriation decision announcement and the compensation shall be transferable in freely convertible currency with the Contracting Party, **and in the event that payment of compensation is delayed the investor shall receive interest at the prevailing market rate in business transactions at the date of compensation payment.*** (emphasis added)

Another category of agreements states that interest shall always be included in the compensation if there is a time lag between the expropriation measures and the payment. Article 7.3 of the BIT between Australia and India (1999) is an example of this approach. It provides that in case of expropriation, the compensation “[...] shall be paid without undue delay, shall include interest at a normal market rate from the date the measures were taken to the date of payment and shall be freely transferable between the territories of the Contracting Parties. The compensation shall be payable either in the currency in which the investment was originally made or, if requested by the investor, in any other freely convertible currency.”

Among those BITs that include the payment of interest, there is a group that states only that such interest shall be *appropriate*, but does not include any objective criteria to calculate it. For example, the BITs that Japan has concluded with Bangladesh (1998) and the Republic of Korea (2002) fall into this category. Other agreements, such as the BIT between Australia and Lithuania (1998), explicitly state that the applicable interest shall be calculated on the basis of the market rate.

According to a third group, the interest shall be calculated using the applicable domestic rates, or by making reference to domestic laws. An example of this approach is the BIT between the Russian Federation and Thailand (2002):

“Article 4

[...]

2. In case of delay the interest shall be paid from the date the payment was due until the date of actual payment at the following rate:
 - a) in Thailand
 - (i) in case of immovable property, from the date compensation is determined by the committee established under Article 23 of the Immovable Property Expropriation Act at the highest rate of interest for the **fixed deposits of the Government Savings Bank**;
 - (ii) in the case of movable property, **as determined by the Civil and Commercial Code**;
 - b) in Russia
 - (i) the **Russian interbank rate** for three month deposit in foreign currency, if the investments were made in foreign currency;
 - (ii) the rate of interests for Russian state short-term notes, issued in Russian currency, if the investments were made in national currency.” (emphasis added)

Some BITs state that interest shall be paid between the date of expropriation and the date of payment. Examples are the agreements between Cyprus and the Russian Federation (1997), Australia and Chile (1996), and Malaysia and Saudi Arabia (2000). However, it may not be easy to determine the exact date of expropriation. Is it the date of enactment of the expropriation decree? Or the date on which the decree is actually implemented? Or rather the date on which the investor is dispossessed of the investment?

To avoid these uncertainties, other BITs seek to clarify the specific moment from which to calculate the applicable interest. This is the case of the BITs of Costa Rica with the Republic of Korea (2000) and Chile (1996). The latter treaty stipulates the following:

“Article VI

[...]

2. Compensation shall be based on the fair market value of the expropriated investments immediately before expropriation was taken or before impending expropriation became public knowledge, whichever is the earlier. It shall include interest based on the applicable commercial rate **from the date of dispossession of the expropriated property until the date of payment** and shall be made without undue delay, be effectively realizable and be freely transferable [...].” (emphasis added)

The reference to dispossession is intended to focus on the date when the investor felt the impact of the Government's action as opposed to the date on which the Government's action was taken. In this sense, one could say that *dispossession* is a more specific term than *expropriation*, although even the date of dispossession might be difficult to ascertain in cases of indirect expropriation. On the other hand, those BITs that accord interest only in case of delay provide that it is due from the moment the country experiences delay until the date of payment.⁷⁷

d. Currency in which compensation has to be paid

An issue that frequently arises is whether compensation has to be paid in a *freely usable* currency as opposed to any *freely convertible* currency.⁷⁸ BITs of the last 10 years have followed different concepts, some of which give Governments more leeway than others.

A first group of BITs does not specify which currency to use for purposes of payment of compensation. In this case, the contracting party is free to pay in whichever currency it considers appropriate, provided that this is in compliance with the terms of the agreement. Among the BITs falling into this category are those between Pakistan and the Syrian Republic (1996), South Africa and Turkey (2000), Germany and Sri Lanka (2000), and Mauritius and South Africa (1998).

Numerous BITs state that compensation has to be paid in any “*freely convertible currency*”. The BIT between Ethiopia and Sudan (2000) illustrates this idea:

“Article 4
Expropriation and Nationalization

[...]

- (c) *The measures are taken against prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investments affected immediately before the measures of expropriation or nationalization are taken or became public knowledge, and it shall be freely transferable in a **freely convertible currency** from the Contracting Party. Any unreasonable delay in payment of compensation shall carry on interest at prevailing commercial rate as agreed upon by both parties unless such rate is prescribed by law.”* (emphasis added)

Other agreements, such as the BIT between Australia and Lithuania (1998), provide that compensation may be paid in the currency in which the investment was originally made, or, at the request of the investor, in any other freely convertible currency.

Unlike the BITs previously referred to, a number of agreements stipulate that compensation shall be paid in a freely usable currency. Article 5 of the BIT between Belgium–Luxembourg and Thailand (2002) is an example of this trend and provides that in case of expropriation, compensation “[...] shall be in freely usable currencies in keeping with the standards and accepted principles of international law [...]”. This particular agreement provides that the term “freely usable currencies” “shall mean currencies that the International Monetary Fund determines, from time to time, as freely usable currencies in accordance with the Articles of Agreement of the International Monetary Fund and Amendments thereafter”.

e. Risk of devaluation

As explained in subsection F.2.b above, if BITs provide that compensation shall be paid in a *freely usable* currency, a foreign investor would be protected against the risk of a devaluation of the host country's currency during the expropriation process. Theoretically, the situation should be the same in those cases where the host country is obliged to pay in any freely convertible currency. In fact, until the final payment is made, the host country is obliged to provide full compensation. In practice, however, most countries have to follow a series of procedures in order to process payments once the final amount to be paid has been fixed. This may lead to situations in which there is a delay between the date on which the amount to be paid is fixed — in convertible currency — and the actual payment. This raises the question as to who should bear the risk of a devaluation of the convertible currency. Among the few recent BITs that address this specific issue, two concepts can be distinguished.

Some BITs provide the investor with a general protection clause against all risks associated with the real value of the compensation during the expropriation process. Article 5.3 of the BIT between Bangladesh and Japan (1998) illustrates this method by stating that in case of expropriation, the compensation “[...] shall be paid in a manner which would place investors in a position no less favorable than the position in which such investors would have been if the compensation had been paid immediately on the date of expropriation, nationalization or any other measure the effect of which would be tantamount to expropriation or nationalization”.

Other recent BITs address the risk of currency devaluation in more specific terms. For instance, the BIT between the United States and Uruguay (2005) states the following:

“Article 6
Expropriation and Compensation

[...]

3. *If the fair market value is denominated in a freely usable currency, the compensation referred to in paragraph 1(c) shall be no less than the fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment.*

4. *If the fair market value is denominated in a currency that is not freely usable, the compensation referred to in paragraph 1(c) – converted into the currency of payment at the market rate of exchange prevailing on the date of payment – shall be no less than:*
 - (a) *the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus*
 - (b) *interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment.”*

This provision states that if the payment of compensation is not made in a freely usable currency, it has to be equivalent to the amount that would have been paid in a freely usable currency at the date the payment becomes effective.

* * *

Several trends concerning expropriation clauses in BITs become evident from the above.

Most agreements include the same four requirements for a lawful expropriation, namely public purpose, non-discrimination, due process and payment of compensation. Furthermore, most BITs have similar provisions regarding the standard of compensation. Notwithstanding some variations in language, the overwhelming majority of BITs provide for prompt, adequate and effective compensation, based on the market or genuine value of the investment. However, BITs differ on the degree of specificity and sophistication concerning the calculation and payment of compensation. The normative convergence among the BITs regarding the conditions for expropriation reflects the important domestic reforms that most developing countries have undertaken during the last 20 years to improve their domestic investment climate.

The above trend contrasts with the variety of means in BITs with respect to the newly emerging issue of indirect expropriations or regulatory takings. Recent investment disputes on this matter have caused some countries, in particular the United States and Canada, to redraft their model BITs. However, at least for the time being, most contracting parties to BITs continue to agree on broad and general clauses to delimit the scope of the expropriation provision — the kind of language that has led to controversy in the context of many investor–State disputes. On the other hand, countries may need more time to assess the impact of these awards on their BIT practice before arriving at any conclusions concerning the need to modify the expropriation clause.

G. War and civil disturbance

Traditionally, many BITs have included clauses ensuring non-discriminatory treatment of foreign investors in situations where their property is damaged as a result of war or civil strife. BITs under review have continued with this trend, although with some variations.

The rationale for including a clause on war and civil disturbance in BITs is that war and civil strife are exceptional situations, which are often excluded from the coverage of insurance contracts that investors may have concluded. Furthermore, customary international law recognizes the exceptional character of a state of national emergency, and distinguishes between destruction of property due to military action and expropriation in ordinary circumstances. As explained in the previous section, while in the latter case customary international law obliges the host country to pay compensation, the general consensus in situations where property is destroyed because of military necessity is that no such obligation exists (UNCTAD 1998).⁷⁹

However, contracting parties to BITs have considered it important to provide investors with some protection against losses incurred in these unusual situations. What are the scope and the content of such clauses in recent BITs?

1. Scope of the compensation for losses

Most BITs include a clause on protection for losses due to situations of war, insurrection, riot, rebellion or other civil disturbance. This trend has continued in the review period, and is illustrated by the BIT between Bangladesh and Japan (1998):

“Article 6

*Investors of either Contracting Party who suffer within the territory of the other Contracting Party damage in relation to their investments, returns or business activities in connection with the investment, **owing to the outbreak of hostilities or a state of national emergency such as revolution, revolt, insurrection or riot**, shall be accorded treatment no less favorable than that accorded to investors of such Contracting Party or to investors of any third country, as regards to any measure to be taken by the other Contracting Party including restitution, compensation, or other valuable consideration. In case payments are made under the present Article, the payments shall be effectively realizable, freely convertible, and freely transferable.”* (emphasis added)

The situations envisaged above are all related to cases of violence attributable to mankind. There is, however, a small group of BITs that extend the coverage to damage caused by natural disasters.⁸⁰ The BIT between Mexico and the Netherlands (1998) is an example:

“Article 6

Compensation for Losses

*Nationals of the one Contracting Party who suffer losses in respect of their investments in the territory of the other Contracting Party **owing to acts of God, war or other armed conflict, revolution, state of national emergency, revolt, insurrection or riot** shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favorable than that which that Contracting Party accords to its own nationals or to nationals of any third State, whichever is more favorable to the nationals concerned.”* (emphasis added)

By inserting the reference to acts of God this provision refers to fortuitous events of nature without involvement of the State.

Another group of BITs contains clauses whose scope is not clear. Numerous BITs fall into this category, and provide that protection shall be granted in situations of *national emergency*. The BIT between Australia and Egypt (2001) demonstrates this approach:

“Article 8

Compensation for losses

*When a Party adopts any measures relating to losses in respect of investments in its territory by citizens or companies of any other country owing to **war or other armed conflict, revolution, a state of national emergency, civil disturbance or other similar events**, the treatment accorded to investors of the other Party as regards restitution, indemnification, compensation or other settlement shall be no less favourable than that which the first Party accords to citizens or companies of any third country.”* (emphasis added)

As a natural disaster can be the cause of a state of national emergency, one could conclude that the protection of the BIT would apply in these situations. On the other hand, most BITs refer to a state of national emergency within the context of a conflict.

2. Protection provided

The standard of protection granted by BITs in the case of damage caused by war or civil disturbance also varies.

A very scant number of agreements does not address the issue at all.⁸¹ However, such situations might be covered by the separate obligation to provide the investor with full protection and security.⁸²

A second group of BITs comprises those agreements that grant MFN treatment with respect to any compensation given by the host country for losses caused by war, insurrection or similar events. The BIT between Ethiopia and Malaysia (1998) illustrates this concept.

“Article 4 Compensation for Losses

*Investors of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party **treatment**, as regards restitution, indemnification, compensation or other settlement, **no less favourable than that which the latter Contracting Party accords to investors of any other third State.***” (emphasis added)

According to this method, the host country does not have to pay compensation to foreign investors, even if the country does provide compensation to its own nationals. However, if a contracting party opts to compensate foreign investors of any third country, it must compensate investors covered by the treaty in a no less favourable manner.

Other BITs provide covered investors with national treatment in addition to MFN treatment. The BIT between Turkey and Yemen (2000) is an example of this widely used method:

“Article III Expropriation and Compensation

[...]

*3. Investors of either Party whose investments suffer losses in the territory of the other Party owing to war, insurrection, civil disturbance or other similar events shall be accorded by such other Party **treatment no less favourable than that accorded to its own investors** or to investors of any third country, whichever is the most favourable treatment, as regards any measures it adopts in relation to such losses.*” (emphasis added)

Within this group of BITs, a variation exists in conditioning the provision of national treatment to the domestic legislation. The BIT between Argentina and New Zealand (1999) is a case in point:

“Article 7 Compensation for other Losses

*The investors of one Contracting Party whose investments in the territory of the other Contracting Party have suffered losses due to a war or any other armed conflict, revolution, state of emergency or rebellion, which took place in the territory of the other Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, **no less favourable than that which the latter Contracting Party accords investors of any state or, subject to its laws and regulations, to its own investors.***” (emphasis added)

Another variant within the group of BITs granting both MFN treatment and national treatment is to distinguish whether the damage was caused by a conflict as opposed to fortuitous situations such as natural disasters. This is the case of article 8 of the BIT between Cuba and Mexico (2001), which provides that the

contracting parties shall grant MFN treatment and national treatment with respect to any compensation that the host country provides to its own investors in the case of losses due to armed conflict, civil strife, state of emergency and other similar circumstances. Conversely, the contracting parties are obliged to provide MFN treatment only if the losses are due to fortuitous events.

The different means explained above all entail relative standards of protection — that is, the host country is free to decide whether it wants to compensate or not, but has to do so on a non-discriminatory basis. As said before, a BIT may, however, also include the absolute treaty standard of full protection and security to the effect that the foreign investor might be entitled to claim compensation.

There is a fourth category of compensation-for-losses clauses, which have attempted to go one step further in providing protection to the investor. These BITs identify specific situations in which, regardless of any applicable relative standard of protection, the host country has an absolute obligation to compensate the foreign investor. They make a distinction between damages caused by war and civil disturbance without direct action by the host country and damages caused by it. In the first situation, these BITs do not impose an absolute obligation to compensate; rather, national treatment and MFN treatment would apply. By contrast, in cases where the host Government has requisitioned the property or has caused unnecessary damage to the investment, there would be an absolute obligation to compensate. The BIT between Hong Kong (China) and the United Kingdom (1998) illustrates this idea:

*“Article 4
Compensation for Losses*

[...]

- (2) *Without prejudice to paragraph (1) of this Article, investors of one Contracting Party who in any of the situations referred to in that paragraph suffer losses in the area of the other Contracting Party resulting from:*
- (a) requisitioning of their property by its forces or authorities; or*
 - (b) destruction of their property by its forces or authorities, which was not caused in combat action or was not required by the necessity of the situation;*
- shall be accorded restitution or reasonable compensation. Resulting payments shall be freely convertible.***” (emphasis added)

Differences also exist among reviewed BITs with respect to the amount of compensation. Some BITs do not explicitly include any parameter regarding the applicable compensation.⁸³ Other agreements, such as the BIT between Hong Kong (China) and the United Kingdom (1998) cited above, only make reference to “*restitution or reasonable*” compensation. Another means, as illustrated by the BIT between Honduras and the Republic of Korea (2000), is to provide for adequate compensation in accordance with national treatment and MFN treatment. Other BITs oblige the contracting parties to provide “*prompt, adequate and effective*” compensation, as is the case of the BIT between Belgium–Luxembourg and Pakistan (1998). Another way is to delegate the determination of compensation, if applicable, to domestic legislation. The BIT between Mauritius and Singapore (2000) illustrates this technique (table 19).

* * *

In conclusion, the majority of BITs of the last decade include a provision on protection for losses due to war, civil disturbance and similar events. While most of them cover violent events attributable to human beings, a small group of BITs extend protection to natural disasters. The standards of protection are national treatment and most-favoured-nation treatment; different approaches exist as to whether protection is limited to one of these standards or whether they are cumulatively provided. A number of BITs identify specific situations where the host country has an absolute obligation to compensate.

Table 19. Examples of provisions on compensation for losses

BIT between Belgium-Luxembourg and Pakistan (1998)	BIT between Honduras and the Republic of Korea (2000)	BIT between Mauritius and Singapore (2000)
“Article 6 Compensation for losses [...] Any payment made under this Article shall be prompt, adequate, effective and freely transferable.” (emphasis added)	“Article 4 Compensation for losses [...] 2. Without prejudice to paragraph 1 of this Article, investors of one Contracting Party who, in any of the situations referred to in that paragraph, suffer losses in the territory of the other Contracting Party resulting from: (a) requisitioning of their property by its forces or authorities; or (b) destruction of their property by its forces or authorities which was not caused in combat action or was not required by the necessity of the situation, shall be accorded restitution or adequate compensation no less favourable than that which would be accorded under the same circumstances to an investor of the other Contracting Party or to an investor of any third State. Resulting payments shall be freely transferable without undue delay.” (emphasis added)	“Article 7 Compensation for losses [...] 2. Without prejudice to paragraph 1 of this Article, an investor of a Contracting Party who, in any of the situations referred to in that paragraph, suffers a loss in the territory of the other Contracting Party resulting from requisitioning or destruction of its property by the armed forces or other authorities of the latter Contracting Party, which was not caused in combat action or was not required by the necessity of the situation, shall be accorded such compensation as may be provided by its laws.” (emphasis added)

H. Transfer of funds

The transfer provisions included in most BITs are particularly important for foreign investors, as they see the timely transfer of profits, capital and other payments as a key condition for the proper operation of their investments (UNCTAD 2000b). However, in an increasingly interdependent international economy, countries need to be able to regulate capital inflows or outflows appropriately. Some economies, especially those of developing countries, may be particularly vulnerable to capital flight, as well as to sudden large capital inflows into their economies.

Transfer provisions in BITs have traditionally reflected a tension between two different objectives: on the one hand, to grant the investor the freedom of investment-related transfers of funds, and, on the other hand, to provide the host country with enough flexibility to properly administer its monetary and financial policies. Thus, a significant number of BITs have included provisions granting investors the right to make capital transfers in relation to their investment without undue delay, in a freely convertible currency and at a specified rate of exchange. At the same time, a large number of BITs have included exceptions to these obligations.

BITs concluded since 1995 have followed the same trend, although their transfer provisions vary in scope, content and degree of specificity.

1. Scope of the transfer provision

Most BITs include transfer clauses that guarantee investors the right to transfer funds related to an investment without delay, and to use a particular kind of currency at a specified exchange rate. Within these general parameters, several issues arise. There is the question whether the transfer right should apply only to transfers out of the host country or also to inbound transfers. Second, should the transfer provision apply to all funds related to an investment or only to those explicitly listed in the transfer provision? And third, should the guarantee be subject to domestic laws and regulations?

a. Coverage of inbound and outbound transfers of funds?

A first group of BITs contain a transfer clause covering only transfers of funds out of the host country. The BIT between Belgium–Luxembourg and Hong Kong (China) (1996) is a case in point:

*“Article 6
Transfers of Investments and Returns*

*(1) Each Contracting Party shall in respect of investments guarantee to investors of the other Contracting Party the unrestricted right to **transfer** their investments and returns **abroad**. [...]*” (emphasis added)

The inclusion of the right to make transfers *into* the host country is more common in BITs granting the investor a right of establishment. As most BITs do not go so far, the transfer clause usually focuses on the stage once the investment has been undertaken.

A second group of BITs contain transfer clauses that explicitly apply to inbound and outbound transfers. The BIT between Japan and Viet Nam (2003) demonstrates this concept:

“Article 12

*1. Each Contracting Party shall ensure that **all payments relating to investments** in its Area of an investor of the other Contracting Party **may be freely transferred into and out of its Area** without delay. Such transfers shall include, in particular, though not exclusively [...]*” (emphasis added)

Another category of BITs has transfer clauses that do not explicitly apply to inbound and outbound transfers, but nevertheless use language general enough to have this effect. The BIT between Malaysia and Saudi Arabia (2000) embodies this frequently used approach.

*“Article 6
Transfers*

*Each Contracting Party shall guarantee to investors of the other Contracting Party, after all taxes and obligations have been met, **the free transfer of payments** in any freely usable currency **in connection with investments** and investment returns they hold in the territory of the other Contracting Party, in particular: [...]*” (emphasis added)

Other BITs include similar wording, but the title of the provision makes reference only to “repatriation of investments and returns”. In such situations, there are doubts about the scope of the provision. An example is the BIT between Ghana and India (2002):⁸⁴

*“Article 7
Repatriation of Investment and Returns*

*(1) Each Contracting Party shall permit **all funds** of an investor of the other Contracting Party **related to an investment** in its territory **to be freely transferred**, without unreasonable delay and on a non-discriminatory basis. Such funds may include: [...]*” (emphasis added)

It should be mentioned that the last three types of provisions add a list of covered transfers. This helps to determine whether the article applies to outbound and/or inbound transfers.

b. Open-ended vs. closed list of covered transfers

There is the issue of whether the transfer clause should apply to all funds related to an investment or only to those explicitly agreed by the parties. One group of recent BITs contains a transfer clause covering in an *illustrative list* all funds related to an investment. This general concept has been used by far the most frequently, for instance in the BIT between Mauritius and Singapore (2000):

“Article 8 Repatriation

1. Each Contracting Party shall **guarantee** to investors of the other Contracting Party **the free transfer**, on a non-discriminatory basis, **of their capital and the returns from any investments**. The transfers shall be made in a freely convertible currency, without any restriction or undue delay. **Such transfers shall include in particular, though not exclusively:**
 - (a) profits, capital gains, dividends, royalties, interest and other current income accruing from an investment;
 - (b) the proceeds of the total or partial liquidation of an investment;
 - (c) repayments made pursuant to a loan agreement in connection with an investment;
 - (d) license fees in relation to the matters in Article 1 (1) (d);
 - (e) payments in respect of technical assistance, technical service and management fees;
 - (f) payments in connection with contracting projects ;
 - (g) earnings of nationals of a Contracting Party who work in connection with an investment in the territory of the other Contracting Party. [...] (emphasis added)

Another group of BITs limits the transfer right to those specific funds included in an *exhaustive list*. The BIT between Cuba and Denmark (2001) illustrates this idea:

“Article 8 Transfer of capital and returns

- (1) Each Contracting Party shall with respect to investments in its territory by investors of the other Contracting Party allow the free transfer in and out of its territory of:
 - (a) the initial capital and any additional capital for the maintenance and development of the investment;
 - (b) the investment capital or the proceeds from the sale or liquidation of all or any part of an investment;
 - (c) interests, dividends, profits and other returns realized; payments made for the reimbursement of the credits for Investments, and interests due;
 - (d) payments derived from rights enumerated in Article 1, section 1, of this Agreement;
 - (e) unspent earnings and other remunerations of personnel engaged in connection with an investment;
 - (f) compensation, restitution, indemnification or other settlement pursuant to articles 6 and 7. [...]

The wording of this article is very general, and comprises most of the possible kinds of transfers that an investor might need to make.⁸⁵ Thus, the practical differences between the two alternatives might not be very substantial. However, by covering all funds related to an investment the first concept allows for the possibility of covering new kinds of funds which, although not currently envisaged, may yet develop in the future.

c. Should the scope of the guarantee be limited only by the agreement and other applicable international rules or also by domestic legislation?

There is the question of whether the transfer guarantee should be a self-standing obligation, limited only by the exceptions included in the BIT and other applicable international rules, such as the IMF Agreement, or instead be subject to the domestic laws and regulations of the host country. BITs under review have followed two main concepts.

Numerous agreements do not subject the guarantee to the domestic legislation of the host country.⁸⁶ Other BITs follow the opposite idea. The BIT between China and Djibouti (2003) provides an example:

*“Article 6
Repatriation of investments and returns*

- 1. Each Contracting Party shall, **subject to its laws and regulations**, guarantee to the investors of the other Contracting Party the transfer of their investments and returns held in its territory, including: [...]” (emphasis added)*

This approach reduces the level of investment protection considerably. It might also generate uncertainty among investors, not only because they might be unfamiliar with the applicable laws and regulations, but also because such laws and regulations may change from time to time.

2. Standards of protection

Several aspects are of particular relevance in this regard. First, the type of currency in which the transfers are to be allowed; second, the exchange rate that will apply for currency conversions; and third, the time frame in which the transfers will be effected. Recent BITs differ with regard to each of these issues.

a. Type of currency

For the host country it is not the same to have complete freedom concerning the currency in which it will honour its transfer obligation, or to be obliged to allow transfers in a particular currency.

A group of BITs under review provide that transfers shall be permitted in any freely convertible currency. The BIT between Greece and Mexico (2000) typifies this widely used concept:

*“Article 7
Transfers*

- 1. Each Contracting Party shall guarantee the right that payments relating to an investment may be transferred. The transfers shall be effected without delay, **in a freely convertible currency**, at the market rate of exchange applicable on the date of transfer [...]” (emphasis added)*

Another category of BITs is more restrictive. They provide that the transfer shall be permitted in the currency in which the investment was originally made or in any convertible currency agreed by the parties. The BIT between Brunei Darussalam and China (2000) exemplifies this mode:

*“Article 6
Repatriation*

- [...]
- 2. Transfers of currency shall be made without delay **in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the relevant investors of one Contracting Party and the other Contracting Party**. [...]” (emphasis added)*

This technique provides a degree of flexibility in the sense that it allows the host country to agree with the investor on the currency to be used. If such agreement cannot be reached, transfers shall be effected in the currency in which the capital was originally invested. If the capital was originally invested in domestic currency, the host country would not need to use its foreign exchange reserves to comply with the obligation.

Under another method transfers shall be permitted in any *freely usable* currency, that is only in those “hard” currencies widely traded in the international markets and recognized as such by the IMF. The BIT between Egypt and Malaysia (1997) illustrates this method:

“Article 6
Transfers

*Each Contracting Party shall, subject to its laws, regulations and national policies, allow without unreasonable delay the transfer in **any freely usable currency**: [...]”* (emphasis added)

This BIT also defines in its article 1.1.(e) “*freely usable currency*” as follows:

“(e) “freely usable currency” means the United States dollar, Pound sterling, Deutschemark, French franc, Japanese yen or any other currency that is widely used to make payments for international transactions and widely traded in the international principal exchange markets.”

This approach regarding the kind of currency to be used for transfer purposes provides greater protection to the investor and less discretion to the host country, since it substantially reduces the number of currencies that could be used for complying with the obligation. Furthermore, this method may entail a more stringent obligation on the part of the host country, as it may need to use its reserves to convert its domestic currency into a freely usable one.

b. Exchange rate

A key aspect that many BITs address is the specific exchange rate to be applied for the conversion of domestic currency. It may not be the same to use an official rate of exchange subject to the control of the host country, or other exchange rates, such as the market rate of exchange or exchange rates calculated using particular international criteria.

A limited number of BITs concluded since 1995 do not address this issue at all.⁸⁷ A second group of BITs address the issue of the applicable exchange rate; however, they do not specify whether transfers shall be made on the basis of official or market rates of exchange. The BIT between Sierra Leone and the United Kingdom (2000) is an example:

“Article 6
Repatriation of Investment and Returns

*Each Contracting Party shall in respect of investments guarantee to nationals or companies of the other Contracting Party the unrestricted transfer of their investments and returns. Transfers shall be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and the Contracting Party concerned. **Unless otherwise agreed by the investor transfers shall be made at the rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force.**”* (emphasis added)

This method basically delegates the determination of the applicable exchange rates for purposes of transfers to the domestic legislation of the host country. If the host country has a “freely floating” currency, regardless of whether there is an official exchange rate, the market will ultimately determine the applicable exchange rate. However, if the host country has an overvalued or undervalued official exchange rate, investors would be favoured (disfavoured), since they would receive a higher (lower) amount than under a market rate.

A third group of BITs specify that the applicable exchange rates shall be the market rate of exchange existing on the date of the transfer. For instance, the BIT between Austria and the Philippines (2002) states:

“Article 6
Transfers

[...]

(2) *The payments referred to in this Article shall be effected at **the market rate of exchange prevailing on the day of the transfer.***

(3) *The **rates of exchange shall be determined according to the quotations on the stock exchanges** or in the absence of such quotations according to the spot transactions conducted through the respective banking system in the territory of the respective Contracting Party. [...]*” (emphasis added)

Some BITs within this category provide for alternatives in case a market rate of exchange does not exist. For example, the BIT between Brunei Darussalam and China (2000) provides as follows:

“Article 6
Repatriation

[...]

2. *Transfers of currency shall be made without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the relevant investors of one Contracting Party and the other Contracting Party. Transfers shall be made at the market rate of exchange of the Contracting Party accepting the investment on the date of transfer. **In the event that the market rate of exchange does not exist, the rate of exchange shall correspond to the cross rate obtained from those rates which would be applied by the International Monetary Fund on the date of payment for conversions of the currencies concerned into Special Drawing Rights.***” (emphasis added)

c. Timing of transfer

Most BITs contain an obligation on the part of the host country to permit the transfers “*without unreasonable delay*”.⁸⁸ The undefined term “*unreasonable delay*” would have to be determined on a case-by-case basis.

Other BITs provide more guidance. The BIT between Belgium–Luxembourg and Pakistan (1998) is an example:

“Article 7
Transfer

[...]

4. *The Contracting Parties undertake to facilitate the procedures needed to make these transfers without delays according to the practices in international financial centers. **In particular no more than three months must elapse from the date on which the investor properly submits the necessary applications in order to make the transfer until the date on which the transfer actually takes place.** Therefore both Contracting Parties undertake to carry out the required formalities both for the acquisition of foreign currency and for its effective transfer abroad within that period of time.*” (emphasis added)

Several BITs in this category provide for shorter or longer periods for the host country to process the transfer.⁸⁹ Despite these differences, all these BITs coincide in establishing objective time frames to assess whether the host country has actually complied with the obligation to allow transfers without delay.

3. Exceptions

The right of free transfer of funds has to be interpreted in consonance with the other provisions of BITs. Among the BITs under review, a large number include different kinds of specific exceptions to the transfer article.

One group indicates that the transfer provision does not prevent contracting parties from ensuring compliance with other measures relating to matters such as bankruptcy, trading in securities, criminal acts or compliance with resolutions of tribunals. The BIT between Mexico and the Republic of Korea (2000) is a case in point:

*“Article 6
Transfers*

[...]

- (3) *Notwithstanding paragraphs 1 and 2 above, a Contracting Party may prevent a transfer through the equitable, non-discriminatory and in good faith application of its laws relating to:*
- (a) *bankruptcy, insolvency or other legal proceedings to protect the rights of creditors;*
 - (b) *issuing, trading or dealing in securities;*
 - (c) *criminal or administrative violations; or*
 - (d) *ensuring the satisfaction of judgements in adjudicatory proceedings. ”*

Recent BITs have increasingly used this concept. Among others, BITs negotiated by Australia, Canada, Japan, the United States, Mexico and some other Latin American countries include this specific exception — which in some cases also encompasses the right to apply laws related to reports on transfers for statistical purposes.

The second category of exceptions comprises those aimed at safeguarding flexibility for host countries to properly administer financial and monetary policies. One group of BITs specifically addresses the problem of speculative capital inflows. A related exception has been included in BITs of Chile, which for many years applied a law requiring all capital inflows to remain in the country for at least one year.⁹⁰ The protocol of the BIT between Austria and Chile (1997) illustrates this idea:

“Protocol

[...]

Ad Article 4

- (1) *Capital can only be transferred one year after it has entered the territory of the Contracting Party unless its legislation provides for a more favourable treatment. [...]*”

Another kind of exception included in various BITs relates to balance-of-payments (“BoP”) crises. Many – if not most – of the more recent investment disputes have arisen in connection with such crises. The “BoP exception” is tailored for situations in which the host country passes through a period when foreign currency reserves are at exceptionally low levels and when it thus becomes extremely difficult to convert and transfer funds related to investments. The BIT between Japan and Viet Nam (2003) shows in great detail the substantive elements of a “BoP” exception:

“Article 16

1. *A Contracting Party may adopt or maintain measures not conforming with its obligations under paragraph 1 of Article 2 relating to cross-border capital transactions and Article 12:*
 - (a) *in the event of serious balance-of-payments and external financial difficulties or threat thereof; or*
 - (b) *in cases where, in exceptional circumstances, movements of capital cause or threaten to cause serious difficulties for macroeconomic management, in particular, monetary and exchange rate policies.*

2. *Measures referred to in paragraph 1 above:*
 - (a) *shall be consistent with the Articles of Agreement of the International Monetary Fund so long as the Contracting Party taking the measures is a party to the said Articles;*
 - (b) *shall not exceed those necessary to deal with the circumstances set out in paragraph 1 above;*
 - (c) *shall be temporary and shall be eliminated as soon as conditions permit; and*
 - (d) *shall be promptly notified to the other Contracting Party.*
3. *Nothing in this Agreement shall be regarded as altering the rights enjoyed and obligations undertaken by a Contracting Party as a party to the International Monetary Fund."*

The BIT between Greece and Mexico (2000) represents a shorter version of the "BoP" exception and provides that:

"Article 7

[...]

4. *In case of a serious balance of payments difficulties or the threat thereof, each Contracting Party may temporarily restrict transfers, provided that such a Contracting Party implements measures or a programme in accordance with the International Monetary Fund's standards. These restrictions would be imposed on an equitable, non-discriminatory and in good faith basis."*

The majority of the BITs under review do not contain a "BoP" exception. One explanation might be that Governments do not consider limiting transfers as the most appropriate mechanism for coping with shortages of international reserves. It has been argued that to restrict international transfers in times of crisis exacerbates the anxieties of foreign and domestic investors alike, and might foster creative means for the latter to circumvent those limitations.

A third kind of exception, which has been used in some recent BITs — in particular those of Canada, Japan and the United States — includes financial services within their scope of application. In many countries, financial services are heavily regulated and subject to close supervision by regulatory authorities.⁹¹ Thus, in order to prevent any BIT obligation from interfering with such regulatory powers, a number of agreements have included an exception safeguarding those prerogatives. The 2004 Canadian model BIT demonstrates this mode:

*"Article 14
Transfer of Funds*

[...]

6. *Notwithstanding the provisions of paragraphs 1, 2 and 4, and without limiting the applicability of paragraph 5, a Party may prevent or limit transfers by a financial institution to, or for the benefit of, an affiliate of or person related to such institution, through the equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions. [...]"*

* * *

The trend in the evolution of transfer provisions in BITs reflects a dual pattern. A limited number of BITs contain innovations regarding the scope and content of the clause and exceptions to it, while another — more numerous — group of agreements have followed traditional concepts developed in different historical contexts. During the last 10 years, the drafting of transfer clauses has focused on how to strike a balance between the interests of the investors and those of the host countries.

I. Other specific clauses

1. Performance requirements

Performance requirements are conditions imposed by host countries on investors in connection with the establishment and operation of investments or in exchange for the granting of a particular advantage (UNCTAD 2001a). The rationale for a country to use performance requirements is to induce certain investor behaviour in pursuance of particular policy objectives. They are implemented with the aim of influencing the location and character of investment and, in particular, its costs and benefits. Within this logic, performance requirements may aim at, for example, generating employment, increasing the demand for local inputs, boosting exports or augmenting foreign exchange.

Historically, numerous developed and developing countries have imposed performance requirements on foreign investors as a condition for allowing them to invest in their territories. These countries have been considering performance requirements as an important policy tool to further their development objectives by modifying the behaviour of foreign investors and to steer them into the desired direction. Other countries, instead, have persuaded investors to accept performance requirements voluntarily by linking them to the granting of incentives (UNCTAD 2003a). Among the most common performance requirements were those that include obligations to hire nationals of the host country, to use locally produced raw materials or inputs, and to export a portion of the finished product (UNCTAD 1998).

The main criticism of the use of performance requirements — especially making the entry of foreign investors conditional on compliance with them — is that they would deter foreign investment rather than being instruments to achieve the desired policy objectives. It is argued that most often, the objectives pursued through performance requirements — such as an increase in exports or generation of employment — cannot be achieved via decree, but are rather the result of a complex mix of policies and variables. Furthermore, it is argued that performance requirements are a disincentive for foreign investors, who refrain from investing under conditions impeding the free management of their investments and forcing them to conduct business in ways that reduce their efficiency (UNCTAD 1998).

Regardless of which particular school of thought one follows, it has been widely recognized that at least some performance requirements may have distorting effects on international trade. Such recognition led to the adoption of the WTO Agreement on Trade-Related Investment Measures (TRIMs). This treaty prohibits performance requirements inconsistent with two main GATT obligations, namely article III, which establishes the obligation of national treatment, and article XI, which contains the obligation to eliminate quantitative restrictions. The treaty applies only to the goods sector. The annex to the TRIMs Agreement provides an illustrative list of the kinds of performance requirements inconsistent with these two obligations. In particular, it states the following:

*“Annex
Illustrative list*

1. *TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:*
 - (a) *the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or*
 - (b) *that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.*
2. *TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:*

- (a) *the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;*
- (b) *the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or*
- (c) *the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.”*

The WTO has 150 member countries; in addition, 31 countries have observer status, with most of them in the process of accession.⁹² The TRIMs Agreement constitutes a normative landmark in the international regulation of performance requirements, and — as will be explained below — also has an important effect on numerous BITs.

Traditionally, most BITs did not include any explicit disciplines on performance requirements. However, this does not mean that the use of such requirements was not constrained by other provisions of these agreements. If a performance requirement were applied only to foreign investors after the investment had been admitted into the host country, such a practice would be inconsistent with the national treatment obligation. However, there would normally be no violation of a BIT if such a requirement were applied on a non-discriminatory basis, or imposed — even on a discriminatory basis — as a condition for the admission of the investment.

In the last 10 years, an increasing number of BITs have included explicit disciplines on performance requirements. They aim at restricting the discretion of host countries in applying performance requirements. The level of disciplines tends to go beyond the level of the obligations included in the TRIMs Agreement.

a. BITs with no explicit restriction on performance requirements

The majority of recent BITs do not contain any specific provision on performance requirements. One might therefore conclude that contracting parties are free to use performance requirements as far as they are imposed as a condition for the establishment of the investment or applied afterwards on a non-discriminatory basis.

However, a significant number of BITs include an “application of other rules” provision, which seeks to ensure that the host country provides the investor with the most-favoured-treatment resulting from the application of its domestic laws or international obligations. The BIT between Germany and Thailand (2002) contains this widely used clause:⁹³

“Article 7 Application of other Rules

- (1) *If the laws and regulations of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Party in addition to this Treaty contain provisions, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by this Treaty, such provisions shall to the extent that they are more favourable prevail over this Treaty.*
- (2) *Each Contracting Party shall observe any other obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party. ”*⁹⁴

On the basis of the first paragraph of this provision, one could argue that, despite not including any specific discipline on performance requirements in the BIT, Germany and Thailand nevertheless have to observe their obligations deriving from their membership of the TRIMs Agreement. The latter agreement contains prohibitions on the use of performance requirements binding both Germany and Thailand under international law, and thereby entails a more favourable treatment for investments than that granted by the

BIT. Thus, according to article 7 cited above, the provisions of the TRIMs Agreement would prevail over the BIT to the extent that they are more favourable to the covered investors.

A question remains as to whether an investor would be entitled to enforce the rights derived from the TRIMs Agreement through the investor–State dispute settlement provisions in the BIT. There are arguments in favour and against this possibility. However, this particular issue could arise only if both contracting parties of a BIT are also Members of the WTO and therefore parties to the TRIMs Agreement.

b. BITs with disciplines on performance requirements

Several BITs concluded since 1995 explicitly deal with performance requirements.

One group of BITs restricts the use of performance requirements, but at the same time states that the obligations undertaken in this regard do not go beyond those assumed in the context of the TRIMs Agreement. An example of this approach is the BIT between Canada and Costa Rica (1998):

“Article VI Performance Requirements

Neither Contracting Party may impose, in connection with permitting the establishment or acquisition of an investment, or enforce in connection with the subsequent regulation of that investment, any of the requirements set forth in the World Trade Organization Agreement on Trade-Related Investment Measures contained in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakech on April 15, 1994.”

Other BITs restrict the use of performance requirements in general terms. Most agreements falling in this subcategory are recent BITs of Finland — a country that usually includes a general restriction on the use of performance requirements in its BITs.⁹⁵ The BIT between Azerbaijan and Finland (2003) embodies this concept:

“Article 2 Promotion and Protection of Investments

[...]

4. *Each Contracting Party shall not impose mandatory measures on investments by investors of the other Contracting Party concerning purchase of materials, means of production, operation, transport, marketing of its products or similar orders having unreasonable or discriminatory effects.”*

This technique restricts only performance requirements that are mandatory and applied after the investment has been established. As this BIT applies only to established investments, performance requirements imposed at the entry phase are not restricted, nor are they made conditional on the receipt of an advantage relating to establishment. In addition, this approach may restrict performance requirements affecting services — an issue not addressed by the TRIMs Agreement.

The third category of BITs restricts the use of performance requirements on the basis of an exhaustive positive list. Thus, the contracting parties assume the obligation to refrain only from those performance requirements explicitly listed in the provision. Furthermore, this mode limits the use of performance requirements both at the pre-establishment phase of the investment and thereafter. Only compulsory performance requirements are restricted; the contracting parties being left with discretion to impose them as a condition for the receipt of investment incentives. Finally, the disciplines apply not only to investment in goods, but also to investment in services.

Most of the Canadian and United States BITs at the end of the 1990s follow this approach.⁹⁶ The BIT between Bahrain and the United States (1999) provides an illustration:

“Article 6

Neither Party shall mandate or enforce, as a condition for the establishment, acquisition, expansion, management, conduct or operation of a covered investment, any requirement (including but not limited to, any commitment or undertaking in connection with the receipt of a governmental permission or authorization):

- (a) to achieve a particular level or percentage of local content, or to purchase, use or otherwise give a preference to products or services of domestic origin or from any domestic source;*
- (b) to limit imports by the investment of products or services in relation to a particular volume or value of production, exports or foreign exchange earnings;*
- (c) to export a particular type, level or percentage of products or services, either generally or to a specific market region;*
- (d) to limit sales by the investment of products or services in the Party's territory in relation to a particular volume or value of production, exports or foreign exchange earnings;*
- (e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party's territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition laws; or*
- (f) to carry out a particular type, level or percentage of research and development in the Party's territory.*

Such requirements do not include conditions for the receipt or continued receipt of an advantage.”

Another group of BITs comprises agreements with sophisticated and detailed clauses. This approach resembles in several aspects the one used in the BITs included in the third group. The provisions on performance requirements are also based on a positive list approach, apply to both the pre-and post-establishment phases of the investment and restrict performance requirements affecting investment in goods and services. However, this fourth category goes one step further. It not only includes additional restrictions on the use of performance requirements, but also — in consonance with the TRIMs Agreement — prevents the host country from using *certain* performance requirements as a condition for granting advantages or incentives.

This approach is mainly used in recent BITs of Japan, such as the agreements with the Republic of Korea (2002) and Viet Nam (2003):

“Article 4

1. *Neither Contracting Party shall impose or enforce, as a condition for investment activities in its Area of an investor of the other Contracting Party, any of the following requirements:*
 - (a) to export a given level or percentage of goods or services;*
 - (b) to achieve a given level or percentage of domestic content;*
 - (c) to purchase, use or accord a preference to goods produced or services provided in its Area, or to purchase goods or services from natural or legal persons or any other entity in its Area;*
 - (d) to relate the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with investments of that investor;*
 - (e) to restrict sales of goods or services in its Area that investments of that investor produces or provides by relating such sales to the volume or value of its exports or foreign exchange earnings;*
 - (f) to appoint, as executives, managers or members of boards of directors, individuals of any particular nationality;*
 - (g) to transfer technology, a production process or other proprietary knowledge to a natural or legal person or any other entity in its Area, except when the requirement (i) is imposed or enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws; or (ii) concerns the transfer of intellectual property rights which is undertaken in a manner not inconsistent with the Agreement on Trade-Related*

- Aspects of Intellectual Property Rights, Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization;*
- (h) *to locate the headquarters of that investor for a specific region or the world market in its Area;*
 - (i) *to achieve a given level or value of research and development in its Area; or*
 - (j) *to supply one or more of the goods that the investor produces or the services that the investor provides to a specific region or the world market, exclusively from the Area of the former Contracting Party.*
2. *The provisions of paragraph 1 above do not preclude either Contracting Party from conditioning the receipt or continued receipt of an advantage, in connection with investment activities in its Area of an investor of the other Contracting Party, on compliance with any of the requirements set forth in paragraph 1 (f) through (j) above."*

Because of the level of detail and scope of the obligation, BITs included in this fourth category allow contracting parties to make reservations at the time of the negotiation. They can exempt existing non-conforming measures or exclude a particular sector from the scope of application of the disciplines on performance requirements.

Another group of BITs contains the most detailed and far-reaching obligations on this subject. Among the BITs applying this approach are recent agreements between Cuba and Mexico (2001), the United States and Uruguay (2005), and the 2004 Canadian model BIT.

Basically, these agreements follow the same concept as the BITs included in the fourth category. However, there are some minor distinctions.

One relates to the scope of application of the obligation on performance requirements. The agreements included in the fourth category establish the obligation of the contracting parties to refrain from imposing certain enumerated performance requirements. The BITs included in the fifth category go one step further, and oblige the contracting parties to refrain from imposing the banned performance requirements not only on each other's investments and investors, but also on investments and investors of any third country. The rationale for this is to ensure a single investment policy of each contracting party concerning all investments regardless of their origin, and thereby to foster a more uniform level playing field for foreign investors.

Another distinction relates to the level of detail with which the provision is drafted. Clauses in the fifth category are typically very elaborate. They list the compulsory performance requirements from which the contracting parties shall abstain in connection with the establishment or operation of the covered investments. They also include the performance requirements from which the contracting parties shall refrain in connection with the granting of an incentive or other advantage. The provisions contain a series of exceptions to the obligations included in the previous two sections. In this regard, it is worth noting the intent of the parties not to impair the regulatory powers of the host country in order to pursue a series of legitimate policy objectives. The 2004 Canadian model BIT provides as follows:

*"Article 7
Performance Requirements*

1. *Neither Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or a non-Party in its territory:*
 - (a) *to export a given level or percentage of goods;*
 - (b) *to achieve a given level or percentage of domestic content;*
 - (c) *to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;*
 - (d) *to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;*

- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
 - (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority, to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
 - (g) to supply exclusively from the territory of the Party the goods it produces or the services it provides to a specific regional market or to the world market.
2. A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 3 and 4 apply to the measure.
 3. Neither Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:
 - (a) to achieve a given level or percentage of domestic content;
 - (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
 - (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
 - (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.
 4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.
 5. Paragraphs 1 and 3 shall not apply to any requirement other than the requirements set out in those paragraphs.
 6. The provisions of:
 - (a) Paragraphs (1) (a), (b) and (c), and (3) (a) and (b) shall not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs;
 - (b) Paragraphs (1) (b), (c), (f) and (g), and (3) (a) and (b) shall not apply to procurement by a Party or a state enterprise; and
 - (c) Paragraphs (3) (a) and (b) shall not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas.”

2. Entry and sojourn of foreign nationals

The proper functioning of a foreign subsidiary may require not only the possibility for investors to visit the site of the investment frequently, but also the presence in the host country of expatriate personnel for extended periods of time. Accordingly, there is an increasing demand not only to allow cross-border flows of capital, but also to facilitate the international movement of people.

The interests of the investors, however, do not necessarily converge with immigration policies of host countries, which aim at granting domestic authorities ample discretion as to whether to allow the entry of foreign nationals into their territory.

BITs provide, in general, little assistance to foreign investors on this issue.⁹⁷ To the extent that agreements include provisions on the subject, they usually refrain from establishing legally binding obligations of the contracting parties to allow the entry and sojourn of covered investors or investment-related personnel. Most BITs have not gone further than including “best efforts” clauses subject to national legislation. This trend has continued among the BITs under review.

One group of BITs, which is relatively numerous, does not deal with this matter at all. Other BITs include a specific clause, but fall short of establishing any right of entry for the investor or investment-related personnel. Different modes are used within this category of agreements. The most important distinction relates to the question of whether the relevant provision covers only nationals of the other contracting party or any foreign personnel employed by the foreign investor (table 20).

Table 20. Examples of provisions on entry and sojourn of foreign nationals

BIT between Botswana and China (2000)	BIT between Bosnia Herzegovina and Germany (2001)	BIT between Australia and India (1999)	BIT between France and Mexico (1998)
“Article 2 Promotion and Protection of Investment [...] 4. Subject to its laws and regulations, one Contracting Party shall provide assistance in and facilities for obtaining visas and work permits for nationals of the other Contracting Party engaging in activities associated with investments made in the territory of that Contracting Party.” (emphasis added)	“Protocol to the Treaty between the Federal Republic of Germany and Bosnia Herzegovina concerning the Encouragement and Reciprocal Protection of Investments [...] (2) Ad Article 3 [...] (c) The Contracting States shall within the framework of their national legislation give sympathetic consideration to applications for the entry and sojourn of persons of either Contracting State who wish to enter the territory of the other Contracting State in connection with an investment; the same shall apply to employed persons of either Contracting State who in connection with an investment wish to enter the territory of the other Contracting State and sojourn there to take up employment. Applications for work permits shall also be given sympathetic consideration.” (emphasis added)	“Article 5 Entry and sojourn of personnel 1. A Contracting Party shall, subject to its laws applicable from time to time relating to the entry and sojourn of non-citizens, permit natural persons who are investors of the other Contracting Party and personnel employed by companies of that other Contracting Party to enter and remain in its territory for the purpose of engaging in activities connected with investments. [...]” (emphasis added)	“Article 4 Protection and treatment of investments [...] 4. Within the framework of their internal legislation, the Contracting Parties shall benevolently examine requests for entry and authorization to reside, work and travel made by the nationals of one Contracting Party in relation to an investment made in the territory or in the maritime area of the other Contracting Party.” (emphasis added)

A third group of agreements provides some degree of discipline, although they do not oblige the contracting parties to allow the entry of foreign nationals into their territories and their sojourn therein. These treaties prohibit the host country from applying labour certification tests or similar procedures as well as any numerical restrictions relating to the temporary entry of businesspersons. The BIT between Japan and the Republic of Korea (2002) is an example:

“Article 8

1. *Subject to its laws relating to entry, stay and authorisation to work, each Contracting Party shall grant temporary entry, stay and authorisation to work to investors of the other Contracting Party for the purpose of establishing, developing, administering or advising on the operation in the territory of the former Contracting Party of an investment to which they, or an enterprise of that other Contracting Party that employs them, have committed or are in the process of committing a substantial amount of capital or other resources, so long as they continue to meet the requirements of this Article.*
2. *Neither Contracting Party, in granting entry under paragraph 1 of this Article, shall apply a numerical restriction in the form of quotas or the requirement of an economic needs test, unless (a) it notifies the other Contracting Party of its intent to apply the restriction no later than sixty days before the intended date of the implementation of the restriction, and (b) it, upon request by the other Contracting Party, consults with that other Contracting Party before the implementation of the restriction.*
3. *Neither Contracting Party shall require that an enterprise of that Contracting Party that is an investment of an investor of the other Contracting Party appoint, as executives, managers or members of boards of directors, individuals of any particular nationality.”*

Paragraph 2 of that provision states that although any permit for entry and sojourn is subject to domestic legislation, no contracting party shall apply quotas or economic needs tests. However, this obligation is not absolute, as any contracting party can apply such measures provided that it notifies and consults with the other contracting party before the restriction is imposed.

Not all BITs falling within this category contain such flexibility. Some agreements, notably several BITs of the United States concluded during the second part of the 1990s, include an absolute obligation for the contracting parties to abstain from imposing quotas or numerical restrictions when granting permits for the entry and sojourn of foreign nationals. The BIT between Nicaragua and the United States (1995) demonstrates this idea:

“Article VII

1. (a) *Subject to its laws relating to the entry and sojourn of aliens, each Party shall permit to enter and to remain in its territory nationals of the other Party for the purpose of establishing, developing, administering or advising on the operation of an investment to which they, or a company of the other Party that employs them, have committed or are in the process of committing a substantial amount of capital or other resources.*
(b) *Neither Party shall, in granting entry under paragraph 1(a), require a labor certification test or other procedures of similar effect, or apply any numerical restriction.*
2. *Each Party shall permit covered investments to engage top managerial personnel of their choice, regardless of nationality.”*

This method is an attempt to limit the discretion that immigration authorities have when granting permits for entry and sojourn to foreign investors. However, mainly as a result of South–North patterns of immigration, but also because of security concerns, most capital-exporting countries have gradually tightened their immigration policies. As far as the entry and sojourn of investors and investment-related personnel is concerned, the evolution in investment rulemaking has not only stagnated, but also might diminish in the future. The practice whereby there is included in the BIT an absolute obligation for the contracting parties to abstain from imposing quotas or numerical restrictions has already been discontinued by one of the few countries that used to follow this practice — the United States. The 2004 United States model BIT no longer includes a specific provision addressing the issue of temporary entry of foreign investors and personnel at all.

3. Top managerial personnel

Host countries might use compulsory legislation to ensure the participation of their nationals in the management or control of foreign investments. In some sectors, countries justify these policies on national security grounds, while in others Governments seek to ensure that their nationals receive technical training and managerial experience. These kinds of policies may conflict with the interests of investors, who would like to employ the most suitable managers regardless of their nationality.

Most BITs lack specific provisions on this matter.⁹⁸ However, more recently, a number of countries have started to include disciplines on top managerial personnel in their treaties.

Subject to the domestic legislation of the contracting party concerned, some BITs allow foreign investors and their *existing* personnel, *regardless of nationality*, to enter and remain in the host country. In addition, these BITs permit foreign investors to employ *new* key technical and managerial personnel of their choice — *regardless of nationality* — unless the legislation of the host country states otherwise. The BIT between Australia and Egypt (2001) is an example:

“Article 5
Entry and sojourn of personnel”

1. *Each Party shall, subject to its laws applicable from time to time relating to the entry and sojourn of non-citizens, permit natural persons who are investors of the other Party and personnel employed by companies of that other Party to enter and remain in its territory for the purpose of engaging in activities connected with investments.*
2. *Each Party shall, subject to its laws applicable from time to time, permit investors of the other Party who have made investments in the territory of the first Party to employ within its territory key technical and managerial personnel of their choice **regardless of citizenship.**”* (emphasis added)

Another group of agreements provides, at least in principle, the investor with the right to employ top managerial personnel regardless of nationality, without making it subject to domestic legislation.⁹⁹ The BIT between Lithuania and the United States (1998) illustrates this concept:

“Article II

[...]

5. *Companies which are legally constituted under the applicable laws or regulations of one Party, and which are investments, shall be permitted to engage top managerial personnel of their choice, regardless of nationality.”*

A further category of BITs addresses the issue of top managerial personnel in the framework of the prohibition of certain performance requirements. The BIT between Japan and Viet Nam (2003) is an illustration:

“Article 4

1. *Neither Contracting Party shall impose or enforce, as a condition for investment activities in its Area of an investor of the other Contracting Party, any of the following requirements:*
[...]
(f) *to appoint, as executives, managers or members of boards of directors, individuals of any particular nationality; [...]*”

This concept makes a distinction between managers and members of the board of directors — a differentiation not made in the previous category of BITs. However, regardless of this distinction, the agreement provides the investor with the same treatment concerning these two groups.

This method contrasts with other BITs, which include a specific provision on top managerial personnel and also make a distinction between the latter and members of boards of directors. In this group of agreements, the distinction is used to differentiate between the treatment given to the two categories. Thus, while the host country is prohibited from imposing the obligation to employ top managerial personnel of a specific nationality on the investor, it can do this with regard to the members of the board of directors. In this latter case, the host country is allowed to require the directors to have a particular nationality, provided, however, that such requirement does not materially impair the investor's control of the investment. The BIT between Canada and El Salvador (1999) exemplifies this approach:

*“Article V
Management, Directors and Entry of Personnel*

A Contracting Party may not require that an enterprise of that Contracting Party, that is an investment under this Agreement, appoint to senior management positions individuals of any particular nationality.

A Contracting Party may require that a majority of the board of directors, or any committee thereof, of an enterprise that is an investment under this Agreement be of a particular nationality, or resident in the territory of the Contracting Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment.

Subject to its laws, regulations and policies relating to the entry of aliens, each Contracting Party shall grant temporary entry to citizens of the other Contracting Party employed by an enterprise who seeks to render services to that enterprise or a subsidiary or affiliate thereof, in a capacity that is managerial or executive or requires specialized knowledge.”

Regardless of which mode a BIT follows, any provision giving foreign investors the possibility of appointing top managerial personnel of their choice has a significant caveat. No BIT under review provides foreign nationals with an unrestricted right of entry into the territory of the host country. Clauses on top managerial personnel do not prevail over the host country's immigration laws. Thus, any entry of particular foreign personnel will, in the end, be subject to domestic legislation.

4. “Umbrella” clauses

Under “umbrella” clause provisions the host country usually assumes the responsibility to respect other obligations it has with regard to investments of investors of the other contracting party. It is estimated that of the almost 2,500 BITs currently in existence approximately 40 per cent contain such an “umbrella” or “respect” clause.¹⁰⁰ While umbrella clauses have not been a very prominent feature of BITs for many years, a large number of recent investment disputes have emerged in connection with such a provision.

A considerable variety of approaches can be found in BITs containing an umbrella clause (table 21).

Table 21. Examples of “umbrella” clauses

BIT between Belarus and the Republic of Korea (1997)	BIT between Greece and Mexico (2000)	BIT between Italy and Jordan (1996)
“Article 10 Application of other Rules [...] (3) Each Contracting Party shall observe any other obligation it may have entered into with regard to investments in its territory by investors of the other Contracting Party.” (emphasis added)	“Article 19 Application of other Rules [...] Each Contracting Party shall observe any other obligation it may have entered into in writing with regard to a specific investment of an investor of the other Contracting Party. The disputes arising from such obligations shall be settled only under the terms and conditions of the respective contract. [...]” (emphasis added).	“Article 2 Promotion and Protection of Investments [...] 4. “Each contracting Party shall create and maintain in its territory a legal framework apt to guarantee to investors the continuity of legal treatment, including the compliance, in good faith of all undertakings assumed with regards to each specific investor.” (emphasis added)

It appears that the example of the BIT between the Republic of Korea and Belarus reflects the most frequently used type of an umbrella clause. It has a potentially broad scope of application (“any other obligation”), thereby giving relative ample protection to foreign investors. The other examples are more restrictive. One option is to protect only obligations made in writing. An additional restriction may be to cover only those obligations that are made in respect of a specific investment. Yet another possibility for limiting the scope of an umbrella clause is to introduce only an indirect obligation, as was done in the BIT between Italy and Jordan, which obliges the contracting parties to have domestic legislation in place that ensures that undertakings in respect of foreign investors are respected.

Another approach is to deal with the umbrella clause specifically in connection with dispute settlement. The objective is to restrict access to the dispute settlement mechanisms established under the BIT, thereby avoiding interference with dispute settlement rules in the individual investment contract between the foreign investor and the host country. An example is the above-mentioned BIT between Greece and Mexico (2000) or the BIT between Denmark and India (1995). The latter provides as follows:

“Article 2

[...]

4. *Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party, **with disputes arising from such obligations being only redressed under the terms of the contracts underlying the obligations.*** (emphasis added)

An umbrella clause is no longer present in the 2004 model BIT of the United States. What is left is the right of a foreign investor to submit a claim in connection with an alleged breach of an “*investment agreement*” to international arbitration (article 24.1). However, submission requires the claimant’s written waiver to initiate or continue the claim before any domestic tribunals or courts of the host country (article 26). It appears that the deletion of the umbrella clause from the United States model BIT is at least partially a reaction to recent investment disputes involving this provision. It remains to be seen whether other countries will review the use of the umbrella clause in their BITs.

There is some uncertainty as to the precise nature and effect of umbrella clauses. On the one hand, it has been asserted that such provisions protect an investor’s contractual rights against “*any interference which might be caused by either a simple breach of contract or by administrative or legislative acts*” (Dolzer and Stevens 1995, p. 82). On the other hand, the precise scope of this obligation is unclear, in particular whether it also covers purely commercial contracts and what degree of specificity the host country’s commitment must have in order to become an obligation under international law.

This issue has generated some recent case law, above all two recent arbitral cases brought by the Swiss-based transnational corporation Société Générale de Surveillance (SGS) against Pakistan and the Philippines. In each case, the central question was whether, through the umbrella clause in the applicable BIT, the investor’s contractual claims against the host country (for breaches of contracts entered into for the provision of pre-shipment customs inspection services) could be resolved under the arbitration provisions of the BIT, rather than under the dispute resolution provisions of the contract in dispute.

The arbitral tribunal in *SGS v. Pakistan* held that, unless expressly stated, an umbrella clause does not derogate from the widely accepted international law principle that a contract breach is not by itself a violation of international law, particularly if such contract had a valid forum selection clause. The tribunal added that the umbrella clause was not a “first order” standard obligation; rather, it would provide a general pledge on the part of the host country to ensure the effectiveness of State contracts.¹⁰¹

The arbitral tribunal in *SGS v. the Philippines* interpreted the umbrella clause — which was not completely identical to the one in *SGS v. Pakistan* — in a way diametrically opposed to the interpretation adopted by the previous tribunal. It held that the umbrella clause did, in principle, have the effect of conferring jurisdiction on an arbitration tribunal constituted under the BIT to determine purely contractual

claims between an investor and the host country. The tribunal disagreed that the umbrella clause was merely a “second order” protection, preferring instead the view that the clause “means what it says”.¹⁰²

The above cases do not offer a uniform or clear approach to the umbrella clause. From the perspective of an investor, the approach taken by the “Philippines tribunal” would offer greater protection, as it makes clear that a breach of a State contract amounts to a breach of a primary obligation in the BIT, placed upon the host country by the umbrella clause, to observe contractual commitments (Schreuer 2004, p. 255). On the other hand, the interpretation in the “Pakistan case” gives greater discretion to the host country to interfere with the contractual relationship with the investor and to have that action judged, not by reference to the mere fact of a breach of the underlying investment contract (which may well be entirely lawful under the national laws and policies of the host country), but by reference to other substantive treatment standards in the BIT. These require a more difficult standard of proof and, as a result, the protection offered by the BIT applies only where an investor meets that standard. It will not be met by reference to the breach of the State contract alone. Arguably, this approach could be seen as depriving the umbrella clause of any independent meaning, in that it would annul any possibility of viewing a breach of an obligation entered into by the host country under a State contract as amounting to a breach of the BIT by reason of an infringement of the umbrella clause (UNCTAD 2005e, pp. 19–23).

In conclusion, the diversity in the way in which the umbrella clause is formulated in BITs makes their proper interpretation dependent on each individual case. The review of the language of this clause indicates that although there are some disparities, the ordinary meaning of “shall observe any commitments/obligations” seems to point towards an inclusive, wide interpretation that would cover all obligations entered into by the contracting States, including contractual ones, unless otherwise stated. On the other hand, there are clauses that specifically narrow the scope of the umbrella clause, including with regard to dispute settlement. The majority of arbitral tribunals, with the exception of the two recent cases mentioned above, when faced with a “proper” umbrella clause, that is one drafted in broad and inclusive terms, seem to be adopting a fairly consistent interpretation which covers all State obligations, including contractual ones.¹⁰³

5. Denial of benefits

Some BITs provide for the right of the contracting parties to deny the benefits of the agreement to investors who are from a third country. The issue of denial of benefits is closely related to the question of how to determine the legal entities considered as *investors* for the purposes of the BIT.

As explained in section B above, BITs use different criteria to ascribe nationality to legal entities. The inclusion of a denial-of-benefits clause particularly makes sense in those BITs that use the place of constitution as the only element to ascribe nationality to legal entities and to consider them to be investors for purposes of the agreement. The denial-of-benefits clause allows the BIT contracting parties to deny treaty protection to those companies that are controlled by investors of a non-party and have no substantial business activities in the territory of the party under whose laws they are constituted. The BIT between Azerbaijan and the United States (1997) illustrates this idea:

“Article XII

Each Party reserves the right to deny to a company of the other Party the benefits of this treaty if nationals of a third country own or control the company and
 (a) *the denying Party does not maintain normal economic relations with the third country; or*
 (b) *the company does not have substantial business activities in the territory of the Party under whose laws it is constituted or organized.”*

Such a provision allows a contracting party of a BIT to deny the benefits of the agreement to a company that is a subsidiary of a shell company organized under the laws of the other contracting party if controlled by nationals of a third country (“letterbox” company). By contrast, a contracting party would not be permitted to deny the benefits to a company of the other contracting party that maintains its central

administration or principal place of business in the territory of the latter, or has a real and continuous link with that other contracting party, even if it is controlled by nationals of a third country.

Most BITs, however, do not contain a denial-of-benefits clause. This could allow investors from third countries to benefit from the agreement. This effect may not necessarily be against the interests of the contracting parties. For instance, small economies such as Singapore and Mauritius have used the “platform concept” under which they have been the base for third party foreign investment to be channelled into China or India, with which they have BITs. On the other hand, investors of non-parties might merely establish a shell company under the laws of a contracting party to benefit from treaty protection, unless the BIT requires that the assets be first located in the platform country.

The above article also makes it possible to avoid having to grant treaty protection to investors of countries with which a contracting party does not maintain normal economic relations. Such a denial-of-benefits clause would apply even in situations where investors of a non-party had not only constituted a company under the laws of the other contracting party but also maintained an effective business presence therein. The use of the denial-of-benefits clause in these circumstances may generate controversy in investment negotiations, as some countries consider that it unduly politicizes investment relations.

* * *

To sum up, BITs concluded in the review period contain — to a varying extent — provisions on other issues, such as performance requirements, the entry and sojourn of foreign nationals, managerial personnel, the umbrella clause and denial of benefits. Disciplines on performance requirements are still rare, although the number of BITs including such clauses — which tend to go beyond the requirements of the TRIMS Agreement — is increasing. The situation is similar with regard to the entry, sojourn and employment of foreign nationals and key personnel. Unlike performance requirements, provisions on these issues are usually non-legally binding or subject to the domestic legislation of the host country. Relatively widespread is the use of “umbrella clauses” in BITs under review; they are usually drafted in broad terms and cover any other obligation that the host country has assumed with regard to the investor or the investment. It remains to be seen whether this trend will continue in the light of the numerous investment disputes that arose in connection with the umbrella clause in the last couple of years. By contrast, only a small group of BITs contains a denial-of-benefit clause excluding the applicability of the agreement under specific circumstances to investors from third countries

J. Transparency

The issue of transparency is one of the areas where investment-rulemaking has evolved in the review period (UNCTAD 2004). The development has been more qualitative than quantitative. Although from a numerical perspective, most BITs have continued to lack any specific provision on transparency, among those agreements that do address the issue, there has been gradual and yet significant qualitative progress in the rationale and content of the obligations. While there has been a trend towards viewing transparency as an obligation imposed on countries to exchange information, new approaches also deem it to be a reciprocal obligation involving host countries and foreign investors. Furthermore, transparency obligations are no longer exclusively geared towards fostering exchange of information; rather, they relate to transparency in the process of domestic rulemaking, aimed at enabling interested investors and other stakeholders to participate in that process. In one arbitral award, it was held that transparency is required by the fair and equitable treatment clause.¹⁰⁴

A survey of the transparency provisions in BITs concluded since 1995 reveals different concepts concerning their rationale. One approach conceives transparency as a commitment by countries to endeavour to inform each other about the existence of investment opportunities for investors of one contracting party in the territory of the other contracting party. The BIT between China and Jordan (2001) exemplifies this perception:

“Article 2
Promotion and admission of investments

[...]

2. *In order to encourage mutual investment flows, each Contracting Party shall endeavour to inform the other Contracting Party, at the request of either Contracting Party on the investment opportunities in its territory. ”*

Most other approaches used in BITs, however, do not focus on transparency concerning investment opportunities, but rather on laws, regulations and administrative practices applicable to foreign investment in the host country. Transparency is conceived as a tool to foster a more predictable investment climate, in which investors can clearly assess the conditions and rules applying to their investments.

BITs following this approach include obligations for the contracting parties to exchange information on laws and regulations governing investment in their respective territories. The transparency of laws and other governmental measures can be addressed from different perspectives, from publicizing all relevant acts and legislation in accordance with the host country's legal framework, to specifically notifying certain measures of one contracting party to officials of the other contracting party.

Some BITs focus on the obligation of the contracting parties to publish all measures that may affect investments. The BIT between Azerbaijan and Finland (2003) is an example:

“Article 3
Transparency

Each Contracting Party shall ensure that its laws, regulations, procedures, administrative rulings and judicial decisions of general application, as well as international agreements after their entry into force, which may affect the investments of investors of the other Contracting Party in its territory, are promptly published, or otherwise made publicly available.”

Some recent BITs also provide for mechanisms to exchange information between the contracting parties. The BIT between Japan and Viet Nam (2003) is a case in point:

“Article 7

1. *Each Contracting Party shall promptly publish, or otherwise make publicly available, its laws, regulations, administrative procedures and administrative rulings and judicial decisions of general application as well as international agreements which pertain to or affect investment activities.*
2. ***Each Contracting Party shall, upon request by the other Contracting Party, promptly respond to specific questions and provide that other Contracting Party with information on matters set out in paragraph 1 above.***
3. *The provisions of paragraphs 1 and 2 of this Article shall not be construed so as to oblige either Contracting Party to disclose confidential information, the disclosure of which would impede law enforcement or otherwise be contrary to the public interest, or which would prejudice privacy or legitimate commercial interests.” (emphasis added)*

Other BITs combine the approaches explained before and address the issue of transparency in a more comprehensive way. The BIT between Cuba and Mexico (2001) illustrates this approach. Despite including obligations, which in most other BITs would fall under the heading of transparency, this agreement denominates the provision as “*investment promotion*”, recognizing the key role of transparency in fostering investment flows:

“Article 3
Investment Promotion

1. *Each Party, with the intention to significantly increase flows of investments of investors of the other Party, may facilitate detailed information, both to the other Party and investors of the other Party, regarding:*
 - a) *investment opportunities in its territory;*
 - b) *national legislation which, directly or indirectly, affects foreign investment including, among others, exchange regimes and those of fiscal nature.*
2. *Each Party may provide to the other Party aggregated information on foreign investment in its country with respect to its origin, economic activities benefited, investment modalities and other which may be available.*
3. *Upon request of any investor of one Party who will make an investment in the territory of the other Party, the latter shall provide the information legally available to fully assess the legal situation of the assets comprised by the investment in question.” (non-official translation from Spanish)*

Most approaches regarding transparency in recent BITs are centred on the relationship between countries, and do not directly establish any obligation between the host country and the investor. However, some BITs — such as the one cited above — have started to deviate from this trend in various ways. These BITs include the investors in transparency regulations. They conceive transparency as extending beyond the traditional notion of publication of laws and regulations: they also focus on the process of rulemaking, attempting to use transparency as an instrument to promote the concept of due process and to allow interested stakeholders to participate in investment-related rulemaking. An example is the 2004 Canadian model BIT:

“Article 19
Transparency

1. *Each Party shall, to the extent possible, ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in such a manner as to enable **interested persons** and the other Party to become acquainted with them.*
2. *To the extent possible, each Party shall:*
 - (a) *publish in advance any such measure that it proposes to adopt; and*
 - (b) *provide **interested persons** and the other Party a reasonable opportunity to comment on such proposed measures.*
3. *Upon request by a Party, information shall be exchanged on the measures of the other Party that may have an impact on covered investments.” (emphasis added)*

This approach applies transparency not only to existing legislation, but also to draft laws and regulations. In addition, all interested persons are to have an opportunity to comment on these proposals. Thus, the obligation is applicable not only in respect of investors of the other contracting party, but also between each contracting party and its own citizens. This method, which is also used in the BIT between the United States and Uruguay (2005) — see below — represents a qualitative leap as regards the content and rationale of transparency provisions in BITs.

The emphasis of some BITs on using transparency provisions to strengthen the concept of due process of law is underlined by some supplementary obligations included in other agreements. An example is the BIT between the United States and Uruguay (2005), which includes within the transparency provision explicit obligations on administrative procedures and the right to have an impartial review and appeal in respect of administrative decisions on investment-related matters.¹⁰⁵

“Article 11: Transparency

1. *Contact Points*

- (a) Each Party shall designate a contact point or points to facilitate communications between the Parties on any matter covered by this Treaty.*
- (b) On the request of the other Party, the contact points shall identify the office or official responsible for the matter and assist, as necessary, in facilitating communication with the requesting Party.*

2. *Publication*

To the extent possible, each Party shall:

- (a) publish in advance any measure referred to in Article 10(1)(a) that it proposes to adopt; and*
- (b) provide interested persons and the other Party a reasonable opportunity to comment on such proposed measures.*

3. *Notification and Provision of Information*

- (a) To the maximum extent possible, each Party shall notify the other Party of any proposed or actual measure that the Party considers might materially affect the operation of this Treaty or otherwise substantially affect the other Party’s interests under this Treaty.*
- (b) On request of the other Party, a Party shall promptly provide information and respond to questions pertaining to any actual or proposed measure referred to in subparagraph (a), whether or not the other Party has been previously notified of that measure.*
- (c) Any notification, request, or information under this paragraph shall be provided to the other Party through the relevant contact points.*
- (d) Any notification or information provided under this paragraph shall be without prejudice as to whether the measure is consistent with this Treaty.*

4. *Administrative Proceedings*

With a view to administering in a consistent, impartial, and reasonable manner all measures referred to in Article 10(1)(a), each Party shall ensure that in its administrative proceedings applying such measures to particular covered investments or investors of the other Party in specific cases that:

- (a) wherever possible, persons of the other Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated, and a general description of any issues in controversy;*
- (b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; and*
- (c) its procedures are in accordance with domestic law.*

5. *Review and Appeal*

- (a) Each Party shall establish or maintain judicial, quasi-judicial, or administrative tribunals or procedures for the purpose of the prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Treaty. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.*
- (b) Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:*
 - (i) a reasonable opportunity to support or defend their respective positions; and*
 - (ii) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority.*
- (c) Each Party shall ensure, subject to appeal or further review as provided in its domestic law, that such decisions shall be implemented by, and shall govern the practice of, the offices or authorities responsible for the administrative action at issue.”*

Although not specifically aimed at addressing the issue of transparency, some BITs do include a generic clause on consultations and exchange of views among the contracting parties, which could be used for the same purpose. The BIT between the Netherlands and Panama (2000) illustrates this approach:

*“Article 11
Consultations*

Either Contracting Party may propose to the other Contracting Party that consultations be held on any matter concerning the interpretation or application of the present Agreement. The other Contracting Party shall accord sympathetic consideration to the proposal and shall afford adequate opportunity for such consultations.”

* * *

In conclusion, only a small — albeit growing — minority of BITs of the last decade include provisions on transparency. However, to the extent that BITs deal with this issue, there have been significant developments concerning the content of the clause. Transparency is no longer exclusively perceived as a matter of the contracting parties exchanging investment-related information. In addition, a few recent BITs grant information rights to all "interested persons" and even allow them to comment on draft legislation. Some BITs also enhance investor rights in administrative and judicial proceedings and provide for third-party participation.

K. Treaty exceptions and emerging issues

1. General treaty exceptions

The rationale for a general exception is to exempt a contracting party from the obligations of the BIT in situations in which compliance would be incompatible with key policy objectives explicitly identified in the agreement. Most often, for a general exception to be permitted, the otherwise non-consistent measure by the contracting party must be taken on a non-discriminatory basis. Some such measures are allowed only temporarily.

In this sense, a general exception is a mechanism enabling the contracting parties to strike a balance between investment protection, on the one hand, and the safeguarding of other values considered to be fundamental by the countries concerned, on the other hand. Such values include, for example, public health, safety, national security and environmental protection. General exceptions ensure that the BIT obligations do not prevent the country concerned from applying its domestic legislation in order to safeguard any of these fundamental values.

In general, it appears that a conflict between these two kinds of objectives would be rare. Even after concluding a BIT, a contracting party may still apply its domestic legislation to pursue a wide range of policy objectives. As most BITs apply only to investments established in the host country in accordance with the latter's laws and regulations, contracting parties have significant leeway to control and restrict the establishment of foreign investment. In addition, insofar as measures are non-discriminatory and respect the other obligations in the BIT, contracting parties retain the right to adopt and implement national policies.

Some BITs under review clarify this point, as demonstrated by the BIT between Mauritius and Singapore (2000):

*“Article 10
Laws*

For the avoidance of any doubt, it is declared that all investments shall, subject to this Agreement, be governed by the laws in force in the territory of the Contracting Party in which such investments are made.”

During the review period, the number of BITs including general treaty exceptions has increased. One might think that this trend would be more evident in those BITs providing for a right of establishment, since in these cases the host country has less leeway to screen the admission of the investment. However, the survey of BITs does not confirm the existence of a co-relation between frequency in the use of general treaty exceptions and inclusion of an admission clause in the agreements.

General exception clauses can safeguard a wide variety of policy objectives. Broadly speaking, general treaty exceptions in BITs of the last 10 years can be divided into the following categories: taxation; essential security and public order; protection of human health and natural resources; protection of culture; prudential measures for financial services; and miscellaneous.

a. Taxation

Taxation policy is a sensitive issue in most countries, and is handled by authorities that are different from those negotiating investment agreements. Countries not only want to prevent any conflict of competence among their different government agencies, but also are keen to prevent BITs from limiting their right to pursue fiscal policies (UNCTAD 2000c).

Several more recent BITs include a general exception on taxation. However, the approaches used to safeguard flexibility for implementing fiscal policies are not always the same.

One type of general exception excludes all taxation matters from the scope of application of the agreement. The BIT between Argentina and New Zealand (1999) is an example:

*“Article 5
Exceptions*

[...]

(2) *The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties [...]*¹⁰⁶

Thus, no taxation law or regulation, regardless of its degree of inconsistency with any of the treaty obligations, could be successfully challenged under the BIT.

Another kind of general exception excludes, in principle, all tax matters from the scope of application of the BIT, and yet leaves the possibility of applying the treaty in certain specific situations. Within this category, some exceptions on taxation are more complex than others. Some provide for only a couple of situations in which the BIT would cover taxation matters. Other exceptions not only apply to more situations, but also specify certain conditions that would need to be met for such purpose. One can distinguish different variations, as exemplified by BITs of Canada and Japan.

The Canadian model BIT (2004) embodies the first approach:

“Article 16
Taxation Measures

1. *Except as set out in this Article, nothing in this Agreement shall apply to taxation measures. For further certainty, nothing in this Agreement shall affect the rights and obligations of the Parties under any tax convention. In the event of any inconsistency between the provisions of this Agreement and any such convention, the provisions of that convention shall apply to the extent of the inconsistency.*
2. *Nothing in this Agreement shall be construed to require a Party to furnish or allow access to information the disclosure of which would be contrary to the Party’s law protecting information concerning the taxation affairs of a taxpayer.*
3. *A claim by an investor that a tax measure of a Party is in breach of an agreement between the central government authorities of a Party and the investor concerning an investment shall be considered a claim for breach of this Agreement unless the taxation authorities of the Parties, no later than six months after being notified by the investor of its intention to submit the claim to arbitration, jointly determine that the measure does not contravene such agreement. The investor shall refer the issue of whether a taxation measure does not contravene an agreement for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).*
4. *The provisions of Article 13 shall apply to taxation measures unless the taxation authorities of the Parties, no later than six months after being notified by an investor that the investor disputes a taxation measure, jointly determine that the measure in question is not an expropriation. The investor shall refer the issue of whether a taxation measure is an expropriation for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).*
5. *An investor may submit a claim relating to taxation measures covered by this Agreement to arbitration under Section C only if the taxation authorities of the Parties fail to reach the joint determinations specified in paragraph 3 and paragraph 4 of this Article within six months of being notified in accordance with the provisions of this Article.*
6. *If, in connection with a claim by an investor of a Party or a dispute between the Parties, an issue arises as to whether a measure of a Party is a taxation measure, a Party may refer the issue to the taxation authorities of the Parties. The taxation authorities shall decide the issue, and their decision shall bind any Tribunal formed pursuant to Section C or arbitral panel formed pursuant to Section D, as the case may be, with jurisdiction over the claim or the dispute. A Tribunal or arbitral panel seized of a claim or a dispute in which the issue arises may not proceed pending receipt of the decision of the taxation authorities. If the taxation authorities have not decided the issue within six months of the referral, the Tribunal or arbitral panel shall decide the issue in place of the taxation authorities.*
7. *The taxation authorities referred to in this Article shall be the following until notice in writing to the contrary is provided to the other Party:*
 - (a) *for Canada: the Assistant Deputy Minister, Tax Policy, of the Department of Finance Canada;*
 - (b) *for _____:”*

This clause attempts to strike a balance between the protection that the BIT and an investment contract may provide to a foreign investor, on the one hand, and the concern of the government authorities to safeguard flexibility to implement their fiscal policies, on the other hand. The exception sets up a mechanism through which the competent authorities of each contracting party may override an investor’s claim that a taxation measure violates the BIT or an agreement negotiated between the investor and the central authorities of a contracting party. In other words, the BIT does not, in principle, apply to taxation measures, unless the competent authorities of each contracting party disagree among themselves that they amount in fact to an expropriation or that such measures violate a contract previously agreed between the investor and the host country.

A second variation of a general exception on taxation is included in recent treaties of Japan. For instance, the BIT between Japan and Viet Nam (2003) states the following:

“Article 19

1. *Nothing in this Agreement shall apply to taxation measures except as expressly provided for in paragraphs 2, 3 and 4 of this Article.*
2. *Articles 1, 3, 7, 9, 22, and 23, shall apply to taxation measures.*¹⁰⁷
3. *Articles 13, and 14, shall apply to disputes under paragraph 2 above.*¹⁰⁸
4. *Article 20, shall apply to taxation measures regarding matters set out in paragraph 2 of this Article.*¹⁰⁹

There are several similarities between this concept and the tax exception used in the Canadian model BIT. However, the Japanese approach contains two important differences. First, more obligations of the BIT apply to taxation measures, and second, the investors do not depend on any decision of the contracting parties to be able to submit a claim.

In contrast to the above examples, there are also some BITs that apply, in principle, to taxation matters. However, they include a limited exception concerning the obligation not to discriminate. These treaties allow a contracting party to abstain from granting national treatment and MFN treatment to investors of the other contracting party with respect to any tax benefit that the former may grant to its citizens or residents. The protocol of the BIT between Germany and Mexico (1998) typifies this approach:

“Protocol

[...]

3. *Ad article 3*

[...]

- (b) *The provisions in Article 3 [National Treatment and MFN Treatment] are not binding for a Contracting State to extend to the natural persons and companies resident in the other Contracting State's territory: the tax benefits, exemptions and reductions which according to tax laws are applicable only to natural persons and residents in the Contracting State's territory.”*

If a contracting party adopted taxation measures inconsistent with any of the obligations of the agreement other than those on national treatment and MFN treatment, they could, in principle, be challenged under the dispute settlement procedures in the BIT. An example is excessive taxation amounting to indirect expropriation (“confiscatory tax measure”).

b. Essential security and public order

A second category of exceptions in several BITs comprises those safeguarding the flexibility of the contracting parties to take any kind of measure that is considered necessary to protect their essential security interests and maintain public order. These exceptions can be analysed from two different perspectives. One is to focus on the clarification of the policy objectives that these exceptions purport to protect. The other is to observe the architecture and scope of the exceptions.

Regarding the first angle, BITs avoid including a definition of what should be understood as *essential security* or *public order*. By leaving these terms undefined contracting parties may wish to safeguard their flexibility to determine on their own, on a case-by-case basis, whether they are facing a situation in which their essential security or public order is threatened. One pertinent question in this respect is, for example, whether measures of a contracting party in response to economic crisis might be covered by an *essential security* exception. It appears that there does not yet exist any jurisprudence on this specific issue.

The context in which the terms *essential security* and *public order* are used in most BITs suggests that they refer to different situations. Some BITs explicitly differentiate between the two concepts. For instance, the BIT between Finland and Kyrgyzstan (2003) states the following:

“Article 14
General derogations

1. *Nothing in this Agreement shall be construed as preventing a Contracting Party from taking any action necessary for the protection of its **essential security interests** in time of war or armed conflict, or other emergency in international relations.*
2. *Provided that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination by a Contracting Party, or a disguised investment restriction, nothing in this Agreement shall be construed as preventing the Contracting Parties from taking any measure necessary for the maintenance of **public order**. [...]* (emphasis added)

Other BITs provide some guidance for differentiating an exception on *national security* grounds from one on *public order* grounds. This is the case of the BIT between Japan and the Republic of Korea (2002):

“Article 16

1. *Notwithstanding any other provisions in this Agreement other than the provisions of Article 11, each Contracting Party may:*
 - (a) *take any measure which it considers necessary for the protection of its **essential security interests**;*
 - (i) *taken in time of war, or armed conflict, or other emergency in that Contracting Party or in international relations; or*
 - (ii) *relating to the implementation of national policies or international agreements respecting the non-proliferation of weapons;*
 - (b) *take any measure in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;*
 - (c) *[...] or*
 - (d) *take any measure necessary for the maintenance of **public order**. The public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society. [...]* (emphasis added)

The protection of essential security interests mainly applies in situations where the country wants to protect itself against international or domestic situations of war, armed conflict or any other kind of belligerence or international emergency. By contrast, the maintenance of public order refers to ensuring peace and the rule of law within the country in situations below the threshold of a threat to national security.

The specific terminology in the drafting of clauses addressing these topics varies among BITs. Instead of the term “*essential security interests*”, other BITs, such as the agreement between Hong Kong (China) and New Zealand (1995), use the term “*essential interests*”, while some treaties refer to “*national security interests*”, as is the case of the BIT between CARICOM and Cuba (1997) (table 22).

Some exceptions refer to other related policy objectives to justify the non-application of the obligations in the BIT. These exceptions relate to *circumstances of extreme emergency* and the necessity to comply with *obligations with respect to maintenance and restoration of international peace and security*.

An example of a reference to situations of “*extreme emergency*” is the BIT between Croatia and India (2001):

“Article 12
Applicable Laws

- (1) *Except as otherwise provided in this Agreement, all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made.*
- (2) *Notwithstanding paragraph 1 of this Article nothing in this Agreement precludes the host Contracting Party from taking action for the protection of its essential security interests or in **circumstances of extreme emergency**, provided such actions have been prescribed by its laws*

which are applied normally and reasonably, on a non discriminatory and a non arbitrary basis.” (emphasis added)

Table 22. Examples of provisions on essential security exceptions

BIT between Australia and India (1999)	BIT between Hong Kong (China) and New Zealand (1995)	BIT between CARICOM and Cuba (1997)
“Article 15 Prohibitions and restrictions Nothing in this Agreement precludes the host Contracting Party from taking, in accordance with its laws applied reasonably and on a non-discriminatory basis, measures necessary for the protection of its own essential security interests or for the prevention of diseases or pests.” (emphasis added)	“Article 8 Exceptions [...] 3. The provisions of this Agreement shall not in any way limit the right of either Contracting Party to take measures directed to the protection of its essential interests ... provided that such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination.” (emphasis added)	“Article XVII General exemptions [...] 2. This Agreement shall not preclude the application by either Party of measures necessary for the protection of its own national security interests.” (emphasis added)

Once again, this mode does not define what should be understood as “*circumstances of extreme emergency*”, leaving the concept to be clarified on a case-by-case basis.

In addition to the protection of essential security interests, several BITs provide for the right of a contracting party to invoke a general treaty exception in situations where compliance with the agreement would impede “*the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security*”. This type of exception is included in practically all BITs of the United States, and, more recently, in the 2004 Canadian model BIT. An illustration of this manner is the BIT between Mozambique and the United States (1998).

“Article XVI

1. *This Treaty shall not preclude a Party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests. [...]*

This clause provides the contracting parties with discretion to determine whether a particular measure is in fact necessary in order to comply with obligations concerning the maintenance or restoration of international peace or security, or to protect a contracting party's essential security interests. Such a “self-judging” provision has important legal consequences, since it would impede a neutral body — such as an international arbitration tribunal — from making its own independent assessment of whether the measure taken by the host country authorities was actually necessary or not. Furthermore, the provision does not specify the origin of such obligations. In this regard, the clause contrasts with the 2004 Canadian model BIT, which explicitly states that such obligations would be those derived from the Charter of the United Nations:

“Article 10
General Exceptions

- [...]
4. *Nothing in this Agreement shall be construed:*
[...]
(c) *to prevent any Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.”*

Another way to look at the essential security exceptions is to observe the different approaches used in BITs regarding their architecture and scope. From this perspective, the agreements under review have applied a number of techniques.

Rather than exempting a contracting party from complying with the BIT in situations of protection of essential security interests, one category of agreements exempts the country concerned only from the obligations of national treatment and MFN treatment. The protocol of the BIT between Germany and Mexico (1998) is an example:

“Protocol

[...]

3. *Ad article 3*

- (a) *The measures taken by reason of national security, public interest, public health or morality shall not be considered as a “less favourable treatment”, according to Article 3. [...]*¹¹⁰

A second means is to oblige the contracting party invoking the essential security exception to comply with certain procedural requirements vis-à-vis the other contracting party. The BIT between Japan and Viet Nam (2003) characterizes this method:

“Article 15

1. *Notwithstanding any other provisions in this Agreement other than the provisions of Article 10,¹¹¹ each Contracting Party may:*
 - (a) *take any measure which it considers necessary for the protection of its essential security interests [...]*
 - (b) *take any measure in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;*
 - [...] *or*
 - (d) *take any measure necessary for the maintenance of public order. The public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.*
2. *In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 10, that Contracting Party shall not use such measure as a means of avoiding its obligations.*
3. *In cases where a Contracting Party takes any measure, pursuant to paragraph 1 of this Article, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 10, that Contracting Party shall, prior to the entry into force of the measure or as soon thereafter as possible, notify the other Contracting Party of the following elements of the measure: (a) sector and sub-sector or matter; (b) obligation or article in respect of the measure; (c) legal source of the measure; (d) succinct description of the measure; and (e) purpose of the measure.”*

A third method is to refrain from including an explicit provision in the treaty, and instead to prevent covered investors from invoking the dispute settlement rules of the agreement. The BIT between Mexico and Sweden (2000) epitomizes this approach.

*“Article 18
Exclusions*

The dispute settlement provisions of this Section shall not apply to the resolutions adopted by a Contracting Party which, in accordance with its legislation, and for national security reasons, prohibit or restrict the acquisition by investors of the other Contracting Party of an investment in the territory of the former Contracting Party, owned or controlled by its nationals.”

A fourth method allows contracting parties to invoke their national laws, including those on essential security grounds, and make this right subject to the obligations of the agreement. For instance, the BIT between Ghana and India (2002) states:

*“Article 12
Applicable Laws*

(1) Except as otherwise provided in this Agreement, all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made including such laws enacted for the protection of its essential security interests or in circumstances of extreme emergency provided however that such laws are reasonably applied on a non-discriminatory basis.”
(emphasis added)

On the one hand, the wording of this clause suggests that the original intention of the contracting parties was to allow themselves total flexibility in protecting their essential security interests. On the other hand, the text states that the laws in force in the territory of the contracting parties shall govern the investments “*except as otherwise provided in this Agreement*”. As most of the core obligations in the BIT cited above are not subordinated to domestic legislation, it appears that the contracting parties are prevented from invoking national laws to refrain from complying with these obligations.

c. Protection of health and natural resources

A third category of exceptions in some recent BITs allows the contracting parties to adopt or maintain a measure inconsistent with the obligations of the agreement, provided that such measure is necessary for ensuring the protection of human, animal or plant life or health or, in some cases, the protection of natural resources. General treaty exceptions for the protection of health, life and natural resources are less frequent than exceptions protecting other policy objectives, such as taxation and essential security interests.

Once again, the specific terminology used in the different exceptions varies from one treaty to another. However, unlike in the case of an essential security exception — the scope of which depends on the interpretation of an undetermined concept subject to the eye of the beholder — the determination of whether a particular measure is *necessary* for the protection of health or natural resources entails a more objective and precise assessment.

BITs concluded since 1996 follow different approaches to drafting this specific kind of exception. A method used in several agreements consists in simply allowing the contracting party to invoke the exception, provided that the inconsistent measure is necessary, and that it serves the purpose of protecting the policy objectives it claims to safeguard. An example is the BIT between Mauritius and Switzerland (1998):

*“Article 11
Other Rules and Specific Commitments*

[...]

(3) Nothing in this Agreement shall be construed to prevent a Contracting Party from taking any action necessary [...] for reasons of public health or the prevention of diseases in animals and plants.”

Another method in some BITs is to make the exception conditional on the fulfilment of certain requirements aimed at preventing its abuse. This method obliges the contracting party to apply the otherwise non-consistent measure on a non-discriminatory basis and to avoid using it as a disguised restriction on investment. Thus, the contracting party invoking the exception has to demonstrate the necessity of the non-consistent measure. In addition, the contracting party would need to show not only that the particular measure is applied on a non-discriminatory basis, but also that it is the less distortional in safeguarding the policy objectives. Different variations of this approach exist (table 23).

Table 23. Examples of exceptions to protect health and natural resources

BIT between Argentina and New Zealand (1999)	BIT between Australia and India (1999)	BIT between Armenia and Canada (1997)
“Article 5 Exceptions [...] (3) The provisions of this Agreement shall in no way limit the right of either Contracting Party to take any measures (including the destruction of plants and animals, confiscation of property or the imposition of restrictions on stock movement) necessary for the protection of natural and physical resources or human health, provided such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination.” (emphasis added)	“Article 15 Prohibitions and restrictions Nothing in this Agreement precludes the host Contracting Party from taking, in accordance with its laws applied reasonably and on a non-discriminatory basis, measures necessary for [...] the prevention of diseases or pests.” (emphasis added)	“Article XVII: Application and General Exceptions [...] 3. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures: (a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; (b) necessary to protect human, animal or plant life or health; or (c) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption. [...]” (emphasis added)

There is a third mode, which relates to the health and natural resources exception. Used in several BITs, it consists in obliging the contracting party invoking the exception to comply with certain procedural requirements vis-à-vis the other contracting party rather than simply allowing the former to grant itself a waiver from the obligations of the BIT.

For instance, article 16.1 (c) of the BIT between Japan and the Republic of Korea (2002) provides that “[n]otwithstanding any other provisions in this Agreement other than the provisions of Article 11, each Contracting Party may [...] take any measure necessary to protect human, animal or plant life or health”.¹¹² Despite this authorization of the contracting parties to deviate from the obligations of the BIT, the exception explicitly conditions this right to the fulfilment of certain procedural requirements. Article 16 paragraphs 2 and 3 of this BIT mandate the contracting parties to refrain from using the exception as a means to avoid their obligations under the agreement.¹¹³ Furthermore, the treaty stipulates that if a contracting party takes any non-consistent measure pursuant to the exception, it shall notify the other party of the measure prior to its entry into force or as soon as possible thereafter, as well as of its elements, legal basis and purpose.

The BIT between the United States and Uruguay (2005) embodies a fourth approach:

“Article 12: Investment and Environment

[...]

2. *Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure **otherwise consistent with this Treaty** that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.*” (emphasis added)

Rather than constituting permission to disregard an obligation included in the treaty, this clause confirms the sovereign right of the contracting parties to take measures that they consider appropriate for the protection of the environment.¹¹⁴ However, such measures are allowed only if they do not violate BIT obligations. The purpose of the clause is therefore mainly explanatory. It is a tool for sending a message to civil societies that the contracting parties take environmental concerns into account.

According to this view, there remains a risk of incompatibility between investment protection and the protection of health or natural resources. Such risk would exist with respect to expropriation if an investor challenges measures taken to protect health or the environment on the basis that they would constitute an indirect expropriation.¹¹⁵ To address this situation, the BIT between the United States and Uruguay (2005) provides the following:

*“Annex B
Expropriation*

The Parties confirm their shared understanding that: [...]

4. [...] (b) *Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.”*

In sum, the above concept relies on the hypothesis that if contracting parties purport to protect health, safety or the environment rather than using those objectives as a disguised means to discriminate against foreign investment, the BIT should not limit the flexibility required in order to safeguard these key values of society.

d. Cultural exceptions

The increasing level of internationalisation generates tendencies in national societies towards cultural harmonization. It is within this context that some BITs under review have included cultural exceptions. They aim at safeguarding the discretion of the contracting parties to adopt measures considered necessary for preserving national culture or promoting cultural diversity.

The inclusion of a cultural exception in BITs has been practically limited to treaties of Canada and to some negotiated by France.¹¹⁶ Although fundamentally pursuing the same ends, the approaches in designing this clause have been different.

The BIT between France and Uganda (2002) demonstrates one method used in these agreements:

*“Article 1
Definitions*

[...]

6. *Nothing in this agreement shall be construed to prevent any contracting party from taking any measure to regulate investment of foreign companies and the conditions of activities of these companies in the framework of policies designed to preserve and promote cultural and linguistic diversity.”*¹¹⁷

This approach is relatively broad. It provides contracting parties with full discretion to adopt any kind of measure to regulate foreign investment, even after it has been admitted into the host country. The exception covers not only measures directly addressing cultural issues, but also those addressing related matters, such as the production or distribution of a manufacture or service, or the regulation of property rights. Insofar as those measures were taken within the framework of policies designed to preserve and promote cultural and linguistic diversity, they would be covered by the cultural exception.

Furthermore, it is the country invoking the exception that, in principle, determines whether a particular measure fits within the policy framework designed to preserve and promote cultural and linguistic

diversity. It would be difficult to second-guess such an assessment in an international arbitration case. In this regard, it should be noted that the exception does not require the measure to be *necessary* for the preservation and promotion of cultural and linguistic diversity. It would be sufficient that the measure was *designed* to pursue those ends.

The other concept is followed by Canada.¹¹⁸ It focuses on investments in *cultural industries*, which are excluded from the scope of application of the agreement. The BIT between Canada and Thailand (1997) is an example:

“Article VI
Miscellaneous Exceptions

[...]

3. *Investments in cultural industries are exempt from the provisions of this Agreement. “Cultural industries” means persons engaged in any of the following activities:*
 - (a) *the publication, distribution, or sale of books, magazines, periodicals or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;*
 - (b) *the production, distribution, sale or exhibition of film or video recordings;*
 - (c) *the production, distribution, sale or exhibition of audio or video music recordings;*
 - (d) *the publication, distribution, sale or exhibition of music in print or machine readable form;*
or
 - (e) *radio communications in which the transmissions are intended for direct reception by the general public, and all radio, television or cable broadcasting undertakings and all satellite programming and broadcast network services.”*

Technically speaking, this approach is not an exception, but rather an exclusion of a sector from the scope of application of the agreement.

Another noteworthy aspect is the use of an exhaustive list of cultural industries. It enables investors to identify the scope of the exclusion before the investment is made. As opposed to using a broad conceptual exception providing the countries with significant flexibility, this approach requires greater clarity on the part of the contracting parties as to the specific activities that they consider to be crucial for the protection of cultural values.

e. Prudential measures for financial services

A fifth category of exceptions included in some recent BITs enables contracting parties to adopt or maintain measures on financial services that are inconsistent with the obligations of the agreement, provided that such measures are justified for prudential reasons.

Financial services are usually heavily regulated and subject to close supervisory control by specialized governmental authorities. This reflects the fact that financial services represent a sector that is not only important in its own right, but also has a crucial impact on other sectors of the economy. Thus, some countries consider it important to explicitly ensure that their supervisory authorities have enough discretion to implement the relevant regulations.

Not many BITs under review include prudential exceptions applicable to financial services. At the beginning of the period, this practice was almost exclusively limited to Canadian BITs and some Caribbean countries. However, more recently, an increasing number of agreements have followed suit. This is the case of several BITs of Japan and the United States.

BITs specifically dealing with financial services usually make reference to different kinds of prudential measures. The first category comprises measures aimed at the protection of the clients of financial institutions, such as investors, depositors or financial market participants. A second group of BITs applies to financial institutions to ensure their safety, soundness, integrity or financial responsibility. Other agreements

refer to those laws and regulations that aim at safeguarding the integrity and stability of the financial system as a whole.

Unlike in the case of other investment-related issues, the level of convergence concerning prudential exceptions for financial services is remarkable. Despite some minor variations of language, the exceptions in the different BITs contain the same basic elements. Contracting parties are authorized to adopt or maintain laws or regulations of a prudential nature with respect to financial services. The clauses also include some specific examples of the kind of measures covered by the exception. Another element often included in this kind of exception is the commitment of contracting parties to abstain from applying a prudential measure as a means of disregarding the obligations assumed under the applicable BIT (table 24).

Table 24. Examples of exceptions on prudential measures in financial services

BIT between the United States and Uruguay (2005)	BIT between Japan and Viet Nam (2003)	Canadian model BIT (2004)
“Article 20: Financial Services 1. Notwithstanding any other provision of this Treaty, a Party shall not be prevented from adopting or maintaining measures relating to financial services for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Treaty, they shall not be used as a means of avoiding the Party’s commitments or obligations under this Treaty. 2. (a) Nothing in this Treaty applies to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies. This paragraph shall not affect a Party’s obligations under Article 7 or Article 8. (b) For purposes of this provision, “public entity” means a central bank or monetary authority of a Party. [...]”	“Article 17 1. Notwithstanding any other provisions of this Agreement, a Contracting Party may adopt or maintain prudential measures with respect to financial services, including measures for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by an enterprise providing financial services, or to ensure the integrity and stability of its financial system. 2. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement, that Contracting Party shall not use such measure as a means of avoiding its obligations. [...]”	“Article 10 General Exceptions [...] 2. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: (a) the protection of investors, depositors, financial market participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution; (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions; and (c) ensuring the integrity and stability of a Party’s financial system. 3. Nothing in this Agreement shall apply to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies. This paragraph shall not affect a Party’s obligations under Article 7 (Performance Requirements) or Article 14 (Transfer of Funds); [...]”

f. Miscellaneous exceptions

In addition to the five subject-specific categories of exceptions previously explained, some recent BITs include general exceptions to address other concerns. For instance, some agreements use exceptions to exclude a certain geographical area from the application of the agreements.¹¹⁹ Other BITs contain exception clauses to clarify the relationship between the treaty and agreements on intellectual property rights.¹²⁰

Thus, general exceptions can serve multiple purposes. They are instruments to adjust the BIT models used by numerous countries to the particularities of the specific negotiation. Despite the significant degree of commonality between most BITs, the negotiation of each agreement has its own dynamics. Exception clauses can play a key role in establishing the necessary flexibility for contracting parties in order to obtain

the necessary political support in each capital. Furthermore, the multiplicity of issues addressed through miscellaneous exceptions evidences a trend that is often overlooked.

g. MFN exceptions

As explained in section E above, most BITs contain an MFN exception exempting contracting parties from granting investors of the other contracting party preferential treatment that they may provide to investors of third countries pursuant to regional economic integration or double taxation agreements. With some variations, this trend has continued among the majority of BITs under review. However, some agreements have converted this limited reservation into a *general* treaty exception, exempting the contracting parties not only from the MFN obligation, but also from any other obligation included in the treaty. The BIT between Finland and Mexico (1999) exemplifies this approach:

“Article 4 Exceptions

The provisions of this Agreement shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege by virtue of:

- (a) any existing or future free trade area, customs union, common market or regional labour market agreement to which one of the Contracting Parties is or may become a party,*
- (b) any international agreement or arrangement relating wholly or mainly to taxation,*
- (c) any multilateral agreement on investments.”*

2. Emerging issues

As mentioned at the beginning of this section, there has been a significant trend in several recent BITs towards providing that investment promotion and protection must not be pursued at the expense of certain other key policy objectives. For this purpose, some BITs have included general exceptions, while other agreements have reiterated the authority of national Governments to design and implement measures to safeguard certain values, such as the protection of health, safety, the environment, and the promotion of internationally recognized labour rights.

The method for including positive language in BITs to reinforce the intention and prerogatives of the contracting parties to protect key societal values does not have the same legal effects as a general treaty exception. The result of the latter is to allow national authorities to disregard any obligation in the BIT on the basis that doing so is required in order to protect one of the policy objectives specified in the exception clause. The effect of including positive language, however, does not allow for exemption from BIT obligations.

One way of introducing positive language into the BIT is to reiterate the notion that there should be no conflict between the obligations in the agreement and the sovereign right of countries to pursue other key policy objectives. This constitutes a political statement by the contracting parties — a message usually included in the preambles of BITs, which may be used for the interpretation of the substantive provisions of the agreement.¹²¹

An alternative is a commitment by the contracting parties to abstain from lowering standards of protection in certain policy areas as a means of attracting foreign investment. This approach not only represents per se a strong political statement, but also may go further by converting the protection of the identified policy objectives into another binding obligation or a “best efforts” commitment. Thus, respect for these policy objectives becomes part of the context in which the rest of the obligations in the BIT have to be interpreted, and this significantly reduces the risk of a legal conflict between the two.

BITs have continued to be seen by contracting parties as *investment* agreements, and, as such, focus on the promotion and protection of investment. However, over the last 10 years, a limited number of BITs

has started to stress the safeguarding of certain other policy objectives. The protection of health, safety, the environment and core labour standards have gradually, but consistently, emerged as new issues in several BITs.

a. Protection of public health and safety

The protection of public health and safety is one of the issues that consistently appear among the BITs negotiated recently. Two different approaches can be distinguished. One approach is to underline the importance of adequately protecting this policy objective in the preambles of the treaties. The BIT between Namibia and the Netherlands (2002) typifies this trend:

“Preamble

The Kingdom of the Netherlands and the Republic of Namibia, hereinafter referred to as the Contracting Parties,

[...]

Considering that a stable framework for international investment will promote effective utilization of economic resources and improve living standards;

[...]

*Considering that these objectives can be achieved without compromising **health, safety** [...] measures of general application;*

Have agreed as follows:” (emphasis added)

This stresses that investment protection should not be considered incompatible with the objective of adequately protecting health and safety. This political statement has increasingly been included in several preambles of recent BITs, regardless of the region where the contracting parties are located. For instance, the preamble of the BIT between the Republic of Korea and Trinidad and Tobago (2002) states that the promotion and protection of investment “[...] *can be achieved without relaxing health, safety [...] measures of general application*”, and the BIT between Finland and Kyrgyzstan (2003) states that the objectives of promotion of investment flows “[...] *can be achieved without relaxing health, safety [...] measures of general application.*”¹²²

The other approach, used in some recent BITs, is to include a non-legally binding commitment by the contracting parties to abstain from relaxing the protection standards as a means of attracting or maintaining investment in their territories. The BIT between Mexico and Switzerland (1995) illustrates this method:

“Protocol Ad Article 3

*The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety [...] measures. **Accordingly, neither Party should waive or otherwise derogate from, or offer to waive or derogate, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If either Party considers that the other Party has offered such an encouragement, it may request consultations.*** [...]” (emphasis added)

This clause, which is very similar to those in other BITs, makes reference to domestic health and safety measures.¹²³ Although this concept is not explicitly defined, it is implied that it applies to any law, regulation or administrative decision regulating health or safety in the territory of the contracting parties. It is not necessary to demonstrate a continuous pattern of behaviour for a contracting party to infringe the clause. Rather, it would suffice that a health or safety regulation was relaxed in favour of a single investor. Finally, the provision deals with the case of non-compliance by one party. In this situation, the other party may request consultations. The provision does not indicate, however, what would happen if those consultations failed.

b. Protection of the environment

Of all the newly emerging issues, the BITs under review most frequently address the topic of environmental protection (UNCTAD, 2001b).

There are BITs that address the importance of protecting the environment in their preambles. They not only have very similar wording, but also stress the idea of compatibility between investment protection and environmental protection. An example is the preamble of the BIT between Mozambique and the Netherlands (2001):

“The Government of the Republic of Mozambique and the Government of the Kingdom of the Netherlands (hereinafter the “Contracting Parties”);

[...]

Agreeing that a stable framework for international investment will maximise effective utilisation of economic resources and improve living standards;

[...]

Agreeing that these objectives can be achieved without relaxing health, safety and environmental measures of general application;

[...]

Have agreed as follows: [...]” (emphasis added)

BITs addressing the importance of environmental protection in their preambles do not in general include any specific clause on this subject in the body of the agreement.¹²⁴ This is the case, for instance, of the BITs between Japan and Viet Nam (2003), between Namibia and the Netherlands (2002) and between Bosnia Herzegovina and Finland (2000). On the other hand, most BITs that include specific clauses on environmental protection do not make any reference to it in their preambles. Examples are the recent BITs of Belgium–Luxembourg with Botswana (2003), Ethiopia (2003), Mauritius (2005) and Zimbabwe (2003), and the Canadian model BIT (2004).

Other BITs deal with the issue of environmental protection in the main body of the agreement. For instance, numerous BITs have provisions that are subject to domestic legislation. This includes laws and regulations protecting the environment. The BIT between Costa Rica and the Netherlands (1999) is illustrative of this approach:

“Article 10

*The provisions of this Agreement shall, from the date of entry into force thereof, apply to all investments made, whether before or after its entry into force, by investors of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party, **including its laws and regulations on labour and environment.***

The provisions of this Agreement shall not apply to any dispute concerning an investment which arose, or any claim which was settled before its entry into force.” (emphasis added)

This approach has the same legal effect as an admission clause. If the latter provides that the BIT shall apply only to those investments admitted into the host country in accordance with the host country's domestic legislation, it is evident that such laws and regulations include rules related to environmental protection. Thus, this approach is particularly useful for political purposes, since it signals to civil society and the international community that the contracting parties take environmental concerns into consideration when admitting foreign investment.

A third mode is, once again, a non-legally binding commitment by the contracting parties authorities to abstain from relaxing domestic standards as a means of attracting or maintaining investment in their territories. This idea has several variations, one of which is illustrated by the new Canadian model BIT (2004), which provides as follows:

“Article 11
Health, Safety and Environmental Measures

*The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or **environmental measures**. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.” (emphasis added)*

The provision refers to “*environmental measures*” without defining them. It seems that this term would cover any law, regulation or administrative decision regulating environmental matters in the territory of the contracting parties. The clause addresses the waiving or relaxing of *any* environmental measure — or offering to do so — in order to attract or maintain an investment. In this connection, it would once again not be necessary to demonstrate a continuous pattern of behaviour by a contracting party in violation of the commitment. Rather, it would suffice that an environmental regulation was relaxed in favour of a single investor. Finally, the article stipulates that the parties will consult each other in situations in which one of them considers that the commitment has not been respected. However, it remains open as to what would happen if these consultations failed.

Several recent BITs of Belgium and Luxembourg show a variation of this approach,¹²⁵ an example of which is the BIT between Belgium–Luxembourg and Zimbabwe (2003):

“Article 5
Environment

1. *Recognising the right of each Contracting Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental legislation, each Contracting Party shall strive to ensure that its legislation provides for high levels of environmental protection and shall strive to continue to improve this legislation.*
2. *The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing **domestic environmental legislation**. Accordingly, each Contracting Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, **such legislation** as an encouragement for the establishment, maintenance or expansion in its territory of an investment.*
3. *The Contracting Parties reaffirm their commitments under the international environmental agreements, which they have accepted. They shall strive to ensure that such commitments are fully recognised and implemented by their **domestic legislation**.*
4. *The Contracting Parties recognise that co-operation between them provides enhanced opportunities to improve environmental protection standards. Upon request by either Contracting Party, the other Contracting Party shall accept to hold expert consultations on any matter falling under the purpose of this Article.” (emphasis added)*

This provision is complemented by a definition of the term “*environmental legislation*”. It reads as follows:

“Article 1
Definitions

*For the purpose of this Agreement,
[...]*

6. *The term “environmental legislation” shall mean any legislation of the Contracting Parties, or provision thereof, the primary purpose of which is the protection of the environment, or the prevention of a danger to human, animal, or plant life or health, through:*

- a) *the prevention, abatement or control of the release, discharge, or emission of pollutants or environmental contaminants;*
- b) *the control of environmentally hazardous or toxic chemicals, substances, materials and wastes, and the dissemination of information related thereto;*
- c) *the protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas in the Contracting Party's territory."*

Unlike the Canadian model BIT previously referred to, this non-lowering of environmental standards clause refers only to "*environmental legislation*". It therefore has a narrower scope. Furthermore, it explicitly refers to the duty of each party to comply with the obligations that it has assumed under international environmental agreements. Another innovation is the explicit recognition that contracting parties may achieve better results in their efforts to improve environmental protection through international cooperation than through punitive means.

The Agreement between Belgium–Luxembourg and Zimbabwe (2003) does not explicitly exclude the right of a contracting party or a covered investor to submit a claim under the dispute settlement procedures of the BIT in order to enforce the commitments in article 5. It could be argued that by establishing a duty to accept consultations on any matter falling under this provision, the contracting parties expressed their intention to have a distinct mechanism to solve their differences in this particular area. However, it could also be argued that by not explicitly excluding dispute settlement article 5 is not different from any other BIT provision, the interpretation and application of which could be subject to those procedures.

The latter issue is explicitly dealt with in the BIT between the United States and Uruguay (2005). It states that the commitment on environmental protection is subject neither to the investor–State¹²⁶ nor to the State–State¹²⁷ dispute settlement procedures of the agreement. Furthermore, the BIT specifies in footnote 13 to article 12.1 that "*For the United States, "laws" for purposes of this Article means an act of the United States Congress or regulations promulgated pursuant to an act of the United States Congress that is enforceable by action of the central level of government*". This footnote indicates not only that administrative decisions are not included in the commitment of article 12.1, but also that laws enacted by State legislatures, at least in the case of the United States, are excluded from its scope.¹²⁸

c. Protection of labour standards

The third emerging issue in BIT negotiations is the protection of labour standards (UNCTAD 2001c). Unions in capital-exporting countries have raised concerns about BITs on the grounds that patterns of international production in general, and FDI in particular, would result in an increase in unemployment in their economies ("job exports"). It is argued that FDI inflows into developing countries would be partially generated by practices of "social dumping", as investors would prefer to locate in countries with lower labour protection standards.

As a result, capital-exporting countries have been confronted with pressure from their domestic constituencies to incorporate labour protection issues in the agenda of international investment negotiations. An increasing group of countries have therefore started to introduce this subject in investment rulemaking. However, at least among the BITs under review, the number of agreements addressing this issue is lower than the number of BITs dealing with environmental protection.

The techniques used to incorporate labour concerns in BITs have been basically the same as those for addressing other emerging issues. Most frequent is a political statement in the BIT preambles. Most agreements use similar language (table 25).

Another — rarely used — means of stressing the commitment of the contracting parties in favour of protecting labour standards is, once again, to provide that they shall strive to abstain from relaxing them as a means of attracting or maintaining investment in their territories. Examples are some agreements negotiated

during the last five years by Belgium and Luxembourg on the one hand, and the United States, on the other hand.¹²⁹

Table 25. Examples of references to international labour standards in preambles

BIT between Finland and Nicaragua (2003)	BIT between Austria and Bosnia Herzegovina (2000)
“The Government of the Republic of Finland and the Government of the Republic of Nicaragua, hereinafter referred to as the “Contracting Parties”, [...] agreeing that a stable framework for investment will contribute to maximising the effective utilisation of economic resources and improve living standards; Recognising that the development of economic and business ties can promote respect for internationally recognised labour rights; [...]” (emphasis added)	“The Republic of Austria and Bosnia-Herzegovina hereinafter referred to as “Contracting Parties”; desiring to create favourable conditions for greater economic co-operation between the Contracting Parties; [...] Reaffirming their commitment to the observance of internationally recognized labour standards; Have agreed as follows: [...]” (emphasis added)

For instance, the BIT between Belgium–Luxembourg and Ethiopia (2003) provides as follows:

“Article 6
Labour

1. *Recognising the right of each Contracting Party to establish its own domestic labour standards, and to adopt or modify accordingly its labour legislation, each Contracting Party shall strive to ensure that its legislation provide for labour standards consistent with the internationally recognised labour rights set forth in paragraph 6 of Article 1 and shall strive to improve those standards in that light.*
2. *The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing domestic labour legislation. Accordingly, each Contracting Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such legislation as an encouragement for the establishment, maintenance or expansion in its territory of an investment.*
3. *The Contracting Parties reaffirm their obligations as members of the International Labour Organisation and their commitments under the International Labour Organisation Declaration on Fundamental Principles and Rights at Work and its Follow-up. The Contracting Parties shall strive to ensure that such labour principles and the internationally recognised labour rights set forth in paragraph 6 of Article 1 are recognised and protected by domestic legislation.*
4. *The Contracting Parties recognise that co-operation between them provides enhanced opportunities to improve labour standards. Upon request by either Contracting Party, the other Contracting Party shall accept to hold expert consultations on any matter falling under the purpose of this Article.”*

This provision is complemented by a definition of the term “labour legislation”. It reads as follows:

“Article 1
Definitions

- [...]
6. *The terms “labour legislation” shall mean legislation of the Kingdom of Belgium, of the Grand-Duchy of Luxembourg or of the Federal Democratic Republic of Ethiopia, or provisions thereof, that are directly related to the following internationally recognised labour rights:*
 - a) *the right of association;*
 - b) *the right to organise and bargain collectively;*

- c) *a prohibition on the use of any form of forced or compulsory labour;*
- d) *a minimum age for the employment of children;*
- e) *acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health."*

This concept explicitly recognizes that each country has the right "to establish its own domestic labour standards and adopt or modify accordingly its labour legislation". However, it is also stated that each contracting party "shall strive to ensure" that its legislation provides for labour standards consistent with the labour rights listed in the definition of "labour legislation" cited above, which are considered to be internationally recognized labour rights. This refers to each party's obligations derived from its membership of the International Labour Organization (ILO) and the ILO Declaration on Fundamental Principles and Rights at Work.

The approach expressly recognizes that international cooperation provides contracting parties with enhanced opportunities to improve labour standards. This feature is an important conceptual innovation, as it perceives consultations between the contracting parties not only as a mechanism to promote the enforcement of commitments, but also as a means to devise joint initiatives in favour of effective development of labour rights.

Among the BITs including an explicit provision on the abstention of contracting parties from relaxing labour standards, there is a second category *applying a variation of this approach*. It is illustrated by some recent BITs of the United States, such as the BIT with Uruguay (2005), which provides as follows:

"Article 13: Investment and Labor

1. *The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic labor laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces adherence to the internationally recognized labor rights referred to in paragraph 2 as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.*
2. *For purposes of this Article, "labor laws" means each Party's statutes or regulations, or provisions thereof, that are directly related to the following internationally recognized labor rights:*
 - (a) *the right of association;*
 - (b) *the right to organize and bargain collectively;*
 - (c) *a prohibition on the use of any form of forced or compulsory labor;*
 - (d) *labor protections for children and young people, including a minimum age for the employment of children and the prohibition and elimination of the worst forms of child labor; and*
 - (e) *acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health.*
3. *Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to labor concerns."*

This approach differs from the example of the BIT between Belgium–Luxembourg and Ethiopia (2003) in several ways.

First, the BIT between the United States and Uruguay (2005) addresses only such waivers from domestic labour laws as *weaken or reduce adherence to internationally recognized labour rights*. By contrast, the BIT between Belgium–Luxembourg and Ethiopia (2003) deals with the relaxation of domestic

labour legislation in general. Second, only the latter treaty obliges contracting parties to strive to *improve* internationally recognized labour rights.

Third, only the BIT between the United States and Uruguay (2005) states that "*nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to labor concerns*". Although at first sight, this provision could be read as establishing a general treaty exception for labour issues, this is not the case. The clause does not exempt the contracting parties from the obligation to comply with the BIT. Rather, it reiterates the powers that national authorities already have to oblige an investor to comply with non-discriminatory and other legitimate labour protection measures. Thereby, the BIT sends a message to civil societies. Provided that the laws adopted to ensure compliance with labour rights are not disguised discrimination or otherwise violate the treaty, there is no reason to believe that investment protection is incompatible with the protection of other legitimate national policy objectives.

Fourth, the commitment included in the BIT between the United States and Uruguay (2005) applies only to laws or regulations enacted by the *Federal Government*. A footnote to article 13.2 states that laws enacted by State legislatures, at least in the case of the United States, are excluded from the scope of this provision.¹³⁰ Fifth, unlike in the case of BITs of Belgium and Luxembourg, this means that the commitment included in article 13.1 is subject neither to the investor–State nor the State–State dispute settlement provisions in the agreement.¹³¹ Thus, the consultations envisaged in the last sentence of article 13.1 are the only means for the contracting parties to enforce the commitment included therein.

* * *

To sum up, BITs concluded in the last decade include more often general exception clauses and draft them in a more complex manner than earlier agreements. The exceptions cover a variety of issues, including taxation, essential security and public order, protection of human health and the environment, cultural diversity and prudential measures in financial services. The more frequent use of exception clauses reflects a tendency to give more weight to certain public policy concerns in connection with BITs. Another approach taken in some recent BITs is to emphasize that investment promotion and protection must not be pursued at the expense of other key policy objectives, particularly in the area of public health and safety, environmental protection and respect for core labour rights.

L. Dispute resolution

In the context of international investment, the importance of dispute settlement provisions can be assessed from different angles. From the perspective of the investor, the most evident role of dispute settlement is to ensure that the obligations of the host country under the BIT are effectively implemented and enforced (UNCTAD 1998). Dispute settlement provisions increase the level of certainty and predictability that investors need. Moreover, these rules constitute one of the key elements in diminishing the country risk, and thus encourage investors of one contracting party to invest in the territory of the other.

Another way of assessing the importance of dispute settlement is to observe the fundamental role that rule-oriented adjudication mechanisms play in international governance, in particular for smaller developing countries.¹³² BITs establish the parameters governing the investment relationship between the host country and the investors, and between the contracting parties. From this perspective, these treaties represent a significant step in the evolution of a rule-oriented system for investment relations.

Disputes may arise between private parties (e.g. between an investor and its supplier), between an investor of one contracting party and the other contracting party, or between the contracting parties. Very few BITs concluded since 1995 contain specific provisions on investment-related disputes between private parties. One example is the BIT between Australia and Egypt (2001), which states as follows:

“Article 14
Settlement of disputes between investors of the Parties

Each Party shall in accordance with its law:

- (a) provide investors of the other Party who have made investments within its territory and personnel employed by them for activities associated with investments full access to its competent judicial or administrative bodies in order to afford means of asserting claims and enforcing rights in respect of disputes with its own investors;*
- (b) permit its investors to select means of their choice to settle disputes relating to investments **with the investors of the other Party**, including arbitration conducted in a third country; and*
- (c) provide for the recognition and enforcement of any resulting judgments or awards.”¹³³*
(emphasis added)

This article imposes an obligation on the contracting parties to provide investors of the other contracting party with access to their domestic courts, subject to their national laws. In addition, the investors of each contracting party have the right to pursue alternative means of dispute resolution. This includes arbitration in a third country.

This approach illustrates another important role of BITs: their impact on domestic reform and institutional modernization in developing countries. Providing private subjects with the right to accede to alternative means of dispute resolution in addition to domestic courts is an important element of modern administration of justice. However, in the above example this right is given only to a contracting party's own investors.

1. Investor–State dispute settlement

Investor–State dispute settlement provisions are a common feature of most BITs (UNCTAD 2003b). This kind of dispute resolution reflects the intention of the contracting parties to provide investors with avenues to directly defend their rights under BITs without having to depend on diplomatic protection of their home countries (UNCTAD 1998).

Having means at their disposal to ensure the host country's compliance with the obligations under BITs increases the level of certainty regarding the business environment in which investors operate in the host country. In addition, this mechanism ensures that the dispute is decided on legal grounds, thus separating legal from political considerations. Numerous BITs prevent the contracting party of which the investor is a national from exercising diplomatic protection while the investor–State arbitral proceeding is pending.¹³⁴ This is also an obligation under the ICSID Convention.¹³⁵

Most BITs include relatively general provisions on investor–State dispute settlement (table 26). Their content is often limited to specifying the different arbitration venues available to the investor, the procedures for appointing arbitrators, and the obligation imposed on the contracting parties to consider the arbitration award to be final and binding and to provide for its enforcement in their respective territories. Thus, numerous procedural aspects of arbitration are not regulated in the BITs themselves. Instead, the contracting parties frequently refer to existing arbitration rules — often ICSID and/or UNCITRAL — to clarify these matters.

During the last decade, an emerging group of BITs has addressed investor–State dispute settlement mechanisms in more detail, providing greater guidance to the disputing parties with respect to arbitration procedures and strengthening the rule orientation of these adjudication mechanisms. NAFTA Chapter 11 had a significant influence on these BITs. More recently, it is the experience acquired from disputes under NAFTA's Chapter 11 that has impacted on the innovations in some of the new model BITs, in particular those of Canada and the United States.

Table 26. Examples of investor–State dispute settlement provisions

BIT between Mauritius and Singapore (2000)	BIT between Hong Kong (China) and the United Kingdom (1998)	BIT between Egypt and Thailand (2000)
“Article 13 Investment Disputes 1. Any dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute. The party intending to resolve such dispute through negotiations shall give written notice to the other of its intention. 2. If the dispute cannot be thus resolved as provided in paragraph 1 of this Article, within 6 months from the date of the notice given thereunder, then, unless the parties have otherwise agreed, it shall, upon the request of either party to the dispute, be submitted to conciliation or arbitration by the International Centre for Settlement of Investment Disputes (called “the Centre” in this Agreement) established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States opened for signature at Washington on 18 March, 1965 (called “the Convention” in this Agreement). For this purpose, each Contracting Party hereby irrevocably consents in advance under Article 25 of the Convention to submit any dispute to the Centre.”	“Article 8 Settlement of Investment Disputes A dispute between an investor of one Contracting Party and the other Contracting Party concerning an investment of the former in the area of the latter which has not been settled amicably, shall, after a period of three months from written notification of the claim, be submitted to such procedures for settlement as may be agreed between the parties to the dispute. If no such procedures have been agreed within that three month period, the parties to the dispute Shall be bound to submit it to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force. The parties may agree in writing to modify these Rules.”	“Article 10 Settlement of Disputes Between an Investor and A Contracting Party 1. Any dispute which may arise between a Contracting Party and an investor of the other Contracting Party shall, if possible, be settled amicably. 2. If the dispute cannot thus be settled within six months following the date on which the dispute has been raised by either Party it may be submitted upon request of the investor (his choice will be final) either to: (a) The competent courts of the Contracting Party in whose territory the investment was made. (b) The International Centre for the Settlement of Investment Disputes (ICSID) created by the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature in Washington D.C. on 18 March 1965, once both Contracting Parties herein become member states thereof.”

Not all recent BITs have evolved at the same pace. The majority of BITs have continued with the traditional approach of only sketching out the main features of the investor–State dispute settlement mechanisms, relying on other arbitration conventions to deal with specific procedural aspects. Even among this group of agreements, significant variations exist. It is therefore important to examine the evolution of investor–State arbitration provisions from two different angles. First, how have the elements traditionally included in investor–State dispute settlement provisions evolved during the period? Second, which new aspects have been included in BITs?

a. Traditional elements addressed in investor–State dispute settlement provisions

(i) Scope of investor–State dispute settlement procedures

The first clause of an investor–State dispute settlement provision typically defines the types of disputes to which the mechanisms apply. The BITs under review provide for a relatively broad scope of application of investor–State dispute settlement procedures. However, significant variations exist among the agreements. Some BITs apply the investor–State dispute settlement mechanism — starting with amicable negotiations — to all kinds of disputes arising between an investor of one party and the other contracting party. The BIT between Chile and New Zealand (1999) is an example:

“Article 10
Dispute between a Contracting Party and an investor of
the other Contracting Party

Any dispute between a Contracting Party and an investor of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute.” (emphasis added)

Under this approach, the investor–State dispute settlement mechanism, starting with negotiations, applies to “any dispute between a Contracting Party and an investor of the other Party”.¹³⁶ Although the most likely scenario would be that the difference relates to an investment matter, one might also think of interpreting this provision in such a way that it would not be strictly necessary for the conflict to fall within that category.

Another group of BITs includes investor–State dispute settlement provisions that apply to disputes directly related to a covered investment. This approach is by far the most common, notwithstanding some differences in detail. Some BITs provide that the investor–State dispute settlement procedures apply to disputes arising “in connection with” an investment, “arising out” of an investment, “with respect to” an investment, “concerning” an investment or “related to” an investment (table 27). These formulations might be sufficiently broad to include disputes not involving an alleged violation of the BIT (UNCTAD 1998).

Table 27. Examples of provisions applying investor-State dispute settlement procedures to all disputes related to investments

BIT between Ethiopia and the Russian Federation (2000)	BIT between Austria and Chile (1997)
“Article 8 Settlement of Disputes between a Contracting Party and an Investor of the Other Contracting Party 1. Disputes which might arise between one of the Contracting Parties and an Investor of the other Contracting Party concerning an investment of that Investor in the territory of the former Contracting Party, shall upon a written notification by the Investor to the dispute, be settled amicably between the parties concerned. [...]” (emphasis added)	“Article 9 Settlement of Disputes between a Contracting Party And an Investor of the other Contracting Party (1) With a view to an amicable solution of disputes between a Contracting Party and an investor of the other Contracting Party, which arise out of an investment covered by this Agreement, consultations will take place between the parties concerned. [...]” (emphasis added)

Other BITs apply their investor–State dispute settlement mechanism to disputes involving a provision of the agreement. The scope is not limited to those instances where the host country has breached an obligation of the agreement. For example, disputes may relate to differences regarding the application or interpretation of a particular clause of the BIT, or other investment-related instruments providing additional rights to the investor.

Some treaties stipulate that the investor–State dispute settlement procedures apply to disputes “concerning an obligation” of contracting parties under the BIT. The BIT between China and Guyana (2003) demonstrates this approach:

“Article 9
Settlement of disputes between one Contracting
Party and an investor of the other Contracting Party

1. For purposes of this Agreement, an “investment dispute” is a dispute between a Contracting Party and an investor of the other Contracting Party, **concerning an obligation** of the former under this Agreement in relation to an investment of the latter. [...]” (emphasis added)

Other BITs provide that the dispute has to relate to “*interpretations or applications of the agreement*”, while yet others state that these procedures shall apply to disputes which arise “*within the terms*” of the agreement.

An example of this trend is Article 8.1 of the BIT between Chile and Peru (2000), which applies to “[...] *the disputes between the Contracting Parties relating to the interpretation or application of the Agreement*” (emphasis added). Article IX.1 of the BIT between Chile and South Africa (1998) illustrates the second approach, and applies the investor–State dispute settlement provisions to “[...] *any disputes which arise within the terms of this Agreement, between a Party and an investor of the other Party*” (emphasis added).

A variation of this approach limits the application of the investor–State dispute settlement procedures to one or very few obligations in the BIT. This is the case of some agreements that only allow the investor to invoke the mechanism with regard to the amount of compensation resulting from nationalization or expropriation. A case in point is the BIT between Mauritius and Swaziland (2000):¹³⁷

“Article 8
Settlement of disputes between an investor
and a Contracting Party

[...]

- (2) *If the dispute cannot be settled through negotiations within six months, either party to the dispute shall be entitled to initiate judicial action before the competent court of the Contracting Party accepting the investment.*
- (3) *If a dispute involving the amount of compensation resulting from expropriation, nationalisation, or other measures having effect equivalent to nationalisation or expropriation, mentioned in Article 6 cannot be settled within six months after resort to negotiation as specified in paragraph (1) of this Article by the investor concerned, it may be submitted to an international arbitral tribunal established by both parties.*
The provisions of this paragraph shall not apply if the investor concerned has resorted to the procedure specified in paragraph (2) of this Article. [...]” (emphasis added)

This approach means that the investor is not allowed to invoke the dispute settlement mechanism with regard to a dispute arising from any other obligation in the BIT. For those kinds of conflicts, the only means available to the investor are negotiations with the host Government or judicial action before the competent tribunals of the host country, provided that after six months of negotiations the matter has not been resolved.

Another group of BITs includes investor–State dispute settlement mechanisms with a narrower scope of application. They require that the dispute be related to the provisions of the treaty, an investment agreement or investment authorization. United States' BITs of the second part of the 1990s typically use this approach. An illustration is the BIT with Jordan (1997):

“Article IX
Settlement of disputes between one Contracting Party and a national or company of the other
Contracting Party

1. *For purposes of this Treaty, an investment dispute is between a Contracting Party and a national or company of the other Contracting Party arising out of or relating to an investment authorization, and investment agreement or an alleged breach of any right conferred, created or recognized by this Treaty with respect to a covered investment. [...]*”

Over the last 10 years, a fifth category of BITs has emerged, one that requires more than an alleged breach of an obligation in the BIT for the investor–State dispute settlement mechanisms to be activated. This approach also requires that the investor has incurred a loss or damage as a result of the violation. It is used more frequently, especially in agreements with more specific procedural provisions on dispute settlement.

The requirements of this approach are threefold: first, a claim of a breach of an obligation; second, the existence of a loss or damage for the investor; and third, a causal link between the two. This approach reinforces the notion that arbitral procedures are mainly geared to addressing conflicts related to property rights. Within this logic, it is the loss or damage inflicted upon the investor that the arbitral procedures attempt to remedy. This method is also used in most recent BITs of Austria, Canada, Japan, Mexico and the United States (table 28).

Table 28. Examples of investor–State dispute settlement provisions requiring breach of obligations and damage or loss to the investor

BIT between the United States and Uruguay (2005)	BIT between Japan and the Republic of Korea (2002)
“Article 24: Submission of a Claim to Arbitration 1. In the event that a disputing party considers that an investment dispute cannot be settled by consultation and negotiation: (a) the claimant, on its own behalf, may submit to arbitration under this Section a claim (i) that the respondent has breached (A) an obligation under Articles 3 through 10, (B) an investment authorization, or (C) an investment agreement; and (ii) that the claimant has incurred loss or damage by reason of, or arising out of, that breach; [...]” (emphasis added)	“Article 15 1. For the purposes of this Article, an investment dispute is a dispute between a Contracting Party and an investor of the other Contracting Party that has incurred loss or damage by reason of, or arising out of, an alleged breach of any right conferred by this Agreement with respect to an investment of an investor of that other Contracting Party.” (emphasis added)

It should be noted that the scope of application of the investor–State dispute settlement procedures not only depends on the specific provisions addressing this subject, but is also connected with the particular wording of the substantive treaty obligations. Even if the dispute settlement provisions state that arbitration is limited to those disputes deriving from an alleged breach of an obligation under the agreement, BITs may contain different solutions concerning the scope of this restraint. This is particularly the case for BITs that include an “umbrella clause”, which incorporates into the treaty any other obligation that a contracting party may have assumed with respect to an investor (see section I.4 above).

(ii) Legal standing

The determination of legal standing for the purposes of investor–State dispute settlement is relatively straightforward. In principle, these procedures are accessible to investors of one contracting party that have invested in the territory of the other contracting party. Thus, in general, any investor of a contracting party has legal standing in arbitration procedures against the other contracting party.

One could ask whether a foreign subsidiary incorporated under the laws of a host country could submit a dispute with that country. Usually, such a legal entity would be considered a company of the host country rather than a foreign investor, and consequently would not have access to investor–State dispute settlement procedures.

Since the legal entity is a subsidiary of a foreign investor, some BITs under review explicitly allow it to submit a dispute with the latter, provided that immediately prior to the dispute, it has been owned or controlled by nationals of the other contracting party. The BIT between Japan and the Russian Federation (1998) exemplifies this latter approach:

“Article 11

[...]

5. *In case when a legal dispute arises in respect of the capital investments made by a company of each Contracting Party and such a company is controlled by investors of the other Contracting Party as of the date when such a company files a petition addressed to the former Contracting Party claiming the dispute's being referred to the arbitration tribunal, then for the purposes of the provisions of the present article such a company of the former Contracting Party shall be deemed a company of the other Contracting Party.”*

Thus, according to this provision, a company established under the laws of country A could submit a dispute against the same country A if the enterprise is owned or controlled by investors of country B.

This approach whereby a local company is considered to be a foreign entity owing to the foreign nationality of the shareholders has also been followed in the ICSID Convention. Under its article 25(2), the disputing parties may agree that, for the purposes of ICSID arbitration, a company shall be considered to be a company of one contracting party if, immediately prior to the action giving rise to the dispute, nationals of that party owned or controlled it.

Several BITs explicitly provide for this consent — in some cases, only for the purposes of article 25(2) of the ICSID Convention. A case in point is the BIT between Ethiopia and Malaysia (1998):

“Article 7

*Settlement of Investment Disputes Between a Contracting Party
and an Investor of the Other Contracting Party*

[...]

3. *A company which is incorporated or constituted under the laws in force in the territory of one Contracting Party and which, before such a dispute arises, is owned by investors of the other Contracting Party shall in accordance with Article 25(2) (b) of the Convention be treated for the purpose of this Convention as a company of the other Party.”*

(iii) Prerequisites for activating the dispute settlement mechanism

BITs usually require that, prior to the submission of a dispute to any legal adjudication mechanism, several conditions have to be fulfilled. The most frequent prerequisites are the following: first, good faith consultations between the disputing parties in order to attempt to settle the difference amicably; second, the consent of both parties to submit the dispute to arbitration; and third, clarification of how the submission will interact with domestic judicial and administrative adjudication procedures. Over the last decade, an increasing number of BITs have specified in greater detail other procedural requirements.

1. Consultations

As a first step in conflict resolution, BITs usually require that the parties to the dispute hold consultations or negotiations in order to resolve it amicably.

In order to ensure that the parties to the dispute actually make an effort to settle their differences amicably, most BITs provide for a minimum period to be respected before the investor may request the establishment of an arbitral tribunal. Most BITs examined provide for a consultation period of six months, as is the case of the BIT between Benin and Ghana (2001) (table 29). Other BITs include shorter periods, very often three months, such as the BIT between Chile and the Netherlands (1998). A few agreements do not specify how long the consultation period should be, such as the BIT between Australia and India (1999).¹³⁸

2. Consent

A fundamental feature of alternative means of dispute resolution such as arbitration is their voluntary nature. Thus, arbitration procedures can be invoked only once the investor and the host country have consented to resolve their quarrel in this manner. The contracting parties may provide their consent in

advance of a dispute by including in the BIT a clause “on compulsory jurisdiction”. Such a provision gives investors the certainty that the host country cannot unilaterally withdraw its consent and force the dispute to be adjudicated in local administrative or judicial tribunals.

Table 29. Examples of provisions establishing consultation periods as a pre-requisite for arbitration

BIT between Benin and Ghana (2001)	BIT between Chile and the Netherlands (1998)	BIT between Australia and India (1999)
“Article 9 Settlement of Investment Disputes between a Contracting Party and a National or Company of the Other Contracting Party 1. Disputes between a national or company of one Contracting Party and the other Contracting Party concerning an obligation of the latter under this agreement in relation to an investment of the former which have not been amicably settled shall, after a period of six months from written notification of a claim, be submitted at the first instance to the competent court of the Contracting Party for decision, or to international arbitration if either party to the dispute so wishes. [...]” (emphasis added)	“Article 8 Settlement of Disputes Between a Contracting Party and a National of the Other Contracting Party (1) Any legal dispute between one Contracting Party and a national of the other Contracting Party concerning an investment of the latter in the territory of the former shall, if possible, be settled amicably. (2) If such a dispute cannot be settled according to the provisions of paragraph 1 of this article within a period of three months from the date either party to the dispute requested amicable settlement, the dispute shall at the request of the national concerned be submitted either to the judicial procedures provided by the internal law of the Contracting Party in the territory of which the investment has been made, or to international arbitration. [...]” (emphasis added)	“Article 12 Settlement of disputes between an investor and a Contracting Party 1. Any dispute between an investor of one Contracting Party and the other Contracting Party in relation to an investment of the former under this Agreement shall, as far as possible, be settled amicably through negotiations between the Parties to the dispute. 2. Any such dispute which has not been amicably settled may, if both Parties agree, be submitted; (a) for resolution, in accordance with the law of the Contracting Party which has admitted the investment to that Contracting Party’s competent judicial or administrative bodies; or (b) to international conciliation under the Conciliation Rules of the United Nations Commission on International Trade Law. [...]”

The BITs under review have followed various approaches concerning the expression of contracting parties’ consent. One method, applied in a significant number of BITs, is to provide for the contracting parties’ explicit and irrevocable consent to submit a dispute to arbitration if a covered investor so requests. The BIT between Mexico and Portugal (1999) is an example of that method:

*“Article 10
Contracting Party Consent*

Each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration in accordance with this Part.”

Other BITs apply a different approach, albeit with similar results, which requires that the contracting parties *shall agree* that an investment dispute be submitted to arbitration. The BIT between Australia and Lithuania (1998) illustrates this method. It obliges the contracting parties to express their consent if an investor requests that a dispute be submitted to arbitration procedures under the ICSID Convention.

*“Article 13
Settlement of disputes between a Party and
an investor of the other Party*

[...]

3. Where a dispute is referred to the Centre pursuant to paragraph 2(b) of this Article:

- (a) *where that action is taken by an investor of one Party, the other Party shall consent in writing to the submission of the dispute to the Centre within thirty days of receiving such a request from the investor; [...]*

This clause means that the arbitration forum shall not have jurisdiction until the contracting party involved gives its consent. However, refusal to give consent would be contrary to the BIT, and would enable the other contracting party to pursue its right under the State–State dispute settlement mechanism. A variation of this approach is to provide that if the dispute involves an autonomous subnational authority, the latter must also consent to arbitration procedures. The BIT between France and Uganda (2002) demonstrates this particular approach:

“Article 7

Settlement of disputes between an investor and a Contracting Party

[...]

In the case where the dispute may involve the responsibility for actions or omissions of sub-sovereign entities of the Contracting Parties as defined in article 1 paragraph 7 of the present Agreement, the fore mentioned sub-sovereign entity must give their unconditional consent to the use of arbitration of the International Centre for the Settlement of Investment Disputes (ICSID), as defined in article 25 of the Convention for the settlement of disputes in respect of investments occurring between States and nationals of other States signed in Washington on March 18, 1965.”

Yet another approach is to reserve the right of the host country to consent to arbitration. Within this group of agreements, some BITs include an explicit reservation. The BIT between Argentina and New Zealand (1999) is an example:

“Article 12

Disputes between a Contracting Party and an investor of the other Contracting Party

[...]

- (3) *In the case of international arbitration, unless the parties to the dispute agree otherwise, the dispute shall be submitted to either:*
- (a) *The International Centre for the Settlement of Investment Disputes (ICSID) created by the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature in Washington on 18 March 1965; or,*
 - (b) ***If both parties to the dispute agree**, arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force.*
- (4) *Paragraph (3) of this Article **shall not constitute, by itself, the consent of the Contracting Party** required in Article 25(1) of the Convention on the Settlement of Investment Disputes opened for signature in Washington on 18 March 1965.” (emphasis added)*

This approach allows a contracting party to decide on a case-by-case basis whether to consent to the submission of an investment-related dispute to international arbitration. This clause not only explicitly states that the contracting parties have to consent to submit a dispute to ICISD, but also provides for the possibility of settling a dispute under the UNCITRAL rules if both parties to the dispute so wish.

A fourth category of agreements makes no explicit reference to the consent of the contracting parties with respect to arbitration. The BIT between Chile and Indonesia (1999) typifies this approach:

“Article IX

Settlement of disputes between a Contracting Party and an investor of the other Contracting Party

- (1) *With a view to an amicable solution of disputes, which arise within the terms of this Agreement, between a Contracting Party and an investor of the other Contracting Party consultations and negotiations will take place between the parties concerned.*
- (2) *If these consultations and negotiations do not result in a solution within four months from the date of a written notification for settlement, the investor may submit the dispute either:*
 - (a) *to the competent tribunal of the Contracting Party in whose territory the investment was made, or*
 - (b) *to international arbitration of the International Centre for Settlement of Investment Disputes (ICSID), created by the Convention on the Settlement of Investment Disputes between States and nationals of other States opened for signature in Washington on March 18, 1965.*
- (3) *Once the investor has submitted the dispute to the competent tribunal of the Contracting Party in whose territory the investment was made or to international arbitration, that election shall be final.*
- (4) *The award shall be final and binding; it shall be executed according to its respective national laws.*
- (5) *Once a dispute has been submitted to the competent tribunal or international arbitration in accordance with this Article, neither Contracting Party shall pursue the dispute through diplomatic channels.”*

The ICSID Convention requires the unambiguous intention of the disputing parties to submit their quarrel to ICSID. This requirement is fulfilled if, as in the above example, the disputing host country allows the foreign investor to submit the case to arbitration. The provision does not expressly reserve the contracting parties' consent to arbitration.

3. Exhaustion of local remedies

A question that often arises in investor–State dispute settlement procedures is whether an investor has to exhaust local remedies before being allowed to submit the claim to international arbitration. Historically, exhaustion of local remedies was considered to be a necessary step prior to elevating a dispute to an international level.¹³⁹ International arbitration was conceived as a subsidiary means of conflict resolution, available to foreign investors only once they had failed to resolve their disputes within the jurisdiction of the host country. Thus, 30 years ago, a number of BITs made the right of invoking international arbitration procedures conditional on the prior attempt of the investor to resolve the quarrel in local courts. However, this trend gradually changed (UNCTAD 1998).

Over the last 10 years, BITs have reinforced the approach whereby international arbitration is regarded as an alternative rather than as a subsidiary means of adjudication. Consequently, most of these agreements do not require investors to exhaust local remedies as a condition for acceding to international arbitration. Within this approach, however, different techniques have been used. Most BITs do not even mention exhaustion of local remedies. A number of BITs concluded since 1995 explicitly include an obligation for the parties not to request the exhaustion of local remedies if the investor has opted to submit the dispute to international arbitration. The BIT between Austria and the United Arab Emirates (2001) exemplifies this approach:

“Article 10

Settlement of disputes between an investor and a Contracting Party

[...]

- (5) *If the investor chooses to file for arbitration, the host Contracting Party agrees not to request the exhaustion of local settlement procedures. [...]*”

Similarly, some BITs state that the requirement for the exhaustion of local remedies is waived by virtue of the host country's consent to arbitration. The BIT between Cambodia and Croatia (2001) is a case in point:

*“Article 10
Settlement of disputes between a Contracting Party and
an investor of the other Contracting Party*

[...]

2.b) [...] In case of arbitration, each Contracting Party, by this Agreement irrevocably consents in advance, even in the absence of an individual arbitral agreement between the Contracting Party and the investor, to submit any such dispute to this Centre. This consent implies the renunciation of the requirement that the internal administrative or judicial remedies should be exhausted [...]

These examples converge in the same direction, in the sense that they all relieve the investor of the obligation to exhaust local remedies as a condition for submitting a dispute to international arbitration. However, a limited number of agreements require that the investor should first exhaust the administrative instances of the host country. Only thereafter is the investor allowed to pursue international arbitration.¹⁴⁰ The BIT between China and Côte d'Ivoire (2002) is a case in point:

*“Article 9
Settlement of disputes between investors and
One Contracting Party*

[...]

3. If such dispute cannot be settled amicably through negotiations, any legal dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall have exhausted the domestic administrative review procedure specified by the laws and regulations of that Contracting Party, before submission of the dispute the aforementioned arbitration procedure [...]

Within the category of agreements requiring the investor to pursue a remedy in local courts before submitting the dispute to international arbitration, some provide that it shall initially be attempted to settle the dispute locally. Only if a resolution has not been reached within a certain period of time is the claim allowed to be submitted to international arbitration. The BIT between Belgium–Luxembourg and Botswana (2003) exemplifies that approach:

*“Article 12
Settlement of Investment Disputes*

[...]

2. In the absence of an amicable settlement by direct agreement between the parties to the dispute or by conciliation through diplomatic channels within six months from the notification, the dispute shall be submitted, at the first instance to a court competent jurisdiction of the latter Contracting Party for a decision. Either party may, six months after the submission of the dispute to a court of competent jurisdiction, refer the dispute to international arbitration.”

4. Other procedural requirements

In addition to the general requirements examined above, an increasing number of BITs deal with different aspects of the arbitration procedures in greater detail. While typically most treaties devote only one article to investor–State dispute settlement, some BITs include a whole section, comprising about 10 detailed articles. This reflects contracting parties' interest in deepening the rule orientation of these mechanisms and in promoting greater predictability in their implementation. For instance, several BITs enumerate all specific

procedural steps an investor must follow in order to properly initiate arbitration. Treaties following this approach normally impose a number of requirements on foreign investors.

First, within certain periods of time, the investor has to give formal notice to the defending contracting party of its intention to submit the dispute to arbitration. The document must describe the basic elements of the dispute. The BIT between Mexico and the Republic of Korea (2000) provides as follows:

“Article 8

Arbitration: Scope and Standing and Time Periods

[...]

- (12) *A dispute may be submitted to arbitration provided that the investor has delivered to the Contracting Party, party to the dispute, written notice of his intention to submit a claim to arbitration at least 90 days in advance, but not later than 3 years from the date that either the investor or the enterprise of the other Contracting Party that the investor owns or controls, first acquired or should have acquired knowledge of the events which gave rise to the dispute.*
- (13) *The notice referred to in paragraph (12) shall specify:*
 - (a) *the name and address of the disputing investor and, where a claim is made by an investor of a Party on behalf of an enterprise, the name and address of the enterprise;*
 - (b) *the provisions of this Agreement alleged to have been breached and any other relevant provisions;*
 - (c) *the issues and the factual basis for the claim; and*
 - (d) *the relief sought and the approximate amount of damages claimed. [...]*

Second, the investor must give in writing its consent to arbitration in accordance with certain procedures set out in the BIT, and explicitly waive the right to initiate before any administrative tribunal or court under the law of the host country, or any other dispute settlement procedures, any proceedings with respect to the disputed measure of the disputing contracting party.¹⁴¹

The approach used in NAFTA's Chapter 11 arbitration mechanism significantly influenced this technique of specifying in the text of the treaty itself a series of procedural matters. This explains why, in the mid-1990s, Canada, Mexico and the United States started to regulate investor-State dispute settlement in greater detail. This approach is, however, not limited to NAFTA countries.¹⁴²

(iv) The arbitration forum

Investor-State dispute settlement provisions in BITs refer to various existing international arbitration conventions to prescribe the rules governing the arbitration. Although earlier BITs contained each contracting party's consent only to ICSID arbitration, the more recent trend has been to give foreign investors the additional right to submit disputes to other arbitration forums. Not all countries are parties to the ICSID Convention, and consequently, this forum is not always available (UNCTAD 1998).

The institutional arbitration forums most commonly referred to in BITs are ICSID and the ICSID Additional Facility Rules — applicable if only one of the contracting parties is a party to the ICSID Convention. Other BITs mention the Court of Arbitration of the International Chamber of Commerce (ICC) in Paris or the Arbitration Institute of the Chamber of Commerce of Stockholm as possible venues. BITs also provide for the possibility of submitting the dispute to ad hoc arbitration. The most frequent approach has been for the contracting parties to agree to conduct such proceedings in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).¹⁴³

Several issues arise when addressing the question of the arbitration forum in BIT negotiations: first, whether the investor will have more than one option available; second, if this is the case, whether the investor will have the right to choose the forum to which the claim will be submitted; and third, whether the variety of options will be exhaustive or left open for later agreement by the parties.

Regarding the first issue, the trend towards providing more than one possible arbitration forum to adjudicate the dispute has continued in the review period. Most BITs provide for the possibility of settling

the investment dispute under ICSID, ICSID's Additional Facility Rules or the UNCITRAL rules. The BIT between Indonesia and Mozambique (1999) illustrates this approach. However, other BITs provide the investor with different arbitration venues, such as the ICC and the Arbitration Institute of the Chamber of Commerce of Stockholm. The BIT between the Russian Federation and Ukraine (1998) and the BIT between the Republic of Korea and Trinidad and Tobago (2002) are two examples. On the other hand, a number of treaties allow only for ICSID-based arbitration, leaving the investor with domestic tribunals as the alternative choice. The BIT between Malaysia and Saudi Arabia (2000) is a case in point (table 30).

Among the BITs providing more than one possible arbitration venue, the prevailing trend is to allow the investor to choose the specific forum in which the dispute will be adjudicated. However, some treaties, such as the BIT between Canada and Costa Rica (1997), refer to ICSID, ICSID's Additional Facility and UNCITRAL in a subsidiary manner, allowing the use of one forum only if the first option — ICSID — is not available.

*“Article XII
Settlement of disputes between an investor and
the host Contracting Party*

[...]

4. *The dispute may be submitted to arbitration under:*

- (a) *The International Centre for the Settlement of Investment Disputes (ICSID), established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature at Washington D.C. on 18 March, 1965 (“ICSID Convention”), if both the disputing Contracting Party and the Contracting Party of the investor are parties to the ICSID Convention; or*
- (b) *the Additional Facility Rules of ICSID, if either the disputing Contracting Party or the Contracting Party of the investor, but not both, is a party to the ICSID Convention; or*
- (c) *and ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) in case neither Contracting Party is a member of ICSID, or if ICSID declines jurisdiction.”* (emphasis added)

The rationale of this approach is to provide the contracting parties with greater certainty as to the forum where the dispute is to be settled.

In addition to the usual arbitration venues already mentioned, some BITs permit the investor and the host country to settle the quarrel according to any other dispute settlement mechanism upon which they agree. For instance, under article 9.3 (a) of the BIT between Bahrain and the United States (1999), the investor may choose from among ICSID, the Additional Facility of ICSID, ad hoc arbitration under UNCITRAL — if ICSID-based arbitration is not available — or any other arbitral institution or rules agreed upon by the parties to the dispute. Furthermore, the BIT between Hong Kong (China) and the United Kingdom (1998) allows the parties to the dispute to agree, in the first instance, on the particular arbitration rules. Only if the parties cannot agree does UNCITRAL operate as a fall-back alternative:

*“Article 8
Settlement of Investment Disputes*

A dispute between an investor of one Contracting Party and the other Contracting Party concerning an investment of the former in the area of the latter which has not been settled amicably, shall, after a period of three months from written notification of the claim, be submitted to such procedures for settlement as may be agreed between the parties to the dispute.

If no such procedures have been agreed within that three month period, the parties to the dispute shall be bound to submit it to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force. The parties may agree in writing to modify these Rules.”

Table 30. Examples of provisions indicating arbitration forums

BIT between Malaysia and Saudi Arabia (2000)	BIT between the Russian Federation and Ukraine (1998)	BIT between the Republic of Korea and Trinidad and Tobago (2002)	BIT between Indonesia and Mozambique (1999)
“Article 11 Settlement of Investment Disputes Between A Contracting Party and an Investor of the other Contracting Party [...] 2. If the dispute cannot be settled in the way prescribed in paragraph (1) of this Article within six (6) months from the date when the request for the settlement has been submitted, it shall be at the request of the investor filed to the competent court of law of the Contracting party in whose territory the invest-ments was made or filed for arbitration under the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States. [...]” (emphasis added)	“Article 9 Resolution of Disputes Between a Contracting Party and the Investor of the other Contracting Party [...] 2. In the event the dispute cannot be resolved through negotiations within six months as of the date of the written notification as mentioned in Item 1 hereof above, then the dispute shall be passed over for consideration to: a) a competent court or an arbitration court of the Contracting Party, on whose territory the investments were carried out; b) the Arbitration Institute of the Chamber of Commerce in Stockholm, c) an "ad hoc" arbitration tribunal, in conformity with the Arbitration Regulations of the United Nations Commission for International Trade Law (UNCITRAL). [...]” (emphasis added)	“Article 8 Settlement of Investment Disputes between a Contracting Party and an Investor of the Other Contracting Party [...] 3. If the dispute cannot be settled within six (6) months from the date on which the dispute has been raised by either party, and if the investor waives the rights to initiate any proceedings under paragraph 2 of this Article with respect to the same dispute, the dispute shall be submitted upon request of the investor of the Contracting Party to: (a) the International Center for Settlement of Investment Disputes (ICSID) established by the Washington Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of other States; or (b) the Court of Arbitration of the International Chamber of Commerce; or (c) an international arbitrator or ad hoc arbitral tribunal to be appointed by a special agreement or established under the Arbitration Rules of the United Nations Commission on International Trade Law. [...]” (emphasis added)	“Article VII Settlement of Disputes between an Investor and a Contracting Party [...] 3. Where the dispute is to be referred to international arbitration, the investor and the Contracting Party involved in the dispute may agree to refer the dispute either to: a.) the International Center for Settlement of Investment Disputes (ICSID) under the rules of the International Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature at Washington, D.C. on 18 March 1965, when such Contracting Party has become a party to the said Convention. As long as this requirement is not met each Contracting Party agrees the dispute may be settled under the rules of the Additional Facility of the Administration of proceedings by the Secretariat of ICSID. b) an ad hoc tribunal to be established under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL).” (emphasis added)

The prevailing trend among recent BITs, however, is to provide for an exhaustive list of options rather than to leave open the possibility for the parties to the dispute to agree on any kind of dispute resolution.

(v) Selection of arbitrators

As previously explained, numerous BITs provide for the possibility of settling the dispute through ad hoc arbitration—that is, arbitration before a single individual, or a tribunal specially constituted for that particular dispute (UNCTAD 1998). In order to make such an option viable, it is necessary for the BIT to indicate the procedures for the appointment of the arbitrators. The BITs examined have basically followed the already existing approaches.

One group of agreements refers only to an existing set of arbitration rules — most commonly the UNCITRAL rules or the ICC arbitration procedures — to govern the selection procedures of the arbitrators. The BIT between Armenia and Austria (2001) exemplifies this method:

*“Article 12
Means of Settlement, Time Periods*

- (1) *A dispute between a Contracting Party and an investor of the other Contracting Party shall, if possible, be settled by negotiation or consultation. If it is not so settled, the investor may choose to submit it for resolution:*
[...]
- c) *in accordance with this Article to:*
- i) [...] *“the ICSID Convention” if the Contracting Party of the investor and the Contracting Party, party to the dispute, are both parties to the ICSID Convention;*
 - ii) *the Centre under the rules governing the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre, if the Contracting Party of the investor or the Contracting Party, party to the dispute, but not both, is a party to the ICSID Convention;*
 - iii) ***a sole arbitrator or an ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (“UNCITRAL”);***
 - iv) ***the International Chamber of Commerce, by a sole arbitrator or an ad hoc tribunal under its rules of arbitration.”*** (emphasis added)

Other BITs provide that ad hoc arbitration shall entail the constitution of a tribunal, and for that purpose, they include specific appointment procedures. Usually, the arbitral tribunal shall have three members, allowing each contracting party to select one arbitrator, and these two arbitrators agree on the appointment of the third arbitrator. The latter acts as the chair of the arbitral tribunal, and usually cannot be a national of either of the contracting parties. BITs that include appointment procedures also provide that, if for any reason, the appointments are not made within the agreed time frames or arbitrators cannot agree on the chair of the tribunal, a third person shall act as the appointment authority. Usually the latter is the President or Vice-President of the International Court of Justice, although some BITs delegate this role to the Secretary-General of ICSID. The BIT between China and Guyana (2003) is a case in point:

*“Article 9
Settlement of disputes between one Contracting
Party and an investor of the other Contracting Party*

- [...]
5. *Without prejudice to Paragraph 4 of this Article, the ad hoc Tribunal referred to in paragraph 4 (b) shall be constituted for each individual case in the following way: each party to the dispute shall appoint one arbitrator and these two shall select a national of a third State which has diplomatic relations with both Contracting Parties as the Chairman. The first two Arbitrators shall be appointed within two months and the Chairman within four months of the written notice requesting arbitration by either party to the dispute to the other.*
6. *If within the period specified in Paragraph 5 above, the Tribunal has not yet been constituted, either party to the dispute may invite the Secretary General of the International Centre for the Settlement of Investment Disputes to make the necessary appointments.”*

A third group of BITs mixes the two approaches explained above and, in principle, refers to an existing set of arbitration rules. At the same time, they provide for some specific modifications agreed by the contracting parties. For instance, the BIT between Ghana and India (2002) refers to the UNCITRAL arbitration rules. However, in this particular case, the contracting parties opted to include some alterations regarding the appointment procedures of the arbitral tribunal:

“Article 9
Settlement of disputes between an investor
and a Contracting Party

[...]

(3) [...] The Arbitration procedure shall be as follows:

- (a) If the Contracting Party of the Investor and the other Contracting Party are both parties to the Convention on the Settlement of Investment Disputes between States and nationals of other States, 1965, and the investor consents in writing to submit the dispute to the International Centre for the Settlement of Investment Disputes, such a dispute shall be referred to the Centre; or
- (b) If both parties to the dispute so agree, under the Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding proceedings; or
- (c) **to an ad hoc arbitral tribunal by either party to the dispute in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law, 1976, subject to the following modifications:**
 - (i) **The appointing authority under Article 7 of the Rules shall be the President, the Vice-President or the next senior Judge of the International Court of Justice, who is not a national of either Contracting Party. The third arbitrator shall not be a national of either Contracting Party.**
 - (ii) **The parties shall appoint their respective arbitrators within two months.**
 - (iii) **The arbitral award shall be made in accordance with the provisions of this Agreement and shall be binding for the parties in dispute.”** (emphasis added)

(vi) Subrogation of insurance claims

Numerous capital-exporting countries have developed insurance programmes to protect the investments of their investors abroad against political risks, such as expropriation or transfer restrictions. These programmes, however, do not purport to relieve host countries of their responsibility in the event that a violation of the BIT generates damage or loss to the foreign investor. In order to enable insurance agencies to recover what they have paid to investors, most BITs include a provision on subrogation. Accordingly, the contracting parties recognize the subrogation to the home country of any rights that the investor may have against the host country as a result of a violation of the BIT, provided that the former has paid compensation for the loss under an insurance contract.

Practically all BITs concluded since 1995 include a provision on subrogation. Although the wording may vary, the substantial content of these clauses is very similar; for example, the BIT between Benin and Ghana (2001) states as follows:

“Article 8
Subrogation

1. *If one Contracting Party or its designated agency makes a payment under an indemnity given in respect of an investment in the territory of the other Contracting Party, the latter Contracting Party shall recognize the assignment to the former Contracting Party or its designated agency by law or any legal transaction of all the rights and claims of the party indemnified and that former Contracting Party or its designated agency is entitled to exercise such rights and enforce such claims by virtue of its subrogation, to the same extent as the party indemnified.*
2. *The former Contracting Party or its designated Agency shall be entitled in all circumstances to the same treatment in respect of the rights and claims acquired by it by virtue of the assignment and any payments received in pursuance of those rights and claims as the party indemnified was entitled to receive by virtue of this Agreement in respect of the investment concerned and its related returns.*
3. *Any payments received by the former Contracting Party or its designated Agency in pursuance of the rights and claims acquired shall be freely available to the former Contracting Party for the purpose of meeting any expenditure incurred in the territory of the latter Contracting Party.”*

The commitment to recognize subrogation in situations such as that illustrated above raises the question of how the dispute settlement procedures of the BIT would operate with respect to this issue. Who would have standing to bring a claim before the host country that has generated the loss? Would it be the investor who has received a payment under an insurance contract or the other contracting party in favour of which the subrogation operates? The contracting party could always invoke the State–State dispute settlement mechanism to enforce the recognition of the subrogation provision. Regarding the possibility of the investor’s seeking compensation under the investor–State dispute settlement mechanisms, recent BITs have adopted different approaches.

Many BITs provide investors with the right to seek redress through investor–State arbitration, even if they have already received compensation under an insurance contract. Under this approach, the investor would initially seek compensation from the host country, and then, arguably, transfer the amount to the insurance agency that had subrogated the rights of the former. The BIT between Brunei Darussalam and the Republic of Korea (2000) exemplifies this method:

*“Article 8
Settlement of Investment Disputes between
a Contracting Party and an Investor of the other Contracting Party*

[...]

7. *During arbitration proceedings or the enforcement of an award, the Contracting Party involved in the dispute shall not raise the objection that the investor of the other Contracting Party has received compensation under an insurance contract in respect of all or part of its loss.”*

A second, equally numerous group of BITs do not address the question of whether the investor still has standing in investor–State dispute settlement procedures if compensation has been previously received. As explained in subsection a (i) above, the scope of the investor–State dispute settlement mechanisms in most BITs is relatively ample. There is no particular requirement for an investor to have standing in addition to being a covered investor under the agreement.¹⁴⁴ Thus, despite the lack of an explicit provision, there is, in principle, no impediment to an investor's seeking redress under investor–State arbitration even in these particular circumstances.

A third group of BITs contain provisions which suggest that once subrogation has taken place, it would be up to the contracting party, and not the investor, to seek compensation for the amount paid to the latter. The BIT between Turkey and Yemen (2000) exemplifies this approach:

*“Article V
Subrogation*

1. *If the investment of an investor of one Party is insured against non-commercial risks under a system established by law, any subrogation of the insurer which stems from the terms of the insurance agreement shall be recognized by the other Party.*
2. *The insurer shall not be entitled to exercise any rights other than the rights which the investor would have been entitled to exercise.*
3. ***Disputes between a Party and an insurer shall be settled in accordance with the provisions of Article VII [State-State] of this Agreement.”*** (emphasis added)

This provision suggests that after subrogation, it is the insurer, and not the investor, who has the right to invoke the dispute settlement procedures. The clause explicitly provides that any dispute between the insurer and the host country would need to be settled in accordance with State–State dispute settlement provisions, rather than through investor–State arbitration.

(vii) Governing law

Traditionally, some BITs have included a provision indicating the substantive law to be used as the basis for adjudicating a dispute between an investor and the host country. The most common trend, which

has continued to prevail among the BITs reviewed, is to specify that the dispute shall be settled in accordance with the agreement, the applicable principles of international law and, in some cases, the domestic laws of the host country. The BIT between Ethiopia and Sudan (2000) and the BIT between Bulgaria and Thailand (2003) are illustrations of this approach (table 31).

Table 31. Examples of provisions stating the applicable law in investor–State dispute settlement procedures

BIT between Ethiopia and Sudan (2000)	BIT between Bulgaria and Thailand (2003)
“Article 8 Settlement of Disputes between the Contracting Parties [...] 5. The Arbitral Tribunal shall determine its own procedure. The tribunal shall reach its award by a majority of votes in accordance with the provisions of this Agreement and the principles of international law recognized by both Contracting Parties. Such award shall be final and binding on both Contracting Parties. [...] (emphasis added)	“Article 9 Settlement of Investment Disputes [...] 3. The arbitral tribunal established under this Article shall reach its decision on the basis of national laws and regulations of the Contracting Party, which is a party to the dispute, the provisions of the present Agreement, as well as applicable rules of international law. [...] (emphasis added)

Not all BITs contain a provision indicating what should be the governing law of the dispute. However, at least in those situations where a BIT provides for the application of the ICSID or UNCITRAL arbitration rules those conventions give certain guidance. For instance, article 42(1) of the ICSID Convention stipulates that in the absence of an agreement between the parties with respect to the choice of law, the tribunal shall apply the law of the host country and such rules of international law as may be applicable. Article 33.1 of the UNCITRAL arbitration rules provides that, in the absence of an agreement of the parties, the arbitral tribunal shall apply the law determined by the conflict-of-laws rules which it considers applicable. Furthermore, under article 31 of the Vienna Convention, an agreement such as a BIT would have to be understood “*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*”.

(viii) Finality and enforcement of arbitral awards

As in the past, most recent BITs state that an arbitral award shall be final and binding for the parties to the dispute. Thus, the conflicting parties are prevented from attempting to resubmit the dispute to another adjudication instance if one of them is dissatisfied with the outcome.

Furthermore, once an arbitral award is issued in investor–State proceedings, the decision will be not only final and binding, but also enforceable. In principle, unless an international convention provides for the recognition and enforcement of an arbitral award made outside its national jurisdiction, a country is under no obligation to recognize and enforce it (UNCTAD, 1998). There are several international conventions that under certain conditions oblige their members to recognize and effectively enforce arbitral awards in their domestic jurisdictions. Two instruments are particularly important, namely the ICSID Convention and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed in New York in 1958, and often referred to as the “New York Convention”.

The ICSID Convention provides the following:

“Article 54

- (1) *Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution*

- may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.
- (2) A party seeking recognition or enforcement in the territories of a Contracting State shall furnish to a competent court or other authority which such State shall have designated for this purpose a copy of the award certified by the Secretary-General. Each Contracting State shall notify the Secretary-General of the designation of the competent court or other authority for this purpose and of any subsequent change in such designation.
 - (3) Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought.”

Pursuant to this provision, arbitral awards issued by an ICSID tribunal have binding effect for countries that are parties to that convention. Furthermore, those countries are also obliged to enforce pecuniary obligations imposed by the arbitral decision as if it were a final judgement of a national court. However, the ICSID Convention does not apply to awards made under other arbitration rules. Furthermore, as previously explained, not all BITs refer to the ICSID Convention as a forum for adjudicating an investment dispute, and those doing so often provide the investor with additional options regarding applicable arbitration rules. Not all of these arbitration rules — for instance, the UNCITRAL rules — contain provisions equivalent to article 54 of the ICSID Convention.

It is within this context that the New York Convention becomes particularly relevant. This instrument applies to the recognition and enforcement of arbitral awards made in the territory of a country other than the country where the recognition and enforcement of such awards are sought, as well as to arbitral awards not considered as domestic in the country where their recognition and enforcement are pursued. One of the main provisions of the New York Convention is Article III:

“Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards.”

Accordingly, countries parties to the New York Convention are obliged to recognize and enforce foreign arbitral awards. However, there are two significant caveats. First, a party may refuse to recognize and enforce a foreign arbitral award in any of the specific situations envisaged in article V of the New York Convention.¹⁴⁵ Second, a party is not obliged to recognize and enforce an arbitral award issued in the territory of another country which has not subscribed to the New York Convention or an award adjudicating a dispute which does not arise out of a legal commercial relationship. In this regard, the New York Convention provides as follows:

“Article I.

[...]

3. *When signing, ratifying or acceding to this Convention, or notifying extension under article X hereof, any State may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards made only in the territory of another Contracting State. It may also declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration.”*

BITs concluded since 1995 have applied different approaches concerning the enforcement of arbitral awards. Taking into consideration the provisions cited above, many BITs have included clauses to prevent the investor–State dispute settlement procedures from having an inoperative result. In particular, BITs within this category usually provide that investor–State arbitration proceedings must take place in a country that is signatory to the New York Convention, and that the claims submitted to arbitration shall be considered to

arise out of a commercial relationship for the purposes of article 1 of that instrument. These agreements not only provide that arbitral awards shall be final, binding and enforceable in the territory of the contracting parties, but also explicitly mandate that arbitration proceedings be held in a country that is a party to the New York Convention (table 32).

Table 32. Examples of enforcement provisions making reference to the New York Convention

BIT between Austria and Lebanon (2001)	BIT between Canada and El Salvador (1999)
“Article 14 Place of arbitration Any arbitration under this Part shall, at the request of any party to the dispute, be held in a state that is party of the New York Convention. Claims submitted to arbitration under this Part shall be considered to arise out of a commercial relationship or transaction for purposes of Article 1 of the New York Convention.” “Article 17 Awards and Enforcement 1) Arbitration awards shall be final and binding upon the parties to the dispute. [...] 2) Each Contracting Party shall make provision for the effective enforcement of awards made pursuant to this Article and shall carry out without delay any such award issued in a proceeding to which it is party.”	“Article XII: Settlement of Disputes between an Investor and the Host Contracting Party [...] Any arbitration under this Article shall be held in a State that is a party to the New York Convention, and claims submitted to arbitration shall be considered to arise out of a commercial relationship or transaction for the purposes of Article 1 of that Convention. [...] An award of arbitration shall be final and binding and shall be enforceable in the territory of Each of the Contracting Parties. ”

However, not all BITs examined have included detailed dispute settlement provisions. Those BITs containing general provisions on investor–State dispute settlement usually provide only that the contracting parties have to comply with and enforce arbitral awards in their territories in accordance with their own laws and regulations. A case in point is the BIT between Japan and the Republic of Korea (2002):

“Article 15

[...]

6. *Any arbitral award rendered pursuant to this Article shall be final and binding on the parties to the dispute. Each Contracting Party shall carry out without delay the provisions of any such award and provide in its territory for the enforcement of such award in accordance with its relevant laws and regulations. [...]*

Under this approach, BITs do not deal with the specific aspects ensuring that an arbitral award be effectively recognized and enforced under the jurisdiction of the contracting party concerned. Rather, it would be for the contracting party to decide how to execute these awards. However, as previously explained, the recognition and enforcement of an arbitral award under national jurisdiction may be a complex matter.

This method is based on the assumption that the contracting parties will take all necessary steps within their legislations to comply with the obligation to enforce international arbitral awards. If this is not the case, the only other avenue for an investor would be to seek diplomatic protection and ask its home country to submit a claim under the State–State dispute settlement provisions of the BIT.

(ix) Espousal of disputes submitted to investor–State arbitration

As previously explained, one of the strategic advantages of investor–State dispute settlement mechanisms for developing countries — in addition to increasing certainty — is that it avoids a political

interplay in the resolution of an investment conflict. As an impartial judicial body decides the dispute, the contracting party of which the investor is a national is, in principle, prevented from exercising diplomatic protection.¹⁴⁶

Taking this aspect into consideration, and to avoid any possibility of reopening the dispute if an investor is not satisfied, most recent BITs have included specific provisions on this issue. Following an already existing trend, many BITs explicitly prohibit the contracting parties from exercising diplomatic protection in favour of their investors once the latter have submitted their claims under investor–State arbitration procedures.¹⁴⁷ The BIT between Australia and India (1999) is an example:

“Article 12

Settlement of disputes between an investor and a Contracting Party

[...]

4. *Once an action referred to in paragraphs 2 [submission of the dispute to local courts or to conciliation] and 3 [international arbitration] of this article has been taken, neither Contracting Party shall pursue the dispute through diplomatic channels unless:*
 - (a) *the relevant judicial or administrative body, the Secretary General of the Centre, the arbitral authority or tribunal or the conciliation commission, as the case may be, has decided that it has no jurisdiction in relation to the dispute in question;*
 - (b) *the other Contracting Party has failed to abide by or comply with any judgement, award, order or other determination made by the body in question.”*

Under this approach, once an investment dispute is submitted to international arbitration, the only two cases in which a contracting party could exercise diplomatic protection are where the arbitration tribunal lacked the jurisdiction to adjudicate the dispute or where the contracting party involved in the dispute does not comply with the arbitral award.

b. Innovations in investor–State dispute settlement provisions

An increasing number of BITs has started to innovate investor–State dispute settlement procedures. Where once only a few paragraphs were devoted to this issue, some agreements now regulate the proceedings in greater detail, in some cases dedicating a whole section to them. This is the case of some BITs of Austria, Canada, Mexico and the United States.¹⁴⁸

These developments have made investor–State dispute settlement procedures one of the key areas where significant innovations in treaty-making have taken place over the review period. Recent BITs have incorporated various novel provisions aimed at fostering the following objectives: to provide greater predictability and contracting parties’ control over arbitration procedures; to promote the principle of judicial economy in investment-related disputes; to ensure consistency among arbitral awards and the development of sound jurisprudence on international investment law; and to promote the overall legitimacy of investor–State arbitration.

(i) Promotion of greater predictability and contracting parties’ control over arbitration procedures

As previously indicated, some innovations in investor–State dispute settlement included in several BITs under review are geared towards greater predictability and control by the contracting parties over arbitration procedures. This objective has been pursued through different techniques.

One of these concerns the drafting stage. Some contracting parties no longer refer only to a set of existing arbitration rules, such as those of ICSID, the ICC or UNCITRAL, for the purposes of determining investor–State dispute settlement procedures. Recent BITs have started to specify a series of matters related to the arbitral proceedings, which other BITs often leave undetermined or subject to the agreement between the disputing parties on a case-by-case basis.

The most elaborate provisions on investor–State arbitration can be found in the NAFTA, and in some recent BITs following the NAFTA model. For the first time, the NAFTA's investment chapter addressed a number of issues on which BITs are often silent, such as the procedures to apply when submitting a notice of intent for arbitration, how to prevent the same dispute from being simultaneously taken up in more than one legal forum, specific procedures for the appointment of arbitrators and expert review groups, specification of the place of arbitration, measures for interim injunctive relief, preliminary objections, conduct of arbitral proceedings and enforcement of awards. Through these regulations contracting parties increase predictability and control over the execution of arbitration procedures.

Another means to that end relates to the implementation of these mechanisms. Recent BITs, such as the one between the United States and Uruguay (2005) and the 2004 Canadian model BIT, include provisions ensuring the involvement of both contracting parties in arbitration proceedings by addressing certain subject matters, such as financial services, taxation or the interpretation of a non-conforming measure. In all these instances, BITs provide for the possibility for specialized authorities of the contracting parties to interpret certain matters or provisions of the agreement, which shall be binding for the arbitration tribunal.

For instance, paragraphs 1 and 2 of article 17 of the 2004 Canadian model BIT provide that where an investor submits a claim to arbitration related to financial services, and the disputing contracting party, as a defence, invokes the general exception based on prudential reasons included in articles 10(2) or 14(6) of the agreement, the arbitral tribunal:

“[...] shall, at the request of that Party, seek a report in writing from the Parties on the issue of whether and to what extent the said paragraphs are a valid defence to the claim of the investor. The tribunal may not proceed pending receipt of a report under this Article [...] The Parties shall proceed [...] to prepare a written report, either on the basis of agreement following consultations, or by means of an arbitral panel. The consultations shall be between the financial services authorities of the Parties. The report shall be transmitted to the Tribunal, and shall be binding on the Tribunal.”

This mechanism leaves — at least in the first instance — to the competent authorities of the contracting parties, and not to arbitral tribunals, the decision whether a claim brought by an investor should be rejected on the grounds of an exception for prudential reasons.

Another example of the inclusion of a control mechanism is found in the BIT between the United States and Uruguay (2005):

“Article 21: Taxation

[...]

3. *Article 6 [Expropriation] shall apply to all taxation measures, except that a claimant that asserts that a taxation measure involves an expropriation may submit a claim to arbitration under Section B [investor-State dispute settlement] only if:*
 - (a) the claimant has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measure involves an expropriation; and*
 - (b) within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.” (text in brackets added)*

This provision allows the competent tax authorities of both contracting parties to decide whether a particular taxation measure is in fact an expropriation. If the authorities agree that this is not the case, the investor is prevented from submitting a claim under the investor–State dispute settlement provisions. This mechanism aims at ensuring that the decision as to whether a tax measure is an expropriation is primarily left to the competent tax authorities of the contracting parties, and not to arbitral tribunals.

A third illustration of this trend is another mechanism provided for in the BIT between the United States and Uruguay (2005):

“Article 31: Interpretation of Annexes

1. *Where a respondent asserts as a defense that the measure alleged to be a breach is within the scope of an entry set out in Annex I, [Non-conforming measures] II [Future measures], or III [Non-conforming measures in financial services], the tribunal shall, on request of the respondent, request the interpretation of the Parties on the issue. The Parties shall submit in writing any joint decision declaring their interpretation to the tribunal within 60 days of delivery of the request.*
2. *A joint decision issued under paragraph 1 by the Parties, each acting through its representative designated for purposes of this Article, shall be binding on the tribunal, and any decision or award issued by the tribunal must be consistent with that joint decision. If the Parties fail to issue such a decision within 60 days, the tribunal shall decide the issue” (text in brackets added).*

Once more, this mechanism reserves the prerogative to interpret the content and scope of the annexes of non-conforming measures and future measures to the contracting parties, and not to arbitral tribunals. Only if the contracting parties cannot reach a joint decision is an arbitral tribunal allowed to give its own interpretation.

(ii) Promotion of judicial economy

Among the BITs of the last decade, a second set of innovations in investor–State arbitration is geared towards promoting the principle of judicial economy. Several novelties included in recent BITs illustrate this trend. One is a provision dealing with potential “frivolous claims” submitted by an investor. A second mechanism seeks to prevent a particular investment dispute from being dealt with in more than one adjudication forum. Another innovation is the possibility of consolidating separate claims that have a question of law or fact in common, and arise out of the same events or circumstances.

1. Mechanism to avoid “frivolous claims”

The significant increase in investor–State disputes has raised concerns that investors might abuse the system.¹⁴⁹ As this may occur in domestic litigation when submitting a dispute to arbitration, investors may think that the greater the number of claims, the better the chance of having the arbitral tribunal adjudicating at least one in their favour. This can take a heavy toll in terms of time, effort, fees and other costs, not only for the defendant contracting party but also for the arbitral tribunal.

Several countries have advocated the inclusion of a procedure to avoid “frivolous claims” in investment-related disputes, i.e. claims that evidently lack a sound legal basis. Accordingly, an arbitration tribunal shall address and decide, as a preliminary question, any objection by the respondent that, as a matter of law, the claim is not one for which an award in favour of the claimant may be made. In deciding an objection under this procedure, the arbitration tribunal shall assume that the claimant’s factual allegations in support of the claims are true, and shall issue a decision or award on the objection on an expedited basis. The BIT between the United States and Uruguay (2005) demonstrates this approach, which has also been included in the investment chapters of several recent free trade agreements of the United States.

“Article 28 Conduct of the Arbitration

[...]

4. *Without prejudice to a tribunal’s authority to address other objections as a preliminary question, a tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim submitted is not a claim for which an award in favour of the claimant may be made under Article 34.*

- (a) Such objection shall be submitted to the tribunal as soon as possible after the tribunal is constituted, and in no event later than the date the tribunal fixes for the respondent to submit its counter-memorial (or, in the case of an amendment to the notice of arbitration, the date the tribunal fixes for the respondent to submit its response to the amendment).
 - (b) On receipt of an objection under this paragraph, the tribunal shall suspend any proceedings on the merits, establish a schedule for considering the objection consistent with any schedule it has established for considering any other preliminary question, and issue a decision or award on the objection, stating the grounds therefore.
 - (c) In deciding an objection under this paragraph, the tribunal shall assume to be true claimant's factual allegations in support of any claim in the notice of arbitration (or any amendment thereof) and, in disputes brought under the UNCITRAL Arbitration Rules, the statement of claim referred to in Article 18 of the UNCITRAL Arbitration Rules. The tribunal may also consider any relevant facts not in dispute.
 - (d) The respondent does not waive any objection as to competence or any argument on the merits merely because the respondent did or did not raise an objection under this paragraph or make use of the expedited procedure set out in paragraph 5.
5. In the event that the respondent so requests within 45 days after the tribunal is constituted, the tribunal shall decide on an expedited basis an objection under paragraph 4 and any objection that the dispute is not within the tribunal's competence. The tribunal shall suspend any proceedings on the merits and issue a decision or award on the objection(s), stating the grounds therefore, no later than 150 days after the date of the request. However, if a disputing party requests a hearing, the tribunal may take an additional 30 days to issue the decision or award. Regardless of whether a hearing is requested, a tribunal may, on a showing of extraordinary cause, delay issuing its decision or award by an additional brief period, which may not exceed 30 days."

The objective of an expedited procedure included in this provision is to avoid spending time and resources on adjudicating claims that lack a sound legal foundation. This intention is also evidenced by the specific time frames provided in paragraph 5 of article 28 above.

2. *Limitation to one arbitration forum*

Some treaties provide that if an investor chooses to submit a claim to domestic courts, that decision extinguishes the right to arbitration, and vice versa. This is known as a "fork in the road" provision. The BIT between Chile and Egypt (1999) demonstrates that approach:

"Article 8

Settlement of disputes between a Contracting Party and an investor of the other Contracting Party

[...]

- 3) *Once the investor has submitted the dispute to the competent tribunal of the Contracting Party in whose territory the investment was made or to international arbitration, that election shall be final. [...]*

That article compels the investor to make a decision *ab initio* as to whether to pursue the adjudication of the dispute in domestic courts or to invoke international arbitration. This method shows that, in addition to conceiving international arbitration as an alternative means of dispute resolution, judicial economy is another reason for contracting parties to abstain from requesting exhaustion of local remedies.¹⁵⁰

Other BITs provide the investor with the possibility of deciding upon the venue for resolving the dispute at a later stage, even after it has been submitted to the administrative or judicial tribunals of the host country. BITs applying this method allow the investor to opt for international arbitration as long as domestic tribunals have not made a final award. Article XIII.3 of the BIT between Canada and Thailand (1997) is illustrative of that method. It provides that an investor may submit a dispute to arbitration only if "[...] the investor has waived to initiate or continue any other proceedings in relation to the measure that is alleged to

be in breach of this Agreement before the courts or tribunals of the Contracting Party concerned or in a dispute settlement procedure of any kind”.

This approach — known as the “no-U-turn” — also forecloses another situation in which the same dispute could be submitted to multiple forums. This would be the case if an investor first submitted the dispute to arbitration and, depending on the outcome, then opted to present it to local courts.

3. Consolidation of claims

Another mechanism included in some BITs to foster judicial economy and to avoid inconsistent results is to allow the consolidation of claims having a question of law or fact in common, and/or arising out of the same events or circumstances. Most BITs concluded by Mexico since 1995, as well as the recent BITs of the United States and the 2004 Canadian model BIT, authorize the formation of a special tribunal to exercise jurisdiction over claims that have the above-mentioned features. The BIT between Greece and Mexico (2000) is a case in point:

“Article 13 Consolidation

- 1. A tribunal of consolidation established under this Article shall be installed under the UNCITRAL Arbitration Rules and shall conduct its proceedings in accordance with those Rules, except as modified by this Part.*
- 2. Proceedings will be consolidated in the following cases:*
 - a) when an investor submits a claim to arbitration on behalf of a legal person that is his investment and, simultaneously, another investor or other investors participating in the same legal person, submit claims on their own behalf as a consequence of the same breaches of this Agreement; or*
 - b) when two or more claims are submitted to arbitration arising from common legal and factual issues.*
- 3. The tribunal of consolidation will decide the jurisdiction of the claims and will jointly review such claims, unless an investor asserts that his interests are seriously harmed.”*

(iii) Promotion of consistent and sound jurisprudence on international investment law

A third category of innovations is geared towards ensuring a consistent and correct application of international law in arbitral awards. As previously explained, more recent BITs have been concluded against the background of a substantial increase in investor–State disputes. The latter have yielded awards that have not always been consistent. Some recent BITs have therefore included provisions to foster a consistent and sound development of the jurisprudence.

A number of BITs include more detailed provisions on several key substantive issues the interpretation of which has been controversial in arbitration proceedings. For example, as was explained in sections E and F of this study, Canada and the United States have recently modified their BITs to clarify the meaning of “fair and equitable treatment” and the concept of indirect expropriation.

It has also been suggested that arbitrations be subject to appeal. For instance, the BIT between the United States and Uruguay (2005) provides that within three years after the entry into force of the agreement, the parties shall consider whether to establish a bilateral appellate body to review awards. In particular, an annex to that treaty provides the following:

“Annex E
Possibility of a Bilateral Appellate Mechanism

Within three years after the date of entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism.”

The possibility of establishing an appellate mechanism for arbitral awards has also been envisaged in other recent investment-related agreements of the United States, such as the Free Trade Agreement between Chile and the United States (2003) and the Free Trade Agreement concluded by the Central American countries, the United States and the Dominican Republic (DR-CAFTA) (2004).¹⁵¹

These appellate mechanisms raise many issues. There is still no clarity regarding the particular features that such an appeal mechanism would have, nor about how it would interact with the existing arbitration conventions or other BITs of the parties concerned. Furthermore, if the main purpose of an appellate mechanism is to ensure consistency in arbitral awards, it should bring under its umbrella most, if not all, existing BITs and other IIAs. However, such an outcome could not be achieved by an appellate mechanism established by only one or several bilateral agreements.

(iv) Promotion of legitimacy of investor–State arbitration

Another novelty that has emerged in recent BITs is geared towards promoting the overall legitimacy of investor–State arbitration. One concern relates to the limited transparency of these proceedings. In response, the 2004 Canadian model BIT and recent BITs of the United States include provisions fostering the transparency of arbitration proceedings.

For instance, article 29 of the BIT between the United States and Uruguay (2005) requires the respondent to transmit certain documents to the home country and to make them available to the public, including the notice of arbitration, the memorials, the transcripts of hearings and the arbitral awards. Similarly, the 2004 Canadian model BIT also requires that the hearings be open to the public, although provisions are made for the protection of confidential business information. However, these rules do not require the parties to make public any negotiations on the settlement of the dispute, nor do they interfere with the confidentiality of the tribunal’s deliberations. The 2004 Canadian model BIT states:

“Article 38
Public Access to Hearings and Documents

1. *Hearings held under this Section shall be open to the public. To the extent necessary to ensure the protection of confidential information, including business confidential information, the Tribunal may hold portions of hearings in camera.*
2. *The Tribunal shall establish procedures for the protection of confidential information and appropriate logistical arrangements for open hearings, in consultation with the disputing parties.*
3. *All documents submitted to, or issued by, the Tribunal shall be publicly available, unless the disputing parties otherwise agree, subject to the deletion of confidential information.*
4. *Notwithstanding paragraph 3, any Tribunal award under this Section shall be publicly available, subject to the deletion of confidential information.*
5. *A disputing party may disclose to other persons in connection with the arbitral proceedings such unredacted documents as it considers necessary for the preparation of its case, but it shall ensure that those persons protect the confidential information in such documents.*
6. *The Parties may share with officials of their respective federal and sub-national governments all relevant unredacted documents in the course of dispute settlement under this Agreement, but they shall ensure that those persons protect any confidential information in such documents.*
7. *As provided under Article 10(4) and (5), the Tribunal shall not require a Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the Party’s law protecting Cabinet confidences, personal privacy or the financial*

affairs and accounts of individual customers of financial institutions, or which it determines to be contrary to its essential security.

8. *To the extent that a Tribunal's confidentiality order designates information as confidential and a Party's law on access to information requires public access to that information, the Party's law on access to information shall prevail. However, a Party should endeavour to apply its law on access to information so as to protect information designated confidential by the Tribunal."*

The trend towards fostering transparency in investor–State dispute settlement goes beyond allowing the public to be informed about the different stages of the proceedings. The 2004 Canadian model BIT and recent BITs of the United States also allow parties not involved in the dispute to submit briefs and to authorize arbitral tribunals to consider submissions from any member of civil society. As a result, these agreements stipulate in detail the procedures under which such *amicus curiae* briefs are to be submitted and administered, intending to prevent them from negatively affecting the normal conduct of the arbitration. This explains, for instance, the screening mechanism included in article 39 of the 2004 Canadian model BIT, which provides for certain criteria under which the arbitral tribunal has to decide on whether a non-disputing party may file a submission, and, if the authorization is granted, provides guidance as to the weight that such submission should have in the proceedings. In its relevant parts, the article states as follows:

*"Article 39
Submissions by a Non-Disputing Party*

1. *Any non-disputing party that is a person of a Party, or has a significant presence in the territory of a Party, that wishes to file a written submission with a Tribunal (the "applicant") shall apply for leave from the Tribunal to file such a submission [...].*
2. *The applicant shall serve the application for leave to file a non-disputing party submission and the submission on all disputing parties and the Tribunal.*
3. *The Tribunal shall set an appropriate date for the disputing parties to comment on the application for leave to file a non-disputing party submission.*
4. *In determining whether to grant leave to file a non-disputing party submission, the Tribunal shall consider, among other things, the extent to which:*
 - (a) the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the arbitration by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;*
 - (b) the non-disputing party submission would address a matter within the scope of the dispute;*
 - (c) the non-disputing party has a significant interest in the arbitration; and*
 - (d) there is a public interest in the subject-matter of the arbitration.*
5. *The Tribunal shall ensure that:*
 - (a) any non-disputing party submission does not disrupt the proceedings; and*
 - (b) neither disputing party is unduly burdened or unfairly prejudiced by such submissions.*
6. *The Tribunal shall decide whether to grant leave to file a non-disputing party submission. If leave to file a non-disputing party submission is granted, the Tribunal shall set an appropriate date for the disputing parties to respond in writing to the non-disputing party submission. By that date, the non-disputing Party may, pursuant to Article 34 (Participation by the Non-Disputing Party), address any issues of interpretation of this Agreement presented in the non-disputing party submission.*
7. *The Tribunal that grants leave to file a non-disputing party submission is not required to address the submission at any point in the arbitration, nor is the non-disputing party that files the submission entitled to make further submissions in the arbitration. [...]"*

This approach demonstrates that transparency provisions serve important goals; however, they may also increase the burden on the disputing parties and limit their discretion. For example, parties may feel the need to submit additional materials for responding to arguments made in the *amicus curiae* briefs. Public knowledge of the disputes may result in pressure on the parties to settle or to refuse to settle the dispute. This may undermine one of the main objectives of investor–State dispute settlement: to foster a rule-oriented

adjudication mechanism, where politics interfere as little as possible with the development of a sound international legal investment regime.

2. State–State dispute resolution

Unlike investor–State dispute settlement, an area where several significant developments in treaty-making have taken place, State–State dispute settlement reveals a much lesser degree of innovation in recent BITs.

Also, there is a higher degree of generality, a feature that contrasts not only with investor–State dispute settlement provisions, but also with State–State arbitration rules in trade agreements. In the trade field, State–State dispute settlement has become one of the most sophisticated areas of international rulemaking, not only in the WTO, where the Dispute Settlement Understanding (DSU) constitutes one of the main innovations of the multilateral trading system after the Uruguay Round, but also in the context of new regional trade agreements, which include dispute settlement mechanisms inspired by the DSU. In sharp contrast, BITs have continued with the traditional approach of devoting one single provision to State–State dispute settlement.

a. Traditional features in State–State dispute settlement provisions

Provisions in BITs regulating this subject are typically very short and deal with the following main issues: the scope of application of the procedures; the obligation of the parties to consult prior to the establishment of an arbitral tribunal; the appointment of the arbitrators; the arbitral procedures; and the costs of the arbitration (UNCTAD 2003c).

Most treaties provide that the State–State dispute settlement provisions shall apply to disputes between the contracting parties concerning the interpretation or application of the BIT. Furthermore, before invoking formal arbitration proceedings, practically all BITs mandate the contracting parties to attempt to settle the dispute by consultations or negotiations. The BIT between Cambodia and Cuba (2001) is an illustration:

*“Article IX
Settlement of disputes between the Contracting Parties concerning interpretation and
application of the Agreement*

1. *Disputes between the Contracting Parties concerning the interpretation and application of the Agreement should, if possible, be settled through diplomatic channels. [...]*”

Most BITs prescribe a period of six months for holding consultations, although some agreements set shorter periods, and some do not cover this issue at all.¹⁵²

Unlike investor–State dispute settlement mechanisms, provisions on State–State arbitration have continued with the traditional approach of establishing an ad hoc arbitration procedure, that is a tribunal specifically constituted for the dispute involved, rather than arbitration before an existing institution (UNCTAD 1998).

The usual procedure included in BITs is for each contracting party to select one arbitrator, and then authorize the two to select a third arbitrator, who usually shall not be a national of any of the contracting parties and who shall serve as the chair of the tribunal. If the appointments are not made within the agreed time frames, or if arbitrators cannot agree on the chair of the tribunal, practically all BITs provide that a third instance shall act as appointment authority. Often, this is the President or Vice-President of the International Court of Justice. The BIT between Australia and India (1999) typifies this approach:

“Article 13
Disputes between the Contracting Parties

[...]

3. Such an arbitral tribunal shall be constituted for each individual case in the following way. Within two months of the receipt of the request for arbitration, each Contracting Party shall appoint one member of the tribunal. Those two members shall then select a national of a third State who on approval by the two Contracting Parties shall be appointed Chairperson of the tribunal. The Chairperson shall be appointed within one month from the date of appointment of the other two members.
4. If within the periods specified in paragraph 3 of this Article the necessary appointments have not been made, either Contracting Party may, in the absence of any other agreement, invite the President of the International Court of Justice to make any necessary appointments. If the President is a national of either Contracting Party or if he is otherwise prevented from discharging the said function, the Vice-President shall be invited to make the necessary appointments. If the Vice-President is a national of either Contracting Party or if he too is prevented from discharging the said function, the Member of the International Court of Justice next in seniority who is not a national of either Contracting Party shall be invited to make the necessary. [...]

Some BITs, however, delegate the appointing authority to the Secretary-General of ICSID.¹⁵³

A number of BITs provide that the UNICTRAL arbitration rules shall govern the procedure unless the contracting parties agree otherwise.¹⁵⁴ Other treaties authorize the tribunal to determine its own procedure. Most BITs also state that decisions of the tribunal have to be taken by majority vote. The tribunal has to decide the case on the basis of the BIT, although some agreements also envisage the possibility of the tribunal's taking into account the law of the host country and, exceptionally, provide for the possibility of deciding *ex aequo et bono* if the contracting parties so wish.¹⁵⁵ Furthermore, the BITs usually specify that all awards shall be final and binding.

Most BITs address the costs of State–State dispute settlement. Usually, they provide that such costs shall be divided among the contracting parties. Thus, each contracting party bears the cost of its own representation before the tribunal and the arbitrator whom it appoints. The remaining costs are divided among the contracting parties. An example is the BIT between Hungary and Lebanon (2001):

“Article 9
Settlement of Disputes between the Contracting Parties

[...]

5. The Arbitral Tribunal shall reach its decision by a majority of votes.
6. The Tribunal shall issue its decision on the basis of respect for the law, the provisions of this Agreement, as well as of the universally accepted principles of international law.
7. Subject to other provisions made by the Contracting Parties, the Tribunal shall determine its procedure.
8. Each Contracting Party shall bear the cost of its own arbitrator and its representation in the arbitral proceedings; the cost of the Chairman and the remaining costs shall be borne in equal parts by both Contracting Parties. The Arbitral Tribunal may make a different regulation concerning the costs.
9. The decisions of the Tribunal are final and binding for each Contracting Parties.”

b. Main innovations in State–State dispute settlement provisions

As mentioned before, in comparison with the innovations in investor–State dispute settlement, the novelties in State–State arbitration have been much more modest. Nonetheless, some BITs under review do

include innovative features that might become important precedents for the future. Three novelties are worth mentioning.

(i) Transparency in arbitral proceedings

Following the trend in investor–State dispute settlement, recent BITs of the United States include provisions aimed at fostering greater transparency and participation of civil society in State–State arbitration. For example, pursuant to article 37.4 of the BIT between the United States and Uruguay (2005), most transparency obligations in investor–State arbitration are also applicable to State–State proceedings.¹⁵⁶ Consequently, this BIT requires the contracting parties to make available to the public certain documents, including the notice of arbitration, the memorials, the transcripts of hearings and the arbitral awards. Furthermore, the BIT between the United States and Uruguay (2005) requires that the hearings be open to the public, although provisions are made for the protection of confidential business information, and allows the tribunal to accept *amicus curiae* submissions.

Not all countries that have recently included transparency obligations in investor–State dispute settlement have also done so with regard to State–State procedures. This might suggest that the pressure for fostering the legitimacy of State–State arbitration does not have the same intensity as in the case of investor–State dispute settlement.

(ii) Special provisions for disputes on financial services

Another innovation relates to financial services. As mentioned previously, financial services are usually heavily regulated and subject to close supervisory control by specialized governmental authorities. Thus, recent BITs of Canada and the United States ensure that in disputes involving financial services the members of the tribunal have particular expertise in this field (table 33).

Table 33. Examples of provisions requiring special qualifications for arbitrators in disputes involving financial services

BIT between the United States and Uruguay (2005)	2004 Canadian model BIT
“Article 20 Financial Services [...] 5. Where a Party submits a dispute involving financial services to arbitration under Section C [State-State Dispute Settlement] in conformance with paragraph 4, and on the request of either Party within 30 days of the date the dispute is submitted to arbitration, each Party shall, in the appointment of all arbitrators not yet appointed, take appropriate steps to ensure that the tribunal has expertise or experience in financial services law or practice. The expertise of particular candidates with respect to financial services shall be taken into account in the appointment of the presiding arbitrator. [...]	“Article 48 Disputes between the Parties [...] 6. Where a Party claims that a dispute involves measures relating to financial institutions, or to investors or investments of such investors in financial institutions, then (a) where the disputing Parties are in agreement, the arbitrators shall, in addition to the criteria set out in paragraph 5, have expertise or experience in financial services law or practice, which may include the regulation of financial institutions; or (b) where the disputing Parties are not in agreement, (i) each disputing Party may select arbitrators who meet the qualifications set out in subparagraph (a), and (ii) if the Party complained against invokes Articles 14(6) or 17 [Exception for Prudential Reasons], the chair of the panel shall meet the qualifications set out in subparagraph (a). [...]

In addition to requiring special qualifications for arbitrators dealing with financial services, the BIT between the United States and Uruguay (2005) provides that the competent financial authorities of both contracting parties shall hold consultations prior to the initiation of any adjudication proceeding. In particular, the treaty states as follows:

“Article 20: Financial Services

[...]

4. *Where a dispute arises under Section C [State-State dispute settlement] and the competent financial authorities of one Party provide written notice to the competent financial authorities of the other Party that the dispute involves financial services, Section C shall apply except as modified by this paragraph and paragraph 5.*
 - (a) *The competent financial authorities of both Parties shall make themselves available for consultations with each other regarding the dispute, and shall have 180 days from the date such notice is received to transmit a report on their consultations to the Parties. A Party may submit the dispute to arbitration under Section C only on the expiration of that 180-day period.*
 - (b) *Either Party may make any such report available to a tribunal constituted under Section C to decide the dispute referred to in this paragraph or a similar dispute, or to a tribunal constituted under Section B [investor-State dispute settlement] to decide a claim arising out of the same events or circumstances that gave rise to the dispute under Section C.”*

The purpose of this mechanism is to provide an opportunity for the competent financial authorities of the contracting parties to attempt to reach an agreement before submitting a dispute to settlement. It also seeks to ensure that if the contracting parties cannot reach a solution on the basis of their expertise, these authorities produce a report that can serve as guidance for an arbitral tribunal.

(iii) Enforcement measures

A third novelty concerns the enforcement of arbitral awards. As explained in subsection L.2.a above, most BITs provide that the decision of the arbitral tribunal in State-State proceedings shall be final and binding for the contracting parties. However, unlike the situation in trade agreements, most BITs do not contain provisions dealing with the case where a contracting party fails to comply with an arbitral award. Exceptions are the Canadian BITs, which include measures that a contracting party may take if the other contracting party fails to comply with the decision. The BIT between Canada and Thailand (1997) is a case in point:

“Article XV

Disputes between the Contracting Parties

[...]

- (7) *The Contracting Parties shall, within 60 days of the decision of a tribunal, reach agreement on the matter in which to resolve their dispute. Such agreement shall normally implement the decision of the tribunal. Such agreement shall also be considered part of the arbitral tribunal’s decision. If the Contracting Parties fail to reach agreement, the Contracting Party bringing the dispute shall be entitled to compensation or to suspend benefits of equivalent value to those awarded by the panel.”*

Although this article provides for negotiations between the contracting parties even after an arbitral decision has been rendered, the prevailing party will presumably have greater leverage to obtain an agreement complying with the final arbitral award. Furthermore, if a contracting party fails to comply with the arbitral decision, the article provides for compensation or suspension of benefits of a value equivalent to those awarded by the panel.

There is the issue of which benefits could be suspended in accordance with this clause. Would it be only those granted to the other contracting party as a result of the BIT? Or could a party suspend any kind of benefits? Could the prevailing contracting party suspend benefits accrued to the other by virtue of another agreement? There is no significant jurisprudence to answer these questions. However, in principle, a contracting party would be free to choose the means by which to suspend the benefits, provided that it did not violate any other obligation in other international agreements to which the parties in dispute are members.

The experience with State–State dispute settlement is much more limited than in the case of investor–State disputes. What does this mean in terms of the role these dispute settlement provisions play from the perspective of international economic governance?

A plausible hypothesis would be that investor–State dispute settlement, and not State–State arbitration, constitutes the main avenue through which compliance with BITs is sought and ensured. The limited — not to say scant — use of State–State dispute settlement may explain why its treatment in most BITs continues to be of a general nature.

* * *

In conclusion, some of the most important innovations in BITs concluded during the review period have been with regard to dispute settlement. Departing from the traditional approach of outlining in the BIT only the main features of the dispute settlement procedures, some recent agreements address the issue in much more detail. By providing more guidance to the disputing parties and the arbitration tribunal, these BITs intend to strengthen the rule of law and to make the outcome of investor–State disputes more predictable. Several means have been used for this purpose, including the involvement of experts, provisions for the consolidation of claims and third-party participation. By contrast, State–State dispute settlement procedures have basically remained unchanged.

Notes

¹ Article 31 of the Vienna Convention states:

“1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: [...]”.

² As will be explained below, even those agreements that include a specific clause on scope of application still rely on the definitions of the terms “investment” and “investor” as a means to delimit the subject matter to which the BIT applies.

³ Increasing experience in the use of investor–State dispute settlement mechanisms during the last decade demonstrates how important it is to clearly delimit the scope of application of the BITs for the purpose of determining whether a particular dispute falls within the jurisdiction of arbitral tribunals. See NAFTA and other ICSID cases for decisions on jurisdiction (<http://www.worldbank.org/icsid/cases/cases.htm>). Also, for further information on the increase in the use of investor–State investment arbitration, see UNCTAD (2005b).

⁴ Such provisions were interpreted in the arbitration cases *Yaung Chi Oo Trading Pte Ltd. v. Government of the Union of Myanmar*, ASEAN Case No. ARB/01/1 (31 March 31), ASEAN Arbitral Tribunal (ICSID Additional Facility Rules) and *Philippe Gruslin v. Malaysia* (ICSID Case No. ARB/94/1).

⁵ This point is developed in VanDuzer (2002) and Dawson (2002).

⁶ *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL, Interim Award on Merits of 26 June 2000; *S.D. Myers, Inc. v. Canada*, UNCITRAL, First Partial Award of 13 November 2000 (NAFTA). See also *Joy Mining Machinery Limited v. Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction of 6 August 2004.

⁷ In this regard, see *Canada – Certain Measures Concerning Periodicals* (WT/DS31/AB/R, 30 July 1997), and *European Communities – Regime for the Importation, Sale and Distribution of Bananas* (WT/DS27/AB/R, 25 September 1997).

⁸ *SGS Société de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of 16 October 2002; *SGS Société de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of 29 January 2004.

⁹ “An initial choice facing BIT negotiators is whether to define the term “investment” at all. The concern about defining the term obviously is that new forms of investment, the protection of which is consistent with United States foreign investment policy, may be excluded from BIT protection simply because the drafters failed to anticipate their creation. Leaving the term undefined permits it to evolve along with the changing nature of circumstances, but creates a risk that an arbitral tribunal might construe it narrowly” (Vandeveld, 1992).

¹⁰ The definition of “investment” in this BIT leaves for a case-by-case determination the decision as to whether a particular debt instrument is a covered investment for the purposes of the agreement. In this regard, the definition contains a footnote that states:

“Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt, such as a bank account that does not have a

commercial purpose and is related neither to an investment in the territory in which the bank account is located nor to an attempt to make such an investment, are less likely to have such characteristics.”

¹¹ And also in the recent 2004 Canadian Model BIT, see subsection (iii) above.

¹² That was the case of the BITs between Germany and Israel (article I(3)(b)), concluded in 1976, and between Denmark and Indonesia (article I (a)) concluded in 1968.

¹³ Dual nationality has been a particular issue in cases before the Iran–United States Claims Tribunal. See, for example, *The Islamic Republic of Iran v. The United States of America, Case No. A/18 (Apr. 6, 1984)*. The Iran–United States Claims Tribunal found that it has jurisdiction over claims against the Islamic Republic of Iran by dual Iran–United States nationals when the dominant and effective nationality of the claimant was that of the United States.

¹⁴ As explained in UNCTAD (1999a), while the place of incorporation is the easiest criterion to determine, it has the caveat that the country where the company is organized may have no other connection with the company. Indeed, it may well be the case that nationals of a non-party to the agreement could constitute an enterprise under the laws of a contracting party simply to gain treaty protection. Bearing in mind this potential problem, BITs using the place of incorporation as the sole criterion to ascribe nationality to a legal entity also include a denial of benefits clause. Such a provision is designed to allow the party concerned to deny treaty protection to a company that is incorporated under the laws of the other party when the company is controlled by nationals of a non-party or when the company does not have substantial business activities in the territory of the other contracting party. The denial of benefits clause is explained in more detail in Section I below.

Ownership or control, by contrast, establishes a much more important link between the investment and the country of nationality, but it is sometimes difficult to ascertain. A company may be owned by thousands of investors from many different countries, with the nationality of the dominant investors changing from time to time as shares in the company are traded. The inclusion of “ownership and control” as one of the criteria for attributing corporate nationality for the purpose of BIT protection represents a significant departure from traditional customary international law.

Basing the nationality on the location of a company’s seat may represent something of a middle ground. It establishes a more genuine link than mere incorporation and is often easier to ascertain and more stable than the country of ownership or control.

¹⁵ Ibid.

¹⁶ *Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain) (1962–1970)*, preliminary objections — judgment of 24 July 1964; and second phase — judgment of 5 February 1970 (<http://www.icj-cij.org/icjwww/idecisions.htm>).

¹⁷ In other words, the rationale of the Court was that, under customary international law, a company may be protected only by its country of incorporation, not the country of ownership. See Vandevelde (1992, pp. 45–46).

¹⁸ The separate judgment of Judge Oda in the ELSI case in 1989 contains an affirmation of this rule. See also AAPL vs. Sri Lanka (1992), where it was held that the physical assets of a company incorporated in a host country are not protected by a BIT if they belong to a national of the host country. In such circumstances, the foreign investor can rely only on shareholder protection (Sornarajah, 2004).

¹⁹ The GATS differentiates between the term “own” and the term “control”: a juridical person is “owned” by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member, and it is “controlled” by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions (Article XXVIII (n) of the GATS).

²⁰ See the example of the GATS cited above.

²¹ Concerning the treatment of corporate nationality in dispute settlement procedures, see chapter K.1.a (ii) below.

²² See *Aguas del Tunari v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction of 21 October 2005.

²³ See, for instance, the BIT between Australia and India (1999).

²⁴ Article 28 of the Vienna Convention reads as follows:

“Non-Retroactivity of Treaties

Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party.”

²⁵ Protecting both existing and new investments could be justified on various grounds. The rationale for countries to provide protection to new investment is that such protection serves to prevent the undermining of investors’ confidence as regards reinvesting profits in the host country. Furthermore, by protecting investments already established countries refrain from altering the conditions of competition in favour of new investors to the detriment of those already located in the host country. Altering those conditions would not only distort the operation of the market, but also generate a negative reaction by existing investors against the conclusion of the new BIT (UNCTAD, 1998).

²⁶ “Countries not only may consider the provision of protection as a windfall to the investor, who decided to make the investment anyway, regardless of the existence of the agreement. Also, the prior investment may have not been admitted by the host country if the latter had realized that later such an investment would benefit from treaty protection.” Ibid.

²⁷ See footnote 25 above.

²⁸ It should be noted that, as far as the services sector is concerned, the GATS has adopted an intermediate approach between the two basic legal methods used in BITs. It provides for an establishment right concerning the setting up of a “commercial presence” on the condition that the relevant host country has undertaken a specific commitment in this respect (positive list approach). The GATS therefore does not go so far as to deny an establishment right altogether, nor does it make the granting of such a right a common obligation of all contracting parties.

²⁹ *Agua del Tunari v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction of 21 October 2005.

³⁰ In the last decade (since 1995), the United States concluded 21 BITs and Canada 18.

³¹ Recent research appears to indicate that this rationale for BITs does indeed work. See, for example, Neumeyer and Spess (2005).

³² According to Walker, “*fair and equitable treatment denotes a non-contingent or absolute standard. This means that it applies to investments in a given situation without reference to standards that are applicable to other investment or entities; it may apply to other investments or entities, but its content does not vary according to how other investments or entities are treated.*” (Walker, 1957–1958, p. 811).

³³ Many BITs, after providing for fair and equitable treatment, add explicitly that investments by investors of the other contracting party should be provided with “full protection and security” or “most constant protection and security”. Unlike the fair and equitable treatment standard, the content of the principle of full protection and security has traditionally been defined with more precision. As pointed out by UNCTAD (1998), not only is this an “old” standard which was commonly used in Friendship, Commerce and Navigation (FCN) treaties, but it was also included separately in the earliest BITs signed before the OECD Draft Convention on the Protection of Foreign Property — before the concept of fair and equitable treatment had been introduced. In this regard, it has been pointed out that this “*provision does not impose strict liability on the host country to protect foreign investment. In effect, the standard does not represent a deviation from the due diligence rule. Thus, the term “full protection and security” connotes the assurance of full protection and security for foreign investors as contemplated or required by customary international law. At the same time, the clause on full protection and security is unusual in that it contemplates protecting investment against private as well as public action, that is, the clause requires that the host country should exercise reasonable care to protect investment against injury by private parties*” (UNCTAD, 1998, p. 55). “*Non-discrimination, in its general sense, means that the host country must abstain from discriminatory action towards foreign investors in general or towards specific groups of foreign investors. [...] Although arguably, the standard of fair and equitable treatment implicitly excludes arbitrary or discriminatory treatment, some BITs explicitly prohibit such treatment*” (ibid.). Recent arbitral awards came to different conclusions about whether the “fair and equitable treatment” standard includes a prohibition on discrimination (see *Methanex v. United States*, Decision on Amici Curiae of 15 January 2001, and Final Award of 3 August 2005; *Eureko v. Poland*, Partial Award of 19 August 2005).

³⁴ For an overview of the current discussion and the different interpretations of the clause by arbitration tribunals, see Dolzer (2005a), Juillard (1994) and Schreuer (2005).

³⁵ For a detailed explanation of this position, see UNCTAD (1999f).

³⁶ As has been clearly explained, according to this view: “*the strength and usefulness of the fair and equitable treatment standard lie in its relative lack of abstract content which appears to be aimed at ensuring the prudent and just application of legal rules...According to this view, the inclusion of this standard in BITs serves several purposes; not only does it provide a basic standard, it also provides a basic auxiliary element for interpretation of the other provisions in the agreement and for filling gaps in the treaty.*” Ibid., p. 54.

³⁷ For a detailed explanation of this subject, see UNCTAD (1999f).

³⁸ These standards have been developed in the “*Neer*” case (*Neer v. Mexico*, Opinion, United States – Mexico General Claims Commission, 15 October 1926, 21 A.J.I.L. 555, 1927). See also Brownlie (2003).

³⁹ See the previous footnote.

⁴⁰ In fact, this was one of the conclusions of the arbitral panel in the *Metalclad* dispute brought against Mexico in the context of the application of NAFTA’s Article 1105. That article explicitly links fair and equitable treatment to international law in a way that makes it relatively easy to find that a violation of another obligation also violates the principle of fair and equitable treatment.

⁴¹ For a detailed discussion of NAFTA’s jurisprudence on Chapter 11 cases, see Dawson (2002), VanDuzer (2002), and Mann and von Moltke (1999).

⁴² The relevant part of the Note of Interpretation issued by the Free Trade Commission states as follows:

“Having reviewed the operation of proceedings conducted under Chapter Eleven of the North American Free Trade Agreement, the Free Trade Commission hereby adopts the following interpretations of Chapter Eleven in order to clarify and reaffirm the meaning of certain of its provisions: [...]

B. Minimum Standard of Treatment in Accordance with International Law

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)” (Note of Interpretation of the NAFTA Free Trade Commission, 31 July 2001).

⁴³ At the beginning of the 1990s, a very limited number of BITs did not make any reference to the fair and equitable treatment standard at all —for example, the BIT between Albania and Bulgaria (1994). However, countries that originally did not include the fair and equitable standard in their BITs later opted to do so. It should be noted that if a country has already provided fair and equitable treatment in at least one BIT, this level of protection must be provided to investors or investments of all other countries with which the country has concluded investment agreements containing an MFN clause, unless a specific exception was included in the agreement concerned. Thus, in many cases, it may make no practical difference

whether the fair and equitable treatment standard explicitly appears in a BIT, because it may still be applicable through the MFN clause in another applicable BIT.

⁴⁴ This is the case for at least 52 BITs concluded during the last decade. Among these are BITs concluded by Australia, Bahrain, Brunei Darussalam, Cambodia, Indonesia, Malaysia and Singapore.

⁴⁵ The scope of the MFN clause is dealt with in more detail in subsection E.2.b.1 below.

⁴⁶ For a detailed discussion on the admission clause, see section C above.

⁴⁷ See, for instance, *S.D. Meyers v. Canada*, UNCITRAL, First Partial Award of 13 November 2000.

⁴⁸ One of the most commented on cases that followed this approach was the 1991 “Tuna Case”, *United States – Restrictions on Imports of Tuna*, DS21/R, (unadopted) dated 3 September 1991 (WTO 1995).

⁴⁹ See *Methanex v. United States*, UNCITRAL, Decision on Amici Curiae of 15 January 2001, and Final Award of 3 August 2005; *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA Case No. UN3467, Final Award of 1 July 2004. See also Dolzer (2005b).

⁵⁰ *S.D. Meyers v. Canada*, UNCITRAL, First Partial Award of 13 November 2000; *Pope & Talbot Inc. v. Canada*, UNCITRAL, Award on Merits of 10 April 2001. See also VanDuzer (2002) and Dawson (2002).

⁵¹ *Ibid.*

⁵² Among numerous other agreements, treaties following this trend are the BITs between Chile and South Africa (1998), Argentina and New Zealand (1999), France and India (1997) and Mongolia and Singapore (1995).

⁵³ Examples of BITs falling within this category are, among others, the agreements between Japan, on the one hand, and Viet Nam (2003) and the Republic of Korea (2002) on the other hand. Other Japanese BITs, although in principle only applying to established investment, do provide MFN treatment at the entry stage. That is the case of the BITs between Japan and Bangladesh (1998), Hong Kong (China) (1997) and the Russian Federation (1998), respectively. Furthermore, most of the BITs of the United States and Canada — after the mid-1990s — fall within this category.

⁵⁴ The BITs between Botswana and China and between Australia and Argentina are two examples among numerous other BITs falling within this category. The most common exceptions to the MFN principle in BITs are explained below.

⁵⁵ An explanation might be that MFN treatment raises fewer objections, as the reasons for a host country to prefer foreign investors of a particular nationality may be limited.

⁵⁶ However, in this particular case, it should be noted that paragraph 2 of the same Article 3 cited above grants MFN treatment to investors of the contracting parties which is not conditioned on the domestic laws and regulations of the host country.

⁵⁷ That is the case of the BIT between China and Netherlands (2001), and the BIT between Cuba and Mexico (2001).

⁵⁸ Numerous agreements follow this approach. Examples are the agreements between China on the one hand, and Djibouti, Cambodia, Qatar and Brunei Darussalam, respectively, on the other hand.

⁵⁹ The BITs between Mexico and Greece (2000) and Australia and Egypt (2001) are two examples of the numerous agreements following this approach.

⁶⁰ *Emilio Agustín Maffezini v. Kingdom of Spain* (ICSID No. Apr/97/7). Decision on Jurisdiction of 25 January 2000 and Award of the Tribunal of 13 November 2000.

⁶¹ See, for example: *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3. 1990, ICSID Reports 246; *Anglo-Iranian Oil Company Case*, International Court of Justice, Reports, 1952, p. 93; *Case concerning the rights of nationals of the United States of America in Morocco*, International Court of Justice, Reports, 1952, p. 176; and *Ambatielos Case*, International Court of Justice, Reports, 1953, p. 10.

⁶² The Arbitral Tribunal elaborated on this point in greater detail and stated:

“63. Here it is possible to envisage a number of situations not present in the instant case. First, if one contracting party has conditioned its consent to arbitration on the exhaustion of local remedies, which the ICSID Convention allows, this requirement could not be bypassed by invoking the most favored nation clause in relation to a third-party agreement that does not contain this element since the stipulated condition reflects a fundamental rule of international law. Second, if the parties have agreed to a dispute settlement arrangement which includes the so-called fork in the road, that is, a choice between submission to domestic courts or to international arbitration, and where the choice once made becomes final and irreversible, this stipulation cannot be bypassed by invoking the clause. This conclusion is compelled by the consideration that it would upset the finality of arrangements that many countries deem important as a matter of public policy. Third, if the agreement provides for a particular arbitration forum, such as ICSID, for example, this option cannot be changed by invoking the clause, in order to refer the dispute to a different system of arbitration. Finally, if the parties have agreed to a highly institutionalized system of arbitration that incorporates precise rules of procedure, which is the case, for example, with regard to the North America Free Trade Agreement and similar arrangements, it is clear that neither of these mechanisms could be altered by the operation of the clause because these very specific provisions reflect the precise will of the contracting parties. Other elements of public policy limiting the operation of the clause will no doubt be identified by the parties or tribunals. It is clear, in any event, that a distinction has to be made between the legitimate extension of rights and benefits by means of the operation of the clause, on the one hand, and disruptive treaty-shopping that would play havoc with the policy objectives of underlying specific treaty provisions, on the other hand.”

⁶³ *Salini Construttori S.p.A. and Italstrade S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001; *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August 2004; *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005.

⁶⁴ The treatment of general exceptions in the BITs concluded in the last decade is addressed in section K below.

⁶⁵ Departures from this trend include the exceptions to the MFN standard contained in some BITs of the United States and Canada, which explicitly provide that MFN treatment does not apply to government procurement or subsidies or grants provided by a party, including government-supported loans, guarantees and insurance.

⁶⁶ For a detailed explanation of the different kind of annexes see section C above.

⁶⁷ Given that a foreign investor operates within the territory of a host country, the investor and its property are subject to the latter's legislative and administrative control. The risk assessment that a foreign investor makes at the time of entry may not be accurate since the host country's political and economic situation, and consequently, its internal policies relating to foreign investment may change. This could be brought about by several factors, such as a new Government, shifts in ideology, economic nationalism or monetary crises. Where these changes adversely affect foreign investment or require, in the view of the host country, a rearrangement of its economic structure, they may lead to the taking of property of a foreign investor.

⁶⁸ Expropriation clauses have traditionally been at the heart of BITs. This was clearly understandable considering the period in which BITs began to be negotiated. The 1960s were the decade of decolonization and also a time when most Governments in developing countries promoted heavy State intervention to foster import-substitution policies. This was also a period during which numerous developing countries focused their economic policy on asserting their national sovereignty, in particular over their natural resources. The risk of a foreign investor being subject to expropriation or nationalization was relatively high. It was also the period when the competing standard of appropriate compensation emerged. Within this context, capital-exporting countries had a clear incentive to negotiate investment regimes that would set a minimum standard of protection for their investments abroad.

⁶⁹ The distinction between these two kinds of takings has been that while "nationalizations" are undertaken for political purposes and may often affect entire sectors of the economy, "expropriations" are takings that are often limited to one specific firm and do not have a political background.

⁷⁰ For more on these various means see UNCTAD (2000a).

⁷¹ See, for example, *S.D. Meyers v. Canada*, UNCITRAL, First Partial Award of 13 November 2000; *Marvin Roy Feldman v. The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award on Merits of 16 December 2002.

⁷² In this connection, see, inter alia, Mann and von Moltke (1999).

⁷³ This is an issue that several arbitral tribunals have addressed in the context of the application of Chapter 11 of NAFTA. Because NAFTA Article 1110 specifically refers to measures tantamount to expropriation as well as indirect expropriation, questions have been raised as to whether this provision could be interpreted as extending beyond protection against indirect expropriation. So far, in cases addressing the issue on the merits, such as *Pope & Talbot* and *S.D. Myers*, it has been held that the reference to "tantamount to nationalization or expropriation" does not expand the expropriation standard beyond what is conventionally considered an indirect expropriation.

⁷⁴ The BIT between Lebanon and Malaysia (2003) is an example.

⁷⁵ The provision cited above could be interpreted as stating that the contracting parties shall abstain from taking "any measures" of expropriation, and that by using the plural form, the article envisages the possibility of its applying to more than one type of expropriation measure. Within this logic, measures having an effect equivalent to that of an expropriation would also be "measures of expropriation" for the purposes of the agreement. On the other hand, it could also be argued that the text of the provision refers only to measures of expropriation, and not to other kinds of measures, regardless of whether the latter have an effect equivalent to that of the former.

⁷⁶ Prompt, adequate and effective compensation was a standard advocated by former US Secretary of State Cordell Hull in his communication to the Mexican Government during the expropriation of American assets in 1939. This approach is thus known as the "Hull formula".

⁷⁷ In this regard, see article 4.2. of the BIT between the Russian Federation and Thailand (2002) cited above.

⁷⁸ While almost any national currency can be convertible, only a limited group of hard currencies are considered by the IMF to be *freely usable*. Among the latter are the United States dollar, the euro, the pound sterling, the Swiss franc and the Japanese yen.

⁷⁹ See also *Asian Agricultural Products Ltd. v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, 27 June 1990.

⁸⁰ There is a reason for this distinction. While it could be argued that in situations of war or civil unrest the damage can be caused by actions or omissions of the country, in situations of natural disasters, which are usually fortuitous, the country does not play a role in generating the damage.

⁸¹ This is the case of the BIT between Argentina and Mexico (1996), which does not have a compensation for losses clause.

⁸² See above chapter D.1.

⁸³ The BIT between China and Djibouti (2003) is an example.

⁸⁴ A similar situation exists with regard to several other BITs of India, such as with Australia (1999), Austria (1999), Croatia (2001), Indonesia (1999) and Sweden (2000).

⁸⁵ During the last decade, BITs applying this approach include the treaties between France and Albania (1995), Azerbaijan (1998), Cambodia (2000), Cuba (1997), the Dominican Republic (1999), India (1997), Mexico (1998) and Uganda (2002), as well as those between Denmark and Algeria (1999), Cuba (2001), India (1995), Kuwait (2001), Kyrgyzstan (2001), the Lao People's Democratic Republic (1998), Mongolia (1995), Nicaragua (1995), Pakistan (1996) and the Philippines (1997).

⁸⁶ The BIT between Brunei Darussalam and the Republic of Korea (2000) is an illustration.

⁸⁷ The BIT between Hong Kong (China) and Japan (1997) is an example.

⁸⁸ The BIT between Ethiopia and the Russian Federation (2000) illustrates this approach.

⁸⁹ For example, the BIT between Austria and Saudi Arabia (2001) provides that the host country should normally process a transfer in no more than one month. By contrast, the BIT between Brunei Darussalam and China (2000) provides for a time frame of no more than four months in which to process the transfer.

⁹⁰ The applicable legislation no longer obliges the Chilean Government to apply the restriction previously mentioned. However, restricting capital outflows remains discretionary for the competent authorities in Chile, and thus Chilean BITs usually include this exception.

⁹¹ This is the case because this sector has a double role: not only is it a significant sector in its own, but also the state of the financial services sector has a direct impact on the other sectors of the economy.

⁹² As of 1 February 2007.

⁹³ Very similar provisions are also included in numerous other BITs under review. See, for instance, the BITs between Thailand and Argentina (2000), Bahrain (2002), Bulgaria (2003) and India (2001); between Belgium–Luxembourg and Costa Rica (2002), Pakistan (1998) and Philippines (1998); between Saudi Arabia and Austria (2001), and the Republic of Korea (2002); and between India and Austria (1999), Croatia (2001), Indonesia (1999), Ghana (2002) and Sweden (2002).

⁹⁴ This paragraph illustrates what is known as an “umbrella clause”, which incorporates into the BIT obligations that the host country may have assumed in a different context. This kind of clause is addressed in more detail in subsection I.4 below.

⁹⁵ Not all BITs negotiated by Finland during the last decade contain this provision. In this regard, see, inter alia, the BITs between Finland and Brazil (1995), China (2004), Lebanon (1997), Mexico (1999), Oman (1997), the Philippines (1998), Poland (1996), Slovenia (1998), South Africa (1998) and the United Arab Emirates (1996).

⁹⁶ BITs negotiated by Canada during the last decade using this approach include the agreements with Armenia (1997), Barbados (1996), Croatia (1997), Ecuador (1996), Egypt (1996), El Salvador (1999), Latvia (1995), Lebanon (1997), Panama (1996), Romania (1996), South Africa (1995), Trinidad and Tobago (1995), and Uruguay (1997). Concerning the US treaty practice, see, for example, the BITs with Albania (1995), Azerbaijan (1997), Bahrain (1999), Bolivia (1998), Croatia (1996), El Salvador (1999), Honduras (1995), Jordan (1997), Mozambique (1998) and Nicaragua (1995).

⁹⁷ See also UNCTAD (1998, pp. 83–84).

⁹⁸ However, numerous BITs contain provisions dealing with the entry and sojourn of foreign personnel in *general* (see above).

⁹⁹ This method is used in BITs that allow countries to make exceptions to some obligations on a negative-list basis. Thus, although non-conforming laws could be reserved, once the BIT enters into force, no new discriminatory restrictions are allowed that would affect the investors’ right to appoint top managerial personnel of their choice.

¹⁰⁰ Figure cited in Gill, Gearing and Birt (2004, footnote 31).

¹⁰¹ See *SGS Société de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of 16 October 2002.

¹⁰² See *SGS Société de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of 29 January 2004.

¹⁰³ See also OECD (2006).

¹⁰⁴ *Metalclad Corp. v. United Mexican States*, Award of 30 August 2000.

¹⁰⁵ This takes up an approach already incorporated into Article VI of the GATS.

¹⁰⁶ This approach is used in all other BITs negotiated by New Zealand over the last decade, such as in Article 8 of the BIT with Hong Kong (China) (1995) and Article 8 of the BIT with Chile (1999).

¹⁰⁷ In this BIT, Article 1 refers to definitions, Article 3 to access to tribunals, Article 7 to transparency, Article 9 to fair and equitable treatment and expropriation, Article 22 to local governments and denial of benefits, and Article 23 to final provisions (footnote added).

¹⁰⁸ In this BIT, Article 13 refers to State-State dispute settlement and Article 14 to investor-State dispute settlement (footnote added).

¹⁰⁹ In this BIT, Article 20 sets up a Joint Committee to oversee the implementation of the agreement (footnote added).

¹¹⁰ Article 3 of the BIT between Germany and Mexico (1998) provides as follows:

“Treatment of Investments

1. Each Contracting State shall ensure to investments in its territory that are owned or controlled by nationals or companies of the other Contracting State, treatment no less favourable than that granted to investments of its own nationals and companies, or to investments of nationals and companies of any third State.

2. Each Contracting State in its territory shall accord to nationals or companies of the other Contracting State, with respect to the activities mentioned in Article 2, paragraph 3 and related to its investments, treatment not less favourable than that accorded to its own nationals and companies or nationals and companies of any third State.

3. The aforesaid treatment does not refer to special advantages that one of the Contracting States grants to nationals or companies of a third State by virtue of an agreement establishing a free trade area, customs unions, a common market or by virtue of its associations with such organizations.

4. The treatment agreed by the present Article does not refer to the advantages that one of the Contracting States grants to the nationals or companies of a third State by virtue of an agreement on the avoidance of double taxation or any other agreement in tax matters.” (footnote added)

¹¹¹ Article 10 of the BIT between Japan and Viet Nam (2003) refers to compensation for losses in cases of civil strife (footnote added).

¹¹² Article 11 stipulates the following:

“An investor of a Contracting Party, which has suffered loss or damage relating to its investment and business activities in the territory of the other Contracting Party due to hostilities or a state of emergency such as revolution, insurrection, civil disturbance or any other similar event in the territory of that other Contracting Party, shall be accorded by that other Contracting Party, as regards restitution, indemnification, compensation or any other settlement, treatment no less favourable than that which it accords to its own investors or to investors of any third country, whichever is more favourable to the investor.” (footnote added).

¹¹² The provision reads as follows:

“Article 16

[...]

2. *In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall not use such measure as a means of avoiding its obligations.*

3. *In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall, prior to the entry into force of the measure or as soon thereafter as possible, notify the other Contracting Party of the following elements of the measure: (a) sector and sub-sector or matter; (b) obligation or article in respect of which the measure is taken; (c) legal source or authority of the measure; (d) succinct description of the measure; and (e) motivation or purpose of the measure. [...]*”

¹¹³ It could be argued that protection of the environment comprises in broad terms not only the protection of natural resources but also the protection of human, animal and plant life or health.

¹¹⁴ See section F.1 above.

¹¹⁵ Only a minority of the agreements signed by France during the last decade include a cultural exception. For instance, the exception is not included in the BITs with Albania (1995), Armenia (1995), Azerbaijan (1998), Cambodia (2000), Cuba (1997), the Dominican Republic (1999), Ghana (1999), Guatemala (1998), Honduras (1998), Hong Kong (China) (1995), India (1997), Kazakhstan (1998), Lebanon (1996), Namibia (1998), Nicaragua (1998), Romania (1995), Slovenia (1998) and South Africa (1995).

¹¹⁶ This exception is identical to the one included in Article 2.3 of the BIT between France and Mexico (1998).

¹¹⁷ This exception has been included in all BITs negotiated by Canada during the last decade, such as the BITs with Armenia (1997), Barbados (1996), Costa Rica (1998), Croatia (1997), Ecuador (1996), Egypt (1996), El Salvador (1999), Latvia (1995), Lebanon (1997), Panama (1996), the Philippines (1995), Romania (1996), Slovakia (2001), South Africa (1995), Thailand (1997), Trinidad and Tobago (1995), Uruguay (1997) and Venezuela (1996). The same exception was also incorporated into Article 10.6 of the 2004 Canadian Model BIT.

¹¹⁸ Article 8 of the BIT between Chile and New Zealand (1999) is an example of this trend. This provision stipulates that the BIT “[...] shall not apply to Tokelau unless the Contracting Parties have exchanged notes agreeing to the terms on which this Agreement shall so apply”. Tokelau is a group of three atolls in the South Pacific Ocean. Originally settled by Polynesian emigrants from surrounding island groups, the Tokelau Islands were made a British protectorate in 1889. They were transferred to New Zealand administration in 1925.

¹¹⁹ An example of a general exception for this purpose is the BIT between Japan and Viet Nam (2003):

“Article 18

1. *Nothing in this Agreement shall be construed so as to derogate from the rights and obligations under multilateral agreements in respect of protection of intellectual property rights to which the Contracting Parties are parties.*

2. *Nothing in this Agreement shall be construed so as to oblige either Contracting Party to extend to investors of the other Contracting Party and their investments treatment accorded to investors of any third country and their investments by virtue of multilateral agreements in respect of protection of intellectual property rights, to which the former Contracting Party is a party. [...]*”

¹²⁰ For more detail on the evolution of preambles in BITs see section A above.

¹²¹ The same trend can be observed in the preambles of the BITs between Mozambique and the Netherlands (2001), Japan and Viet Nam (2003), and Japan and the Republic of Korea (2002), among others.

¹²² Article 11 of the 2004 Canadian Model BIT includes very similar language. This provision is cited below when the subject of environmental protection is addressed.

¹²³ An exception to this trend is the BIT between the United States and Uruguay (2005), which in its preamble makes reference to the intention of the contracting parties to achieve the objectives of the BIT in a manner consistent with the protection of the environment, and also contains specific provisions on this particular subject in the body of the agreement.

¹²⁴ This group of BITs includes the agreements between Belgium–Luxembourg and Botswana (2003), Ethiopia (2003) and Mauritius (2003), among others.

¹²⁵ Articles 24.1(a)(i)(A) and 24.1(b)(i)(A) provide that, for the purposes of the investor–State dispute settlement procedures, investors can only submit claims arguing that the host country has violated Articles 3 to 10 of the BIT. The commitment on environment is in Article 12.

¹²⁶ Article 37.5 of the BIT explicitly provides that State–State dispute settlement procedures “...shall not apply to a matter arising under Article 12 or Article 13”.

¹²⁷ Article 12.1 is complemented by a second paragraph, which provides as follows:

[...]

“2. Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”

This provision is commented on in subsection 1.c above, where the exceptions on the protection of natural resources are explained.

¹²⁸ This is the case of the BITs negotiated between Belgium–Luxembourg and countries such as Botswana (2003), Ethiopia (2003), Mauritius (2005) and Zimbabwe (2003).

¹²⁹ Footnote 14 to Article 13.2 states as follows: “For the United States, “statutes or regulations” for purposes of this Article means an act of the United States Congress or regulations promulgated pursuant to an act of the United States Congress that is enforceable by action of the central level of government.”

¹³⁰ Articles 24.1(a)(i)(A) and 24.1(b)(i)(A) provide that, for the purposes of the investor–State dispute settlement procedures, investors can only submit claims arguing that the host country has violated Articles 3 to 10 of the BIT. The commitment on labour standards is in Article 13. Article 37.5 of the BIT explicitly provides that State–State dispute settlement procedures “[...] shall not apply to a matter arising under Article 12 or Article 13”.

¹³¹ The concept of “rule-oriented” adjudication mechanisms contrasts with “power-oriented” means of peaceful dispute resolution. “In broad perspective one can roughly divide the various techniques for peaceful settlement of international disputes in two types: settlement by negotiation and agreement with reference (explicitly or implicitly) to relative power status of the parties; or settlement by negotiation or decision with reference to norms or rules to which both parties have previously agreed [...] To a large degree, the history of civilization may be described as a gradual evolution from a power-oriented approach, in the state of nature, towards a rule-oriented approach. [...] [There are] advantages which accrue generally to international affairs through a rule-oriented approach –less reliance on raw power, and the temptation to exercise it or flex one’s muscles, which can get out of hand; a fairer break for the smaller countries, or at least a perception of greater fairness [...]” (Jackson, 1997).

¹³² This approach has also been used in other BITs of Australia over the last decade, such as those negotiated with Argentina (1995), Lithuania (1998), Pakistan (1998), Peru (1995), the Philippines (1995), Sri Lanka (2002) and Uruguay (2001).

¹³³ An example of this approach is illustrated by the BIT between Chile and Egypt (1999), which in its Article 8.6 states that “[...] Once a dispute has been submitted to the competent tribunal or international arbitration in accordance with this Article, neither Contracting Party shall pursue the dispute through diplomatic channels unless the other Contracting Party has failed to abide or comply with any judgment, award, order or other determination made by the competent international or local tribunal in question”.

¹³⁴ Article 27.1 of the ICSID Convention states that “No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.”

¹³⁵ Among the BITs following this approach are the agreements between Australia and Chile (1996), Cambodia and the Republic of Korea (1997), and Eritrea and Uganda (2001).

¹³⁶ BITs following this approach are, among others, those between Cambodia and China (1996) and Bahrain and China (1999).

¹³⁷ Other BITs, such as the agreements between Chile and Indonesia (1999) and Bahrain and China (1999), provide for a consultation period of four and five months respectively.

¹³⁸ Under customary international law, a home country may generally not espouse a private investor’s claim against a host country unless the investor has first exhausted local remedies (UNCTAD, 1998).

¹³⁹ Among the BITs using this approach are the agreements between China and Bahrain (1999), Bosnia and Herzegovina (2000), Botswana (2000), Guyana (2003), Jordan (2001), Qatar (1999), Trinidad and Tobago (2002) and Djibouti (2003).

¹⁴⁰ Paragraph (6) of Article 8 cited above provides that “A disputing investor may submit a claim to arbitration only if he consents to arbitration in accordance with the procedures set out in this Agreement and waives his right to initiate before any administrative tribunal or court under the law of a Contracting Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Contracting Party that is alleged to be a breach of this Agreement.” The importance of this waiver lies in preventing the dispute from being submitted to more than one forum, as explained in subsection L.b below.

¹⁴¹ Among others, this approach is used in BITs between Austria and Armenia (2001), Bosnia and Herzegovina (2000), Jordan (2001), the Libyan Arab Jamahiriya (2002), Lebanon (2001), the Former Yugoslav Republic of Macedonia (2001), Mexico (1998), the United Arab Emirates (2001) and Uzbekistan (2000).

¹⁴² Some BITs refer to regional arbitration forums such as the Cairo Regional Centre for International Commercial Arbitration (see, for example, the BIT between Egypt and Nigeria (2000) and the BIT between Egypt and Pakistan (2000)) or

the Arab Investment Court (see, for example, the BIT between Egypt and the Syrian Arab Republic (1997) and the BIT between Jordan and the Syrian Arab Republic (2001)).

¹⁴³ The promotion of judicial economy is one of the policies behind a series of innovations in investor—State dispute settlement provisions in BITs. This point is developed in subsection L.b below.

¹⁴⁴ As subsection L.1.a.(i) above also explains, some BITs require that for an investor to have standing, it is necessary that the claim consists in an alleged violation of the agreement and that such breach has generated a loss to the detriment of the investor. However, most of the BITs requiring this standing also tend to explicitly recognize the possibility for the investor to invoke arbitration procedures, even if compensation under an insurance contract has previously been granted. For instance, see Article 10 of the Annex of the BIT between Cuba and Mexico (2001), Article IX of the BIT between Jordan and the United States (1997), and Article 15 of the BIT between Austria and Bosnia Herzegovina (2000), among others.

¹⁴⁵ Article V of the New York Convention provides the following:

“Article V

1. *Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:*
 - (a) *The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or*
 - (b) *The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or*
 - (c) *The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decision on matters submitted to arbitration can be separated from those not submitted, the part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or*
 - (d) *The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or failing such agreement, was not in accordance with the law of the country where the arbitration took place; or*
 - (e) *The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.*
2. *Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:*
 - (a) *The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or*
 - (b) *The recognition or enforcement of the award would be contrary to the public policy of that country.”*

¹⁴⁶ For instance, Article 27.1 of the ICSID Convention explicitly provides that “no Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.”

¹⁴⁷ However, some BITs do not address this matter.

¹⁴⁸ For instance, the BIT between Armenia and Austria (2001) has a chapter on dispute settlement, one part of which, containing six articles, regulates investor—State arbitration. Other BITs that include detailed investor—State dispute settlement provisions are the agreements of Austria with Bosnia and Herzegovina (2000), Jordan (2001), Lebanon (2001), the Libyan Arab Jamahiriya (2002), the Former Yugoslav Republic of Macedonia (2001), the United Arab Emirates (2001) and Uzbekistan (2000), among others. The 2004 Canadian Model BIT has a whole section, comprising 27 provisions and two annexes, on investor—State dispute settlement. Furthermore, the BIT between Finland and Mexico (1999) has a section with 10 provisions on investor—State dispute settlement. The same approach applies to the BITs that Mexico has concluded with Belgium—Luxembourg (1998), Cuba (2001), Germany (1998), Greece (2000), the Netherlands (1998), Portugal (1999), the Republic of Korea (2000) and Sweden (2000), among others.

¹⁴⁹ See UNCTAD (2005b).

¹⁵⁰ DR-CAFTA even goes further, and provides for the establishment of a negotiating group to draft an amendment to the agreement authorizing the establishment of an appellate body within one year after the entry into force of the treaty.

¹⁵¹ For example, the BIT between China and Guyana (2003) provides for a period of six months from the date on which either contracting party raised the matter. Examples of shorter periods include the BIT between Austria and Bosnia and Herzegovina (2000), which allows a contracting party to initiate the proceedings 60 days after notification of the intention to do so.

¹⁵² This is the case of United States' BITs, for instance the BIT with Uruguay (2005). This approach has already been used in BITs negotiated earlier in this period, such as in the BITs between the United States and Azerbaijan (1997), Bahrain (1999), Jordan (1997) and Mozambique (1998).

¹⁵³ This is the case of most BITs of the United States.

¹⁵⁴ For instance, the BIT between Mexico and the Netherlands (1998) provides that:

*“Article 11**Settlement of Disputes between the Contracting Parties**[...]*

(5) The tribunal shall decide on the basis of respect for the law. Before the tribunal decides, it may at any stage of the proceedings propose to the Contracting Parties that the dispute be settled amicably. The foregoing provisions shall not prejudice settlement of the dispute ex aequo et bono if the Contracting Parties so agree. [...]

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*“Article 37: State-State Dispute Settlement**[...]*

4. Articles 28(3)[amicus curiae], 29,[Transparency of Arbitral Proceedings] 30(1) [Governing Law] and 31[Interpretation of Annexes] shall apply mutatis mutandis to arbitrations under this Article.”

CONCLUSIONS: EVOLUTION IN INVESTMENT RULEMAKING — NEW CHALLENGES FOR DEVELOPING COUNTRIES

This study has shown that BITs concluded since the late 1990s continue to have a structure and a content similar to those of earlier BITs. However, the fact that most BITs address basically the same issues does not mean that they have the same underlying rationale, nor does it mean that all agreements provide the same degree of investment protection or have evolved homogeneously over the last decade. Rather, the enormous increase in BITs during the review period has resulted in a greater variety of approaches with regard to individual aspects of their content. A small number of BITs has introduced some significant innovations. These BIT developments have also been reflected in the investment chapters of free trade agreements and other recent economic integration agreements concluded by countries (UNCTAD, 2006c).

A. Similarities and dissimilarities between BITs

Core elements found in most BITs include provisions on the scope of application, entry and establishment of investment, fair and equitable treatment, national treatment and MFN treatment, expropriation and compensation, transfer of funds and dispute settlement, both between contracting parties and between a contracting party and an investor.¹ However, despite including provisions addressing basically the same issues, BITs negotiated over the last decade have adopted a variety of approaches concerning specific aspects of investment promotion and protection. Two main models can be distinguished.

Continuing with a trend that already existed in the mid-1990s, the overwhelming majority of BITs negotiated during the last decade follow the traditional “admission” model. These agreements apply to investment only once it has been admitted into the host country in accordance with the latter’s domestic laws and regulations. Within this group of BITs, important differences exist regarding the degree of precision of several key obligations applying to established investments (see below). A minority of BITs provide relatively little protection to foreign investment. For instance, these BITs do not provide national treatment even after the investment has been admitted in accordance with the laws and regulations of the host country.² In other BITs falling into this category, standards such as the freedom of transfers, or even fair and equitable treatment, have been subject to domestic legislation. This weakens the degree of protection afforded to the investor.

Another — relatively small — category of BITs imposes a higher degree of discipline on the contracting parties compared with the previous categories. These agreements are geared to both investment liberalization and protection. In addition to applying to investments both in the pre- and post-establishment phases, these BITs include commitments on certain issues often not covered by treaties based on the “admission” model, such as performance requirements, top managerial personnel, and, more recently, transparency. These are the BITs negotiated by the United States since the 1980s, by Canada after the mid-1990s and by Japan at the beginning of this century. Over the last 10 years, these countries have concluded more than 40 new BITs providing national treatment and MFN treatment in the pre-establishment phase. However, considering that during this period more than a thousand agreements were negotiated, these BITs are still a small minority.

B. Assessment in terms of innovations in investment rulemaking

The vast majority of BITs concluded during the review period follows drafting and regulatory approaches typical of treaties negotiated before the mid-1990s. These treaties therefore demonstrate the considerable degree of common ground that has been achieved over the last few decades concerning the main content of BITs. On the other hand, a relatively small, but increasing, group of BITs have started to introduce some innovations in investment rulemaking.

An important distinction to be made is that — with the exception of the first subsequent category (“protection of public policy concerns”) — all other types of innovations are mainly limited to BITs

concluded by a few countries, including Canada, Colombia, Japan, the Republic of Korea and the United States.

1. Protection of public policy concerns

Against the background of the ongoing debate about possible negative effects of FDI, a growing number of countries emphasize in their BITs that *investment protection made must not be pursued at the expense of other legitimate public concerns*. To that end, more recourse is made to treaty exceptions, thereby safeguarding the right of the host country to enact regulations — even inconsistent with the obligations in the BIT. In addition to the "traditional" areas where such exceptions have been a common feature of BITs for many years, namely taxation and regional economic integration, more agreements now also exempt from the scope of the BIT — fully or partially — host country measures related to such diverse fields as essential security and public order, protection of health, safety and natural resources, cultural diversity, and prudential measures for financial services. These exceptions show the scale of values in the policymaking of contracting parties, and subordinate investment protection to those other key policy objectives.

The proliferation of general exceptions does not respond to a particular regional pattern. Rather, the increase in general treaty exceptions in BITs is a *worldwide trend*.³ However, some countries emphasize the protection of certain policy objectives more than others.⁴

Instead of using general exceptions, other BITs have included positive language — either in their preambles or in specific provisions in the body of the text — to reinforce the commitments of the contracting parties to safeguard certain values, basically the protection of health, safety, the environment, and the promotion of internationally recognized labour rights. Although this approach has legal effects that are different from those of a general exception, it gives the same political signal that contracting parties do not place investment protection above other important public policy objectives. Once again, this approach is *not limited to specific countries or regions*.⁵

2. Other innovations

A small group of BITs concluded over the last decade include further innovations in investment rulemaking. As previously stated, the new model BITs of Canada and the United States exemplify this approach. The normative evolution has focused on a number of areas: to clarify individual BIT provisions; to provide greater transparency; and to improve the transparency and predictability of dispute settlement.

Clarification of individual BIT provisions

Most BITs continue to use very general language, such as the provisions on fair and equitable treatment, MFN treatment and expropriation. In view of Canada's and the United States' past involvement in numerous investor-State disputes, recent BITs of those countries have departed from this approach and spell out in more detail the content of some core provisions.

One example is the definition of "*investment*". The new Canadian model BIT has replaced the open-ended, asset-based definition with a comprehensive and finite definition. The recent BIT between the United States and Uruguay (2005), on the other hand, has opted to define the term "*investment*" in economic terms; in principle, it covers every asset that an investor owns and controls, but adds that such assets must have the "*characteristics of an investment*", such as "*the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk*". Also, several kinds of assets not considered to be covered investments under the agreement are excluded. Both approaches attempt to strike a balance between maintaining a comprehensive investment definition and excluding assets that are not intended by the parties to be covered.

Another trend is the revision of the wording of various substantive treaty obligations. The new Canadian and United States model BITs, learning from the technical intricacies faced in the implementation of the investment chapter of NAFTA, use more detailed language and elaborate on the meaning of absolute standards of protection, in particular the minimum standard of treatment in accordance with international law

and indirect expropriation. The new language is geared to indicating that both sets of obligations are intended to reflect the level of protection granted by customary international law. In addition, both BIT models include annexes specifying guidelines and criteria in order to determine on a case-by-case basis whether an indirect expropriation has in fact taken place.

Transparency

Recent BITs of Canada and the United States explicitly deal with the issue of transparency. There has been a gradual evolution in the rationale and content of the obligations on this subject. Where once transparency was regarded as an obligation imposed on contracting parties to exchange information, this kind of BIT also considers transparency to be a reciprocal commitment between the host country and the investor. Furthermore, transparency is extended to the process of domestic rulemaking, aimed at allowing investors and other interested persons to participate in it. These transparency obligations are not subject to the ISDS provisions — that is, they are not enforceable by investors.

Investor–State dispute settlement

Another feature of recent Canadian and United States BITs is their significant innovation regarding investor–State dispute settlement. This includes greater and substantial transparency in arbitral proceedings, open hearings, publication of related legal documents and the possibility for representatives of civil society to submit *amicus curiae* briefs to arbitral tribunals. Other new detailed clauses provide for more law-oriented, predictable and orderly conduct at the different stages of the investor–State dispute settlement process. The Canadian model BIT, for example, even includes specific standard waiver forms to facilitate waivers as required by the agreement for the purposes of filing a claim. The BIT between the United States and Uruguay (2005) not only provides for a special procedure at the early stages of the investor–State dispute settlement process aimed at eliminating frivolous claims, but also envisages the possibility of setting up an appellate mechanism to foster a more consistent and rigorous application of international law in arbitral awards.

Mexico is another country that has introduced innovations on investor–State dispute settlement in its BITs. After negotiating Chapter 11 of NAFTA, Mexico started to negotiate BITs with several countries, mostly in Europe and Asia, incorporating some of the specific clauses included in Chapter 11. After the negotiation of the BIT with Austria in 1998, it seems that the latter country followed suit and included more detailed investor–State dispute settlement provisions in some — though not all — of its subsequent agreements.

C. Implications

BIT negotiations during the last decade have two main characteristics. First, the enormous increase in BITs has resulted in a remarkable degree of similarity as far as their *basic structure and content* are concerned. Apart from the traditional divide between BITs with and without liberalization commitments, there is no major disagreement about what should be the core elements of a BIT and what basic content its key provisions should have. Second, despite this broad general consensus, it is clear that the picture becomes much more diverse when one looks into the details of individual BIT provisions. In this respect, it is fair to say that the level of variation between BITs has increased during the review period. While some differences relate to the substance of the provisions, others concern only minor linguistic variations, although sometimes with major implications. A few issues stand out as the most important new developments. They include the introduction of additional elements of investment protection, a greater emphasis on key public policy concerns as a counterweight to investment protection, the clarification of individual treaty provisions, more transparency and more detailed rules on investor–State dispute settlement.

The consolidation of core BIT provisions should contribute to facilitating future negotiations on international investment rulemaking and gives foreign investors more assurance about what they can reasonably expect from host countries as investment protection. The greater diversity of BITs when it comes to the details of the agreement reflects the flexibility that countries would like to have in choosing the

partners to enter into an agreement, and to tailor individual agreements to their specific situations, development objectives and public concerns. Furthermore, more elaborate rules may enhance legal clarity on rights and obligations, and may fill existing gaps in the overall treatment of foreign investment.

On the other hand, the developments in BIT negotiations also mean that the last decade has witnessed the emergence of a new pattern in international investment rulemaking. In addition to the different approaches to investment liberalization in BITs, one can now also distinguish agreements according to their degree of complexity. However, it needs to be underlined that BITs with more elaborate structures are still a relatively small minority. Furthermore, to some extent these BITs might *look* more different on paper than they really are, since they are not intended to substantially deviate from or even contradict “traditional” BITs. Rather, to some degree these more complex BITs “only” spell out explicitly what contracting parties to conventional agreements implicitly have in mind when concluding the treaty. All this suggests that these differences are less significant than the divide between BITs that include liberalization commitments and those that do not.

Nevertheless, the growing diversity of the BIT universe poses new challenges for keeping it coherent. The risk of incoherence is particularly great for developing countries that lack expertise and bargaining power in investment rulemaking, and that may have to conduct negotiations on the basis of divergent model agreements of their negotiating partners (UNCTAD 2006b). Already in the past, developing countries concluded different kinds of BITs, depending on whether their developed market economy treaty partner followed the approach of excluding or including pre-establishment obligations in the agreement. With the recent emergence of more complex BITs, an additional layer of potential incoherence has been introduced.

One example is the more frequent recourse to exception clauses in recent BITs. It could mean that a developing country's measures to protect certain public values (e.g. national security or the environment) are not subject to the disciplines of some BITs while others cover them. Another illustration is the interpretation of the international minimum standard in accordance with the principles of customary international law in recent Canadian and United States BITs. Although these interpretative clauses are intended only to clarify the content of the provision and do not therefore set out to introduce substantive amendments, they may have a decisive impact on arbitration proceedings. As a result, tribunals might arrive at different conclusions with regard to the legality of basically the same host country measure, depending on whether the BIT contains an interpretative statement.

It remains to be seen whether the future development of BIT negotiations will result in a gradual convergence of the different models. To a considerable extent this will depend on the further evolution of investment disputes. Many of the recent changes that Canada and the United States have made in their BITs reflect their arbitration experience. If ever more countries become defendants in investment disputes and if they consider that arbitration tribunals have too much discretion in interpreting BIT provisions, they might wish to follow the Canadian and United States approach. However, it is also possible that the substantial increase in investment disputes (and awards) results in a consolidation of case law that makes the outcome of future arbitration both more predictable and acceptable and thereby reduces the need for interpretative statements in the BITs.

For the time being, the MFN principle included in most BITs could contribute to furthering coherence between different agreements. It might ensure, at least in principle, that an investment from a country with a “lower” protection standard BIT will receive treatment no less favourable than the treatment granted to an investment from a country with a “higher” protection standard BIT. The MFN standard could therefore have the effect of “levelling the playing field” for the protection that is provided to investors of different nationalities.

Applying the MFN principle to BITs with different degrees of complexity might be a challenging task. On the one hand, it might mean that the BIT provision with the higher level of sophistication becomes applicable. This could be the case, for instance, if one BIT grants the foreign investor additional rights with regard to transparency or in dispute settlement proceedings. On the other hand, the greater complexity of one BIT might also imply a reduction in the level of investment protection as compared with other BITs with the

result that this BIT provision could become inapplicable. For example, if BIT A includes an unqualified obligation to grant fair and equitable treatment, and BIT B states that such treatment refers only to the international minimum standard, the MFN clause in BIT B might override this statement. The result might be similar if one BIT includes a specific exception and the other does not. Such policy coherence through the MFN clause could render useless the efforts of contracting parties to distinguish their BIT from other agreements. It also needs to be underlined that the scope and effect of the MFN clause has become uncertain in the light of some recent contradictory awards.⁶

Another challenge for developing countries in future BIT negotiations has to do with the fact that a growing number of them are becoming capital exporters. As a result, they are not only concerned about ensuring sufficient flexibility for themselves in regulating inward FDI, but also seek to provide their investors with ample protection abroad. Reconciling these two potentially conflicting interests may not be easy.

D. The development dimension

Beyond the inherent objective of investment protection that BITs pursue, the vast majority does not directly address specific development-related issues. As in the past, most recent BITs include language stressing the importance of encouraging foreign investment, creating favourable conditions for it, and the like. However, they rarely contain an obligation to promote investments — that is, whereas there is a duty on the part of the host countries to protect investment, there is no *quid pro quo* in treaties that would oblige home countries to promote flows of investment.

Some BITs concluded in the review period have explicitly adopted development-oriented provisions that refer to the notions of investment promotion and facilitation, including home country measures. A number of BITs contain provisions for the exchange of information with regard to investment opportunities, and some go so far as to call for the offering of incentives and the establishment of investment promotion offices. Few BITs also contain provisions concerning the establishment of institutional mechanisms to follow up on the application and interpretation of the treaty — a matter that has been identified as development-friendly, as it allows the contracting parties to review their obligations and to adapt them to changing circumstances.⁷ A few BITs also contain specific exceptions and safeguards that are intended to cater for the different objectives and needs of parties at different levels of development (although most exceptions in BITs are of a general nature and apply irrespective of the level of development of a country). These qualifications may apply to all substantive provisions and are particularly frequent with regard to the establishment of foreign investment and the repatriation of funds.

In sum, current BIT practice does not, in general, expressly deal with development matters. For most BITs concluded over the past decade, it remains true that, “a striking feature [...] is the multiplicity of provisions they contain that are specifically designed to protect foreign investments, and the absence of provisions specifically designed to ensure economic growth and development”.⁸ The need is, therefore, for further clarification of the interrelationship between existing standards of investor protection and investment promotion, on the one hand, and the best means by which development concerns can be (or should be) expressed in the future evolution of BITs, on the other hand.

* * *

In conclusion, the evolution of BITs during the last decade confirms a trend that had already become apparent in the previous review period. Countries share similar perceptions as regards the basic structure and content of these agreements. That having been said, BITs have become more diverse when it comes to the individual facets of investment promotion and protection. A small group of countries stand out with regard to treaty innovations; however, it is too early to say whether this trend will develop into a more general movement in the future.

More variation in BITs has its benefits but also gives rise to concern about policy coherence, in particular for developing countries. One consequence of this situation is the growing need for capacity-building to help developing countries in assessing the implications of different policy options before they

enter into new agreements, in identifying the potential obligations deriving therefrom and in implementing commitments made. Rigorous policy analysis of the evolution of the BIT universe and further international consensus-building on key development-related issues are other vital tasks. This includes more research on emerging trends concerning internationally recognized principles in investment rulemaking and the identification of common elements. International organizations can lend a helping hand in this regard.

Notes

¹ It is difficult to define in detail the standard typology of a traditional BIT. For a detailed analysis of this typology, see UNCTAD (1998).

² In this regard, see subsection E.2.a.(i) above.

³ For instance, general exceptions on taxation can be found in, inter alia, the BITs between Germany and Mexico (1998), Argentina and New Zealand (1999), Chile and New Zealand (1999), Hong Kong (China) and New Zealand (1995), Barbados and Canada (1996), Canada and Costa Rica (1997), Japan and Viet Nam (2003), and the United States and Uruguay (2005). General exceptions on the protection of natural resources can be found in, inter alia, the BITs between Mauritius and Switzerland (1998), Australia and India (1999), and Armenia and Canada (1997). General exceptions on public order and essential security interests can be found in, inter alia, the BITs between Finland and Kyrgyzstan (2003), Japan and the Republic of Korea (2002), Australia and India (1999), CARICOM and Cuba (1997), Croatia and India (2001), and Mozambique and the United States (1998).

⁴ For example, the use of the exception for the protection of cultural diversity is practically limited to BITs negotiated by Canada and France.

⁵ For instance, positive language enhancing the commitment of the contracting parties to enforce health and safety standards can be found in, inter alia, the BITs between Namibia and the Netherlands (2002), and Mexico and Switzerland (1995). Commitments for the protection of the environment can be found in, inter alia, BITs between Finland and Kyrgyzstan (2003), Mozambique and the Netherlands (2001), the 2004 Canadian model BIT, Japan and Viet Nam (2003), the Republic of Korea and Trinidad and Tobago (2002), the United States and Uruguay (2005), and Belgium–Luxembourg and Ethiopia (2003). Commitments for the protection on internationally recognized labour rights can be found in, inter alia, the BITs between Armenia and Austria (2001), Namibia and the Netherlands (2002), Finland and Nicaragua (2003), and Belgium–Luxembourg and Zimbabwe (2003).

⁶ See subsection E.2.b (i) above.

⁷ See UNCTAD (2002, para. 5.d (vi)).

⁸ See Robinson (1998, p. 84).

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**THE INTERACTION BETWEEN INVESTMENT AND SERVICES CHAPTERS
IN SELECTED REGIONAL TRADE AGREEMENTS**

OECD Trade Policy Working Paper No. 55

By Marie-France Houde, Akshay Kolse-Patil and Sébastien Miroudot

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ABSTRACT

This report analyses the interactions between the investment and services chapters of 20 regional trade agreements. It classifies agreements into two broad categories of NAFTA-inspired and GATS-inspired agreements and identifies four major types of interaction between the investment and trade in services chapters. The report then looks at the implications of the services/investment interface for levels of investment protection and liberalisation.

Keywords: investment, services, regional trade agreements, RTA, investment liberalisation, investment protection, MFN, GATS, NAFTA.

JEL-codes: F13, F21.

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KEY FINDINGS

This report analyses the interactions between the investment and services chapters of 20¹ Regional Trade Agreements (RTAs), in terms of the implications for levels of investment protection and liberalisation.

RTAs can generally be classified into two broad categories of NAFTA-inspired and GATS-inspired agreements. Investment disciplines in the former are lodged in the investment chapter and there is limited interaction with the services chapter. In GATS-inspired agreements, investment disciplines are divided between the services and the investment chapters and as a consequence interactions between them are more prevalent and are governed in either the investment or in the services chapter.

The level of investment protection is determined by the scope and coverage of the investment protection provisions and not by the type of interaction between the two chapters. In both types of RTAs, investment in services industries may benefit from the protections provided by the investment chapter (such as on expropriation, transfers, compensation for losses or investor-to-state dispute settlement). As investment provisions vary from one RTA to another, some countries have decided to maintain a former BIT alongside the more recently negotiated RTA.

Concerning the level of investment liberalisation, NAFTA-inspired agreements tend to have an advantage in terms of the number of sectors covered by non-discrimination disciplines and the degree of transparency and predictability through a “one-shot” liberalisation encompassing all sectors and a “ratchet” mechanism that locks in future reforms. GATS-inspired agreements are often favoured by countries that want to preserve a certain flexibility and progressiveness in their liberalisation, while they reform and establish new regulatory frameworks. But the differences between the two approaches should not be overstated. Provisions on future liberalisation and transparency can add transparency and predictability in the context of GATS-inspired agreements, while flexibility also exists in NAFTA-inspired agreements through reservations on existing and future non-conforming measures.

An ambitious level of investment liberalisation in a GATS-inspired agreement is possible by taking commitments in additional sectors or by increasing the transparency of schedules. Progressive liberalisation of investment can in principle also be pursued in NAFTA-inspired RTAs. Even more recently, some GATS-inspired agreements provide insights into the possibilities offered by a combination of positive and negative listing.

Several factors influence the choice of a GATS- or NAFTA-inspired approach: existing liberalisation of the negotiating partners’ regimes; their administrative capacity; past approaches; and the pace at which

1. The list includes one North/North agreement (AUSFTA), 13 North/South agreements (NAFTA, US-CAFTA-DR, US-Morocco, Japan-Singapore, Japan-Mexico, Japan-Malaysia, TAFTA, EC-Chile, EC-Jordan, EFTA-Korea (EFTA-Singapore, TPSEP and ANZSCEP) and six South/South agreements (Chile-Korea, India-Singapore, ASEAN agreements, COMESA and Andean Community Decisions).

they wish to liberalise. Choosing between positive or negative listing (or a hybrid approach) is a matter for negotiation between partners.

Not all agreements include a most-favoured-nation clause (MFN). When they do, GATS-inspired agreements tend to prevent the MFN rule from applying to third parties through a regional economic integration organisation (REIO) exception clause. Nonetheless, new investment liberalisation in third party agreements may be extended to parties of earlier RTAs, following a review of commitments. A difference in NAFTA-inspired agreements tends to be that the MFN rule can apply as regards future agreements that might contain better treatment for investors. However some countries have listed reservations in specific sectors limiting the extension of any possible better treatment. In the light of this, one can question the effectiveness of the MFN rule with respect to investment liberalisation in creating a level playing field between investors from various Parties.

SYNTHESIS

1. This document presents the results of the joint work carried out in 2006-2007 by the Working Parties of the Investment and Trade Committees on the interaction between investment and trade in services provisions in regional trade agreements (RTAs). The study is divided in three Parts preceded by a one page summary of the Key Findings and synthesis. Part I analyses the interactions between the investment and services chapters in a representative sample of 20 agreements. Part II analyses their implications for the level of investment protection provided. Part III analyses the implications of the services/investment interface and of the MFN rule for the level of the liberalisation provided².

The embracing trend of RTAs

2. After the abandonment of the Havana Charter of the International Trade Organisation in 1950, rule-making in international trade and investment largely evolved along two separate tracks, the first largely dominated by the GATT system, the second by the conclusion of bilateral investment treaties (BITs) aimed at “protecting”, “promoting” and in the case of some later agreements, “liberalising” foreign investment. This general pattern started to change, however, with the entry into force of North American Free Trade Agreement (NAFTA) in 1994 and the establishment of the World Trade Organisation (WTO) in 1995. The NAFTA was the first agreement to combine BIT-like disciplines with comprehensive trade in services disciplines. The WTO brought in, for the first time, through the GATS, the supply of services into the realm of multilateral trade rules. These two important developments have expanded the landscape of regional agreements and the possible types of interactions between investment and service disciplines.

3. Since 1994, some 180 regional agreements combining investment and trade in services rules, mainly in the form of Free Trade Areas (FTAs), have come into existence as compared with 38 RTAs during the previous forty years altogether. The pace has markedly picked up since 2000. Over forty per cent of the cumulative total has come into being since 2000, cutting across countries or regions increasingly further apart and with more diversified economic backgrounds. Some 70 more agreements are reported to be under active consideration or negotiation. Mexico, Chile, Singapore, the United States, Australia and New Zealand are leading in terms of agreements concluded. EFTA, the EU and ASEAN stand out as the most active country groupings.

Two distinct cultures and sets of disciplines

4. RTA investment chapters essentially take their origins in BITs introduced in the late 1950s or early 1960s to provide absolute standards of protection for the foreign investor and their investments as regards transfers, expropriation and compensation, fair and equitable treatment, and investor-to-state-arbitration of investment disputes. Comprehensive obligations on national treatment and MFN treatment obligations at all phases of operation including establishment as well as the prohibition of performance requirements were later introduced in the US and Canadian treaties in the early 1990s. Today's RTA

2. In the present study, the term “investment protection” is intended to cover the typical core protections found in BITs while the term “investment liberalisation” is principally intended to cover the non-discrimination obligations found in OECD liberalisation instruments as well as the WTO and other trade liberalisation agreements. The BITs and FTA/RTA investment chapters of some OECD countries also include some of the non-discrimination obligations characterised here as “investment liberalisation” provisions.

investment chapters typically provide broad investment coverage, strong protection and non-discrimination commitments and recourse to investor-state international arbitration.

5. Investment disciplines lodged in RTA services chapters, are, on the other hand, usually based on the GATS. Investment is covered only in the narrower form of a “commercial presence”. Transparency and MFN treatment are the only general obligations. Obligations on market access and national treatment arise only to the extent liberalisation commitments are listed in separate schedules. Because of the importance they play in the ability to supply a service, domestic regulatory issues are also addressed. Avoidance of restrictions on international payments and transfers is the only significant “protection” provided by the trade in services chapters, and even so, only in sectors where liberalisation commitments are scheduled.

6. The Investment and Services chapters of NAFTA-inspired and GATS-inspired agreements differ, therefore, in their coverage of investment in services.³ This leads to four major types of interaction between these chapters.

(1) NAFTA-inspired Agreements – Limited interaction

7. The first type of interaction is characterised by a clear separation between the Investment chapter and Cross-Border Trade in Services (CBTS) chapters designed to limit the interaction between the two chapters. The Investment chapter acts as the depository of, or controls, all the investment provisions of both goods and services (except for financial services). The CBTS chapter, which is partly inspired by the GATS, is uniquely devoted to the liberalisation of services provided without a commercial presence. Both chapters use a negative list approach for lodging reservations to their respective obligations.

8. NAFTA provides the classical example of no interaction between the Investment and Services chapters. More recent NAFTA-inspired agreements (US-CAFTA-DR or US-Morocco for example) allow for a limited interaction. In this latter case, the Market Access, Domestic Regulation and Transparency articles of the CBTS chapter apply to the Investment chapter subject to certain limitations.

9. The Financial Service chapters may incorporate from the Investment chapter and the Trade in Services chapters the provisions to be applied to this sector.

10. A “Relations to Other Chapters” clause states that in the event of any inconsistency between the Investment chapter and other chapters, these other chapters shall prevail to the extent of the inconsistency.

(2) GATS-inspired agreements where the interaction is stated in the Investment chapter

11. GATS-inspired agreements also generally have separate chapters on investment and services. However, investment in services is typically covered by both chapters. Liberalisation of the supply of services, including through commercial presence is controlled by the Trade in Services chapter whereas the protection of investments in services, notably the clauses on expropriation, compensation for losses, investor state dispute resolution, is located in the chapter on Investment. In addition, these agreements also usually employ a positive list approach for specific commitments for Trade in Services.

12. A majority of these agreements have adopted a second type of interaction between the investment and services chapters which is stated in the Investment chapter. The Trade in Services chapter comes first and contains the market access and non-discrimination obligations on commercial presence. The Investment chapter – which has a broader coverage based on an asset-based definition of investment – identifies the scope of its application and rules to deal with potential inconsistency between this chapter

3. The two EU agreements examined here due to their specificities are separately discussed in paragraph 25.

and the Trade in Services chapter(s). The Financial Service chapters however are responsible for the core obligations on financial services.

13. EFTA agreements provide clear examples of this mode of interaction. In these agreements, the limitations mainly take the form of the non-application of the National Treatment and Most Favoured Nation Treatment obligations to Mode 3 (commercial presence) operations. A similar approach is followed by other agreements such as TAFTA or New Zealand-Singapore Agreement. Japan's Economic Partnership Agreements also generally fall in this category as the Investment chapter's scope article describes how inconsistencies between overlapping provisions should be resolved. In the case of Japan-Singapore FTA, the interaction is not stated in the Investment chapter but in the parties' reservations to this chapter.

(3) GATS-inspired agreements where the interaction is stated in the Trade in Services chapter

14. In a third type of interaction between the investment and services chapters, it is the Trade in Services chapter through a "Service-Investment" linkage clause which determines which provisions from the Investment chapter listed therein would apply. This approach has recently been introduced by the India-Singapore CECA. The specific provisions borrowed from the Investment chapter concern compensation for losses, expropriation, repatriation, subrogation, measures in public interest, special formalities and information requirements, access to courts of justice, senior management, investment disputes, other obligations and performance requirements. This type of interaction seeks to minimize any possible conflict between the two chapters by listing the various liberalisation and protection obligations that would apply to investment in services.

(4) GATS-inspired agreements where no interaction is stated

15. A fourth group of agreements are silent on the interaction. This approach solely relies on the rules of interpretation of international law to sort out the relationship between the investment and services provisions. This case mainly concerns separate agreements on investment and trade in services (ASEAN agreements and Andean Community Decisions). But this situation may also arise within individual agreements. For example, in the Japan-Singapore or EFTA-Korea agreements, the clause on transfers is contained in two chapters, the Trade in Service and Investment chapters, with one less permissive than the other. However, this duplication does not necessarily lead to conflict. Rather, both these obligations apply simultaneously to investments in services, which are subject to the obligations of both chapters. More recent agreements, however, are abandoning this approach in favour of an explicit and more precise mode of interaction between the investment and services chapters.

EC Trade Agreements

16. Even though European Communities (EC) Association Agreements with non-European partners generally follow the GATS approach, other features set them apart from the GATS-inspired agreements described above. The European Community and the member states share competence in the investment area. The coverage and structure of EC agreements are also unique. For example, the EC-Chile Agreement, which is the most comprehensive agreement concluded so far, has separate chapters on Trade in Services (covering all four modes of supply of services), Financial Services, Establishment and Current Payments and Capital Movements. In this case, it is the establishment chapter which excludes services from its coverage. In the EC-Jordan Association Agreement, however, the services chapters only cover the cross-border supply of services while the establishment chapter applies to all investments. The methodology for listing liberalisation commitments also differs in the two agreements, the EC-Chile agreement follows a positive list approach while the EC-Jordan agreement list the reservations to the obligations. EC agreements provide for national treatment (and MFN in some cases) on post-establishment and for

protection of transfers – capital movements. Other protection issues are addressed by the BITs concluded by Member States.

Level of investment protection provided

17. The level of investment protection does not seem to be affected by the types of interaction chosen. In all the agreements reviewed with dual coverage of investment in services, all investment in services benefits from the basic protections provided by the Investment chapter (such as on expropriation, transfers, compensation for losses or investor-to-state dispute settlement). This is because the “asset-based” definition of investment normally used for applying the basic standard protections of the Investment chapter obligations includes the narrower concept of “commercial presence”, which is used for the liberalisation of investment in services in GATS-inspired agreements. This broad-asset based definition typically includes, in addition to majority or controlling participations in an enterprise, minority interests, intellectual property rights, concessions and other forms of property.

18. If the level of investment protection is indifferent to the type of RTA adopted, it is certainly determined by the scope and coverage of the investment protection provisions. Judging from the sample, the level of investment protection provided by RTAs is largely comparable if not interchangeable to that traditionally provided by BITs (as in the case of US BITs and RTA Investment chapters). Nonetheless, the investment provisions may still vary from one RTA to another. For a significant number of agreements reviewed (such as NAFTA, AUSFTA, Japan EPAs, India-Singapore CECA, Australia-Thailand), these obligations are new in the absence of former BITs between the parties. But in a number of other agreements reviewed, BITs remain in place alongside RTAs, with both sets of rules complementing each other (EC agreements, ASEAN agreements, Andean Community Decisions). BITs have been replaced by RTAs only when the latter’s contents and coverage are clearly superior to that of BITs (for example EFTA-Korea Investment Agreement, as compared to Korea-Switzerland BIT).

Levels of liberalisation commitments achieved

19. The study provides a detailed analysis of the schedules of commitments in ten RTAs,⁴ focusing on investment in services. The difference between the NAFTA-inspired and the GATS-inspired approach that was described before is also relevant for the analysis of the schedules of commitments. It is often presented as a difference between the negative list (or “top-down”) approach and the positive list (or “bottom-up”) approach, but it should be understood mainly as a difference in the objective of the agreements and their coverage with respect to investment liberalisation. Although it is technically possible to offer the same level of commitments with a negative list of reservations or with the hybrid approach used in GATS (with a positive list of sectors where commitments are made and a list of reservations for these commitments), this is not the case from what can be observed in the schedules of the agreements analysed.

20. The NAFTA-inspired agreements aim at liberalising all kinds of investments and grant national treatment and MFN in all sectors covered. The coverage of the agreements is generally wider than in GATS-inspired agreements and reservations are fewer, although some of them can be quite general and give an opportunity to parties to maintain or to adopt non-conforming measures in a certain number of activities. The “ratchet” effect of NAFTA-inspired agreements locks in the investment regime and includes as commitments under the RTA any new effort towards liberalisation. Therefore, these agreements generally bring a higher degree of certainty and predictability for investors. Their higher degree of

4. The list includes five NAFTA-inspired agreements (AUSFTA, NAFTA, US-Morocco, Japan-Mexico and Chile-Korea) and five GATS-inspired agreements (Japan-Singapore, TAFTA, EU-Chile, EFTA-Singapore and India-Singapore).

transparency should however be nuanced in cases where not all restrictions are listed in the Annex (e.g., sub-federal non conforming measures). There are other provisions in NAFTA-inspired agreements that also illustrate the liberalisation intent such as phasing-out commitments for certain non-conforming measures and other disciplines beyond national treatment and MFN on performance requirements or citizenship and residency requirements.

21. GATS-inspired agreements (where investment in services is covered in the services chapter) provide schedules of commitments with commitments in a higher number of sectors and sub-sectors compared with those made at the multilateral level (under the GATS). On the other hand, there is no willingness to expand the coverage of non-protection disciplines to all sectors. The approach remains close to GATS with commitments in a set of sectors and sub-sectors, flexibility and progressive liberalisation through a review of the commitments.⁵ An important perceptible difference is that the number of commitments tends to be more reciprocal in RTAs than in GATS schedules.

22. From countries' experience, the "hybrid" approach of GATS-inspired agreements is appreciated for its flexibility, as it allows countries to conduct a selective liberalisation of investment and to keep options in sectors where there are on-going regulatory reforms, while the NAFTA-inspired approach is favoured for its higher degree of predictability and transparency for investors through a "one-shot" liberalisation encompassing all sectors. However, there is no specific constraint coming from one approach or the other and countries can use either a positive list or negative list to achieve an ambitious degree of liberalisation. The negative list approach can also be flexible through its reservations on existing and future measures while transparency and predictability can be improved in the context of a positive list by providing enough information to investors, simplifying the way schedules of commitments are presented and by a clear commitment to future liberalisation.

23. The comparison between the schedules of commitments in the RTAs and GATS commitments in Mode 3 confirms that all agreements analysed are WTO-plus. The liberalisation of investment in services goes further than in the GATS both in NAFTA- and GATS-inspired agreements. This should be the case as these regional agreements need to provide for a higher degree of liberalisation in order to be consistent with WTO rules (GATS Article V). In the regional trade agreements, there is a tendency to create a degree of bilateral reciprocity in the commitments, unlike what can be observed in the GATS. It is particularly the case in agreements between developed countries and developing or emerging countries that have made fewer commitments under the GATS. This may well be a positive sign of how RTAs have the potential of promoting further investment liberalisation in services.

The MFN rule and its implications

24. The most-favoured-nation clause (MFN) is a common provision found both in the investment and trade in services chapters of RTAs. The MFN clause requires a party to a given agreement to provide investors and investments from the other party treatment "no less favourable" than that it accords to investors and investments of any other party or non-party to the agreement. MFN provisions in RTAs tend to be unconditional and to apply to all covered investments both pre- and post-establishment. However, not all of the agreements analysed in this study have an MFN provision. COMESA, EC-Chile, Japan-

5. While some of the NAFTA-inspired RTAs can organise a gradual liberalisation of investment through phasing-out reservations, the approach is different in the sense that GATS-inspired agreements foresee a review of their commitments and further negotiations with a view to deepening liberalisation. In NAFTA-inspired agreements, such mechanisms are not necessary as almost all sectors are already committed and the ratchet effect locks in any new liberalisation. The negative list approach is also embodied in other mechanisms such as in the OECD Codes of Liberalisation for instance.

Singapore, Korea-Singapore and the India-Singapore Comprehensive Economic Co-operation Agreement have no MFN treatment for investment.

25. In services chapters modelled after the GATS, MFN clauses are generally inspired by GATS article II with a negative list of exemptions. The MFN clause found in investment chapters inspired by NAFTA has its scope more precisely defined, as the “no less favourable treatment” applies to both “investors” and “investment of investors” with respect to “the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments”. However, the clause specifies that such treatment should be granted “in like circumstances”. Another important distinction between the NAFTA and the GATS approach is that no further exceptions can be negotiated in a GATS-type agreement after it has entered into force. The NAFTA approach allows for members to adopt new exceptions and non-conforming measures when they have listed the sectors concerned in the annex on future measures.

26. As some countries have signed both NAFTA-inspired and GATS-inspired agreements with different levels of liberalisation commitments, one could wonder if through the MFN rule there is a “multilateralisation” of regional commitments. In an RTA, the MFN rule is not only designed to ensure non-discriminatory treatment between the parties to the agreement but also to benefit from better treatment in third-party agreements. In the case of bilateral RTAs, it is only as regard to third-party investors that the MFN rule has any application. However, many agreements tend to prevent the extension of some liberalising commitments from one agreement to another through the MFN rule.

27. In GATS-inspired agreements, there is often a regional economic integration organisation (REIO) exception similar to GATS article V where a more favourable treatment granted to members of a third party RTA is not automatically extended to the parties of the current RTA on the basis of MFN treatment. The existence of an REIO exception does not *require* discriminatory treatment between members of different RTAs but it does allow for it and therefore can undermine the effect of the MFN clause. The result therefore is a risk of discriminatory treatment between the parties of different RTAs signed by the same country. To prevent this from happening, GATS-inspired agreements rely on a review of commitments to extend the more favourable treatment of a new agreement to parties of a prior RTA. In practice, commitments can be easily extended through a simple exchange of letters or a joint meeting between the Parties.

28. In NAFTA-inspired agreements, there is, in principle, an automatic extension of the more favourable treatment granted in a new agreement through the MFN clause (in many agreements, this principle applies to new agreements only, as there is often an MFN exception for past agreements). In some NAFTA-inspired agreements however, countries have also listed certain sectoral exceptions for future agreements. Such sectors will not automatically benefit from the better treatment of future agreements through the MFN clause. But very few sectors are concerned.

29. It is also possible to avoid investment distortions by signing RTAs with the same commitments as some countries tend to do. While the MFN rule can still operate in NAFTA-inspired agreements to extend new liberalisation commitments to investors from countries parties to a former agreement, a review of commitments is necessary in GATS-inspired agreements to ensure a level playing field between investors. Hence, one may question the *de facto* impact of the MFN clause in RTAs and its capacity to “multilateralise” regional commitments.

PART I.

INTERACTIONS AMONGST INVESTMENT AND TRADE IN SERVICES CHAPTERS OF DIFFERENT TYPES OF RTAs

1. The study sample

30. At the end of 2005 around 218 RTAs⁶ were known to contain investment provisions of one kind or another. While initially they belonged to the same region with similar levels of economic development, an increasing number of RTAs are being concluded between countries with different level of economic development and located in regions or continents far apart. Individually, Mexico, Chile, Singapore, the United States, Australia and New Zealand are leading in terms of the number of agreements concluded while EFTA, the EU and ASEAN stand out as the most active country groupings. A rapid rise in the number of agreements between developing countries is also apparent. This picture is far from frozen as a relatively large number of RTAs – 70 or so – are under negotiation or under consideration. RTAs are therefore covering a growing share of world trade and investment, increasingly moved by strategic market considerations unbound by geographical considerations, and this trend is likely to continue.⁷

31. Not all these agreements are comparable, however, in terms of objectives and purposes, coverage, depth, legal robustness, sophistication or impact. RTAs are also in constant evolution and various types of RTAs co-exist. This study examines a sample of 20 North/North, North/South and South/South agreements that would appear to represent the latest approaches across countries, regions or continents, about the role of investment-related provisions in RTAs, including on services.⁸ All but one⁹ have been notified to the WTO:

-
6. In a speech delivered in mid-January 2007, WTO Director General Pascal Lamy estimated that the number of these agreements could rise to 400 by 2010, See WTO News – 17 January 2007. For a comprehensive inventory of regional agreements with investment content up the end of 2005 see http://www.unctad.org/en/docs/iteiit200510annex_en.pdf.) “Economic integration” is the expression used by Article V for designating preferential trade in service liberalisation agreements. GATT Article XXIV refers to customs unions and free trade areas. Customs unions require the establishment of a common external tariff and harmonization of trade policies. In an FTA, each party maintains its own trade policy *vis-à-vis* third parties. “Regional Trade Agreements” is the generic term used for notification to WTO of all these preferential agreements. See also Jo-Ann Crawford and Robertino V. Fiorentino, the “Changing Landscape of Regional Trade Agreements” Discussion Paper No 8, WTO, http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf
7. According to the WTO, at least one half of world trade now takes place between members of RTAs and all WTO Member engaged in RTAs of one sort or another. A similar trend has been observed on the investment side. It is estimated that RTAs capture about 60 per cent of outward investment in Australia, 44 per cent in Canada and 20 per cent in the United States. See “Novel Features in OECD Countries’ Recent Investment Agreements: An Overview”, pp 1-2, <https://www.oecd.org/dataoecd/42/9/35823420.pdf>.
8. A deliberate decision has been made to leave intra-European RTAs – that is the European Community and the European Free Trade Association and their agreements with other European countries – outside the scope of this study on the grounds that they constitute a unique process of economic and political integration. The study also leaves out the RTAs that have succeeded the trading arrangements between former Soviet republics.

1. *North/North Agreements*

- **(1) Australia-United States Free Trade Agreement (AUSFTA) (2004)** as the most recent example of a comprehensive **North/North Agreement**.

2. *North/South Agreements*

- **(2) The North American Free Trade Area (NAFTA)** – The first RTA to combine the disciplines of Services and Investment.
- **(3) Free Trade Agreement between Central America, the Dominican Republic and the United States of America (US-CAFTA-DR) (2006)** as an example of the last generation of NAFTA-inspired agreements concluded by the United States with Latin American countries.
- **(4) US-Morocco Free Trade Agreement (2006)** as an illustration of a US FTA with a MENA region country.
- **(5), (6) and (7) Japan-Singapore New-Age Economic Partnership Agreement (JSEPA) (2002), Japan-Mexico Economic Partnership (2005) and Japan-Malaysia Economic Partnership (JMEPA) (2006)** as an illustration of FTAs concluded between countries with different levels of economic development.
- **(8) Thailand-Australia Free Trade Agreement (TAFTA) (2005)** as example of an Australia's FTA with an Asian developing country.
- **(9) and (10) EC-Chile Association Agreement (2003-2005) and Euro-Mediterranean Agreement establishing an Association with Jordan (2002)** as representatives of the last generation of EU trade agreements, one with a Latin American country, the other as part of the Euro-Mediterranean Free-Trade Area initiative.
- **(11) and (12) Free Trade Agreement between EFTA States (Switzerland, Liechtenstein, Norway and Iceland) and Singapore (ESFTA) (2003) and Free Trade Agreement between EFTA States and Korea (2006)** as examples of the new generation of EFTA FTAs. ESFTA is also the first FTA concluded between the continents of Europe and Asia and the first EFTA agreement to address the right of establishment. The Investment Agreement between Korea and Iceland, Liechtenstein and Switzerland is, in addition, the most comprehensive investment agreement ever concluded by EFTA.
- **(13) and (14) Trans-Pacific Strategic Economic Partnership among Brunei Darussalam, Chile, New Zealand and Singapore (TPSEP) (May 2006)** as an example of an intercontinental agreement combining four APEC economies including one OECD country. **The New Zealand-Singapore Closer Economic Partnership (ANZSCEP) (2001)** is also analysed separately.

3. *South/South RTAs*

- **(15) and (16) Free Trade Agreement between the Republic of Korea and the Republic of Chile (2004) and Free Trade Agreement between the Republic of Korea and the Republic of Singapore (KSFTA) (2006)** as examples of one intercontinental FTA between two successful emerging market economies and one economically successful Asian economies.

9. Namely the India-Singapore Comprehensive Economic Co-operation Agreement (2005).

- **(17) India-Singapore Comprehensive Economic Co-operation Agreement (2005)** as an illustration of India's new policy towards FTAs.
- **(18) ASEAN Agreement for the Promotion and Protection of Investment (1987), as amended by the 1996 Protocol, and 1998 Framework Agreement on ASEAN Investment Area and the ASEAN Framework Agreement on Services (1995) as amended by the 2003 Protocol**, as an example of a more gradual approach but with the potential of serving as a platform for the negotiation of FTAs with major players (such as China, India, EU, Australia or New Zealand).
- **(19) Common Market for Eastern and Southern Africa (COMESA) (1993)** although created to be a common market, is included as an illustration of a cooperative arrangement on investment among African countries.
- **(20) Andean Community – Community instruments on Foreign Investment and Transfer of Technology (Commission Decisions 291 and 292 (1991) and Decision 439 on a General Framework for the Liberalization of Trade in Services (1998)** as an illustration of a sub-regional initiative to liberalize investment and trade in services.

2. Key features of the investment and trade in services chapters of RTAs

32. As elaborated in Annex 1 to the present document, recent RTAs address an increasing number of issues with the general intent of creating opportunities for developing the parties' economic potential and growth in a more integrated and complementary way.¹⁰ Investment and services chapters are one of the most important additions to recent RTAs.¹¹ The disciplines in the investment chapters are usually based on those of BITs while the disciplines in the services chapters are usually based on those of the GATS. Taken together, these two chapters create two sets of disciplines for investment in services, one horizontal which applies to goods and services and the other exclusively devoted to services.

33. Table 1 below lists the broad categories of disciplines and associated measures that can be found in RTA Investment chapters. They typically include a broad asset-based definition of investment, universal coverage of goods and services, core legal protections, establishment and non-discriminatory treatment, investment promotion and facilitation and capacity building, and recourse to investor-state international arbitration. These chapters also employ, as a general rule, a negative list of reservations or exceptions with respect to liberalisation. Annex 1 provides an overview of how these various provisions are covered in the sampled agreements.

10. For a recent survey, see *Investment Provisions in Economic Integration Agreements*, UNCTAD, 2005.

11. In addition, in addition to trade in goods, RTAs may cover intellectual property, government procurement competition, labour, environment, e-commerce, capacity building issues among others.

Table 1. Assessing Investment Chapters of RTAs¹²

Definition	Coverage	Investment liberalisation	Investment Protection	Investment Promotion/Facilitation	Dispute Settlement	Schedule of commitments
– Asset Based definition of investment – Open/Closed Direct/Indirect – Definition of investor	– National measures – Sub-national measures – State enterprises – Corporate responsibility	General obligations – Transparency – Establishment – Post-Establishment – National treatment – MFN treatment – Performance requirements – Senior Management/Board of Directors – Temporary Movement of Key Personnel – Standstill/rollback – Country exceptions – Economic integration clause – General exceptions – Monopolies and Concessions – Taxation – Environment – Labour – Origin requirements/ - Denial of benefits	General obligations – Payments and transfers – Fair and equitable/Minimum standard – Full protection and security – Expropriation – Compensation	– Investment Promotion – Cooperation/Capacity Building Mechanisms	– State-to-State arbitration – Investor-State arbitration	Negative or positive

34. Table 2 lists the broad categories of investment disciplines and associated measures that can be found in GATS-based RTA trade in services chapters. Striking differences emerge from a comparison with the investment template provided in Table 1. Trade in services is generally defined as the supply of a service through four distinct modes: cross-border trade (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3) and temporary movement of natural persons (Mode 4). All the measures listed in the chapter apply to these four modes of supply. If the inclusion of Modes 3 and 4 underlines the importance of factor mobility to trade in services, these two Modes are also those that come the closest to the activities covered by investment chapters.

35. The concept of “commercial presence” for trade in services is significantly narrower than the standard definition of investment in the investment chapter. While it covers matters relating to both the establishment and post-establishment phase and applies to both existing and *de novo* agreements, it

12. Investment liberalisation covers the provisions which essentially aim to promote and secure non-discriminatory treatment and limit departures from this treatment. These provisions correspond to the traditional obligations of the OECD Codes of Liberalisation, the WTO and other trade liberalisation agreements. Investment protection covers the obligations typically found in bilateral investment protection and promotion agreements that provide absolute levels of protection. The dividing line between these two concepts is not always clear cut however. The provisions aimed at protecting the investment of an investor may reinforce liberalisation commitments. Conversely liberalisation commitments can also be viewed as providing legal security against future changes in the investment regimes of host countries. This categorisation of the various provisions of investment chapters helps highlight the main differences with the main provisions of trade in services chapters as presented in Table 2.

remains an “enterprise-based”¹³ as opposed to an “asset-based” definition of investment. In other words this definition only encompasses foreign investment in services where the foreign investor holds more than 50 per cent of the equity interest or exercises control over the foreign investment enterprises.¹⁴ The coverage of Mode 4 may generally be considered broader, on the other hand, to that of key personnel and the movement of business persons covered by Investment or other RTA chapters. Transparency and MFN treatment are usually framed as “general obligations” in contrast to that of market access¹⁵ and national treatment which apply solely in sectors listed in separate schedules of commitments. Other obligations are conditioned by these schedules such as the objective administration of domestic regulations and the avoidance of restrictions on international payments and transfers. The latter is often the only investment protection provision incorporated in trade in services chapters. At the same time, the Trade in Services chapters normally contain special disciplines on non-discriminatory quantitative restrictions and other behind-the-border regulatory issues.¹⁶ These chapters usually employ a positive list approach for specific commitments. Annex 1 describes how these various provisions are covered in the sampled agreements.

Table 2. GATS-based investment provisions in RTA services chapters

Definition	Coverage	Investment liberalisation	Investment protection	Investment promotion/facilitation provisions	Dispute Settlement provisions	Schedule of commitments
Commercial presence (Mode 3) as one of four modes ¹⁷ of supplying services	– All services with carve-outs¹⁸ – National measures – Sub-national measures – State enterprises	General obligations – Transparency – MFN treatment – Domestic Regulation – Recognition – Monopolies and Exclusive Service Suppliers – Business practices – BOP Safeguards – General exceptions – Security exceptions – Origin requirements/denial of benefits	Specific commitments – Transfers	– Cooperation/Capacity Building Mechanisms	State-to-State (separate chapter) Investor-to-state (investment chapter)	Positive list

13. The standard definition of commercial presence given by Article XXVIII (d) of the GATS consists of any type of business or professional establishment, including through the constitution, acquisition or maintenance of an enterprise or the creation or maintenance of a branch or a representative office.
14. Article XXVIII (g) of the GATS defines a “service supplier” as “any person that supplies a service”. “A person means either a natural person or a juridical person” [Article XXVIII (j)]. A juridical person means in the case of a supply of a service through commercial presence any person “owned” or “controlled” by juridical persons from a Member. Ownership requires holding more 50 per cent of the equity interest in the commercial presence; control requires the power to name a majority of the directors or the direct control over the actions of the juridical person in question. [Article XVIII, paragraph (m)(ii) and (n)(i) and n(n)(ii)].
15. Article XVI(2) of the GATS defines six limitations to market access, namely limitations on the number of service suppliers, service operations or employees in a sector, the value of transactions, the legal form of the service supplier, or the participation of foreign capital.
16. These paragraphs are derived from Chapter 3 “Investment”, Regionalism and the Multilateral Trading System, OECD, 2003.
17. The other three are: cross-border supply (Mode 1), Movement of consumer (Mode2), Movement of Supplier (Mode 4).
18. The GATS does not apply to air traffic rights and services supplied in the exercise of a governmental authority.

		Specific commitments – Market access – National treatment – Specific commitments – Annexes ¹⁹ and Decisions				

36. While the new generation of FTAs often feature separate chapters on Investment and Services, the interactions are largely a function of the respective contents of these chapters. NAFTA-inspired and GATS-inspired agreements markedly differ in their coverage of investment in services. This leads to four major types of interaction between the investment and services chapters in the investment area.

(1) *NAFTA-inspired Agreements – Limited interaction*

37. The first type of interaction is characterised by a clear separation between the investment and cross-border trade in services chapters designed to limit the interaction between the two chapters. The Investment chapter acts as the depositary of, or controls, all investment protection and liberalisation obligations (except for financial services). The Cross-border Trade in Services (CBTS) chapter excludes services supplied through an investment, akin to Mode 3 of the GATS (commercial presence). As in GATS, the CBTS chapter also addresses some behind-the-border regulatory issues.

38. NAFTA was the first RTA to introduce this form of agreement. Countries in the Western Hemisphere have been especially influenced by this approach. They have also subsequently “exported” this model to nations in different parts of the world through bilateral agreements. For instance, the US-Singapore FTA, the Australia-US FTA, the US-Morocco FTA, the Japan-Mexico EPA and Chile-Korea FTA are clearly inspired by the NAFTA approach. The NAFTA model has also been adopted by a number of Asian countries in their FTAs with regional partners such as in the case of Singapore-Australia or Singapore-Korea FTAs. As a result, this approach has proliferated beyond the Americas.

39. NAFTA provides the classical example of no interaction between the Investment and Services chapters. Therefore NAFTA has a separate Investment Chapter, which covers investment in goods and services, and an independent chapter on Cross Border Trade in Services (CBTS). This means that none of the obligations contained in the CBTS chapter apply to investment in services.

40. More recent NAFTA-inspired agreements provide, however, for a limited interaction between the Investment and the CBTS chapter by allowing application of specific provisions from the CBTS chapter to investment in services. For example, Article 11.1 (2) of the Chapter on CBTS in US-Morocco Agreement provides that “Articles 11.4 (Market Access), 11.7 (Transparency in Developing and Applying Regulations), and 11.8 (Domestic Regulation) also apply to measures by a Party affecting the supply of a Service in its territory by a covered investment”. This enables to bring in behind-of-the border issues of particular relevance to services, including investment. However, a footnote provides that “nothing contained in the Chapter on CBTS, including in paragraph Article 11.1(2) shall be subject to investor-state dispute settlement.” Thus, this approach, whilst generally separating Investment in Services from CBTS, does allow for a limited interaction between the two. It affords the protections provided in the investment chapter for investments in services while simultaneously allowing more limited benefits from the CBTS chapter.

19. These include special annexes on financial services, telecommunications and air transport services.

41. A “*Relation to Other Chapters*” clause removes any possible ambiguities in regard to the application of other chapters. This clause states that “*in case of an inconsistency between the Investment chapter and another chapter, the other chapter shall prevail to the extent of the inconsistency*”. This implies that commitments contained elsewhere in the agreement takes precedence over commitments in the investment chapter in case of conflict.

42. In short, NAFTA-inspired agreements establish a clear distinction between the Investment chapter and the CBTS chapter. The end result is to provide investors in services with the same protections that are offered to other investors, while a separate set of protection provisions applies to cross-border suppliers of services.

(2) *GATS-inspired agreements where the interaction is stated in the Investment Chapter*

43. GATS-inspired agreements also generally have separate chapters on investment and services. However, investment in services is typically covered by *both* the Investment and Trade in Services chapters (and the Financial Services chapter when this sector is treated separately). Liberalisation of the supply of services, including through commercial presence, is controlled by the services chapter(s) whereas the protection of investments in services, notably the clauses on expropriation, compensation for losses, investor state dispute resolution, is controlled by the chapter on Investment. In addition, these agreements usually employ a positive list approach for specific commitments for Trade in Services.

44. In the majority of the agreements reviewed, the interaction is stated in the Investment chapter. This is the second type of interaction observed in the sampled agreements. The Trade in Service chapter comes first and contains liberalisation obligations on commercial presence. The Investment chapter – which has a broader coverage due to its asset-based definition of investment – then identifies the limitations that need to be applied to ensure consistency with the Trade in Services chapter. Financial Service chapters are responsible for the obligations on financial services.

45. This approach has also the advantage of preserving the integrity of the GATS Agreement whose provisions are often reproduced *verbatim* in the services chapters. EFTA, TAFTA, JSEPA, JMEPA provide concrete examples of this approach despite significant variations in the number and coverage of the provisions of the chapters concerned.

■ EFTA

46. EFTA agreements provide for a GATS-based chapter on Trade in Services followed by a chapter on Investment. Investment in services (commercial presence) is covered by both the Trade in Services chapter and the Investment chapter. The Investment chapter explicitly states the limitations concerning its application to services. This approach can be seen in the EFTA-Singapore and EFTA-Korea FTAs (the EFTA-Korea FTA has a separate Investment Agreement to which Norway is not a party), which belong to the second generation of EFTA’s FTAs. The Trade in Services chapter includes commercial presence as defined by GATS. As the narrower concept of “commercial presence” is included in the “asset-based” definition of an investment in the Investment Chapter, investment in services through this mode of supply is entitled to all the rights and protections provided to investments. The EFTA approach borrows heavily, in the form of definitions, clauses etc., from the GATS and uses a positive listing methodology to specify each party’s commitments.

47. For example Article 2(2) of the separate Investment Agreement²⁰ between Korea, Iceland, Liechtenstein and Switzerland defining the scope and coverage of this agreement provides that “Article 4

20. This agreement does not include Norway.

(National and MFN Treatment) shall not apply to measures affecting trade in services, provided that the sector concerned is covered by Chapters 3 (Trade in Services) or 4 (Financial Services) of the EFTA-Korea Free Trade Agreement". Thus the Investment Agreement provides for interaction with the services chapters of the EFTA-Korea Agreement. A service provider falling within the definition of an investor or an investment would be entitled to all the rights provided for in the Trade in Services or Financial Services chapters as well as those provided in the Investment chapter, except to the extent of the express limitations relating to National Treatment and MFN Treatment. An investor can, however, raise a dispute with a Party only with regards to infringements of his rights under the Investment chapter.

48. It is also interesting to note that the scope and coverage of the investment provisions varies across EFTA agreements. So whilst the agreement with Korea excludes sectors covered by the Trade in Services and Financial Services chapters of the EFTA-Korea Trade Agreement, the EFTA-Singapore FTA exclusion is somewhat broader in stating that in Article 38.2 and 38.3 on Scope and Coverage that "*Article 40(1) (National and Most Favoured Nation Treatment) shall not apply to measures affecting trade in services whether or not a sector concerned is scheduled in Chapter III (Trade in Services)... as well as to investors of a Party in services sectors and their investments in such sectors*". The EFTA-Korea FTA is therefore more "liberal" than the EFTA-Singapore agreement, which could be considered more "prudent" on the subject of services and investment in services.

- New-Zealand-Singapore

49. The New Zealand-Singapore Agreement has a similar approach. The Investment chapter at the outset proclaims in Article 26.1 that it applies "*to all investments in goods and services*" and then lays down exceptions to its scope and coverage. Article 26.2 states that "*Article 28 (Most Favoured Nation Status), Article 29 (National Treatment) and Article 30 (Standard of Treatment) shall not apply to any measures affecting investments adopted or maintained pursuant to Part 5 (of the Agreement relating to Services) to the extent that they relate to the supply of any specific service through commercial presence... whether they or not they are covered by Annex 2 (devoted to the parties schedules of specific commitments)*".

- Thailand-Australia Free Trade Area (TAFTA)

50. The TAFTA FTA also provides for an interaction between the Trade in Services and Investment chapters. The Trade in Services chapter (Chapter 8) follows the GATS approach by defining commercial presence. At the same time the Investment chapter (Chapter 9) does not exclude from its ambit trade in services unless a limitation is provided for. Clause 903 states that the part on "*Liberalization of Investments*" does not apply to "*the measure which is a measure by that Party affecting trade in services as set out in Article 803(1)*". Similarly, the Post-Establishment National Treatment is also excluded. However, the part on "*Promotion and Protection of Investments*" would apply to investment in services. Unlike the general practice in GATS-inspired agreements, there is also a single country schedule of commitments for presentation of the schedule of commitments on investment and services. This enhances the transparency of investment liberalisation commitments.

- Japan EPAs

51. The Japan-Singapore Economic Agreement for a New Age Partnership (JSEPA) provides an example of an agreement with dual coverage of investment in services but where the Services and Investment chapters remain silent on the interactions. It is an annex to the JSEPA which provides an answer to this ambiguity. Annex V (b), which contains the list of Singapore's exceptions in the area of investment, provides that "*National treatment and prohibition of performance requirements shall not apply*

to services sectors not scheduled in Chapter 7” (Trade in Services). This entry also goes to state that “Where a service sector is scheduled in Chapter 7, the provisions, terms, limitations, conditions and qualifications in Chapter 7 (including market access measures) shall apply to investments in that service sector under Chapter 8”. Thus investment in a sector listed under Chapter 7 (Trade in Services) is entitled to coverage both under the Chapter on Trade in Services and Chapter on Investment subject to any stated conditions or qualifications. It is worth noting that the list of Japan’s exceptions in the area of investment does not provide for any limitations of that sort.

52. This would not appear; however, to be a general trend in more recent Japanese EPAs.²¹ The Japan-Malaysia EPA which entered into force in July 2007 establishes a clearer articulation between the Investment chapter (Chapter 7) and the Trade in Services chapter. Article 73 of the Investment chapter states that with respect to matters covered by the National Treatment, MFN and Performance Requirements the Trade in Services chapter “shall prevail to the extent of any inconsistency”. With respect to any other matter, the Investment chapter shall prevail to “the extent of inconsistency”. This approach implies that all the obligations should be applied simultaneously in the absence of any inconsistency. The two chapters also provide for own separate lists of reservations/exceptions and commitments following a negative scheduling approach in the first instance and a positive one in the second. The construction requires nevertheless a full analysis of the relevant provisions and annexes of the agreement.

53. There are exceptions. Japan’s EPA with Mexico follows the NAFTA approach by clearly separating investment from services obligations. In addition to the standard NAFTA Relation to Other Chapter article (Article 69), the Investment chapter excludes financial services from its coverage. This is stated in its Article 57 (Scope and Coverage) which provides that “Nothing in this Chapter shall apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter 9 (Financial Services). The Financial Services chapter states in turn, in its Article 111 (Relation to Other Chapters), that the provisions of Chapter 7 (Investment Chapter) and 8 (CBTS) shall not apply to measures mentioned in paragraph 1 of Article 107 which refers to “measures adopted or maintained by a Party affecting (a) cross-border trade in financial services; (b) financial institutions of the other Party; and (c) investors of the other Party, and investments of such investors, in financial institutions in the Party”.

(3) *GATS-inspired agreements where the interaction is stated in the Trade in Services Chapter*

54. According to the third type of interaction, it is the Trade in Services chapter through a “Service-Investment” linkage clause which determines which provisions from the Investment chapter listed therein would apply. This approach has recently been introduced by the India-Singapore CECA. The order of the two chapters is also reversed as compared to other GATS-based agreements, with the Investment chapter preceding the Trade in Services chapter.

55. CECA’s Trade in Services (Chapter 7) covers all four modes of supply of service. A “Services-Investment Linkage” clause (Article 7.24) states that a number of clauses in the chapter on Investment apply, *mutatis mutandis*, to “measures affecting the supply of a service by a service supplier of a Party through commercial presence in the territory of the other party, only to the extent that they relate to an investment, regardless of whether or not such service sector is scheduled in a Party’s Schedule of Specific Commitments”. These clauses cover compensation for losses, expropriation, repatriation, subrogation, measures in public interest, special formalities and information requirements, access to courts of justice,

21. Japan is actively pursuing FTAs and particularly in their broader form, the economic partnership agreements (EPAs), which cover trade liberalisation and extend to other areas. Japan’s EPAs with Singapore, Mexico and Malaysia took effect in November 2002, April 2005 and July 2006 respectively. In addition, Japan has signed an EPA with the Philippines and the texts of the EPAs with Thailand, Indonesia and Chile are largely completed. In addition, Japan is currently negotiating a broad agreement with the ASEAN as a whole.

senior management, investment disputes, other obligations and performance requirements. Article 6.2 of the Investment chapter²² also states that “*In the event of any inconsistency between the Investment chapter and another Chapter, the other Chapter shall prevail to the extent of the inconsistency.*”

56. This type of interaction thus selectively chooses rights and protections provided under the Chapter on Investment to apply to commercial presence. It is a clear but a la carte approach. This approach leads to transparency and leaves no room for ambiguity in the relationship between provisions on investment and those on services.²³

(4) *GATS-inspired agreements where no interaction is stated*

57. A fourth group of agreements, accounting for a minority of those reviewed, are silent on the interaction(s). This approach therefore would rely on the rules of interpretation of international law²⁴ to determine the relationship between investment and services provisions. This case mainly concerns separate agreements on investment and services or agreements with a partial coverage of investment or services issues. This situation can arise as well within individual agreements where there is a duplication of clauses of general application in the investment and services chapters.

■ *ASEAN*

58. ASEAN provides a clear example of the absence of a stated interaction between investment and service provisions. Instead of a comprehensive all inclusive agreement, ASEAN has separate “Agreements” on Investment and Services, namely the ASEAN Agreement for Promotion and Protection of Investment, 1987 (amended in 1996), the Framework Agreement on ASEAN Investment Area (AIA), 1998 and the ASEAN Framework Agreement on Services, 1998 (amended in 2001). The ASEAN Agreement for Promotion and Protection of Investment offers to all investments, including investment in services, the typical protections found in BITs. The ASEAN Framework Agreement on Services includes “commercial presence” and related schedules of liberalisation commitments. The AIA covers “investment in incidental services” in five sectors, namely manufacturing, agriculture, fishery, forestry and mining and quarrying. This means that instead of providing interlinking between these two agreements, the AIA lists the specific sectors and related services sectors which are entitled to the liberalisation provisions of the agreement while liberalisation of services in general is covered by the ASEAN Framework Agreement on Services.

■ *Andean Community*

59. Decision 439 of the Andean community provides for liberalisation of trade in services. The decision lays down that the Commission will adopt an inventory of all the measures that are inconsistent with the principles of Article 6 (Market Access) and Article 8 (National Treatment) with the intention to eventually eliminate these measures and create an Andean Common Market in Services. Protection to

22. Paragraph 6.2.3 of this Scope of Application article also states that “*The Provisions of this Chapter as specified in Article 7.24 shall apply mutatis mutandis to the measures affecting the supply of services by a service provider of a Party through commercial presence in the territory of the other Party*”.

23. As regards other interesting innovations introduced by CECA, see “Salient Features of India’s Investment Agreements”, OECD, *Investment for Development*, Annual Report 2006.

24. For a succinct clear description of the applicable principles of public international law, see OECD Working Paper Moshe Hirsch, “Interactions between Investment and Non-Investment Obligations in International Law”, Section II, in *Trade Dispute Management*, 2006, Vol. 3, Issue 5.

investments in general is provided by Andean Decision 291. It is worth mentioning that both Decisions follow a negative list approach to the scheduling of specific commitments.

▪ *Trans-Pacific Strategic Economic Partnership (TPSEP)*

60. The TPSEP contains a GATS based chapter on trade in services but no chapter on investment. The agreement however uses the negative list approach for the parties' non-conforming measures. Therefore, even though the agreement does provide for liberalisation of the services sector, it does not provide for protection of investment in the services sector.

▪ *COMESA*

61. COMESA contains a BIT-like chapter on Investment Promotion and Protection. COMESA is still negotiating the liberalisation of services.

▪ *Duplication of clauses*

62. Another characteristic of Japan's EPAs is the duplication, in both the Investment and Trade in Services chapters, of certain clauses which are of general application and not subject to country specific exceptions of reservations. This concerns in particular the Transfers clause, which, as in the case of the JSEPA, is much broader in scope in the Investment chapter than in the Trade in Services chapter. Neither chapter however addresses the issue of possible conflict in applying these two provisions. The obligations should therefore be looked at as "cumulative" where each party has to abide by the two transfer provisions. The duplication would not always lead to conflict.²⁵ In case of conflict, unless otherwise provided, when issues fall under the coverage of the two different chapters, the parties would have to abide by the higher standard as provided by the rules of interpretation of international law.²⁶

EC Trade Agreements

63. The EC Trade Agreements with the Mediterranean region²⁷ and Chile²⁸ provide two variations in the EC's FTAs. The EC Agreements with countries in the Mediterranean mainly seek to liberalize services and investment in the future and to that end establish the necessary institutional framework and cooperation mechanisms. The EC-Chile Agreement is more recent and achieves greater liberalisation of Trade in Services and allows for "commercial presence/investment in services". Other features set them apart, however, from other agreements described above.

64. First, because of the shared competence between the European Community and the member states in the investment area, investment protection is largely covered by the member states' own bilateral

25. Martin Roy, "Implications for the GATS Negotiations on a Multilateral Investment Framework", *Journal of World Investment* 4 (6, 2003) pp 963-986.

26. Relationships between Investment Agreements, OECD Working Papers on International Investment 2004/1.

27. The relevant articles on investment are Articles 1, Title III (Right of Establishment and Services), Article 30-36 Title IV (Payments, Capital Movements and Other Economic Matters), Articles 48-52, 67 and Annex V and VI (EU-Jordan).

See http://europa.eu.int/comm./external_relations/euromed/med_ass_agreements.htm

28. The relevant articles on services investment in the Association Agreement with Chile: Part I, Title I, Articles 20-21; Part IV Title III, V, Annexes VII, VIII, X and XIV. See http://europa.eu.int/comm./trade/issues:bilateral/countries/chile/euchlagr_en.htm

investment treaties while liberalisation of establishment and trade in services is covered by EC agreements. The structure of the investment obligations is also unique. These agreements may have separate chapters on trade in services, financial services, establishment and current payments and capital movements.

65. The EC-Chile agreement has a chapter on Trade in Services (Title III, Chapter 1) inspired from the GATS.²⁹ The chapter on Trade in Services defines a commercial presence and provides for specific commitments (positive lists) on both national treatment and market access. The Establishment chapter provides for National Treatment with respect to establishment in sectors listed in a separate Annex and subject to any conditions and qualifications set out therein (Article 132) but it “*shall not apply to trade in services or financial services*” (Article 130).³⁰ The freedom of current account transactions and free movements of capital relating to direct investments is provided by Title V (Current Payments and Capital Movements) subject to certain exceptions.³¹

66. The EC-Jordan Association Agreement is different. As for NAFTA-inspired agreements, it provides for a separate chapter on CBTS. With regards to investment, the agreement has a chapter on Establishment and a chapter on Payments and Capital Movements which apply to both goods and services. The chapter on establishment contains MFN and National Treatment obligations³² as well as certain provisions on key personnel. The Chapter on Payments and Capital Movements provides for the freedom of current and capital transactions subject to certain exceptional safeguards. The agreement, however, does not provide for other issues relating to investment protection such as expropriation.³³

29. Financial services are covered however separately by Chapter II of Title III.

30. Article 133 also states that each Party may regulate the establishment of legal and natural persons subject to the provisions of Article 132.

31. Article 164 provides that the “*the Parties shall allow, in freely convertible currency and in accordance with the Articles of Agreement of the International Monetary Fund, any payments and transfers of the Current Account between the Parties.*” Article 165 provides that the Parties “*shall allow the free movements of capital relating to direct investments made in accordance with the laws of the host country and investments established in accordance with the provisions of Title III (Trade in Services and Establishment) of this Part (of the Agreement) and the liquidation or repatriation of these capitals and of any profit stemming there from*” Article 165 provides that the Parties “*shall allow the free movements of capital relating to direct investments made in accordance with the laws of the host country and investments established in accordance with the provisions of Title III (Trade in Services and Establishment) of this Part (of the Agreement) and the liquidation or repatriation of these capitals and of any profit stemming there from*”. In addition, under Annex XIV, Chile reserves the right to maintain certain requirements regarding the transfers of the proceeds from the sale or liquidation of investments in Chile.

32. Article 30.1 provides for MFN treatment for the establishment of Jordanian companies and National Treatment (post-establishment) by the Community and its Member states to Jordanian companies; Article 30.2 provides for the best of MFN treatment or National Treatment as regards the establishment and post-establishment of Community companies.

33. In the realm of investment protection the chapter on Capital Movements provides:

(i) Article 48 of the agreement says that “*Subject to the provisions of Articles 51(difficulties for the operation of exchange-rate policy or monetary policy) and 52(Balance of Payments), current payments connected with the movement of goods, person, services and capital within the framework of this Agreement shall be free of restrictions.*”

(ii) Thereafter article 49 provides that “*there shall be no restrictions on the movement of capital from the Community to Jordan and on the movement of capital involving direct investment from Jordan to the Community*”.

67. The methodology for listing liberalisation commitments also differ in the two agreements, the establishment and trade in services chapters in the EC-Chile agreement follow a positive list approach while the disciplines of the EU-Jordan agreement apply unless excluded by explicitly listed reservations.

Financial Services

NAFTA-inspired Agreements

68. All the NAFTA-inspired agreements reviewed, except for the Korea-Chile agreement, have separate chapters for financial services. The Financial Services chapter acts, in this case, as the depositary of the obligations with respect to investment and cross-border trade in financial services and states the interaction with the Investment and CBTS chapters. Only the provisions that are explicitly incorporated in the Financial Services chapter shall apply subject to any stated qualifications. This interaction has the effect of minimizing the relationship with other chapters while allowing it to define provisions adapted to the special needs and requirements of this sector.

69. For example, the chapter on Financial Services in the AUSFTA begins by first stating in Article 13.1 that the scope of the chapter is limited to “*measures adopted or maintained by a Party relating to (a) financial institutions of the other Party (b) investors of the other Party, and investments of such investors, in financial institutions in the Party’s territory; and (c) cross-border trade in financial services*” (which excludes supply of a financial service in the territory of a Party by an investment in that territory). Thereafter article 13.1 [1(2)] states that Chapters Ten (Cross-Border Trade in Services) and Eleven (Investment) “*apply to measures described in paragraph 1 only to the extent that such Chapters or Articles of such Chapters are incorporated into this Chapter*”. Then it goes on to incorporate Articles 10.11 (Denial of Benefits), 11.7 (Expropriation and Compensation), 11.8 (Transfers), 11.11 (Investment and the Environment), 11.12 (Denial of Benefits), and 11.14 (Special Formalities and Information Requirements). It also provides that “*Article 10.10 (Transfers and Payments) is incorporated into and made a part of the Chapter to the extent that cross-border trade in financial services is subject to obligations pursuant to Article 13.5*” (National Treatment of Cross-Border Trade in Financial Services).

70. Dispute settlement is also given a special treatment. Article 13.18 of the AUSFTA states that “*Section B (Dispute Settlement Proceedings) of Chapter Twenty-One (Dispute Settlement) applies as modified by this Article to the settlement of disputes arising under this Chapter*”. The scope and coverage of the financial services in KSFTA is more precise; Article 12.12(c) states that “*Section C of Chapter 10 (Investment) is hereby incorporated into and made a part of this Chapter solely for claims that a Party has breached Article 10.11 (transfers), 10.13 (expropriation and compensation), 10.16 (special formalities and information requirements) and 10.17 (denial of benefits), as incorporated into this Chapter*. When an investor invokes the national treatment clause of the investment or the country exceptions on financial services, Article 12.13 (investment disputes in financial services) requires that the matter be referred to the Financial Services Committee for decision.

GATS-inspired Agreements

71. Among the GATS-inspired agreements reviewed, only the EFTA-Korea, EFTA-Singapore and EC-Chile agreements contain a chapter on financial services. In the other agreements, financial services are covered by the Trade in Services Chapters.

72. The *EFTA-Korea* chapter is clearly inspired by GATS as it contains verbatim many of its provisions. The chapter on Financial Services also provides that the provisions of chapter 3 (Trade in Services) apply to financial services only where specifically stated. Thereafter, the chapter goes on to include some of the definitions contained in GATS Annex on Financial Services and chapter on Trade in

Services. All the provisions of the Investment Agreement apply to the chapter on Financial Services except to the extent of express limitations contained in the agreement. The Investment Agreement also has a specialized investor-state dispute settlement mechanism for issues relating to financial services. *The EFTA-Singapore* agreement contains additional provisions relating to Financial Services in Annex VIII agreement. This Annex mainly defines the relevant terms and provides for national treatment of financial service suppliers.

73. The *EC-Chile* agreement contains a separate chapter on Financial Services which covers all four modes of supply. Annex IV to the Agreement lists the specific commitments by each Party on Market Access and National Treatment.

PART II.

IMPLICATIONS FOR INVESTMENT PROTECTION

74. Since the Investment chapters of the RTAs are the main depository of the traditional protections offered by bilateral investment treaties, the implications that various types of interaction may have for the level of investment protection thus impinge upon whether these disciplines apply to services as well to non-services sectors. Three key findings emerge from the analysis of the sampled agreements.

75. First, the level of investment protection does not seem to be affected by the types of interaction followed. In all the agreements reviewed, investment in services benefits from the basic protections provided by the Investment chapter (namely expropriation, transfers, compensation for losses or investor-state dispute settlement). This is because the broad “asset-based” definition of investment which generally delineates the scope of application of these protections encompasses the narrower concept of “commercial presence” upon which the liberalisation obligations of GATS-inspired agreements are normally based. This is illustrated in Table 3 below. Even when the Trade in Services chapters incorporate basic protections from the Investment chapters – as it is the case of the India-Singapore Comprehensive Economic Cooperation Agreement or some Financial Services chapters – the Investment chapters’ protections apply to other investments that meet the asset-based definition of these chapters. Put differently, “commercial presence” defines the level of liberalisation provided by GATS-inspired services disciplines but not the level of investment protection.

Table 3. Scope of Application of Investment Chapters’ Protections*

Agreement(s)	Definition of investment in Investment Chapter	Definition of commercial presence in Services Chapter	Scope of Application of Investment Protection Disciplines
NAFTA and NAFTA-inspired Agreements			
NAFTA	Asset based definition – Closed list – Includes FDI, portfolio investment and various forms of tangible and intangible property		All protection (and liberalisation) disciplines of the Investment chapter apply to goods and services
Japan-Mexico EPA	Asset based definition – Closed list – Includes FDI, portfolio investment and various forms of tangible and intangible property		All protection (and liberalisation) disciplines of the Investment chapter apply to goods and services
US-CAFTA-DR US-Morocco FTA Australia-US FTA Chile-Korea FTA Korea-Singapore FTA	Asset based definition – Open List Includes FDI, portfolio investment and various forms of tangible and intangible property		All protection (and liberalisation) disciplines of the Investment chapter apply to goods and services
GATS-inspired Agreements			
EFTA-Singapore FTA, New Zealand-Singapore FTA, EFTA-Korea FTA	Asset-based definition – Open list; includes FDI, portfolio investment and various forms of tangible and intangible property	GATS definition of commercial presence	All the protections of the Investment chapter (separate Investment Agreement in the case of EFTA-Korea FTA) apply to commercial presence

Agreement(s)	Definition of investment in Investment Chapter	Definition of commercial presence in Services Chapter	Scope of Application of Investment Protection Disciplines
Japan-Singapore EPA Japan-Malaysia EPA	Asset based definition – Open list Includes FDI, portfolio investment and various forms of tangible and intangible property	GATS definition of commercial presence	All the protections of the Investment chapter apply
Australia-Thailand FTA	Foreign direct investment, as defined by IMF	GATS definition of commercial presence	The protection of the Investment Chapter (limited to post-establishment, fair and equitable treatment and full protection and security of investment) apply to commercial presence
India-Singapore ECA	Asset based definition – Open list: includes FDI, portfolio investment and various forms of tangible and intangible property	GATS definition of commercial presence	The Services chapter incorporates selected protections of the Investment chapter to be applied to commercial presence. The protection of the Investment chapter applies to other investments.
ASEAN Agreement for Promotion and Protection of Investment, 1987 (AAPPI) and ASEAN Framework Agreement on Services (AFAS)	Asset-based definition of investment in AAPPI – Open list	Commercial presence in AFAS not explicitly defined, but implicitly follows GATS	AAPPI protection applies to investment in services
Andean Community	Direct Foreign Investment	GATS definition of commercial presence	Except for Free Transfers of intra-Andean direct investments, no investment protection disciplines
EC-Chile Association Agreement	Direct investment including branches	GATS definition of commercial presence	Free Transfers
EC-Jordan Association Agreement	Direct investment including branches	GATS definition of commercial presence	
Trans-Pacific EPA		GATS definition of commercial presence	No investment disciplines (only GATS-inspired obligations)
COMESA	Closed list		Non investment protection disciplines

*These are the general obligations on Payments and Transfers, Fair and Equitable/Minimum standard, Full protection and security, Expropriation and Compensation.

76. Second, if the protection accorded by the Investment chapters appears to be indifferent to the mode of interaction chosen, the level of investment protection is no doubt determined by the coverage and scope of the protection provisions. As with any other obligations, this depends on what the negotiators set themselves to achieve at the beginning of the negotiations and what they ultimately obtain at the end of the negotiating process. As no negotiation is the same, the types of investment protection included and/or the way they are formulated may vary from one agreement to another. This is illustrated by Table 4 below.

Although both the NAFTA-inspired and GATS-inspired agreements are largely based on BIT-like protections³⁴ and are thus broadly similar, some differences can still be observed.

77. A number of the reviewed NAFTA-inspired agreements have developed interpretative notes to clarify the scope of application of the fair and equitable treatment standard and/or that of the expropriation provisions. If this practice is not apparent in GATS-inspired agreements, there are other distinctive features. The India-Singapore ECA does not contain any fair and equitable treatment standard. Some pre-conditions are imposed on the recourse to investor-state arbitration in the case of the EFTA-Singapore and EFTA-Korea agreements and New-Zealand Singapore agreement. In the case of the ASEAN agreements and the Australia-Thailand FTA, investor-to-state arbitration applies only to post-establishment. Three agreements (Andean Decisions, Trans-Pacific EPA and COMESA) do not contain any investment protection or investment disciplines.

78. A great majority of the reviewed agreements contain robust provisions on transfers however. In EC agreements, they apply to free movements of capital relating to direct investment and the liquidation and repatriation of these capitals. These observations are consistent with the recent findings of the work of the Investment Committee on international investment agreements.³⁵

Table 4. Key Investment Protections of Investment Chapters

Agreement(s)	Fair and Equitable treatment	Full protection and security	Transfers	Protection from Strife/Compensation for Losses	Expropriation		Investor-State Arbitration
					Direct	Indirect	
NAFTA and NAFTA-inspired Agreements							
NAFTA	Yes	Yes	Yes ¹	Yes	Yes	Yes	Yes
Japan-Mexico EPA Korea-Singapore FTA	Yes ¹	Yes ¹	Yes ¹	Yes	Yes	Yes	Yes
Australia-US FTA US-CAFTA-DR US-Morocco FTA	Yes ¹	Yes ¹	Yes ¹	Yes	Yes	Yes ²	Yes ³
GATS-inspired Agreements							
EFTA Singapore FTA	Yes	Yes	Yes ¹	Yes	Yes		Yes ²
EFTA-Korea	Yes	Yes	Yes ¹	Yes	Yes	Yes	Yes ¹
Japan-Singapore EPA	Yes	Yes	Yes ¹	Yes	Yes	Yes	Yes
Japan-Malaysia EPA	Yes	Yes	Yes ¹	Yes	Yes	Yes	Yes

34. These provisions were initially elaborated by the 1967 OECD Draft Convention on the Protection of Foreign Property.

35. Stocktaking of Developments in Investment Agreements, DAF/INV/WD/(2005)10/FINAL and International Investment Law: A Changing Landscape, (2005).

Agreement(s)	Fair and Equitable treatment	Full protection and	Transfers	Protection from Strife/Compensation for Losses	Expropriation		Investor-State Arbitration
India-Singapore ECA	No	Yes	Yes ¹	Yes	Yes	Yes	Yes
Australia-Thailand FTA	Yes	Yes	Yes ¹	Yes	Yes	Yes	Yes ³
ASEAN Agreement for Promotion and Protection of Investment, 1987 (AAPPI) as confirmed by ASEA Investment Framework	Yes	Yes	Yes ¹	Yes	Yes	Yes	Yes ³
New-Zealand Singapore CER	No	No	Yes ¹	No	No	No	Yes ¹
EC-Chile Association Agreement			Yes ²				
EC Jordan	No	No	Yes ²	No	No	No	No
Andean Community	No investment protection disciplines						
Trans-Pacific EPA	No investment disciplines						
COMESA	No Investment disciplines						

F&ET – Fair and equitable treatment

1. Interpretative Note on minimum standard of treatment

Full protection and security

1. Interpretative Note on minimum standard of treatment

Transfer of funds

1 Allows for current and capital transactions

2 Free movements of capital relating to direct investment and the liquidation and repatriation of these capitals

Expropriation**Investor-state arbitration**

1 No automatic consent given by the states

2 No automatic consent for pre-establishment disputes

3. Post-establishment only

79. Third, if there are no apparent legal or technical impediments to the inclusion of BIT-like protections into RTAs, this does not necessarily imply that RTAs' investment chapters always supplant BITs. Again this depends on the particular circumstances and outcome of each negotiation. As Table 5 shows, various situations are possible.

80. For a majority of the RTAs reviewed, the basic protections of the Investment chapters constitute, in the absence of BITs, the first obligations ever contracted by the parties between them. This is the case for AUSFTA, NAFTA, KSFTA, TAFTA, Japan's EPAs or CECA. But the pre-existence of BITs may also lead the parties to continue maintain them along side RTAs, with both set of rules complementing each other. This is the case for several other agreements reviewed (EFTA-Chile agreement, EC agreements, ASEAN Agreements and Andean Decisions). In other words, BITs seem to be replaced by RTAs only when the latter's contents and coverage are considered to be clearly superior or more comprehensive to those of BITs (for example EFTA-Korea Investment Agreement as compared to Korea-Switzerland BIT or US-Morocco FTA as compared to US-Morocco BIT). In the absence of any RTA investment disciplines, the parties have to rely on the legal guarantees provided by BITs. Those contracted between COMESA partners, for instance, are listed in the last entry of the Table.

Table 5. BITs concluded by RTA partners

Agreement(s)	BITs?	Partners
NAFTA and NAFTA-inspired Agreements		
NAFTA (1994)	No	
Japan-Mexico EPA (2006)	No	
Japan-Singapore EPA (2006)	No	
Korea-Singapore FTA (2006)	No	
Australia-US FTA (2005)	No	
US-CAFTA-DR FTA (2006)	Yes	US-Honduras (2001)
US-Morocco FTA (2006)	Yes	US-Morocco (1991)
GATS-inspired Agreements		
EFTA Singapore FTA (2003)	Yes	Singapore-Switzerland (1978)
EFTA-Korea (2006)	Yes	Korea-Switzerland (1971)
Japan-Singapore EPA (2006)	No	
Japan-Malaysia EPA (2006)	No	
India-Singapore ECA (2005)	No	
Australia-Thailand FTA (2005)	No	

Agreement(s)	BITs?	Partners
ASEAN Agreement for Promotion and Protection of Investment, 1987 (AAPPI) and AIA (1998)	Yes	Cambodia-Indonesia (1999), Cambodia-Malaysia (1994), Cambodia-Philippines (2000), Cambodia-Singapore (1996), Cambodia-Thailand (1997), Cambodia-Vietnam (2001), Indonesia-Lao People's Democratic Republic (1994), Indonesia-Malaysia (1994); Indonesia-Philippines (2001), Indonesia-Singapore (2000), Indonesia-Thailand (1998), Lao People's Democratic Republic-Malaysia (1992), Lao People's Democratic Republic-Myanmar (2003), Lao People's Democratic Republic-Singapore (1998), Lao People's Democratic Republic-Thailand (1990), Lao People's Democratic Republic-Vietnam (1996), Malaysia-Vietnam (1990), Myanmar-Philippines (1998), Myanmar-Vietnam (2000), Philippines-Thailand (1996), Philippines-Vietnam (1993), Singapore-Vietnam (1992) and Thailand-Vietnam (1992).
New-Zealand Singapore CER (2001)	No	
EC-Chile Association Agreement (2005)	Yes	Chile-Poland (2000), Chile-Portugal (1998), Chile-Spain (2003), Chile-Romania (1997), Chile-Sweden (1995) and Chile-United Kingdom (1997).
EC-Jordan (2003)	Yes	Jordan-Austria (2001), Jordan-Bulgaria (2003), Jordan-Czech Republic (2001), Jordan-France (1979), Jordan-Germany (1977), Jordan-Greece (2005), Jordan-Italy (2001), Jordan-Netherlands (1998), Jordan-Poland (1999), Jordan-Romania (1999), Jordan-Spain (2000), Jordan-Switzerland (2001) and Jordan-United Kingdom (1980)
Andean Community (1991)	Yes	Bolivia-Ecuador (1997), Bolivia-Peru (1995), Columbia-Peru (1994), Ecuador-Peru (1999), Ecuador-Venezuela (1995) and Peru-Venezuela (1997).
Trans-Pacific EPA (2006)	No	
COMESA (1994)		Burundi-Comoros (2001), Comoros-Egypt (2000), D.R. Congo-Egypt (1998), D.R. Congo-South Africa (2004), D.R. Congo-Switzerland (1973), Djibouti-Egypt (1998), Egypt-Malawi (1999), Egypt-Mauritius (2003), Egypt-Sudan (2003), Egypt-Swaziland (2000), Egypt-Uganda (1995), Egypt-Zambia (2000), Egypt-Zimbabwe (1999), Eritrea-Uganda (2001), Ethiopia-Libya (2004), Ethiopia-Mauritius (2003), Ethiopia-Sudan (2000), Ethiopia-Uganda (2003), Libya-Egypt (1991), Madagascar-Mauritius (2005), Malawi-Zimbabwe (2003), Mauritius-Burundi (2001), Mauritius-Comoros (2001), Mauritius-Rwanda (2001), Mauritius-Swaziland (2000), Mauritius-Zimbabwe (2000), Uganda-Ethiopia (2003), Uganda-Zimbabwe (2003), and Zimbabwe-Malawi (2003).

Sources: Andean Community, COMESA, OECD and UNCTAD

PART III. IMPLICATIONS FOR INVESTMENT LIBERALISATION

1. GATS and the NAFTA-inspired approach to the liberalisation of investment in services

81. Part I of the study has described the interaction between provisions on investment and trade in services and Part II has addressed the implications for the protection of investment. We turn now to the implications for the degree of liberalisation achieved. Two models of liberalisation commitments can be identified. The first model is represented by NAFTA, the first major RTA with investment content, which groups provisions on investment for all sectors and grants national treatment and most-favoured-nation treatment in all covered sectors with a negative list of reservations. The second model is based on the GATS approach that is followed in other types of agreements and combines the positive listing of sectors where countries undertake commitments with a negative list of limitations that countries wish to maintain in scheduled sectors.

82. This part of the study focuses on investment in services and assesses the degree of liberalisation achieved according to the approach adopted with respect to the investment/services interaction. The first section describes the GATS approach and the second section the NAFTA-inspired lists of reservations. Section three provides the results of the analysis of the schedules of commitments in ten of the RTAs presented in Part I.³⁶ Section four compares the regional schedules of commitments with GATS schedules of commitments. It identifies to what extent the regional agreements are “WTO-plus”, that is whether they offer more at the regional level than the multilateral liberalisation of investment in the GATS (Mode 3). The methodology used to analyse the schedules of commitments is detailed in Annex 2. It is also in this Annex that can be found the tables describing the commitments on investment in services in the RTAs and the comparison with GATS schedules of commitments on Mode 3.

a) The GATS-inspired approach to scheduling commitments

83. The General Agreement on Trade in Services (GATS) covers all forms of trade in services, including Mode 3, “the supply of a service (...) by a service supplier of one Member, through commercial presence in the territory of any other Member” (Article I). It organises “a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization”. The liberalisation of investment in GATS is undertaken through commitments in sectors and sub-sectors.

84. Although the GATS is often presented as a model of a “positive list” approach, it can be more accurately described as an hybrid model where specific commitments on market access (Article XVI) and national treatment (Article XVII) are made in a positive list of sectors, but where limitations to these commitments are presented in a negative list. The MFN principle in GATS is a general obligation and applies to all services sectors covered by the agreement with a negative list of exemptions. Another characteristic of GATS schedules is that limitations are listed by mode of supply.

36. Five of these agreements have NAFTA-inspired lists of reservations (AUSFTA, NAFTA, US-Morocco, Japan-Mexico and Chile-Korea) and the other five have GATS-inspired schedules of commitments (Japan-Singapore, TAFTA, EU-Chile, EFTA-Singapore and India-Singapore).

85. GATS schedules of commitments are considered by some authors as difficult to read or lacking transparency (Hoekman, 1995; Stephenson, 2002; Mattoo, 2005).³⁷ To assess the real level of market access, it is necessary to determine the activities covered in a given sector, to read the limitations on market access and national treatment listed for this sector according to the mode of supply, to check that there is no horizontal limitation that could apply and also to look at the possibility of MFN exemptions that can be found in a separate table. As only sectors where commitments are made are listed, it is necessary to make a deduction to find the sectors or sub-sectors that were excluded from the schedule and a minimum knowledge of the classification is therefore required. The absence of a commitment in a sector does not mean that foreign investment is prohibited or that discriminatory treatment is effectively applied to foreign investors. There is simply no information on the kind of restrictions that can exist in non-committed sectors (and it could be the case that no restriction exists). Additional research would be needed to know the kind of regulation applicable and the information cannot be in the schedule of commitments. Hence the “lack of transparency” pointed out by some analysts. In financial services, parties have the option to schedule their commitments in accordance with the negative list approach of the GATS Annex on Understanding on Commitments in Financial Services. Virtually all OECD countries and a few non-OECD countries have indicated to use this option.

86. Moreover, as GATS covers the four modes of supply of services, the definitions provided for market access, national treatment and most-favoured-nation treatment are not specific to investment (which is “commercial presence” in GATS, already a somewhat more restrictive concept). In particular, there is no distinction made in GATS between pre- and post-establishment. Market access is defined in Article XVI through a list of limitations that cannot be adopted or maintained in sectors where market access commitments are taken.³⁸ While the concept of “market access” could be understood as an equivalent of “pre-establishment” in the realm of investment, this definition does not lend itself to such an interpretation as national treatment limitations can also cover the pre-establishment phase. As a consequence, some authors point out that there is some confusion in GATS about the relationship between market access and national treatment, especially in the case of investment (Low and Mattoo, 2000).³⁹ A generally accepted interpretation(although not shared by all) is that national treatment applies to any existing or future market access commitment even when they are not scheduled (Mattoo, 1997).

87. Despite these issues, the GATS approach to scheduling commitments on investment in services has been quite popular in regional trade agreements. In the list of RTAs analysed in this study, TAFTA, Japan-Singapore, Japan-Malaysia, EC-Chile, EFTA-Singapore, EFTA-Korea, New Zealand-Singapore, and India-Singapore have GATS-like schedules of commitments.

88. There are several reasons to explain why the GATS approach is followed in these agreements. First, it is an easy way to ensure the consistency of the regional liberalisation with multilateral disciplines and to use a model well-known by negotiators where commitments are fully understood. Reproducing GATS at the regional level certainly help negotiators to strike a deal and ensure consistency with the

37. Guidelines for the scheduling of specific commitments under GATS have been adopted by the WTO Council for Trade on Services (S/L/92, 28 March 2001). Transparency is a general obligation of GATS (Article III) requiring that all measures affecting trade in services shall be made publicly available.

38. This list includes limitations on: (1) the number of service suppliers; (2) the value of service transactions or assets; (3) the total number of service operations or total quantity of service output; (4) the total number of natural persons that may be employed; (5) the type of legal entity or joint venture that may supply a service; and (6) the participation of foreign capital.

39. The confusion comes also from a scheduling convention set out in Article XX:2 of GATS. This article states that when a limitation is relevant for both Articles XVI (market access) and XVII (national treatment), it should be entered in the “market access” column of the schedule and should be understood as being also a limitation to national treatment.

GATS, at least for governments who are used to the GATS approach and have already determined in the GATS context the kind of commitments they are willing to make (or not make). Second, it is likely that those countries that used the GATS as a model endorsed its approach and in particular the flexibility offered not to bind themselves in a given sector even if no restriction may actually apply. In that sense, one can expect agreements with a GATS approach to reproduce the same kind of commitments as in GATS, going further at the regional level or with a bilateral partner than it is possible at the multilateral level.

89. When an agreement is described as reproducing the GATS approach, it goes further than simply having a positive list of commitments or a schedule of commitments presented in the same way as in a GATS schedule. These agreements tend to incorporate different provisions of the GATS and make many explicit references to it. First, they generally refer to GATS for the definitions of the main terms used in the services chapter and their schedules of commitments such as “trade in services”, “service supplier” or “market access”. For example, article 3.3 of the EFTA-Korea agreement says that “The following definitions of Article I of the GATS are incorporated into and made part of this Chapter (...)” and subsequently “The following definitions of Article XXVIII of the GATS are hereby incorporated and made part of this Chapter (...)”. Similarly, the articles on MFN treatment, market access, and national treatment usually refer to, respectively, Article II, Article XVI and Article XVII of the GATS.

90. Most of the GATS-inspired RTAs tend to reproduce a schedule of commitments similar to their GATS schedule, with additional commitments in specific sub-sectors (see section 4 below). In the case of the Thailand-Australia Free Trade Agreement (TAFTA), the presentation of the schedule is however different. Instead of reiterating the commitments made in the GATS, only the additional sub-sectors liberalised are listed. In particular, while limitations are scheduled both horizontally, and by reference to specific sectors and sub-sectors, per the GATS approach, they are not scheduled by reference to mode of supply, market access or national treatment. Instead, all limitations in relation to each horizontal commitment and sector specific commitment are listed together.

91. Future liberalisation is often foreseen in the RTAs along the same lines as in GATS Article XIX on progressive liberalisation. The mechanism involved is generally a review of the commitments after the entry into force of the agreement. For example, in the EU-Chile association agreement, article 100 indicates that the Parties shall review Chapter I on services “three years after the entry into force of [the] Agreement, with a view to further deepening liberalisation and reducing or eliminating remaining restrictions on a mutually advantageous basis and ensuring an overall balance of rights and obligations”. An agreement like the EFTA-Singapore FTA shows a stronger commitment to future liberalisation, as it aims at “the elimination of substantially all remaining discrimination between the Parties with regard to trade in services (...) at the end of a transitional period of ten years from the date of entry into force of [the] Agreement”. It also indicates that “such review shall continue if substantially all remaining discrimination has not been eliminated at the end of this transitional period”.

b) *NAFTA-inspired lists of reservations*

92. In NAFTA chapter 11, national treatment (Article 1102) and MFN (Article 1103) are granted to all covered investments “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments”. However, there are exceptions and reservations to the application of these two obligations. Article 1108 states that national treatment and MFN do not apply to a list of non-conforming measures set out in Annex I (Reservations for existing measures and liberalization commitments), Annex II (Reservations for future measures), Annex III (Activities reserved to the State) and Annex IV (Exceptions from most-favoured-nation treatment).

93. The reservations are all presented according to the same layout with information on the sector and sub-sector concerned, the industry classification (where national classifications can be used), the

obligations against which a reservation is taken, level of government, the measure, and its description. Some guidelines on the interpretation of the schedules are provided at the beginning of each annex. In that sense, the NAFTA-inspired schedules of commitments are easier to read. They also tend to be shorter as a consequence of the top-down approach, since it is not necessary to give an exhaustive list of all the sectors and sub-sectors where commitments are made.

94. Originally, Annex I of NAFTA was to have listed all non-conforming measures maintained at the sub-national level, within two years of the date of entry into force of the agreement. However, in 1996, NAFTA countries decided to “grandfather” existing restrictions (that is to freeze existing measures with a commitment to not make measures more non-conforming in the future) and no list of non-conforming measures at the local or sub-federal level is annexed to the agreement.

95. The difference between existing and future measures (between Annex I and Annex II in NAFTA) is important. Existing non-conforming measures that are listed in Annex I cannot be changed unless it is to increase the conformity of the measure with the obligation (“ratchet” effect). Only for activities or sectors listed in Annex II can future non-conforming measures be adopted. That is why the NAFTA scheduling has been presented as a “list it or lose it” approach. If a government has not included a reservation in its schedule in the period where it could do so, it cannot adopt any new measure that would be discriminatory for foreign investors. For each reservation listed, a phase-out commitment can be taken. However, there is no obligation to commit to future liberalisation and the phase-out element in the schedule can be filled in with “none”. However, as in the GATS, nothing prevents the parties from progressively liberalising measures and lifting reservations if they so wish. A key difference between the GATS and NAFTA approaches is that the ratchet mechanism of the latter locks in liberalisation as it occurs and thus provides an added degree of predictability for investors.

96. In the Annex on future measures (Annex II in NAFTA), some reservations can be very broad with potentially a wide impact on the investment regime. For example, it is not uncommon to find reservations such as Country X “reserves the right to adopt or maintain any measure relating to investment in...” In that case, the outcome is not different than an “unbound” in a GATS schedule. In the Annex on future measures, it is possible to identify sectors that may be subject to non-conforming measures without listing a specific measure. It should also be kept in mind when comparing NAFTA lists of non-conforming measures and GATS-inspired schedules of commitments that in the latter, a broad reservation with a potentially discriminatory treatment affecting different sectors will have to be reiterated for each sector (unless it can be put in the horizontal section of the schedule). With the negative list approach it is possible to state one time the law involved and to list the actual sectors implicated by the reservation.

97. The NAFTA approach seems to have gained ground among regional trade agreements. In the sample of RTAs analysed in this study, AUSFTA, CAFTA-DR, US-Morocco, Japan-Mexico, the Trans-Pacific Strategic Economic Partnership, Chile-Korea and Korea-Singapore have NAFTA-like schedules of commitments. The approach has diffused beyond original NAFTA signatories, as the Trans-Pacific Strategic Economic Partnership, Chile-Korea or Korea-Singapore are agreements where no party is a member of NAFTA.

98. What is common to these agreements is not only the negative list approach but also the way the lists are organised and presented, in particular the difference between existing measures and future measures. There are however small variations in the NAFTA-inspired agreements. For example, the phase-out element is not always present and some agreements, such as US-Morocco, have reservations that apply during a transitory period. But the way investment is liberalised and commitments are made is the same.

99. NAFTA-inspired agreements are nonetheless influenced by GATS in the financial services chapters which incorporate the results of the WTO negotiation on financial services that took place after

the signature of GATS. An equivalent to the concept of “market access” appears in Article 1403 of NAFTA as “establishment of financial institutions”. There is even a more explicit reference to GATS in the agreement between Mexico and Japan where GATS commitments on financial services are incorporated in the agreement. It highlights that GATS schedules and NAFTA lists of reservations are not incompatible and can be combined.

100. In the NAFTA approach, new services are automatically granted national treatment and most-favoured-nation treatment, since no reservation could have been taken for them at the time the agreement was signed (another manifestation of the “ratchet” effect previously mentioned). In a GATS-like schedule of commitments, these new services would not be covered if they are in sectors or sub-sectors without commitments.⁴⁰ However, it is possible in the NAFTA approach, through the list of reservations on future measures, to prevent new services from falling automatically under the disciplines of the agreement. In the Mexico-Japan FTA for example, Japan has a reservation to deal with new services.

101. As highlighted before regarding GATS, the defining characteristic of the approach is not solely in the way commitments are scheduled. If a negative list approach can be seen as contributing to promote the liberalisation of investment, the pro-liberalisation approach in NAFTA relies on a broader set of disciplines that supplement national treatment and MFN treatment disciplines and that have been described in Part I:

- Article 1104 (standard of treatment) accords to investors the better of MFN or national treatment.
- NAFTA includes provisions on performance requirements (Article 1106) that are very comprehensive and that are extended to services.
- There are also provisions prohibiting certain types of nationality requirements for senior management (Article 1107)⁴¹
- Lastly, as emphasised before, the definition of the investor is broader than the GATS commercial presence of a service provider. The origin requirement is thus more liberal and all types of established companies benefit from the liberalisation commitments (Stephenson, 2002).

102. To the extent that NAFTA-inspired RTAs follow this approach – and they generally do so – they have the same liberalizing bias that can be found in NAFTA.

c) *The degree of liberalisation achieved in the RTAs*

103. To assess to what extent investment in services has been liberalised in regional trade agreements and to compare the NAFTA and GATS approaches, an analysis of the schedules of commitments on investment in services has been conducted for ten RTAs. The details of the methodology are presented in Annex 2, including a certain number of caveats that have to be acknowledged in such an analysis. The exercise aims to provide some transparency on the schedules of commitments in RTAs and to understand the underlying forces of liberalisation of investment in services.

40. An example often mentioned is the case of sectors “unbound due to lack of technical feasibility”. Mode 3 is however not concerned. When the new service is in sectors or sub-sectors where commitments have been made, its classification and the existence of the commitment could be questioned.

41. Article 1107 of NAFTA prohibits in its first paragraph requirements that an investor “appoint to senior management positions individuals of any particular nationality”. The second paragraph specifies that a Party may require that a majority of a board of directors, or any committee thereof, “be of a particular nationality, or resident in the territory of the Party”, provided that such requirements do not materially impair an investor’s control over its investment.

104. The interesting question is to know if there is a relationship between the approach followed in scheduling commitments and the degree of liberalisation achieved. One might expect GATS-inspired agreements to reproduce the same level of commitments as in the GATS and some authors have questioned the real liberalisation of services trade in regional trade agreements of this type (as GATS schedules at the time of the end of the Uruguay round were seen as a *status quo* rather than a higher level of access to the market). While NAFTA and the negative list approach are often considered as more favourable to liberalisation, it is also important to check if lists of reservations do not introduce restrictions that would make these agreements not so different than the ones following a GATS approach. Many authors have asked such questions but there is very little detailed analysis of the schedules of commitments in RTAs.⁴²

105. Tables 12 to 14 in Annex 2 summarise the results of the analysis. Table 12 shows the commitments in five RTAs with a NAFTA-inspired approach to liberalisation (Australia-US, NAFTA, US-Morocco, Mexico-Japan and Chile-Korea). All the agreements using a negative list approach are agreements with very few reservations and where no sector has been totally excluded. There are some sectors where some activities or sub-sectors have no commitments, either because of a public monopoly (“activities reserved to the State” in the schedules of Mexico) or because of a broad reservation on future measures (where the country reserves the right to maintain or adopt any measure in a given sub-sector). There are only a few reservations of this type in sectors that have been traditionally more regulated with a certain degree of state intervention (communication services, health related and social services, transport services and some specific business services).

106. No sector is however in our analytical category of “commitments in a limited number of sub-sectors” (where less than 75% of the sector has no limitations). A number of reservations are listed, in particular in business services, communication services, financial services, health-related and social services and transport services. But their number is again not very high and these reservations are not here to exclude some services from the liberalisation but to pinpoint exceptions to national treatment or most-favoured-nation treatment (that is the difference in the table between the colour of the cell – which shows the level of commitments – and the number reported – which indicates the reservations listed).

107. Table 13 presents the results of an analysis carried out for five agreements with a GATS-inspired schedule of commitments on investment in services. There is a definite difference with Table 12. Entire sectors can be without commitments in the case of these agreements. For example, Chile in the EU-Chile Association Agreement has no commitments in educational services, health related and social services and “other services not included elsewhere”. India in its agreement with Singapore has also 3 out of 12 sectors without any commitment (educational services, environmental services and “other services not included elsewhere”). There are also sectors where only a limited number of commitments have been made (appearing as grey plain cells in the Table). This means that less than 75% of the sub-sectors of the GATS W/120 classification have commitments. It is often the case for communication services (where few or no commitments are made in postal and courier services, as well as audiovisual services) or transport services (where not all of the means of transportation are generally included).

108. There are very few “blank cells” that would indicate a commitment in the whole sector and the most frequently found category is “commitments in most of the sector”. Here the positive rather than negative listing approach plays a role. Countries generally do not list the “other” sub-category in their schedules. It is often the case that commitments are made in all the sub-sectors of the classification but not

42. Such an analysis can be found in Stephenson (2002) and recently in Roy et al. (2006) and Fink and Molinuevo (2007).

the last one which is the “other” category, grouping services of the same sector not listed before.⁴³ The comparison between Tables 12 and 13 should therefore be made carefully. In practice, there might be a very small difference in the investment regime when the cell is blank or has a lattice pattern in the Table, especially if the “other” sub-sector does not correspond to any meaningful activity. The difference that is worth taking note of is in the sectors where few commitments or no commitments are made. This is the main difference between agreements in Table 12 and Table 13.

109. As far as the number of limitations is concerned, there is a tendency to find higher numbers in the GATS-inspired agreements, but as pointed out before, this can be a consequence of the way the limitations are listed. The limitations are also concentrated in a few sectors, in particular financial services and business services. Another characteristic of the GATS-inspired agreements seems to be that countries prefer to exclude a sub-sector (i.e. to not list it in the schedule) rather than including it with all the existing limitations. This cautious approach is not possible in the top-down approach of NAFTA where all reservations must be listed. Another caveat regarding the number of limitations concerns the non-conforming measures at the local or sub-federal level. In GATS-inspired agreements, the schedule generally covers all government levels. Limitations that apply only in a province or state and not at the federal level are separately listed. In NAFTA-inspired agreements, while this need not be inherent to the negative list approach, non-conforming measures at the sub-federal level are generally not listed, as previously mentioned regarding NAFTA.

110. Technically, there could be the same level of commitments with a positive list or a negative list. Results similar to those found in Table 12 for NAFTA-inspired agreements could be reproduced in GATS-type agreements by scheduling all the sectors of the W/120 classification. Looking at the schedule of Japan in the Japan-Singapore FTA, it is interesting to see that there are several sectors with full coverage of all sub-sectors (construction, distribution, education, environmental and financial services). Conversely, it would be possible for countries in NAFTA-inspired agreements to reserve the right to maintain or adopt any measure in a whole sector, such as educational services or health related and social services. But this is not the case in the agreements analysed. Parties to the US-Australia, NAFTA, US-Morocco, Japan-Mexico and Chile-Korea FTAs have listed reservations, including the possibility of taking any discriminatory measure in some activities or even prohibiting investment when the sub-sector is a public monopoly but it does not lead to the exclusion of full sectors of the scope of the liberalisation commitments.

111. From the comparison between Table 12 and Table 13 in Annex 2, it is clear that NAFTA-inspired agreements have the advantage in terms of sectors covered by non-discriminatory principles when the agreement is signed. However, the analysis should be completed by taking into account several differences in the GATS-inspired and NAFTA-inspired approaches to scheduling liberalisation commitments. Table 6 below provides a summary of these main differences. It is not the objective of this study to settle the debate on positive versus negative lists of commitments but the following points should be considered:

- GATS-inspired agreements establish a progressive and selective liberalisation of investment in services. The full liberalisation is generally referred to as an objective in the agreement and the RTA provides for reviews of commitments in order to achieve this objective. NAFTA-inspired agreements in contrast can be described as “one-shot agreements” where from the onset all sectors are covered by the non-discriminatory disciplines and where further liberalisation is likely to occur through autonomous liberalisation (automatically binding in the agreement through the “ratchet” mechanism). To fully assess the degree of liberalisation achieved in each type of

43. This is true for the twelfth sector “Other services not included elsewhere” where only 8 countries among all WTO Members have taken commitments. But it is also the case that few commitments are made inside each of the other eleven sectors where there is also a sub-category for sub-sectors not listed in the classification.

agreement would require taking into account future liberalisation in the GATS-inspired agreements.⁴⁴

- While the sectoral coverage of agreements provides useful information on the degree of liberalisation achieved, the type of commitments also matters. For example, GATS-inspired agreements cover non-discriminatory quantitative restrictions as one type of limitation to market access while NAFTA-inspired agreements do not deal with this type of barriers in their investment chapter. On the other hand, while commitments are bound in both GATS- and NAFTA-inspired agreements, there is in addition a ratchet mechanism in NAFTA-inspired agreements that locks in further liberalisation of non-conforming measures.
- Regarding the transparency achieved, the top-down approach of NAFTA-inspired agreements lists in theory all reservations to non-discriminatory disciplines and can offer predictability and certainty to investors as the investment regime is fully stated in the agreement. The idea of greater transparency for negative lists can however be nuanced when not all limitations are listed (e.g. sub-federal non-conforming measures). In GATS-inspired agreement, if schedules of commitments can be said to a certain extent to be less transparent, transparency is a general obligation (that applies therefore to all sectors) and information on the investment regime has to be provided to investors.
- Moreover, the way reservations are listed in the GATS-inspired agreements is not very different than in the NAFTA-inspired agreements. In both cases, it is a negative list explaining where there are exceptions to the non-discriminatory treatment. The positive versus negative list approach concerns only the coverage of the schedule (the number of sectors where commitments are made). There is a complexity inherent to the nature of the exercise and negative lists as well as positive lists have to manage the issue of limitations that apply to all sectors, the interpretation of “national treatment”, “MFN” or “market access” in the context of the specific measure scheduled, the issue of the definition of services sectors and activities, the difference between temporary, existing and future non-conforming measures, etc. One advantage of NAFTA-inspired schedules is that the reservation can be explained in greater detail and more information provided (in particular on the domestic laws involved).
- The negative list approach is also more favourable to liberalisation when new services are introduced or become tradable as a consequence of technological progress. These new services are automatically covered by non-discriminatory disciplines in NAFTA-inspired RTAs (unless provided otherwise in the Annex on future reservations), whereas measures can be adopted if these new services are not in a sector scheduled in the case of a GATS-inspired agreement.
- GATS-inspired agreements can be said to provide for a higher degree of flexibility because a country can have a more liberal investment policy than reflected in its schedule of commitments while preserving options to regulate a given sector. As long as the sector is not committed or reservations have been made, it is possible to (re-)introduce non-conforming measures. Of course, this added flexibility reduces the transparency and predictability of the investment regime, thus creating a trade-off. In NAFTA-inspired agreements, the ratchet and standstill mechanisms automatically bind any liberalisation of a non-conforming measure that was listed in the Annex on reservations for existing measures. Any liberalisation of a measure becomes a commitment in the RTA. In the context of NAFTA-inspired agreements, flexibility can however be introduced through the Annex on future reservations, where full sectors can also be exempted

44. As the agreements analysed are relatively recent it is not possible to assess yet the pace at which new sub-sectors or sectors are added in schedules of commitments that are reviewed.

from non-discriminatory treatment with the possibility of introducing non-conforming measures in the future.

112. What emerges from the above points is that the differences between the positive and negative list approach are not so marked in the sense that any country can use one approach or the other to achieve the same degree of liberalisation, transparency, flexibility and predictability. It is important to make a distinction between the practice (the current investment regime in GATS-inspired and NAFTA-inspired regional trade agreements) and what would be theoretically possible to achieve through one model or the other. So far, GATS-inspired agreements tend to have a smaller number of sub-sectors liberalised, as illustrated by Table 13, and as a consequence may offer less transparency and predictability for investors while being more suitable for a certain number of developing countries to reform and establish their regulatory framework. The analysis however shows that this flexibility can also be sought in agreements with a negative list approach or that transparency, if not through the schedules of commitments, is also part of GATS-inspired agreements.

Table 6. A comparison between the GATS-inspired and NAFTA-inspired approach to scheduling liberalisation commitments in regional trade agreements

	NAFTA-inspired negative list approach	GATS-inspired “hybrid” approach with a positive list of sectors where commitments are made
Type of commitments or reservations listed	National treatment and MFN reservations are listed ^b .	Market access and national treatment commitments (covering also non-discriminatory quantitative restrictions). ^a
Bound commitments?	Commitments are bound. Standstill and ratchet mechanism (any new liberalisation of non-conforming measures becomes a commitment in the agreement)	Commitments are bound. Standstill in sectors where commitments are made (subject to reservations listed).
Further liberalisation?	No further liberalisation foreseen. The agreement might include phasing out non-conforming measures (but already stipulated when the agreement is signed)	Further liberalisation foreseen in the agreement through a review of commitments (sometimes with a view to provide for the elimination of all remaining discrimination at the end of a certain period)
Transparency	The top-down approach offers a higher degree of transparency for investors as all sectors are covered by non-discriminatory disciplines and only listed limitations apply. This transparency is reduced when some of these reservations are not listed (e.g., non-conforming measures at the sub-federal level)	No information is provided in the schedules of commitments on the liberalisation of investment in services sectors where no commitments are made. However, transparency is a general obligation of the agreement and information on the investment regime in all sectors should be made available
Flexibility	Flexibility can be introduced through reservations on future measures but such reservations have to be taken when the agreement is signed.	Countries can take commitments in the sectors of their choice and limitations are listed only in committed sectors, leaving some flexibility on the degree of liberalisation offered in other sectors.
Predictability	The ratchet mechanism locks in any new liberalisation of a non-conforming measure. New services sectors are automatically covered by non-discriminatory disciplines.	Predictability is limited to the sectors where commitments are made.

a. The MFN principle is a general obligation that is not found in all agreements.

b. Some NAFTA-inspired agreements also list reservations to obligations related to performance requirements and citizenship or residency requirements for senior managements and boards of directors.

113. Therefore, countries are not constrained by one approach or the other. It is possible to reach an ambitious level of investment liberalisation in a GATS-inspired agreement by taking commitments in new sectors or to increase the transparency of GATS-like schedules of commitments. It is also possible to pursue a progressive and cautious liberalisation of investment through negative lists that include enough

reservations on existing and future measures. The most recent agreements give some insights of the many possibilities offered by the combination of positive and negative lists in GATS-inspired agreements (see Part I).

114. To conclude, it should also be recalled that whether the negative or positive list approach is adopted in an agreement depends on several factors:

- First, the degree of liberalisation of the negotiating partners and their willingness to create a substantially preferential investment regime. The advantages of the negative list approach have been emphasised for countries aiming at a high degree of investment liberalisation in a relatively short term.
- Countries are also inclined to stay with the same approach once they have started to negotiate NAFTA-style or GATS-style agreements. It is easier for them to draft annexes and schedules of commitments following the same model and it becomes an updating exercise. It also ensures the consistency of commitments across different regional trade agreements.
- The administrative capacity of countries can be another factor. Some lesser developed countries may not have the expertise or resources to develop a negative list for the first time. Negative lists can be demanding as the transparency achieved requires a detailed description of non-conforming measures and a full assessment of the reservations that have to be introduced to preserve some flexibility in future public policies.⁴⁵
- For developing countries that consider in their interest to preserve flexibility to introduce new restrictions in the future or to liberalise gradually at a pace that remains to be determined, the GATS-inspired approach has attraction. Tables 12 and 13 show that India or Thailand are part of regional agreements that follow a GATS-approach, while early reformers such as Korea, Mexico and Chile are the developing countries that are signatories of NAFTA-inspired agreements. Developed countries and emerging economies are more likely to use the negative list approach (Fink and Molinuevo, 2007)
- Last but not least, the choice between the positive or the negative list approach is matter of negotiation between the Parties to the agreement. While some Parties may favour positive list and others the negative list, they have sometimes to negotiate on the basis of another approach than the one they would have preferred to use.

d) *Regional agreements and multilateral liberalisation: to what extent are the regional agreements “WTO-plus”?*

115. Another question that has been asked regarding the schedules of commitments in regional trade agreements is to what extent these agreements go beyond GATS commitments in investment in services. It has been argued that RTAs are not offering much in terms of liberalisation, especially when they reiterate GATS schedules for trade in services. This section looks at what happens in Mode 3.

116. Table 14 includes the GATS schedules in Mode 3 for all the countries parties to RTAs analysed in Tables 12 and 13. A comparison between the regional and multilateral commitments is thus possible. It is clear that NAFTA-inspired agreements offer a much wider schedule of commitments than in GATS. The difference is especially striking for countries like Mexico, Morocco or Singapore. They make full

45. However, once it has been done, it requires much less level of effort to update such a list. There is also the possibility of using a negative list approach without explicitly listing non-conforming measures as it is the case in some Bilateral Investment Treaties signed by Canada or the US. These agreements do not list reservations for existing measures (reservations for future measures are however listed).

commitments with very few reservations in the bilateral agreements in sectors where they have no commitments at the multilateral level. And the US, Australia or Japan have also more commitments in their bilateral agreements than in their GATS schedules. For this group of countries, the regional agreement is clearly a way of liberalising investment in services with specific partners by offering them a substantially preferential treatment.

117. Comparing Tables 13 and 14 throws up a less clear-cut result but a careful analysis also shows that the GATS-inspired RTAs go further in terms of liberalising investment than what is committed under the GATS. Again there is a difference between developing countries (as defined in WTO) and developed countries. In the case of the EFTA-Singapore agreement for example, Switzerland has almost the same schedule of commitments as in GATS. The regional schedule has however additional commitments, in particular in supporting services for railway transport (CPC 743) and in freight transportation (CPC 7123). But Singapore offers a lot more than it does under GATS. The country has commitments in distribution services, educational services, environmental services and health-related and social services in the RTA, whereas these sectors were excluded from their GATS schedule. The regional agreement thus represents an opportunity for Singapore to liberalise services trade in Mode 3 with EFTA countries. The same analysis can be applied to the Singapore-Japan Economic Agreement for a New Age Partnership. The difference is that Japan has a schedule also with a substantial improvement in its commitments. Japan –together with Australia- is a country that has used both the negative and the positive list approach with different trading partners. Commitments from Japan under the positive list of the GATS-inspired agreement are closer to the ones that can be found in Table 12 in NAFTA-inspired agreements where Japan is a party.

118. A similar analysis can be carried out in the case of the EU-Chile agreement. Sectors where there are EU commitments in the RTA that are not in GATS are the following: interdisciplinary R&D services (CPC 853), services relating to the handling of postal items (a list of sub-sectors in postal and courier services), electronic mail, voice mail, on-line information and data retrieval, electronic data interchange (EDI), code and protocol conversion, libraries, and some maritime and internal waterways transport services. For Chile, commitments are extended to the following sectors in the RTA: legal services (not limited to public international law or international commercial law), computer and related services, research and development services, real estate services, many business services in the category “other business services”, a few additional financial services, but also new commitments in construction, distribution services, environmental services, recreational, cultural and sporting services that had no equivalent in their GATS schedule. Reciprocity in the commitments is an objective of the agreement. Article 94 of Title III on Trade in Services and Establishment states that “The Parties shall reciprocally liberalise trade in services, in accordance with the provisions of this Title and in conformity with Article V of the GATS”. This reciprocity element is not part of GATS and implies larger commitments from Chile.

119. The analysis shows that all the agreements studied are “WTO-plus” and that even agreements following the GATS model offer a more liberal schedule of commitments. This is not surprising since RTAs have to achieve a higher degree of liberalisation to be consistent with multilateral rules. Of course, there is again a difference between NAFTA-inspired and GATS-inspired agreements. In the case of the NAFTA approach, the agreements show that they aim at universal coverage of all sectors in the schedules of commitments, an approach different than GATS flexibility and progressive liberalisation. This is true for both countries from the North and the South in the case of North-South RTAs. In GATS-inspired schedules of commitments, the same philosophy as under GATS applies at the regional level. However, the fewer commitments the country has in its GATS schedule, the more the effort towards liberalisation in the regional agreement is visible. As pointed out in the case of EU-Chile, there is also a tendency for more reciprocal commitments than in GATS.

120. To the extent that regional liberalisation can serve as a laboratory for future liberalisation and that RTAs can be “building blocks” towards multilateral liberalisation, the two kinds of RTAs described can

help to make progress in this evolution. Developing countries that can be reticent about liberalising investment and trade in services have achieved a much higher degree of liberalisation with bilateral or regional partners in GATS-inspired as well as NAFTA-inspired agreements. To be complete, the analysis should take into account the future liberalisation that is foreseen in GATS-inspired agreements as well as future developments at the WTO in the services negotiations. We have assessed only one type of agreement, but liberalisation of investment in services can also rely on other types of agreements, including bilateral investment treaties, and also on domestic (unilateral) reforms.

2. The implications of the Most-Favoured-Nation clause for the liberalisation of investment⁴⁶

121. To complete the analysis of the role of regional trade agreements in promoting the liberalisation of investment in services, it is also interesting to look at the implications of the most-favoured-nation clause (MFN). This clause is a common element of trade agreements and creates specific interactions between investment and services agreements, as well as regional and multilateral agreements. The MFN clause aims to put foreign investors on a level playing field within a particular host country by extending to investors from one foreign country the same treatment given to investors from any other foreign country.

122. Preferential trade agreements are by definition an exception to the MFN principle as they can give more favourable treatment to parties to the agreement. They nonetheless include various types of MFN clauses that can serve as a guarantee that investors from non-parties will not receive better treatment or that this more favourable treatment can be extended to the parties of this agreement. MFN clauses in investment chapters of the RTAs tend to be unconditional and to apply to all covered investments and investors, although exceptions may be added through the RTA schedules of commitments.

123. This section first describes the different types of MFN clauses that can be found in the sample of RTAs studied and the exemptions to MFN treatment, distinguishing between GATS-inspired and NAFTA-inspired agreements. It then examines to what extent the provisions of the regional trade agreements are extended to other RTAs or “multilateralised” and what is the value of the MFN provision in practice.

124. Among the 20 RTAs covered in this study, five have no MFN provision (COMESA, EC-Chile, Japan-Singapore, Korea-Singapore and the India-Singapore Comprehensive Economic Co-operation Agreement)⁴⁷. In other cases, when investment in goods and services is dealt with in separate chapters, it may be the case that MFN treatment is accorded to either goods or services or partly to certain obligations relating to both. This is another consequence of the interaction between investment and services chapters described in Part I. For example, TAFTA and the New Zealand-Singapore CEP grant MFN treatment for goods but not for services, while the Trans-Pacific SEP has a MFN clause only in the services chapter (that covers Mode 3).⁴⁸ A first observation is hence that there is less regularity in the prevalence of MFN treatment as compared to national treatment.

a) The MFN provision in GATS-inspired agreements

125. In services chapters dealing with investment, MFN clauses are generally inspired by GATS article II with a list of exemptions. Article II of the GATS (that can be found reproduced – sometimes with

46. This section will not address the application and interpretation of the MFN clause in regard to the investment protection and procedural aspects of investment agreements. These issues have been addressed by a recent study by the Investment Committee "Most-Favoured-Nation in International Investment Law", OECD (2005), *International Investment Law: A Changing Landscape*, Chapter 4.

47. See Table 11 in Annex 1 for a summary table.

48. In the case of the Trans-Pacific SEP, the investment chapter has not yet been negotiated and will be added later in the framework of the agreement.

slight changes – in some of the RTAs) states that “With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country”.

126. As the MFN clause is the same for all kinds of trade in services in GATS-inspired agreements (that is for the 4 modes of supply), the scope of the provision can be ambiguous regarding the pre- or post-entry MFN treatment. There is however no doubt that the MFN provision inspired from Article II of GATS covers both pre- and post-establishment.

127. MFN treatment does not come without exceptions and RTAs with a MFN clause include a list of specific exceptions. The NAFTA and GATS approach come close to each other in this area, as both have a negative list of reservations. There is nonetheless a difference. In GATS-inspired agreements, the member countries may make any exemption to the MFN clause that they can negotiate, but exemptions have to be made at the time the agreement enters into force. The elimination or narrowing of MFN exemptions may be negotiated in at a later time.

128. An important exception to the MFN treatment that can be found in certain GATS-inspired agreements is the regional economic integration organisation (REIO) exception. According to this clause, a more favourable treatment granted to members of another (third party) regional grouping by a Party of a given RTA is not (automatically) accorded on an MFN basis to the other Parties of the current (first) agreement. It is only through a request, a review of commitments, a renegotiation or through the unilateral decision of this Party to extend the more favourable treatment to its partners that the other Parties could benefit from the more favourable treatment.

129. The REIO exception in GATS-like agreements is generally inspired by Article V of GATS. This article provides that any member of GATS may be a party to a REIO while containing safeguards for non-REIO members. EFTA-Singapore and EFTA-Korea are examples of the GATS approach for investment in services. EFTA-Korea excludes from MFN treatment the “other agreements concluded by one of the Parties and notified under Article V or Article V *bis* of the GATS”. Article 3.4 adds that “If a Party enters into an agreement of the type referred to in paragraph 2, it shall upon request from another Party afford adequate opportunity to that Party to negotiate the benefits granted therein.” It is thus through a renegotiation that the benefits of another (third party) RTA can be extended to the parties of the (first) RTA and not through the application of the MFN clause.

130. When a GATS-inspired agreement has no REIO exception clause, it is assumed that the commitments are already reflecting the “most favoured” treatment available in a preferential trade agreement. There is then an article about the better treatment that could be granted in the future to a third party in another RTA. For example, in the Japan-Malaysia EPA, article 101 indicates that “if a Country has entered into an agreement on trade in services with a third State or enters into such an agreement after this Agreement comes into force (...), it shall, upon the request of the other Country, consider according to services and service suppliers of the other Country, treatment no less favourable than that it accords to like services and service suppliers of that third State pursuant to such an agreement”. In some cases the request has to be “favourably” considered or the Party has to “afford adequate opportunity to the other Parties” to negotiate the new benefits, but there is no binding obligation to grant a no less favourable treatment than the one accorded in the more recent agreement.b) The MFN provision in NAFTA-inspired agreements

131. The scope of the MFN clause is more precisely described in NAFTA-inspired agreements. The treatment “no less favourable” applies “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments” (Article 1103 of NAFTA). It is also clear that both “investors” and “investments of investors” benefit from the MFN standard.

However, the MFN clause found in NAFTA and the NAFTA-inspired agreements specifies that the treatment “no less favourable” is accorded “in like circumstances”.⁴⁹ The Australia-United States FTA, the FTA between Central America, the Dominican Republic and the United States (CAFTA-DR), US-Morocco and the Japan-Mexico Economic Partnership are other examples of NAFTA-like agreements, according pre- and post-establishment MFN treatment “in like circumstances.”

132. In EFTA-Singapore and EFTA-Korea, the MFN clause reflects the hybrid inspiration of these agreements with a MFN clause in the services chapter modelled after GATS and a MFN clause in the investment chapter modelled after NAFTA (with the difference that NT and MFN are merged in a single article). It remains to be seen if the difference in the way the two MFN clauses are drafted has practical implications.

133. In NAFTA-inspired agreements, an equivalent to the REIO exception can be found as a reservation in the annex on reservations for future measures or in a specific annex on exceptions from MFN treatment (as in the NAFTA treaty, see Box 1). This creates another difference between GATS-inspired and NAFTA-inspired agreements. There is a wide exception to MFN treatment for all other RTAs in the case of GATS-inspired agreements, while in NAFTA-inspired agreements the parties can benefit from better treatment granted to third parties in another RTA signed after the entry into force of the later one.

Box 1. NAFTA-inspired reservations on MFN treatment

In NAFTA-like agreements, there is often an exception to MFN treatment regarding commitments made in other regional or multilateral agreements signed before the entry into force of the RTA in question. The exception is listed as a non-conforming measure in the annex of the agreement. However the exception does not cover future regional or multilateral agreements (with the exception of a few designated sectors).

For example, the US schedule in NAFTA (Annex IV) says: “The United States takes an exception to Article 1103 [MFN] for treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the date of entry into force of this Agreement. For international agreements in force or signed after the date of entry into force of this Agreement, the United States takes an exception to Article 1103 for treatment accorded under those agreements involving: (a) aviation; (b) fisheries; (c) maritime matters, including salvage; or (d) telecommunications transport networks and telecommunications transport services (...).” Apart from the four sectors mentioned, there is no reservation for future agreements and parties to RTAs in force can benefit from more favourable treatment granted in later agreements signed by the US. In that sense it is better than a provision excluding all other RTAs from the application of MFN treatment.

In CAFTA-DR, the Dominican Republic has the same MFN reservation about past and future agreements as the US in its schedule, while El Salvador, Guatemala, Honduras and Nicaragua have included it only *vis-à-vis* the United States and the Dominican Republic. US-Australia, US-Morocco and Japan-Mexico also have this wide MFN reservation.⁵⁰ The Chile-Korea FTA, although inspired by NAFTA does not use a reservation in the annex to exclude other regional trade agreements from the application of MFN. It has a REIO exception stated in the MFN Article (Article 10.4). The Trans-Pacific Strategic Economic Partnership has a GATS-inspired services chapter that lists reservations through a NAFTA-inspired negative list. It also reproduces the NAFTA-approach towards MFN exemptions with the same kind of reservation regarding past and future third-party RTAs in the schedules of Chile, New Zealand and Singapore.

49. See OECD (2005), *International Investment Law: A Changing Landscape*, Chapter V for a discussion of the implications of the “like circumstances”.

50. In the other agreements than NAFTA, only three sectors are concerned for future agreements: aviation, fisheries and maritime matters (including salvage).

c) *The difference between a multilateral and regional MFN rule*

134. The implications of the MFN rule are different at the regional and bilateral level as compared to the multilateral level since in the former group only the partner countries benefit from “no less favourable” treatment. The multilateral MFN rule ensures that all partners to the (global) trade agreement are given non-discriminatory treatment. It is a guarantee for an investor to receive treatment no less favourable than other investors from other countries. If more favourable treatment is granted to one of these investors it is automatically extended to all investors from all parties. At the multilateral level, the MFN rule is a principle of non-discriminatory treatment between a broad number of countries (e.g. currently 150 in the WTO).

135. The MFN rule has a different function in a regional trade agreement. To begin with, RTAs are the major exception to the above mentioned non-discriminatory treatment at the multilateral level. With the multiplication of RTAs, the scope of application of the multilateral MFN rule is reduced as most-favoured-nation treatment is replaced by preferential treatment not extended to other parties in the multilateral agreement because of REIO exception clauses. The preferential treatment of the RTA is thus not “multilateralised” (unless it is a unilateral decision from the country to do so – the MFN treatment is a guarantee of non-discrimination but nothing prevents a country from applying non-discriminatory treatment to all partners and extending a more favourable treatment to them in the absence of any MFN obligation or any RTAs).

136. The “regional” MFN rule, which is the same most-favoured nation treatment included this time in a regional or bilateral trade agreement, organises non-discrimination among countries that benefit from preferential treatment (as an exception to the multilateral MFN rule). The purpose is different as parties are less interested by the no less favourable treatment granted to the other parties *within* the RTA than by a more favourable treatment that could be granted to other parties in *another* RTA and could be extended to them through the MFN principle. The first RTA that includes the MFN provision can be called the “basic agreement” while the other agreement with more favourable treatment can be referred to as the “third-party agreement”.

137. In the case of a bilateral RTA, it is clear that the MFN rule is not there to guarantee a treatment no less favourable than the one granted to other parties since there is only one partner in the agreement. In RTAs with a sufficiently large number of parties, the MFN rule could have a similar purpose than at the multilateral level. But even in a regional agreement with several parties, the value of the MFN rule will lie more often in comparing the preferential treatment of the basic agreement with the treatment obtained in third-party RTAs, in particular in more recent agreements that could offer more favourable treatment. To put it in a nutshell, the MFN clause in a RTA has a value for investors, not only as a standard to prevent any discriminatory treatment *vis-à-vis* other investors, but also if it can create a liberalisation dynamic.

138. One can even question if a MFN clause is required in a regional trade agreement. If national treatment is also granted (both pre- and post-establishment), the usefulness of the MFN clause may be questioned. The treatment afforded to domestic companies can generally be expected to be more favourable and the national treatment standard could be sufficient. It is only if market access is limited and reservations on national treatment have been listed that, as a “second best”, investors can turn to the MFN principle to be at least treated as well as other foreign investors. However, once again, this rationale is less likely to apply in the context of a regional trade agreement. The MFN provision at the multilateral level already offers the level playing field that is sought by foreign investors. A regional trade agreement is interesting only if it creates a preferential treatment that would give an advantage to investors from the signatory countries.

139. Regarding investment, a noticeable difference is that there is a MFN rule at the multilateral level for investment in services, as MFN is a general obligation of the GATS. But there is no corresponding principle for non-services sectors. There is no multilateral agreement with non-discriminatory provisions for investment in the production of goods. In this context, the MFN principle in regional trade agreements has certainly more value for goods than for services. But that would suppose that through the MFN rule, countries could be granted the same kind of treatment than provided to investors from third-party agreements.

140. The only case where the MFN treatment might be *more* advantageous than national treatment is for investment incentives granted to foreign investors only (UNCTAD, 2004). In this case, foreign investors are favoured over domestic companies and the MFN treatment can be more enjoyable than the national treatment.

141. Another difference between the multilateral and regional MFN rule is that at the multilateral level the MFN clause can create a “free rider” situation, by unilaterally extending to all partners any additional rights that are granted to other parties in future agreements. Such a situation has the potential of creating an asymmetrical contractual imbalance between parties. This is not the case in a RTA where the MFN provision has a more limited scope of application.

142. To conclude, it seems that in a regional trade agreement, the MFN principle can have value for investors only if it creates a link with the treatment granted to foreign investors in third-party agreements. Either these other agreements provide an equivalent treatment and the MFN principle acts as a guarantee of non-discrimination among investors receiving a preferential treatment, or this third-party agreement is more advantageous for foreign investors and the MFN rule plays a positive role in extending this better treatment to all investors from signatory countries.

c) *Are liberalising commitments extended to third parties through the MFN rule?*

143. However, there are several obstacles for the MFN clause to operate in the context of RTAs. As pointed out before, RTAs themselves have exceptions to the application of the MFN treatment. REIO exception clauses or NAFTA-inspired reservations can prevent the commitments made in a third-party RTA to be extended to parties of the basic agreement.

144. As GATS-inspired agreements reproduce the multilateral MFN clause found in GATS Article V, they often include a REIO exception where non-parties to the RTA cannot claim the benefits of the preferential treatment accorded at the regional level under the multilateral MFN clause. The result therefore is a risk of discriminatory treatment between the parties of different RTAs signed by the same country. To prevent this from happening, GATS-inspired agreements rely on a review of commitments or further negotiations to extend the more favourable treatment of a new agreement to parties of a prior RTA.

145. In GATS-inspired agreements, the existence of an REIO exception does not *require* discriminatory treatment between members of different RTAs but it does allow for it. The selective liberalisation in GATS-inspired agreements (where countries choose sectors where commitments are taken) can to some extent encourage a different treatment for investors from different RTAs. However, there is no tangible sign of such a practice when looking at Table 13. A detailed analysis at the sub-sector level could say otherwise, but one observes in the Table a certain consistency in the schedules of commitments made by the same country in different RTAs. The only visible trend is that more recent agreements tend to include more commitments.

146. If not through the MFN rule, the extension of more favourable treatment across RTAs can take place in GATS-inspired agreements through a request or a review of commitments. For example, the

Thailand-Australia FTA allows for different mechanisms to incorporate treatment more favourable made in a newer agreement. Article 812 states that “If, after the Agreement enters into force, a Party enters into any agreement on trade in services with a non-Party, it shall consider a request by the other Party for the incorporation in this Agreement of treatment no less favourable than that provided under the former agreement”. A requirement that is however sometimes found for such an extension is that it be made on a reciprocal basis. But nothing prevents a party from unilaterally extending the benefit of new commitments to all parties of other RTAs.

147. Of course, the review of commitments is less interesting for investors than the MFN rule, as additional rights from future third party agreements are not granted automatically. But it should be noted that the review of commitments tends to be different from a renegotiation of the treaty, e.g. by not creating a new agreement that would have to be ratified and to go through the Parliament in each country. A simple exchange of letters between Parties or the decision taken during a joint meeting may be sufficient for commitments to be improved or to be aligned on new concessions made in third-party agreements.

148. In NAFTA-inspired agreements, there is an automatic extension of the more favourable treatment granted in a new agreement through the MFN clause, as there is no REIO exception clause and the general MFN exception mentioned applies only to past agreements. It is the only example of a MFN rule that could be applied to extend the commitments of newer agreements to parties of former RTAs. However, in most of the NAFTA-inspired agreements, countries have listed exceptions in certain sectors. Such sectors will not automatically benefit from the better treatment of future agreements through the MFN clause.

149. Another way of limiting the risk of investment distortions is to negotiate RTAs with the same liberalisation commitments and same reservations (and this is true for both GATS-inspired and NAFTA-inspired agreements). By looking at Tables 12 and 13, it seems to be what most countries have done. The US schedules of commitments for example show very few variations from one agreement to another. However, the situation of countries having negotiated a NAFTA-inspired agreement with a partner and a GATS-inspired agreement with another country can lead to distortions as the coverage of commitments varies between the two kinds of agreements.

150. As far as non-discrimination among investors is concerned, the question of the scope of the MFN clause is an important issue that is beyond the scope of this paper but should be kept in mind. Special privileges or incentives can be granted to an individual investor without falling under the scope of the MFN provision.⁵¹ Some agreements specify that the MFN principle apply “in like circumstances” but even without such a mention, international law has recognised the *ejusdem generis* principle according to which a MFN clause can only apply to the same subject matter.⁵² In the context of BITs, different ICSID cases have also brought questions on the scope of application of the MFN principle, in particular if it applies to procedural matters in addition to substantive matters.⁵³ As the exact scope of application of the MFN principle is not always clear, it seems that a cautious approach has been followed in recent RTAs with the different forms of “neutralization” of the MFN rule that we have described.

151. In sum, one may question the *de facto* impact of the most-favoured nation clause in regional trade agreements. It certainly has a value as a principle of non-discrimination among the parties of the agreement when the RTA has a large number of parties. However, while the MFN clause has also the potential to bestow additional benefits on investors and investments that are not specially negotiated by that party, it is

51. UNCTAD (2004).

52. OECD (2005), *International Investment Law: A Changing Landscape*, Chapter V provides a review of the principle and its application.

53. Idem.

unclear that this happens in practice. In GATS-inspired agreements where the MFN rule cannot apply because of the REIO exception clause, the review of commitments offers no guarantee of a non-discriminatory treatment, especially if the agreement asks for reciprocity in the new concessions made. In NAFTA-inspired agreements, the practice so far has been to have very few reservations on MFN treatment as regard to future RTAs, but as noted above newer agreements are generally signed with very similar schedules of commitments. In other words, the scope for MFN benefits is very limited and one can question the potential liberalising effect of RTAs and their capacity to “multilateralise” investment commitments.

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ANNEX 1 – KEY FEATURES OF THE RTAS REVIEWED

A. General contents of recent RTAs

152. Today's RTAs cover diverse policy areas with the purpose of developing the parties' economic potential and growth in a more integrated and complementary way. Their obligations often go beyond the WTO regulatory framework and include issues not traditionally covered by trade agreements such as investment, trade services, competition policy, intellectual property protection, technical cooperation and policy capacity building. The review of the general contents of the 20 RTAs included in the present study leads to the following observations.

- Apart from the preambles and general sections on objectives and purposes, and definitions, the agreements are typically divided into three distinct parts covering (a) trade in goods; (b) trade in investment, services and/or other related issues and (c) implementation and review. Schedules of commitments and special understandings are usually lodged in separate annexes. In some cases, exchanges of letters also clarify the scope of application of the agreements.
- All but two of the agreements contain separate chapters on Investment and Trade in Services. In the case of ASEAN, services and investment disciplines are lodged in two separate "Framework Agreements", the first concluded in 1995,⁵⁴ the second in 1998.⁵⁵ In the case of the Andean Community, the main obligations are contained in two separate Decisions, Decision 291⁵⁶ and Decision 439⁵⁷ respectively adopted in 1991 and 1998.
- The investment and services disciplines are embedded in a wider web of mutually supportive and complementary disciplines. In addition to trade rules for goods, which still remain the core of the agreements, all but 4 contain separate chapters on government procurement and intellectual property, all but 5 contain separate chapters on competition policy and all but 5 contain separate chapters on transparency. Ten agreements also have a chapter on the movement of natural persons or business persons and 7 on environment and labour. New subjects (E-commerce) or forms of cooperation (science and technology, education and media) are also emerging. Corporate responsibility is included in one instance.
- The agreements are based on the trade-in-goods rules developed in the WTO. They all contain binding obligations on market access and non-discrimination, detailed provisions on rules of origin, customs procedures, sanitary and phytosanitary measures and technical barriers to

54. The ASEAN Framework Agreement on Services (AFAS).

55. The Framework Agreement on ASEAN Investment Area (AIA).

56. Decision 291 establishes a Regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties.

57. Decision 439 establishing a General Framework of Principles and Rules and for Liberalizing the Trade in Services in the Andean Community.

trade. Trade remedies and safeguards are also covered in separate chapters in most of the cases.⁵⁸

- On the implementation side, all agreements contain their own special administrative and institutional arrangements to monitor compliance of the obligations and dispute settlement provisions to resolve disputes over the application of the agreement. In the majority of cases dispute settlement provisions also include investor-to-state procedures as regards investment disputes.

B. Key features of investment chapters

153. RTA investment chapters typically include different types of disciplines and associated measures dealing with the subjects of investment liberalisation, investment protection, investment promotion and facilitation and dispute settlement. The review of the investment chapters of the 20 RTAs covered by the present study leads to the following observations. Tables 7, 9A and 10 present the observed features in a schematic form.

Regarding coverage

- All the investment chapters are tri-dimensional in that they provide for, albeit to various degrees, (a) investment liberalisation, (b) investment protection and (c) investment promotion, cooperation and facilitation.
- All agreements (except for those concluded by the EU and the ASEAN Investment Area which follow an FDI based approach) have adopted an “asset-based” definition of investment. The list of assets is also an open one except for Japan-Mexico EPA (which follows an exhaustive closed list). They also cover investment directly or indirectly owned or controlled except for CECA, the ASEAN Investment Agreement and Decision 291 of the Andean Community.
- Only the EFTA agreements reviewed contain umbrella clauses, provisions that place undertakings made by host States vis-à-vis investors under the investment chapter’s protective umbrella.⁵⁹

Regarding liberalisation

- Transparency – which may range from the publication of laws and regulations to procedural transparency – is provided for in all the agreements but, as a general rule, as a horizontal obligation lodged in a separate chapter applicable to the whole RTA. The investment chapters of the EFTA-Korea FTA, India-Singapore CECA and the ASEAN Investment Area include provisions in this area. COMESA or the Andean Community agreements do not contain such provisions.
- All agreements provide for national treatment with respect to establishment and post-establishment – except for COMESA and the EU Agreements which do not cover establishment. EFTA agreements and the New Zealand-Singapore CERTA excludes Mode 3 delivery of services from this obligation. In TAFTA, the National Treatment obligation at the

58. Except in the case of Japan-Singapore EPA, EFTA-Korea and EU-Jordan.

59. See “*Interpretation of Umbrella Clauses in Investment Agreements*”, OECD Working Papers on International Investment, 2006/3.

establishment phase applies to covered “direct” investment and investments other than Mode 3; at the post-establishment to all investments other than Mode 3. In Japan-Malaysia FTA, the National Treatment obligation in the Investment chapter does not apply to the establishment, acquisition and expansion of portfolio investments. The ASEAN Investment Agreement only applies to five listed sectors and incidental services.⁶⁰

- Similarly all agreements provide for MFN treatment, except CECA, Japan-Singapore FTA (concerning establishment), Korea-Singapore and the Andean Pact. TAFTA, however, has an unqualified coverage of MFN treatment as it applies across the board, including to Mode 3.
- Obligations on performance requirements are absent from the EU and EFTA agreements, the New-Zealand-Singapore CERTA, the ASEAN Investment Area and COMESA. The NAFTA-based agreements have “TRIMS plus” obligations.
- Obligations on key personnel (Senior Management and Boards of Directors) are also absent from Japan-Singapore EPA, TAFTA, EC-Chile Agreement, New-Zealand-Singapore FTA, ASEAN, COMESA and the Andean Pact. The investment chapter in EFTA agreements and Japan-Malaysia EPA also include provisions on the temporary movement of business or certain other natural persons, as do Japan-Singapore EPA, Korea-Singapore FTA, TAFTA, New-Zealand-Singapore CERTA and India-Singapore CECA but in a separate chapter.
- All agreements except COMESA provide for country exceptions for non-conforming measures to the investment chapters. The scheduling of these commitments follows a negative list approach in all cases except for India’s commitments under India-Singapore CECA and the EC- Chile Agreement which follow a positive list approach.
- Economic integration: Except for the EC-Jordan and EU-Chile agreements, all the others do not contain a special regional integration clause.
- Horizontal exceptions, often lodged in separate chapters, relating to the protection of essential security interests or taxation is a common feature of all agreements.
- General exceptions based on GATT Article XX and/or GATS Article XIV provisions are also provided for except for COMESA and the Andean Community Decision 291.
- Some agreements (AUSFTA, CAFTA-DR, US-Morocco FTA, CECA) also maintain separate provisions in separate chapters (except for CECA) on disclosure of information.
- Most of the reviewed agreements (except CAFTA-DR, US-Morocco FTA, COMESA, Andean Community) contain balance of payments safeguards to deal with BOP difficulties and/or temporary safeguard measures for addressing serious difficulties for the operation of monetary and exchange rate policy. These provisions generally share the features of temporality, non-discrimination, necessity, phase out, notification and consistency with IMF Articles. In addition, CAFTA-DR, US-Morocco, Japan-Malaysia Japan-Mexico and Japan-Singapore EPAs, Chile-Korea FTA, EFTA-Korea FTA and Korea-Singapore have included prudential derogation provisions that deal with more precision and in detailed situations relating to the need for preserving the parties’ financial and monetary stability and integrity.

60. Manufacturing, agriculture, fishery, forestry, mining and quarrying.

- The chapter on Investment in a majority of agreements contains a clause on *Denial of Benefits* that denies the benefits of the agreement to investors not conducting substantial business operations in the territory of a party and certain other circumstances.

Regarding Protection

- All but the EU agreements and the Andean Decisions give guarantees on both direct and indirect expropriation. In the New-Zealand Singapore Agreement, the protection and expropriation obligations are subject to MFN and National Treatment.
- Free transfers are provided for by all agreements studied.
- Clauses on standard treatment or minimum standard of treatment are found, on the other hand, in only five agreements (Australia-USA FTA, CAFTA-DR, US-Morocco FTA, Japan-Mexico EPA and Korea-Singapore FTA). The Japan-Singapore FTA does not contain a general treatment clause.
- As indicated above, umbrella clauses have been found only in EFTA-based agreements.

Regarding Dispute Settlement

- All the agreements reviewed except AUSFTA, the EC agreements, COMESA and the Andean Community provisions contain investor-to-state dispute settlement procedures. Prior consent is given in a majority of these cases except for the EFTA-Singapore FTA⁶¹ and New Zealand-Singapore Agreement. Transparency of awards or proceedings, amicus curiae submissions and consolidation of claims are only provided for in a handful of agreements, namely the US-modelled agreements.

Investment promotion and facilitation

- Investment promotion and facilitation provisions are clearly on an upward trend, particularly in Japan EPAs. These provisions may be of the cooperation mechanisms set up for implementing the agreement. In some more recent agreements (EFTA-Singapore and EFTA-Korea Agreements, TAFTA, Japan-Malaysia and Japan-Singapore EPAs), these issues are singled out in the investment chapters or separate chapters (EC agreements) for further action.

61. Article 48(3) provides that “A Party may conclude contractual agreements with investors of another Party giving its unconditional and irrevocable consent to the submission of all or certain types of disputes to international conciliation or arbitration in accordance with paragraph 2 above”.

C. Key features of services chapters

Tables 8, 9B and 10 list the investment disciplines and associated measures that can be found in the 20 agreements reviewed. Two different approaches are taken. RTAs based on the GATS provide only for cross-border trade-in-services and excludes investment in services unless otherwise specified. From the sampled agreements it can be particularly observed that:

Market Access:

- All the agreements make market access commitments in the chapter on services (except for EC-Jordan which aims for future liberalisation of services). The commitments may be in the form of a positive list or a negative list depending on whether the agreements subscribe to the GATS approach or are NAFTA based. In the case of some NAFTA based agreements which distinguish between Investment in Services (contained in the Investment chapter) and Cross-Border Trade in Services the provisions on Market Access are contained in the Chapter on Cross-Border Trade in Services. However, as elaborated in part III of the study, these provisions also apply to Investment in Services.

National Treatment:

- All the agreements also provide for pre and post-establishment national treatment . The commitments again can be in the form of positive or negative lists.

Most Favoured Nation Treatment:

- Except for EC-Chile, New Zealand-Singapore, Japan-Singapore, India-Singapore, Korea-Chile, all other agreements provide for pre and post establishment MFN.

Temporary Movement of Natural Persons:

- All the agreements except US-Australia, US-Morocco and CAFTA-DR provide for movement of natural persons either in the chapter on trade in services or in a different chapter. The EC-Chile contains a review provision to improve the liberalisation commitments on Mode 4. In the EC-Jordan agreement, Mode 4 is to be liberalised in the course of future negotiations.

Domestic Regulation:

- The Domestic regulation clause requires parties to apply measures relating to services in a reasonable, objective and impartial manner. All agreements except for Japan-Mexico, Chile-Korea and the Andean Community decision provide for a clause on domestic regulation.

Recognition

- All the agreements provide for working towards the recognition of qualifications of service providers who are nationals of other parties. Some of the agreements provide for a specific time frame within which the parties shall work towards recognition. For example, the EFTA-Singapore agreement provides that within three years rules shall be framed for mutual recognition.

Monopoly Service Providers:

- GATS based agreements like Japan-Singapore and Japan-Malaysia, EFTA-Korea, EFTA-Singapore, New Zealand-Singapore and India-Singapore generally address monopoly service providers. The Korea-Singapore FTA's CBTS chapter includes this provision. The clause on Monopoly service providers requires parties to prevent any abuse of monopolies.

Horizontal Exceptions:

- All the agreements analysed provide for General and Security exceptions either in the chapter on services or in an independent chapter. The agreements based on a NAFTA approach do not provide for general exceptions dealing with investment but some do provide General Exceptions for Cross-Border Trade in Services by referring to Article XIV of GATS.

Country Exceptions:

- Depending on whether they are based on the GATS approach (except for Andean Community and Trans-Pacific SEP) or the NAFTA approach, agreements use positive or negative lists.

Clause for further liberalisation:

- Korea-Singapore, TAFTA, EC-Jordan, India-Singapore, ASEAN Framework Agreement and the Andean Community Decision 439 contain a clause for further liberalisation.

Transparency:

- All the agreements, except for EC-Jordan agreement have either an independent clause on transparency in the chapter on services or elsewhere in the agreement.

Denial of Benefits:

- All agreements, except for EC-Chile and EC-Jordan agreements, EFTA agreements with Singapore and Korea, New Zealand-Singapore and the Andean Community decision 439, contain this provision a Denial of Benefits clause. This clause extends preferential treatment to all legal persons conducting substantial business operations in the territory of a party.

Services Promotion and Facilitation:

- Almost all the agreements establish the necessary institutional mechanisms for aiding in the implementation of the agreement, review of commitments and future negotiations on the commitments made under the agreements.

Business Practices:

- For ensuring fair competition GATS has the Business Practices clause (Article IX). This clause seeks to remedy the inequities that maybe caused due to monopolies and unfair competition. Only Japan-Singapore, EFTA Korea and India-Singapore provide for an independent clause on Business Practices, based on GATS Article IX.

Transfers:

- On the protection front most agreements allow for free transfers in the chapter on services. Except for Japan-Mexico, EFTA-Singapore and Korea-Chile all agreements have clauses relating to transfers. Some of the GATS based agreements refer only to transfers relating to “current transactions” in accordance with GATS, while NAFTA based agreements allow all transfers related to cross border supply of services and also list exceptions to the rule.

Expropriation:

- Only the India-Singapore agreement provides for provision on expropriation in the services chapter. The services chapter in Article 7.24 provides for services investment linkage. This article lists provisions of the investment chapter which apply mutatis mutandis to the services chapter. This includes expropriation of a commercial presence.

Table 7. Substantive provisions in Investment and related chapters of recent RTAs – Part 1

Agreement	Date of Agreement	Definitions/Scope/Coverage				Umbrella clause	Treatment of Investment						Senior Management/ Key Personnel	Temporary Movement of Business/ Natural Persons	Investment Protection				
							Establishment			Post Establishment									
		Asset based		Investment			NT	MFN	Performance requirements	NT	MFN	Performance requirements			Standard of treatment/ Fair and Equitable	Transfers	Compensation for losses	Expropriation	
		Open list	Closed list	Direct	Indirect													Direct	Indirect
North-North																			
Australia-USA	1 Jan. 2005	+		+	+		+	+	+	+	+	+	+		+	+	+	+	+
North-South																			
NAFTA	1 Jan. 2004		+	+	+		+	+	+	+	+	+	+	±	+	+		+	+
CAFTA-DR	1 July 2006	+		+	+		+	+	+	+	+	+	+		+	+	+	+	+
US-Morocco	1 July 2006	+		+	+		+	+	+	+	+	+	+		+	+	+	+	+
Japan-Malaysia	13 July 2006	+		+	+		+(except portfolio investments	+	+	+(Portfolio investment is excluded from establishment, acquisition, expansion of investment)	+	+	+	+	+	+	+	+	+
Japan-Mexico	1 Jan. 2006		+	+	+		+	+	+	+	+	+	+		+	+	+	+	+
Japan-Singapore	1 May 2006	+		+	+		+		+	+	+		±	+	+	+	+	+	+
TAFTA	1 Jan. 2005	+		+	+		+(Only for covered direct investment and other than Mode 3)	+		+(Other than Mode 3)	+			±	+	+	+	+	+
EC-Chile	1 Apr. 2005						+												
EC-Jordan	1 Feb. 2003							+		+	+		+			±			
EFTA-Singapore	1 Jan. 2003	+		+	+	+	+(Other than mode 3)	+(Other than mode 3)		+(Other than mode 3)	+(Other than mode 3)		+	+	+	+		+	+

Agreement	Date of Agreement	Definitions/Scope/Coverage				Umbrella clause	Treatment of Investment						Senior Management/ Key Personnel	Temporary Movement of Business/ Natural Persons	Investment Protection				
		Asset based		Investment			Establishment			Post Establishment					Standard of treatment/ Fair and Equitable	Transfers	Compensation for losses	Expropriation	
		Open list	Closed list	Direct	Indirect		NT	MFN	Performance requirements	NT	MFN	Performance requirements						Direct	Indirect
EFTA-Korea ^a	1 Sept. 2006	+		+	+	+	+	(Other than mode 3)	+	(Other than mode 3)		+	(Other than mode 3)	+	+	+	+	+	+
Trans-Pacific SEP	1 May 2006																		
New Zealand-Singapore	1 Jan. 2001	+		+	+		+	(Other than mode 3)	+	(Other than mode 3)		+	(Other than mode 3)	+	(Other than mode 3)		+		
South-South																			
Chile - Korea	1 Apr. 2004	+		+	+		+		+	+	+	+	+	+		+	+	+	+
Korea-Singapore	2 March 2006	+		+	+		+		+	+		+	+	±	+	+	+	+	+
India-Singapore CECA	1 Aug. 2005	+		+			+		+	+		+	+	±		+	+	+	+
ASEAN Investment Area ^b	1998			+			+	+							+	+	+	+	+
COMESA	8 Dec. 1994		+					+			+				+	+		+	+
Andean Community (Decisions 291 & 292)	1 Jan. 1991	+		+			+									+			

a. Separate Agreement on investment, referred to in FTA, between Korea, Iceland, Liechtenstein and Switzerland.

b. Protection of Investment contained in ASEAN Agreement for Promotion and Protection of Investment, 1987. Article 12 of the AIA provides that *"Member States affirm their existing rights and obligations under the 1987 ASEAN Agreement for the Promotion and Protection of Investments and its 1996 Protocol."*

Key:

1. + Provisions contained in the Investment Chapter
2. ± provisions are contained in a different Chapter

Table 7. Substantive provisions in Investment and other related chapters of recent RTAs – Part 2

Agreement	Trans- parency	Exceptions					Future Liberaliz- ation	Balance of Payments/ Safeguards	Denial of Benefits	Disclo- sure of Infor- mation	Tax- ation	Environ- ment	Investment Promotion and Cooperation		
		EIA	General Excep- tions	Security Interests	Pruden- tial mea- sures	Country excep- tions							Invest- ment Promo- tion	Co-opera- tion Mechan- isms	Review
North-North															
Australia- USA	±			±		+			+	±	±	+		±	±
North-South															
NAFTA	±			±		±			+		±	+		±	±
CAFTA-DR	±			±		+			+	±	±	+			
US- Morocco	±			±		+			+	±	±	+		±	±
Japan-Malaysia			+	+	+	+		+	+		+	+	+	+	±
Japan- Mexico	±			±		+		+	+		±	+			
Japan-Singapore			+	±	+	+		+			+			+	+
TAFTA	±	+	±	±	±	+		±	+		±		+	±	+
EC-Chile	±	±	+	±		+	+	±			±		±	+	
EC-Jordan	±	±	+	±		+	+	±			±		±	±	
EFTA-Singapore	±	±	+	±		+		±			+		+	±	±
EFTA-Korea	+	±	+		+	+		+			+	+		+	+
Trans-Pacific SEP															
New Zealand- Singapore	±		±	±		+		+		±	±				±
South-South															
Chile-Korea	±			±		+	+	+	+		±	+		±	
Korea-Singapore	±		±	±		+	+	+	+	+	±	+	±	±	±
India-Singapore CECA	+		+	+		+		+		+					+
ASEAN Investment Area	+		+			+									
COMESA															
Andean Community (Decisions 291 & 292)						+									

Key:1. + Provisions contained in the Investment Chapter

2. ± means that the stated provisions are contained in a different Chapter

Table 8. Substantive provisions in Services and related chapters – Part 1

Agreements	Date of entry into force	Definitions/Scope/Coverage		Umbrella Clause	Treatment of Services								Temporary Move-ment of Business Persons/ Professionals	Recog-nition	Protection of Services		
		Mode 3/ Com-mercial Presence	Invest-ment Chapter Covers Mode3/ Com-mercial Presence		Establishment				Post Establishment						Transfer of Pay-ments	Expropriation	
					Market Access	NT	MFN	Perfor-mance Require-ments	Market Access	NT	MFN	Perfor-mance Require-ments				Direct	Indirect
North-North																	
Australia-USA*	1 Jan. 2005		+		+	+	+		+	+	+			+	+		
North-South																	
NAFTA**	1 Jan. 2004		+			+	+			+	+		±	+			
CAFTA-DR*	1 July 2006		+		+	+	+		+	+	+			+	+		
US-Morocco*	1 Jan. 2006		+		+	+	+		+	+	+			+	+		
Japan-Malaysia	13 July 2006	+	+		+	+	+		+	+	+			+	+		
Japan-Mexico**	1 Apr. 2005		+			+	+			+	+		±	+	+		
Japan-Singapore	30 Nov. 2002	+	+		+	+			+	+			±	±	+		
TAFTA	1 Jan. 2005	+			+	+			+	+			±	+	+		
EC-Chile	1 March 2005	+			+	+			+	+			+(future lib)	+	±		
EC-Jordan	1 May 2002														±		
EFTA-Singapore	1 Jan. 2003	+			+	+	+		+	+	+		+	+			
EFTA-Korea	1 Sept. 2006	+			+	+	+		+	+	+		+	+	+		
Trans-Pacific SEP	1 May 2006	+			+	+	+		+	+	+		±	+	+		
New Zealand-Singapore	1 Jan. 2001	+			+	+			+	+			±	+			

Agreements	Date of entry into force	Definitions/Scope/Coverage		Umbrella Clause	Treatment of Services								Temporary Movement of Business Persons/ Professionals	Recognition	Protection of Services		
		Mode 3/ Commercial Presence	Investment Chapter Covers Mode3/ Commercial Presence		Establishment				Post Establishment						Transfer of Payments	Expropriation	
					Market Access	NT	MFN	Performance Requirements	Market Access	NT	MFN	Performance Requirements				Direct	Indirect
South-South																	
Chile-Korea**	1 Apr. 2004		+		+	+	+		+	+	+		±	+	+		
Korea-Singapore	2 March 2006		+		+	+			+	+				+	+		
India-Singapore CECA	1 Aug. 2005	+			+	+		+	+	+		+	+	+	+	+	
ASEAN Framework Agreement on Services	1995	+			+	+	+		+		+			+			
COMESA	8 Dec. 1994																
Andean Community (Decision 439)	25 May 1998	+			+	+	+		+	+	+		+	+	+		

Key:

1. + Provisions contained in the Services Chapter
2. ± provisions are contained in a different Chapter
3. * Contains chapter on Cross Border Trade in Services. Only provisions on Market Access, Domestic Regulation and Transparency in Developing and Applying Regulation apply to Investment in Services.
4. ** Contains chapter on Cross Border Trade in Services which does not apply to Investment in Services

Table 8. Substantive provisions in Services and related chapters – Part 2

Agreement	Exceptions					Clause for further Liberalization	Balance of Payments/ Safe-guards	Financial Services	Tele-com	Mono-poly Ser-vice Pro-viders	Domes-tic Regu-lation	Trans-parency	Tax-ation	Denial of Bene-fits	Disclo-sure of Infor-mation	Services promotion and facilitation		Business Practices
	General Excep-tions	Security Interests	Pruden-tial mea-sures	Country Exceptions												Co-operation Mecha-nisms	Review of Commit-ments	
				+ve List	-ve List													
North-North																		
Australia-USA	±	±			+			±	±		+	+	±	+		±	±	
North-South																		
NAFTA	±	±					±						±		±	±	±	
CAFTA-DR		±			+			±	±		+	+	±	+		±	±	
US-Morocco	±	±			+			±	±		+	+	±	+		±	±	
Japan-Malaysia	±	±		+		+	+			+	+	+	±	+	±		+	
Japan - Mexico	±	±			+		±	±	+			±	±	+		+	+	
Japan-Singapore	+	±		+			+	+	+	+	+	±	±	+		±	±	+
TAFTA	±	±	±	+		+	±	+	+			±	±	+		+	+	
EC-Chile	+	±		+			±	±	+		+	+	±			±	+	
EC-Jordan	+					±	±						±			±		
EFTA-Singapore	+	+		+		+	+	+	+	+	+		±			±	+	
EFTA-Korea	+	+		+			+	±	+ ¹	+		+				±	+	+
Trans-Pacific SEP	±	±			+		±		+		+	+	±	+			+	
New Zealand-Singapore	±	±		+			±	+	+	+	+	±	±		±	±	±	

1. Applies only to interstate disputes.

Agreement	Exceptions					Clause for further Liberalization	Balance of Payments/ Safeguards	Financial Services	Telecom	Mono-poly Service Providers	Domestic Regulation	Transparency	Taxation	Denial of Benefits	Disclo-sure of Infor-mation	Services promotion and facilitation		Business Practices
	General Exceptions	Security Interests	Pruden-tial mea-sures	Country Exceptions												Co-operation Mechanisms	Review of Commitments	
				+ve List	–ve List													
South-South																		
Chile - Korea	±	±			+		±		±			±	±	+		±		
Korea-Singapore	±	±			+		±	±	±	+	+3	±	±	+	+(Financial services)	±	±	
India-Singapore CECA	+	+		+		+	+	+	+	+	+	+		+	+	±	±	+
ASEAN Framework Agreement on Services				+		+			+					+				
COMESA																		
Andean Community (Decision 439)	+	+			+	+	+	+			+	+						

Key:

1. + Provisions contained in the Services Chapter
2. ± provisions are contained in a different Chapter
3. Also applies to investments covered by the Investment Chapter.

Table 9A. Country Exceptions/Commitments in Investment Chapter

Agreement	Date of Entry into force	Establishment						Post Establishment					
		Markets Access		National Treatment		Most favoured nation treatment		Market Access		National Treatment		Most Favoured Nation	
		Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List
North-North													
Australia-USA	1 Jan. 2005				+		+				+		+
North-South													
NAFTA	1 Jan. 2004				+		+				+		+
CAFTA-DR	1 July 2006				+		+				+		+
US-Morocco	1 July 2006				+		+				+		+
Japan-Malaysia	13 July 2006				+		+				+		+
Japan-Mexico	1 Jan. 2006				+		+				+		+
Japan-Singapore	1 May 2006				+						+		
TAFTA	1 Jan. 2005			+			+			+			+
EC-Chile	1 Apr. 2005			+									
EC-Jordan	1 Feb. 2003						+			+			+
EFTA-Singapore	1 Jan. 2003				+		+				+		+
EFTA-Korea	1 Sept. 2006				+		+				+		+
Trans-Pacific SEP	1 May. 2006												
New Zealand-Singapore	1 Jan. 2001				+		+				+		+

Agreement	Date of Entry into force	Establishment						Post Establishment					
		Markets Access		National Treatment		Most favoured nation treatment		Market Access		National Treatment		Most Favoured Nation	
		Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List
South-South													
Chile-Korea	1 Apr. 2004				+		+				+		+
Korea-Singapore	2 March 2006				+						+		
India-Singapore CECA	1 Aug. 2005			+	+					+			
ASEAN Investment Area	1998				+		+				+		+
COMESA	8 Dec. 1994												
Andean Community (Decisions 291 & 292)	1 Jan. 1991				+						+		

Table 9B. Country Exceptions/Commitments in Services Chapter

Agreement	Date of Entry into force	Establishment						Post Establishment					
		Markets Access		National Treatment		Most favoured nation treatment		Market Access		National Treatment		Most Favoured Nation	
		Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List	Positive List	Negative List
Australia-USA	1 Jan. 2005		+		+		+		+		+		+
NAFTA					+		+				+		+
CAFTA-DR			+		+		+		+		+		+
US-Morocco	1 Jan. 2006		+		+		+		+		+		+
Japan-Malaysia	13 July 2006	+		+			+	+		+			+
Japan-Mexico	1 Apr. 2005				+		+				+		+
Japan-Singapore	30 Nov. 2002	+		+				+		+			
TAFTA	1 Jan. 2005	+		+				+		+			
EC-Chile	1 Feb. 2003	+		+				+		+			
EC-Jordan	1 Jan. 2005												
EFTA-Singapore	1 Jan. 2003	+		+			+	+		+			+
EFTA-Korea	1 Sept. 2006	+		+			+	+		+			+
Trans-Pacific SEP	1 May 2006		+		+		+		+		+		+
New Zealand-Singapore	1 Jan. 2001	+		+						+		+	
Chile Korea	1 Apr. 2004				+						+		
Korea-Singapore	2 March 2006		+		+			=	+		+		
India-Singapore CECA	1 Aug. 2005	+		+				+		+			
ASEAN Framework Agreement on Services	1995	+					+	+					+
COMESA	8 Dec. 1994												
Andean Community Decision 1998	28 May 1998		+		+		+		+		+		+

Table 10. Dispute Settlement with respect to Investments

	State/ State	Investor/ State	Specific Investor/ State provisions															
			Claims by an investor of a Party on its own behalf and on behalf of an Enterprise	Prior Consent	Waivers of initiating/ continuing a proceeding before local courts/ Non- Exhaustion of local remedies	Participa- tion by the non- disputing Party	Transpa- rency (access to filing, minutes, transcript- ions and deci- sions)	Open hearings	Protec- tion of sensitive informa- tion	Amicus curiae submis- sions	Monetary awards and no punitive damages	Comment period before effective- ness of awards/ delay of enforce- ment	Enforcement	Interim measures	Experts	Consolidation	Applicable law	Appeals
North-North																		
AUSFTA	±						±		±	±	±							
North-South																		
NAFTA	±	+	+	+		+	+		+	+	+	+	+	+	+	+	+	
CAFTA- DR	±	+	+	+		+	+	+	+	+	+	+	+	+	+	+	+	
US- Morocco	±	+	+	+		+		+	+		+	+	+	+	+	+	+	
Japan- Malaysia	±	+		+	(for authorised investments)		Article 85 (3) allows non- disputing Party to submit interpretation of the Agreement to arbitral tribunal.				(it provides monetary award but there is no prohibition clause for punitive damage)		+(Article 85 (15)	+				
Japan- Mexico	±	+	+	+		+	+		+		+		+	+	+	+	+	
Japan Singapore	±	+		+									+	+				
TAFTA	±	+															+	
EC-Chile	+															+		
EC-Jordan																		
EFTA- Singapore ^a	±	+							±			±	±		±			
EFTA-	±	+		+								±	±	+	±			

	State/ State	Investor/ State	Specific Investor/ State provisions															
			Claims by an investor of a Party on its own behalf and on behalf of an Enterprise	Prior Consent	Waivers of initiating/ continuing a proceeding before local courts/ Non- Exhaustion of local remedies	Participa- tion by the non- disputing Party	Transpa- rency (access to filing, minutes, transcript- tions and deci- sions)	Open hearings	Protec-tion of sensitive informa- tion	<i>Amicus curiae</i> submis- sions	Monetary awards and no punitive damages	Comment period before effective- ness of awards/ delay of enforce- ment	Enforcement	Interim measures	Experts	Consolidation	Applicable law	Appeals
Korea																		

COMESA Investment (2006) / IPR																				
	State/ State	Investor/ State	Specific Investor/ State provisions																	
			Claims by an investor of a Party on its own behalf and on behalf of an Enterprise	Prior Consent	Waivers of initiating/ continuing a proceeding before local courts/ Non- Exhaustion of local remedies	Participa- tion by the non- disputing Party	Transpa- rency (access to filing, minutes, transcript- ions and deci- sions)	Open hearings	Protec- tion of sensitive informa- tion	<i>Amicus curiae</i> submis- sions	Monetary awards and no punitive damages	Comment period before effective- ness of awards/ delay of enforce- ment	Enforcement	Interim measures	Experts	Consolidation	Applicable law	Appeals		
Trans- Pacific SEP																				
New Zealand- Singapore ^b	±	+							±						±					
South-South																				
Chile- Korea					±	+	+	+						+	+	+	+	+	+	
Korea-Singapore					±	+	+	+						+						
India-Singapore CECA					±	+		+			±			±	±	+				
ASEAN Investment Area					+	+ ^c		+												± ^d
COMESA					±															
Andean Community (Decisions 291 & 298)					±		1 Jan. 1991													

Key:

1. + Provisions contained in the Investment Chapter
2. ± provisions are contained in a different Chapter

Notes:

- a. In the EFTA-Singapore agreement the provisions marked by “±” symbol apply only to State/State dispute.
- b. In the New Zealand-Singapore agreement the provisions marked by “±” symbol apply only to State/State dispute.
- c. Obligation contained in the 1987 ASEAN Agreement for the Promotion and Protection of Investments.
- d. Applies only to interstate disputes.

Table 11. MFN Treatment Provisions in Selected Regional Trade Agreements

Agreements	Chapter	MFN treatment?	Reservations on MFN treatment	REIO exception clause?	Specific MFN reservation regarding third party agreements?	Request for incorporation of treatment no less favourable in a third party agreement	Review of commitments foreseen in the agreement with the aim of improving overall commitments?
NAFTA and NAFTA-inspired agreements							
AUSFTA	Investment	Yes	Negative list	No	Reservation for all past agreements and in 3 sectors for future agreements	No	No
NAFTA	Investment	Yes	Negative list	No	Reservation for all past agreements and in 4 sectors for future agreements	No	No
US-CAFTA-DR	Investment	Yes	Negative list	No	Reservation for all past agreements and in 4 sectors for future agreements (US, Dominican Republic). Only vis-à-vis the US and Dominican Republic for the other countries.	No	No
US-Morocco	Investment	Yes	Negative list	No	Reservation for all past agreements and in 3 sectors for future agreements	No	No
Japan-Mexico	Investment	Yes	Negative list	No	Reservation for all past agreements and in 3 sectors for future agreements	No	No
Korea-Chile	Investment	Yes	Negative list	Yes	-	Yes	Every two years
Korea-Singapore	Investment	No	-	-	-	Yes	Annually
GATS-inspired agreements							
Japan-Singapore	Investment	No	-	-	-	Yes	No
	Services	No	-	-	-	Yes	No
Japan-Malaysia	Investment	Yes	Negative list	No	Malaysia has a reservation with respect to preferential treatment granted in any ASEAN agreement	-	No
	Services	Yes	Negative list	No	No	Yes	Within five years
TAFTA	Investment	Yes	None	No	No	Yes	No
	Services	No	-	-	-	Yes	Within three years
EFTA-Singapore	Investment	Yes	Negative list	Yes	-	Yes	Every two years
	Services	Yes	Negative list	Yes	-	Yes	Every two years
EFTA-Korea	Investment	Yes	Negative list	Yes	-	Yes	Within three years and in regular intervals thereafter
	Services	Yes	Negative list	Yes	-	Yes	Every two years
Trans-Pacific SEP	Services	Yes	Negative list	No	Chile, New Zealand and Singapore have a reservation for all past agreements and in 3 sectors for future agreements	-	Within two years and every three years thereafter
New Zealand-Singapore CEP	Investment	Yes	Negative list	No	No	-	Every two years
	Services	No	-	-	-	No	Every two years
India-Singapore CECA	Investment	No	-	-	-	Yes	Every two years
	Services	No	-	-	-	Yes	Every two years

ANNEX 2 - ANALYSIS OF THE SCHEDULES OF COMMITMENTS: METHODOLOGY, CAVEATS AND SUMMARY TABLES

This annex explains the methodology used in Part II to assess the degree of liberalisation achieved in the RTAs and to make a comparison between the schedules of commitments contained in RTAs and GATS schedules.

A. Methodology

The analysis has been conducted on 10 of the agreements listed in Part I: AUSFTA, NAFTA, US-Morocco, Japan-Mexico, Japan-Singapore, Thailand-Australia, EC-Chile, EFTA-Singapore, Chile-Korea, and India-Singapore. To illustrate the commitments from EFTA countries, the schedule of Switzerland has been used in the analysis of the agreement between EFTA states and Singapore.

The assessment of liberalisation commitments focuses on services as it is in the services sector that the main obstacles to FDI remain. The analysis of the schedules of commitments shows that most reservations, exceptions, non-conforming measures listed deal with services. There are very few entries on manufacturing goods in the schedules. There are sometimes reservations in the primary sector (in particular mining and fishing activities) but the vast majority are in services sectors. This is not surprising since FDI in services accounts for 60% of total FDI flows; and this share of total FDI flows is considerably lower than the 80 to 90 per cent of total reservations or limitations in the schedules taken by services.

There are several difficulties involved in analysing schedules of commitments on investment in services and making comparisons among different trade agreements (and in particular between RTA schedules and GATS schedules for Mode 3):

- First, there is no agreed and official classification of services sectors and countries can schedule their liberalisation commitments according to their own definitions of services sectors. During the Uruguay Round which established the GATS, a services sectoral classification list (GNS_W/120) was widely used and is reproduced in Annex 3. WTO members were free to use this classification or the UN Central Product Classification (CPC)⁶² to which the GATS list refers (or their own classification). Many RTAs – especially when they follow a GATS approach – list commitments using W/120.
- Liberalisation commitments are presented differently in NAFTA-inspired agreements (with a negative list of reservations) and GATS-inspired agreements (with a positive list of sectors where commitments are taken and a list of limitations that apply in these sectors). There are also several models and concepts involved in “liberalising” investment: national treatment (pre- and post-entry), most-favoured-nation treatment (pre- and post-entry), right of establishment, market access. Foreign investors have access to domestic markets and benefit from non-discriminatory treatment according to different models of liberalisation.

62. The CPC has been updated twice, in 1997 and 2002, and CPC 2.0 is foreseen for 2007.

- There are also several issues with the definition of national treatment, MFN and market access. In the NAFTA approach, the two principles are national treatment and MFN and they are granted pre- and post-establishment. Things become more complicated in GATS and in agreements that reproduce the GATS approach for investment in services. In the GATS, there is no distinction between pre- and post-establishment and it is not always clear whether limitations listed as “market access” are not also, *de facto*, limitations on “national treatment”.
- Lastly, there is an intrinsic difference between a RTA covering investment in services and a multilateral agreement on trade in services covering Mode 3 (the GATS). For several of the RTAs analysed, their objective is to liberalise all forms of investment between two countries, while the GATS is a multilateral agreement on trade in services including supply through commercial presence (Mode 3). Also the GATS allows countries to take varying degrees of commitments. RTA schedules and the GATS schedules should be compared bearing in mind this difference. There is also a difference in chronology as the GATS was negotiated in 1994 and the agreements analysed are more recent (with the exception of NAFTA) and therefore may reflect policy developments towards investment in services.

An early methodology to quantitatively assess GATS schedules by creating an index (Hoekman, 1995) cannot be extended to analyse investment commitments in RTAs where liberalisation commitments take various forms. An index of the extensiveness of commitments would not be robust enough when calculated in the context of negative lists of reservations in NAFTA-inspired agreements and GATS-inspired schedules in other agreements. The comparison between a GATS index and an index of commitments in RTAs could also be misleading.

Here therefore a simpler methodology has been developed based on a graphical and numerical analysis at a less disaggregated level (the 12 services sectors in W/120).⁶³ The W/120 classification covers all sectors relevant for investment, although their economic importance may vary. The W/210 classification has often been criticised for inadequately reflecting the reality of trade in services (for example regarding environmental services or energy services). An analysis at a more aggregated level has the advantage of limiting the distortions inherent to classification issues.

Tables 12 and 13 summarise the results of the analysis. They provide a “mapping” of the schedules of commitments in the RTAs with respect to the three disciplines usually found in the agreements: national treatment, MFN treatment and market access commitments. The first column of the table reports the reservations that apply to all sectors or “horizontal limitations” in GATS language (this is why the column is tagged with “H”). The subsequent columns describe the 12 sectors of the W/120 classification. Box 2 details how the schedules were analysed to construct the tables.

For each sector, the tables report two kinds of information:

- First, the degree of commitments in the sector is indicated by the colour (or pattern) of the cell. The typology is the following:
 - **No commitments in the sector or sector excluded** (dark cell with black hatched lines).

63. Roy *et al.* (2006) analyse commitments undertaken by 29 WTO Members under mode 1 and mode 3 in 28 RTAs at the level of the 152 sub-sectors (for mode 3) of the W/120 Classification List. For each country and each RTA, they report the proportion of sub-sectors where commitments are made. They also indicate if in comparison to GATS schedules and GATS offers the commitments are further improved in the regional agreement.

- ***Commitments in a limited number of sub-sectors***: it means that the number of sub-sectors liberalized is less than 75% of the sub-sectors where commitments can potentially be made (dark grey cell).
- ***Commitments in most of the sector***: more than 75% of the sub-sectors where commitments can potentially be made are scheduled. Only a few sub-sectors have been excluded (light grey lattice pattern)
- ***Commitments across the entire sector*** describes the situation where there are commitments in the totality of the sector (no sub-sector is excluded). If no figure appears in the cell, there are no limitations at all, *i.e.* full non-discriminatory treatment applies (white cells).
- The second information reported in the table is the number of limitations in each sector. It is indicated by a figure in the middle of the cell. There is no figure when no limitations are listed in the schedule.

Box 2. Specific rules that were followed when analysing the schedules and counting the limitations

- Only limitations or reservations on investment in services are taken into account. For NAFTA-inspired agreements, the services sectors were identified on the basis of their description in the relevant annex. Reservations for “all sectors” are reported when they are relevant for investment in services. For GATS-like schedules of commitments, only information on Mode 3 has been used (including for horizontal limitations).
- Only limitations to national treatment, MFN treatment and market access are reported. The definition used is the one from the agreement (and can therefore be different according to the RTA analysed).
- Non-conforming measures that are phased-out (NAFTA-inspired agreements) are not counted and pre-commitments in GATS-inspired schedules are included (we look at the degree of liberalisation achieved at the end of the transitory periods).
- There are commitments in the totality of the sector (blank cells) if no reservation is listed in the case of a negative list or if all the sub-sectors of the W/120 classification have commitments in the case of a GATS-inspired schedule.
- The number of limitations tries to reflect the real number of measures that are inconsistent with the disciplines of the agreements but maintained by the parties. When several measures are listed in a same paragraph or a same “entry” in the schedule, they are counted separately. When a non-conforming measure is described through lengthy paragraphs that detail the reservation, it is counted as one. However, the number of limitations is still influenced by the way the schedule is organised (the same measure that applies to several sectors can be counted several times).
- When a sector or sub-sector is listed in the annex on future measures in a NAFTA-inspired agreement and the country can take any measure in the future, it is treated in the same way as an unbound sector in a GATS schedule (absence of commitment).

B. Caveats

This methodology comes with certain caveats. It should be kept in mind that commitments do not reflect the actual level of liberalisation of investment. A country that makes no commitment in a sector can nonetheless allow foreign investment. But it will be without guarantee of non-discriminatory treatment and the country may take any kind of measure in the sector. The schedules may be understood as reflecting the minimal treatment that is guaranteed.

On the other hand, investment may be restricted more than indicated by the schedules of commitments. “Liberalisation” in the context of services is measured through non-discriminatory treatment (national treatment, MFN) and/or the concept of “market access” (as defined in the agreements). For example, a restrictive investment regime can be applied equally to domestic and foreign investors. The analysis is about the schedules of commitments and not the actual level of investment liberalisation (or the implementation of these schedules).

The number of limitations should be interpreted with care, especially when comparing different agreements.⁶⁴ Countries have adopted different approaches in reporting their limitations to national treatment, MFN treatment, or market access. In particular, schedules of commitments that are provided at a disaggregated sectoral level will tend to have a higher number of limitations reported, some of them being reiterated for different sub-sectors. Some double-counting may therefore occur. The number of limitations is also not a very good indicator of how detrimental these limitations are for investment. A limitation can be very general and wide with a potentially high impact on investment. It can also be very specific and not essential. While limitations reported can be real barriers to foreign investment (such as a limitation on the percentage of foreign participation or a citizenship requirement), they can also be clarifications or indications about domestic legislation that does not necessarily represent a barrier to investment.

The number of limitations can also be higher when there are more commitments in the schedule. It can be surprising to see in the tables that there are sometimes more limitations in a RTA than in the GATS schedule but it is important also to consider the number of sub-sectors where commitments are taken. A country can open up to its bilateral partner more sub-sectors while listing additional limitations for these sub-sectors. The number of limitations is thus higher but the schedule has a greater coverage. From the point of view of investors, this situation is better than facing sectors with no commitments or where many sub-sectors are excluded (rather than included with limitations).

Despite these limitations, the advantage of the methodology is to its simplicity and providing a quick snapshot of the level of commitments by looking along the line which adds up the different sectors. It is also easy to make a comparison between the schedules of the parties to a same agreement or with schedules in another agreement.

64. In the case of the EU, it should be noted that most limitations concern specific Member states and only limitations that exist across all EU countries are reported in the tables.

Table 12. Commitments and reservations in 5 NAFTA-inspired regional trade agreements

Investment commitments	All sectors H			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5			Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN

US-Australia FTA

Australia	4	n/a	2	1	n/a	1	5	n/a	3		n/a		1	n/a	1	n/a		n/a	3		2	n/a	1		n/a			n/a	6	n/a			n/a					
United States	3	n/a	4	1	n/a	1	2	n/a	2		n/a			n/a			n/a		10	11	5	1	n/a	1		n/a		n/a	4	n/a	3			n/a				

NAFTA

Canada	8	n/a	2	2	n/a	1	n/a	1		n/a			n/a		n/a	1		1	n/a	1		n/a		n/a		2	n/a	2		n/a			
Mexico	6	n/a	1	3	n/a	2	10	n/a	4	1	n/a		3	n/a		1	n/a		10	12	1	1	n/a	1		n/a		n/a	10	n/a	2		n/a
United States	4	n/a	5	2	n/a	2	3	n/a	2		n/a			n/a			n/a		7		4	1	n/a	1		n/a		n/a	5	n/a	4		n/a

US-Morocco FTA

Morocco	2		1	10	4	5	6						2		2			1		7	11		7	4	5	1					3	4	2				
United States	3	1	4	1		1	1												10	11	5	1	1	1						4			3				

Japan-Mexico Economic Partnership*

Mexico	8	n/a	1	9	n/a	2	8	n/a	4	1	n/a		1	n/a		1	n/a		n/a		GATS & OECD	1	n/a			n/a		1	n/a	1	18	n/a	1		n/a			
Japan	4	n/a	1	5	n/a	4	n/a				n/a			n/a			n/a	1	n/a		GATS & OECD	1	n/a			n/a			n/a	11	n/a	4		n/a				

* The commitments in financial services are those of the OECD Code of Liberalisation of Capital Movements and of the GATS.

Chile-Korea FTA*

Chile	5	n/a		8	n/a		11	n/a			n/a			n/a			n/a						1	n/a			n/a			n/a	24	n/a			n/a			
Korea	8	n/a		6	n/a		26	n/a			n/a			n/a	3	n/a		n/a					3	n/a			n/a	3	n/a	9	n/a			n/a				

* Financial services are not in the agreement yet (a negotiation is scheduled four years after the entry into force of the agreement)

No commitments in the sector - sector excluded

Commitments in a limited number of sub-sectors

Commitments in most of the sector

Commitments across the entire sector

Horizontal limitations (affect all sectors) * first column only *

Number of limitations

Non applicable



2

n/a

Table 13. Commitments and reservations in 5 GATS-inspired regional trade agreements

Investment commitments	All sectors H			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5			Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN

Japan-Singapore New Age Economic Partnership Agreement

Japan-Singapore New Age Economic Partnership Agreement																																														
Japan	2			8	14			1	1			10	5			3					1								1	2							7	7								
Singapore	3			5	5				2							1				1									15	34			2	2							1	1				

Thailand-Australia FTA (TAFTA)

Australia	4	9		2	3			5												2	13			1								1	2					
Thailand	1	12		32			15	10		3			2			4	1		9		6	29				5	4		2	4		15	9					

EU-Chile Association Agreement

Chile	5	5		7	8		4													1	25								1	1		6	7				
EU*	2*	1*		1*	1*		1		*									*		3*	3*						*		*		3	3*					

* Limitations that apply in specific EU Member States are not reported but an asterisk signals their presence

EFTA-Singapore FTA

Singapore	3			3	3							3		1	1					7	22		2	2							2	2					
Switzerland	3			7	2					3										2	2				2	1					3	4					

India-Singapore Comprehensive Economic Co-operation Agreement

India-Singapore Comprehensive Economic Co-operation Agreement																																					
India	7	2		9	13		8	19		1	1			2							3	30		1	2					1		1	2				
Singapore	3			4	6			5					5			1				42	45		1	2						1	1						

No commitments in the sector - sector excluded

Commitments in a limited number of sub-sectors

Commitments in most of the sector

Commitments across the entire sector

Horizontal limitations (affect all sectors) * first column only *

Number of limitations



2

Table 14. Mode 3 commitments in GATS schedules

GATS Mode 3 commitments	All sectors H			Business services 1			Communication services 2			Construction and related engineering services 3			Distribution services 4			Educational services 5			Environmental services 6			Financial services 7			Health related and social services 8			Tourism and travel related services 9			Recreational, cultural and sporting services 10			Transport services 11			Other services not included elsewhere 12		
	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN	NT	MA	MFN
Australia	4	1		2	2			3	2												2	13											1						
European Union*	2	1*	2*			1*		*	5*		*								*	2*	1*										2		1*	2*					
Canada	8	2	1	4	4		1	3	2	1	1			3							9	9	2				1	2					1	5	3				
Chile	4	3	1		4			4	1												1	21													5				
India	1				4		3	12	3		1										8	20			1		2				1				2				
Japan					8												1		1	3											2								
Jordan	1	1	1	2	14	3		4	2		1			2		2					1	8			2		4	1		1	1	5	1						
Korea	4	2			4			3			6			5				4			4	36					1					4	8	1					
Mexico	1	1		2	33		1	17			1			4							30			4			10	2				5	6	1		6			
Morocco		1			1			4			1										1						3						3	1					
Singapore	3		2		5	1		2	2												10	16	2				1							2					
Switzerland	3				2				3					3	1						2	2	1				2	1					2	4	4				
United States	3		3		4		1	3	1						2						5	36	5		1			2				1		2	5				
Thailand	1	2		29		3	9	10		3			1		3		9				6	29					5			2			15	8	3				

* Limitations that apply in specific EU Member States are not reported but an asterisk signals their presence

No commitments in the sector - sector excluded

Commitments in a limited number of sub-sectors

Commitments in most of the sector

Commitments across the entire sector

Horizontal limitations (affect all sectors) * first column only *

Number of limitations



2

ANNEX 3 - THE GATS W/120 SERVICES SECTORAL CLASSIFICATION LIST

SECTORS AND SUB-SECTORS

1. BUSINESS SERVICES

A. Professional Services

- a. Legal Services
- b. Accounting, auditing and bookkeeping services
- c. Taxation Services
- d. Architectural services
- e. Engineering services
- f. Integrated engineering services
- g. Urban planning and landscape architectural services
- h. Medical and dental services
- i. Veterinary services
- j. Services provided by midwives, nurses, physiotherapists and paramedical personnel
- k. Other

B. Computer and Related Services

- a. Consultancy services related to the installation of computer hardware
- b. Software implementation services
- c. Data processing services
- d. Data base services
- e. Other

C. Research and Development Services

- a. R&D services on natural sciences
- b. R&D services on social sciences and humanities
- c. Interdisciplinary R&D services

D. Real Estate Services

- a. Involving own or leased property
- b. On a fee or contract basis

E. Rental/Leasing Services without Operators

- a. Relating to ships
- b. Relating to aircraft
- c. Relating to other transport equipment
- d. Relating to other machinery and equipment
- e. Other

F. Other Business Services

- a. Advertising services
- b. Market research and public opinion polling services
- c. Management consulting service
- d. Services related to management consulting
- e. Technical testing and analysis services
- f. Services incidental to agriculture, hunting and forestry
- g. Services incidental to fishing
- h. Services incidental to mining
- i. Services incidental to manufacturing
- j. Services incidental to energy distribution
- k. Placement and supply services of Personnel
- l. Investigation and security
- m. Related scientific and technical consulting services
- n. Maintenance and repair of equipment
(not including maritime vessels, aircraft or other transport equipment)
- o. Building-cleaning services
- p. Photographic services
- q. Packaging services
- r. Printing, publishing
- s. Convention services
- t. Other

2. **COMMUNICATION SERVICES**

A. Postal services

B. Courier services

C. Telecommunication services

- a. Voice telephone services
- b. Packet-switched data transmission services
- c. Circuit-switched data transmission services
- d. Telex services
- e. Telegraph services
- f. Facsimile services
- g. Private leased circuit services
- h. Electronic mail
- i. Voice mail
- j. On-line information and data base retrieval
- k. Electronic data interchange (EDI)
- l. Enhanced/value-added facsimile services, incl. store and forward, store and retrieve
- m. Code and protocol conversion
- n. On-line information and/or data processing (incl. transaction processing)
- o. Other

- D. Audiovisual services
 - a. Motion picture and video tape production and distribution services
 - b. Motion picture projection service
 - c. Radio and television services
 - d. Radio and television transmission services
 - e. Sound recording
 - f. Other
- E. Other

3. CONSTRUCTION AND RELATED ENGINEERING SERVICES

- A. General construction work for buildings
- B. General construction work for civil engineering
- C. Installation and assembly work
- D. Building completion and finishing work
- E. Other

4. DISTRIBUTION SERVICES

- A. Commission agents' services
- B. Wholesale trade services
- C. Retailing services
- D. Franchising
- E. Other

5. EDUCATIONAL SERVICES

- A. Primary education services
- B. Secondary education services
- C. Higher education services
- D. Adult education
- E. Other education services

6. ENVIRONMENTAL SERVICES

- A. Sewage services
- B. Refuse disposal services
- C. Sanitation and similar services
- D. Other

7. FINANCIAL SERVICES

- A. All insurance and insurance-related services
 - a. Life, accident and health insurance services
 - b. Non-life insurance services

- c. Reinsurance and retrocession
- d. Services auxiliary to insurance (including broking and agency services)
- B. Banking and other financial services
(excl. insurance)
 - a. Acceptance of deposits and other repayable funds from the public
 - b. Lending of all types, incl., *inter alia*, consumer credit, mortgage credit, factoring and financing of commercial transaction
 - c. Financial leasing
 - d. All payment and money transmission services
 - e. Guarantees and commitments
 - f. Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
 - money market instruments (cheques, bills, certificate of deposits, etc.)
 - foreign exchange
 - derivative products incl., but not limited to, futures and options
 - exchange rate and interest rate instruments, inclu. products such as swaps, forward rate agreements, etc.
 - transferable securities
 - other negotiable instruments and financial assets, incl. bullion
 - g. Participation in issues of all kinds of securities, incl. under-writing and placement as agent (whether publicly or privately) and provision of service related to such issues
 - h. Money broking
 - i. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial depository and trust services
 - j. Settlement and clearing services for financial assets, incl. securities, derivative products, and other negotiable instruments
 - k. Advisory and other auxiliary financial services on all the activities listed in Article 1B of MTN.TNC/W/50, incl. credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy
 - l. Provision and transfer of financial information, and financial data processing and related software by providers of other financial services
- C. Other

8. HEALTH RELATED AND SOCIAL SERVICES

(other than those listed under 1.A.h-j.)

- A. Hospital services
- B. Other Human Health Services
- C. Social Services
- D. Other

9. TOURISM AND TRAVEL RELATED SERVICES

- A. Hotels and restaurants (incl. catering)
- B. Travel agencies and tour operators services
- C. Tourist guides services
- D. Other

10. RECREATIONAL, CULTURAL AND SPORTING SERVICES

(other than audiovisual services)

- A. Entertainment services (including theatre, live bands and circus services)
- B. News agency services
- C. Libraries, archives, museums and other cultural services
- D. Sporting and other recreational services
- E. Other

11. TRANSPORT SERVICES

- A. Maritime Transport Services
 - a. Passenger transportation
 - b. Freight transportation
 - c. Rental of vessels with crew
 - d. Maintenance and repair of vessels
 - e. Pushing and towing services
 - f. Supporting services for maritime transport
- B. Internal Waterways Transport
 - a. Passenger transportation
 - b. Freight transportation
 - c. Rental of vessels with crew
 - d. Maintenance and repair of vessels
 - e. Pushing and towing services
 - f. Supporting services for internal waterway transport
- C. Air Transport Services
 - a. Passenger transportation
 - b. Freight transportation
 - c. Rental of aircraft with crew
 - d. Maintenance and repair of aircraft
 - e. Supporting services for air transport
- D. Space Transport
- E. Rail Transport Services
 - a. Passenger transportation
 - b. Freight transportation
 - c. Pushing and towing services
 - d. Maintenance and repair of rail transport equipment
 - e. Supporting services for rail transport services
- F. Road Transport Services
 - a. Passenger transportation
 - b. Freight transportation
 - c. Rental of commercial vehicles with operator
 - d. Maintenance and repair of road transport equipment
 - e. Supporting services for road transport services

G. Pipeline Transport

- a. Transportation of fuels
- b. Transportation of other goods

H. Services auxiliary to all modes of transport

- a. Cargo-handling services
- b. Storage and warehouse services
- c. Freight transport agency services
- d. Other

I. Other Transport Services

12. OTHER SERVICES NOT INCLUDED ELSEWHERE



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Regional Approaches to Services Trade and Investment Liberalisation

Jane Drake-Brockman
Managing Director,
Trade and Environment Solutions
and
Executive Director
Australian Services Roundtable

A U S T R A L I A — J A P A N R E S E A R C H C E N T R E
A S I A P A C I F I C S C H O O L O F E C O N O M I C S A N D G O V E R N M E N T

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Australia–Japan Research Centre
Asia Pacific School of Economics and Government
The Australian National University
Canberra ACT 0200

Telephone: (61 2) 6125 3780
Facsimile: (61 2) 6125 0767
E-mail: ajrc@anu.edu.au
URL: <http://apseg.anu.edu.au>

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REGIONAL APPROACHES TO SERVICES TRADE AND INVESTMENT LIBERALISATION

This paper addresses the question of whether the difficult issues associated with services trade and investment liberalisation are more likely to be tackled effectively in the bilateral or the multilateral context. It provides a first examination of the services trade and investment outcomes in some bilateral free trade agreements (FTAs) in the Asia Pacific region, especially those centred around Singapore. The author draws the preliminary conclusion that bilateral FTAs which attempt to explore territory beyond the World Trade Organization (WTO) may well prove to be 'WTO minus' in terms of their impact on nascent WTO rule-making in these new areas and to have potentially negative impacts on the WTO architecture itself. The paper calls for vigilance and objective evaluation to ensure that bilateral efforts contribute in a positive way to a successful and rapid outcome to the currently troubled Doha Round of multilateral negotiations.

Introduction

Some commentators suggest that the special features of the services sector make smaller group trading arrangements a potentially efficient means of promoting services trade and investment liberalisation. Others argue that small group arrangements pose at least as many risks for services as they do for goods, and that the priority is to establish the global rules in a multilateral process. Between these positions, awareness of the risks can help identify possible ways of using regional arrangements to support the multilateral process.

There is some concern, meanwhile, that the developing countries, including those in East Asia, are not sufficiently effective in the current Doha Round of services negotiations, and that there are some key structural issues (including policymaking capacity) which contribute to this outcome. Failure to tackle this problem now could lead to haphazard outcomes from the services negotiations, with consequent serious implementation issues in developing countries, resulting in increased levels of regional disillusionment with the multilateral process. Designing effective capacity-building programs is critical, including formulating negotiating positions which complement the domestic policy reform agenda.

This paper reports work on these issues in order to contribute to developing a coalition of interests on an East Asian approach to services trade and investment liberalisation. The aim is to identify areas of common interest among the East Asian economies that will contribute to the development of a more concerted trade policy strategy in the Doha Round as well as in APEC and in smaller subregional and bilateral groupings.

WTO Doha Round GATS negotiations

Under Article XI of the Uruguay Round General Agreement on Trade in Services (GATS), a further set of services negotiations aiming for progressive liberalisation was built into the post Uruguay Round agenda of the World Trade Organization (WTO), to commence no later than five years from 1995. Negotiations were initiated in 2000 and, importantly, guidelines and procedures were agreed by the Council for Trade in Services in March 2001. The guidelines allow in particular for flexibility for developing countries under Article XIX:2; special priority for least developed countries under Article IV:3; and no a priori exclusion of sectors or modes of supply. Paragraph 3 of the guidelines affirms that ‘The process of liberalization shall take place with due respect for national policy objectives, the level of development and the size of individual Members, both overall and in individual sectors’.

Like the ‘built-in’ negotiations on agriculture, which have also been under way since 2000, the ongoing built-in negotiations on services were effectively rolled into the Doha Round negotiating mandate. Paragraph 15 of the Doha Ministerial Declaration endorsed the work already done, reaffirmed the negotiating guidelines and procedures, and established key elements of a timetable, including the deadline of 1 January 2005 for the conclusion of the negotiations as part of a single undertaking.

The Uruguay Round left some key issues in the GATS unresolved. The rule-making itself is unfinished with respect to emergency safeguards (Article X), domestic regulation relating to issues such as qualifications, technical standards and licensing (Article VI:4), government procurement (Article XIII) and subsidies (Article XV). The deadline for negotiation of rules on emergency safeguards was 15 March 2002 but this has now been extended to 15 March 2004. Most favoured nation (MFN) exemptions in GATS schedules are specifically subject to negotiation, with flexibility for developing countries.

With respect to modalities and procedures, the request–offer approach is the main method adopted, although other options remain potentially in play. These include a sector-specific

approach (likely candidates are energy, environment and legal services); a cluster approach (likely candidates are energy, environmental and tourism services); and a formula approach, which could include the elimination of discrepancies between actual and bound practice, elimination of certain types of restrictions, and exchange of commitments in Mode 3 (commercial presence) versus Mode 4 (movement of natural persons).

Prospects and current state of play in the GATS negotiations

The general assessment is that the services negotiations are more or less on track. A larger number of key developing countries are engaged than was the case during the Uruguay Round; some outstanding issues (for example how to handle autonomous liberalisation) have recently been resolved; important negotiating deadlines have largely, if not entirely, been met; and the negotiations have entered the market access phase. This compares favourably with progress in other areas of the Doha Round, particularly agriculture.

GATS requests were tabled at the end of June 2002 and initial GATS offers are due to be presented at the end of March 2003. With the tabling of offers, the real market access bargaining stage of the negotiations has now begun in earnest.

Around 40 requests were tabled, half of them from developing countries. It has been expected that 20–30 countries would table offers, with the initial degree of substance depending perhaps on progress in other areas. At the time of writing, relatively few countries within the Asia Pacific region had tabled their offers. The offers from the bulk of these countries, moreover, were not transparent to the public.

To the extent that there is transparency, the general assessment is that countries have tended to hold back in their GATS offers, pending more certain progress in other areas of the Doha Round. Overall the level of ambition does not seem high. Certainly in the case of the United States and Australia, which have been examined in greater immediate detail, the offers are in effect ‘standstill’ offers. They entail no new liberalisation and would require no changes in domestic legislation if they were to become part of a final Doha Round outcome. The offers are to bind autonomous liberalisation which has already taken place since the end of the Uruguay Round. Binding is nevertheless a significant step forward as it entails commitments to WTO dispute settlement and exchange of equivalent concessions in the case of any potential backsliding and hence sends strongly positive signals to foreign investors.

The immediate negotiating aim is to maintain momentum so that progress in services keeps running on a parallel track with agriculture, industrials and other rules issues in order to see what sort of package might start to emerge as the end of the negotiating process (in 2005) approaches. It is already clear that progress on services risks becoming hostage to progress on agriculture and on the extraction of concessions of interest to developing countries, for example on special and differential treatment.

In the GATS negotiations there are likely to be bottlenecks on the unfinished rules issues, especially on safeguards. The evidence is, however, that these issues are largely becoming accepted as second-order objectives for this round. In addition, governments have had to meet major difficulties in handling civil society interests in the GATS negotiations. The anti-GATS campaign is closely focused on the misguided but widespread sense in domestic community constituencies that trade and investment liberalisation will facilitate the dismantling of vital public services, especially in the health and education sectors. While the negotiations are in general less politicised than negotiations in some other areas, real progress will obviously be hampered unless breakthroughs also occur there.

In essence, the Uruguay Round GATS commitments did not go much beyond the status quo in national policies. A successful outcome this time round will clearly require all parties to make more commitments on national treatment and fewer MFN exemptions in their schedules. Put simplistically, developing countries need to make more commitments on Mode 3 (commercial presence, or investment), developed countries need to make more commitments on Mode 4 (movement of natural persons), and these need to go beyond the movement of intercorporate transferees. All countries need to improve the transparency of domestic regulations covering services access. If anything, the security environment following September 11 has made progress on Mode 4 harder. And there is new protectionist sentiment emerging: in many Organisation for Economic Co-operation and Development (OECD) countries there is unrest about the impact of information technology outsourcing on domestic labour markets.

ASEAN countries and the GATS

With the exception of Singapore, ASEAN countries generally are not well placed to address the newer aspects of the WTO agenda, including services. Clearly very few of them are fully engaged in the GATS negotiations. In general, ASEAN countries' services commitments in the Uruguay Round were weak. Sally (2003) points out that intra-ASEAN negotiating differences are evident,

particularly in the services negotiations. Singapore has a strong market access focus and is hence a demandeur on services, but the other ASEAN members are defensive – and increasingly so since the Asian crisis, despite autonomous liberalisation achieved since the end of the Uruguay Round. On the related new issues of investment, competition and transparency in government procurement, Singapore is open to new negotiations while the others are much more cautious.

In general, ASEAN services sectors remain highly protected. Stephenson and Nikomborirak (2002) point out that in nearly every service subsector examined in the ASEAN countries, except transport and sometimes tourism, there is a cap or ceiling imposed on foreign equity. Another common restriction is on the type of commercial establishment a foreign company is allowed to establish. The third most common type of barrier is on Mode 4 commitments.

The lack of concerted ASEAN engagement is reflected in the very small number of service requests and offers forthcoming from individual ASEAN members in the Doha Round to date. Until the recent decision of the United States, Canada, Australia, New Zealand and the European Union (EU) to go public with their GATS offers, there had been no transparency in the GATS negotiations. Requests were not publicly available, so information is limited. But we know, for example, that neither Indonesia nor the Philippines has made GATS requests of Australia. It is therefore unlikely that they have made requests of other countries. It is important to ask why these countries are not playing the WTO game.

One problem relates to the regulatory intensity of services trade and the difficulties associated with the much wider, more complex domestic consultation process required, including with regulatory agencies, to formulate appropriate international strategies. Negotiators tend to be overwhelmed with the breadth and complexity of the issues, generating a higher level of caution and defensiveness. Within ASEAN there is no common approach to regulation of key services sectors, and this divergence of domestic policy makes international coordination more difficult. Finally, there is a major information deficit with respect to the commercial service export interests of individual countries.

While these are all understandable factors, the consequence is that ASEAN is not operating as a group in the GATS and hence is punching well below its potential considerable weight. Each ASEAN member has a different approach, with the result that the overall position is fragmented and not influential. With the simultaneous drive for regional and bilateral trading arrangements under way, there is a real danger that the ASEAN countries will be picked off individually by major bilateral trading partners. This will further fragment ASEAN trade policy, losing ASEAN all opportunity to act as any kind of regional hub.

The continued absence of a safeguards mechanism for services is one explanation which developing countries, including ASEAN members, tend to offer in Geneva for holding back on GATS commitments and GATS offers to date. ASEAN countries appear to be suggesting that GATS offers might indeed be forthcoming if a safeguards clause is put in place. Whatever the technical pros and cons associated with this issue, it is important that East Asian countries take note of the steps which have been initiated by Australia, despite opposition from the United States and the EU, to mediate on this issue in favour of developing countries. Australia has taken an informal position which offers scope for a potential alliance with East Asian economies in resolving this issue and facilitating developing country offers from the region.

Treatment of services in bilateral FTAs

Is it easier to solve the problems of trade and investment liberalisation in services among smaller groups of trading partners on a bilateral basis in free trade agreements (FTAs) with major trading partners or in a plurilateral regional arrangement of East Asian countries? Presumably the recent interest in bilateral FTAs is partly driven by a desire to find potential ways around the challenges and difficulties presented in the multilateral negotiating framework. So it is worthwhile asking whether FTAs are indeed succeeding in meeting these challenges.

There are relatively few studies available to date which compare the disciplines of the GATS with the liberalising thrust or otherwise of the services provisions in FTAs – and none which examine the services aspects of the most recent series of FTAs centred on Singapore. In the following section, this paper takes a first quick look at the Singapore–Japan, Singapore–Australia and Singapore–US FTAs.¹ In doing so it draws on recent OECD Secretariat research (Sauve 2002) which identifies a number of criteria or GATS benchmarks against which to make this comparative assessment.

The OECD study concludes that (at least up until the recent series of FTAs listed above) services trade and investment liberalisation has tended to prove no easier to achieve in smaller groups than it has in the WTO. Stephenson and Nikomborirak (2002) argue on the contrary that, in the Western Hemisphere, services liberalisation as reflected in the texts of regional FTAs like the North American Free Trade Agreement (NAFTA), the Mercado Común del Sur (MERCOSUR), the Andean Pact and the Caribbean Community agreement (CARICOM) achieve more far-reaching disciplines than does the GATS. The authors admit, however, that the liberalisation

achieved on paper in these agreements is not necessarily played out in practice and is difficult to assess in the absence of relevant information.

Obviously, with the GATS incomplete, there is considerable scope for regional and bilateral experimentation. In particular, the negative list approach increasingly adopted in FTAs seems to offer good governance benefits in terms of enhanced transparency. Yet most of the time, and certainly with respect to domestic regulation, the OECD study (Sauve 2002) concludes that GATS disciplines go further than what has been achieved in FTAs, despite the opportunities provided by the use of the negative list approach. One possible exception, noted in Stephenson and Nikomborirak (2002), results from the 'Standard of Treatment' clause used in some NAFTA-type FTAs. This confers whichever is the more favourable treatment under either the MFN or the national treatment principle. The agreements also contain a mechanism which ratchets up future liberalisation and binds it automatically to the FTA. On the face of it, NAFTA-style ratchet mechanisms appear highly liberalising in that they extend to bilateral partners any liberalisation negotiated subsequently with any new partner. However, unlike simple 'review of commitments' clauses, they do not necessarily encourage bilateral trading partners to work away on sensitive areas carved out of their own original agreement.

The OECD study (Sauve 2002) points out, in addition, that none of the FTAs to date have really tackled the issues proving most difficult in Geneva – the interface between domestic regulation and liberalisation. There is little evidence of regulatory integration anywhere other than in the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) – at least not in the NAFTA-type agreements. Where agreements do have provisions in this area, they tend to be less fleshed out, weaker or more narrowly drawn – for example, focusing solely on professional services – than those arising under Article VI of the GATS (including the Article VI:4 work program). Stephenson and Nikomborirak (2002) note that the NAFTA-type agreements go beyond the GATS in actually trying to encourage mutual recognition but, as noted above, that they target recognition very narrowly to subsectors such as professional services.

Nor, according to the OECD Secretariat, has there been any real progress in FTAs on the sectors proving most sensitive in Geneva – for example, air and maritime transport, audiovisual services and energy services – with the notable, but occasional, exception of transport, where the OECD suggests that regional proximity may sometimes have been a major facilitating factor. The ASEAN Framework Agreement on Services provides a relevant example. In general, Stephenson and Nikomborirak assess the market access commitments undertaken within ASEAN to date to be only marginally better than those in the GATS. However, the air and

maritime transport sectors do show greater preferential commitments than in the GATS. Agreements involving the United States, however, typically carve out both air and maritime services, even with regional neighbours. And sectors other than transport which have proved elusive multilaterally have also proved elusive bilaterally.

FTAs are often seen as offering scope for speedier headway in areas such as services-related standards and the recognition of licences and professional or educational qualifications. Despite the presumed possibilities, the OECD study argues, however, that FTAs have not actually achieved much on standards. Progress in this area has been slow and generally disappointing, even at the regional level.

And FTAs have achieved no progress on the unfinished GATS rule-making, especially on safeguards and subsidies (which are typically grandfathered or carved out through negative listing). Progress has occasionally been made in the NAFTA-type FTAs on government procurement, but this has usually been in the context of negotiations on government procurement rather than services as such. The bilateral discussions on rules have otherwise seemed to face the same technical challenges and political sensitivities found in Geneva.

The OECD study (Sauve 2002) also concludes that, in the two key infrastructure sectors of telecoms and financial services, on balance, FTAs have seen less progress in bound liberalisation than is the case under the GATS, though in developing countries they may have encouraged greater transparency in implementation. The OECD suggests that this result confirms the political economy gains associated with the achievement of critical mass through multilateral bargaining.

Finally, the OECD research suggests that FTAs have rarely, if ever, achieved much of value on Mode 4. ASEAN's own experience tends to confirm this finding. Stephenson and Nikomborirak (2002) also note that NAFTA-type agreements do not cover Mode 4 as such but are limited to coverage of temporary movement of business service providers.

What emerges from this discussion is that regulatory harmonisation and mutual recognition in particular seem to remain difficult whatever the negotiating arena. There are no easier answers at the bilateral level. This can be expected to be the case also in FTAs between developed countries such as Australia and the United States. It is likely to be more constructive, therefore, especially for developing countries, to concentrate services trade policy attention on the WTO.

Before moving on to look briefly at the more recent FTAs centred on Singapore, it is important to recognise two other important general characteristics of FTAs covering services.

First, the OECD study draws attention to the fact that, with very few exceptions, FTAs covering services typically feature a liberal ‘rule of origin’/denial of benefits clause. That means they extend the preferential treatment to all legal persons conducting substantial business operations in the member countries. In practice, this implies that at least the post-establishment treatment of what in many instances represents the most important mode of supplying services in foreign markets – that is, investment – is extended to third-country investors and is non-preferential.

Second, the OECD study notes that governments participating in FTAs have shown a greater readiness in services than in goods to subsequently extend regional preferences on an MFN basis under the GATS. This may reflect a realisation that preferential treatment is harder to confer in services trade. Multilateral liberalisation also offers the opportunity to secure access to the world’s most efficient suppliers. This is economically vital in critical infrastructure services which are likely to exert significant effects on economy-wide performance.

Role of services in recent FTAs in the region

A key question is whether the above conclusions hold also for the most recent agreements, for example those agreed recently between Singapore, Japan, Australia and the United States. In their own way, these will tend to serve as models for future agreements in the region, at least with developing countries. In fact, one would hope that an FTA between two developed countries, for example between Australia and the United States, might attempt to go beyond these models and display a greater degree of ambition in setting a potential template for problem solving in the GATS.

Even a quick glance at the tables of contents of these recent agreements and at the services and investment chapters themselves shows that services issues have come to dominate the content of regional FTAs. It is worth noting that ASEAN countries other than Singapore would presumably have difficulties entering FTAs of this nature that entail extensive commitments on services, investment and associated domestic regulatory reforms.

Although this analysis is far from complete – in the case of the Singapore–US agreement the negotiating text was strictly still available only in draft at the time of writing – some basic early conclusions emerge. Judged against the benchmarks set out in the OECD study discussed above (Sauve 2002), the recent agreements can be seen on balance to tend to focus on specific bilateral market access issues (and to provide access on a reciprocal preferential basis) rather

than grappling with the GATS – plus issues which might facilitate trade in services more generally. They tend, admittedly with some exceptions, not to sufficiently address issues such as competition policy, mutual recognition or regulatory harmonisation.

Usefully, the Singapore–US agreement does make some progress on competition policy and investment policy issues in Singapore which will in effect have MFN application. The Singapore–US and Singapore–Australia agreements both seek to make limited starts in the direction of regulatory convergence, with a welcome focus on the transparency of regulation. The Singapore–Japan agreement focuses, importantly, on transparency of implementation. The Singapore–Australia agreement attempts in a limited (and in practice relatively unsuccessful) way to encourage the process of mutual recognition for professional services.

However, there is nothing positive to report in the recent agreements on the unfinished GATS rule-making front. On the contrary, the negative list approach risks locking in certain existing restrictions which new GATS rules (for example, on subsidies) might well seek to discipline.

Nor is there anything especially creative on the ‘movement of natural persons’ front. The Singapore–US agreement follows the example already set in the other NAFTA-type agreements. With respect to services, Modes 3 and 4 are separated out and dealt with in generic chapters (Mode 3 in the chapter on investment and Mode 4 in the chapter on temporary movement of business people). The services chapter consequently deals only with cross-border trade in services (Modes 1 and 2). The investment chapter covers bilateral investment promotion and protection and defines basic MFN and national treatment disciplines on investment in both goods and services.

The Singapore–Australia agreement covers Mode 3 more traditionally in the services chapter. The difference between these two approaches is largely cosmetic. The inclusion of Mode 3 in the investment chapter serves to pad that chapter out. Clearly, however, the US approach, should it continue to become institutionalised, especially in agreements involving developed countries such as Australia, risks setting precedents which could have a pre-emptive impact both on the structure of the GATS and on the modalities for future investment and government procurement negotiations in Geneva.

Through the generic investment disciplines, the Singapore–US agreement provides for a right of non-establishment – that is, there is no local presence requirement as a precondition to supply services. This is seen as a means of encouraging cross-border trade in services. Such

a provision, for which no GATS equivalent exists, is thought to be well suited to promoting e-commerce.

The jury is out on whether these agreements, despite the claims of GATS-plus, can serve effectively as benchmarks either for the Doha Round negotiations or for broader regional integration. New market access commitments are only truly GATS – plus if they are applied on an MFN rather than a preferential basis. As these recent agreements are implemented, we will see the extent to which participating governments choose to extend the commitments multilaterally and bind them in the GATS as part of the Doha Round outcome. It would be consistent with the rhetoric of ‘competitive liberalisation’ for the governments involved to take such a step. Meanwhile, trade and investment diversion will apply in services just as it does in goods, with the effect of locking in new bilateral partnerships instead of seeking access to world’s best practice in services delivery.

The domestic politics associated with FTAs are complex, with local protectionist interests to defend, especially in infrastructure services. Dealing with market access issues in a repeated reciprocal bilateral manner is unlikely to lead to agreements which can be broadened to include a progressively wider number of regional players. Bilateral market access deals, moreover, unless they also deal effectively with the competition policy environment, can create new opportunities for rent seeking. This can lead to ‘first-mover’ gains to particular firms, which then have a vested interest against the extension of the bilateral agreement to include other trading partners. In particular, the chances that individual ASEAN countries will succeed in negotiating consistent and complementary non-exclusive arrangements, allowing opportunities for eventual wider subregional participation, seem to be very poor.

Despite the fact that other ASEAN countries would have difficulty participating in FTAs involving significant liberalisation of services and more transparent domestic regulation, other ASEAN countries increasingly feel forced to try to follow the Singaporean example. This trend carries very real dangers for ASEAN cohesion.

ASEAN fragmentation in the GATS negotiations

ASEAN cohesion on the international trade policy front is already a major problem. Despite ASEAN’s strong and visibly influential role in the Uruguay Round, Sally (2003) argues that ASEAN coordination in the WTO has now effectively broken down. While individual ASEAN members are separately active, to varying degrees, in the WTO, ASEAN as a collective group

currently has no voice whatsoever. The convergence of WTO negotiating interests on agricultural and industrial market access issues, which was so evident in the Uruguay Round, seems to have fragmented completely in the Doha Round. This new reality is most clearly evident in the case of trade and investment in services. As discussed above, the regional drift to FTAs that are focused – as they increasingly must be – on services trade and investment issues is likely to make this fragmentation much worse.

As noted by Sally (2003), this is a problem for ASEAN and also a problem for the WTO. At this particular juncture of the Doha Round, with the fifth ministerial meeting to take place in September 2003, there are good reasons for Southeast Asian countries to address the issue and in so doing to also help ensure a more united East Asian front in the negotiations. As Sally points out, the developing countries in East Asia account for roughly half of the relatively few active developing country members of the WTO. This translates into real and potential influence, both in terms of individual activity and in multi-country coalitions. The accession of China and Chinese Taipei to the WTO reinforces the potential. China's evident constructive engagement in the Doha negotiations also bodes well for regional influence in the WTO, particularly as China is now the leading developing country in the organisation. East Asian countries – including those from North Asia, Southeast Asia, Australia and New Zealand – are well positioned to exercise considerable influence in the outcome to the Doha Round.

Gains from reform²

'What's in it for us?' is a common question among developing countries, including those in the East Asian region. It is important first to recognise that, according to WTO estimates (Sauve 2002), international trade in services was worth US\$2.3 trillion at the end of 2000 – more than one-third of total world trade (up from 18 per cent in 1995). Moreover, from 1980 to 1995, trade in services grew by 8 per cent compared with 6 per cent for merchandise trade. Complex though the GATS issues might appear, services trade is too important to ignore.

Various modelling studies show that the global gains from services trade and investment liberalisation are likely to be substantial, and to be shared very evenly between developed and developing economies. The Australian Department of Foreign Affairs and Trade (DFAT 1999) estimates that halving trade distortions affecting services would bring annual global gains of US\$250 billion, almost three times the gains from comparable reductions in trade barriers on agriculture. This study indicates that all economies would gain – and, in proportion to their GDP

size, some smaller economies would benefit substantially. Another study by the Australian Productivity Commission (Dee and Hanslow 2000) confirms the relative importance of services trade liberalisation. This study found that about half the estimated global gains from trade liberalisation – about US\$130 billion – would derive from services sector liberalisation. Moreover, these gains would be concentrated in particular in the developing world where the scale of impediments is largest.

A more recent study by the Productivity Commission (Verikios and Zhang 2001) assesses the effects of liberalising trade in the financial services and telecommunications sectors and suggests that economies gain both from removing barriers to the establishment of new operations (domestic or foreign) and by liberalising the operations of existing operators. For the world as a whole, the one-off gains are estimated to be at least 0.2 per cent of combined GNP, or about US\$50 billion. The report suggests that gains from liberalising telecommunications are overwhelmingly derived from improvements in resource allocation. The global gains from liberalising financial services are mainly due to an increase in the returns to the world capital stock.

This reinforces the results of other studies showing that the gains from services liberalisation, like goods liberalisation, accrue to the countries implementing the reforms, whether or not other economies also liberalise.

These results highlight the economic cost associated with the services trade and investment impediments currently in place in developing countries and the potential scope for significant improvements in international competitiveness that trade reform can bring. The main gains are from autonomous or unilateral reform. They include:

- access to services at lower prices
- enhanced access in the infrastructure sector to badly needed foreign investment and associated technology
- access not just to capital but to improved ways of organising a business (for example, in logistics)
- the introduction, through foreign participation in financial services, of strengthened risk management capacity.

Business interests in all sectors appreciate the value of reforms in the above directions. Modelling results also highlight an important contribution from the intersectoral effects of

liberalisation. A more efficient services sector removes impediments to international competitiveness in other sectors. For example, improved efficiency in transport services facilitates market integration in agriculture and reformed telecoms service provision can facilitate back-office data-processing or health diagnostics services.

Developing countries have export interests in services and can gain from new international market access commitments from trading partners under the GATS. Table 1 shows that Hong

Table 1 Trade in services in Asian countries, 2000

(a) Exports			
Rank	Exporter	Value (US\$ billion)	Share (% total in Asia)
1	Japan	68.3	22.6
2	Hong Kong	42.1	13.9
3	China	30.1	10.0
4	South Korea	29.2	9.6
5	Singapore	26.6	8.8
6	Taiwan	20.2	6.7
7	Australia	17.8	5.9
8	India	17.6	5.8
9	Malaysia	13.6	4.5
10	Thailand	12.8	4.2
(b) Imports			
Rank	Importer	Value (US\$ billion)	Share (% total in Asia)
1	Japan	115.7	31.7
2	China	35.9	9.8
3	South Korea	33.4	9.1
4	Hong Kong	26.2	7.2
5	Taiwan	25.7	7.0
6	Singapore	21.3	5.8
7	India	19.9	5.5
8	Australia	17.7	4.8
9	Malaysia	16.6	4.5
10	Thailand	14.7	4.0

Source: World Trade Organization data from <http://www.wto.org/english/res_e/statis_e/its2002_e/its02_appendix_e.htm> (Tables A6, A7) and UNCTAD trade in services database relating to the World Development Report (originally 1999–2000, updated to 2000–01, Table 20).

Kong China, China, South Korea and Singapore are all very important regional services exporters as well as importers. Indeed, as illustrated in Table 2, Singapore is the largest developing or transition economy services exporter in the world, followed by South Korea, China and Thailand. Malaysia follows in seventh position. On the import side, South Korea ranks number one, followed by China; Thailand, Singapore, Malaysia and Indonesia are all in the top 10. Singapore, South Korea and China are larger exporters and importers of services than Australia.

Table 2 Trade in services in developing and transition economies

(a) Exports			
Rank	Exporter	Value (US\$ billion)	Share (% world total)
1	Singapore	26.6	1.9
2	South Korea	29.2	2.0
3	China	30.1	2.1
4	Thailand	12.8	0.9
5	Turkey	19.2	1.3
6	Russian Federation	9.6	0.7
7	Malaysia	13.6	0.9
8	Mexico	13.6	0.9
9	Egypt	9.7	0.7
10	India	17.6	1.2
(b) Imports			
Rank	Importer	Value (US\$ billion)	Share (% world total)
1	South Korea	33.4	2.3
2	China	35.9	2.5
3	Saudi Arabia	10.9	0.8
4	Thailand	14.7	1.0
5	Singapore	21.3	1.5
6	Russian Federation	17.4	1.2
7	Malaysia	16.6	1.2
8	Brazil	15.9	1.1
9	Indonesia	14.3	1.0
10	Mexico	16.8	1.2

Source: World Trade Organization data from <http://www.wto.org/english/res_e/statis_e/its2002_e/its02_appendix_e.htm> (Tables A6, A7) and UNCTAD trade in services database relating to the World Development Report (originally 1999–2000, updated to 2000–01, Table 20).

There are many examples of areas in which developing countries might be exporters. One is tourism; another is Mode 4 (movement of natural persons). Mode 4 has potentially broad scope to cover executives, contractors and low-skill workers. This is of interest to many, if not all, developing economies. Most ASEAN countries would appear to have strong comparative advantages in Mode 4. The Philippines, in particular, is performing strongly in IT outsourcing.

Towards a services trade agenda for East Asia

There is scope for East Asian countries to work more closely together on services trade and investment liberalisation issues, both in the GATS negotiations in the Doha Round and in the regional context. A more concerted East Asian approach would have a very influential impact in the WTO. There is also separate and complementary scope for the East Asian developing countries to themselves play much larger roles in the various issues-based coalitions in the Doha Round. They do not have to be formal, close-knit coalitions. Loose informal cooperation is also extremely valuable, especially to developing countries with less negotiating experience in Geneva. Small 'friends' groups already exist – for example, the 'Really Good Friends of GATS' group – but they need new members if they are to impact on progress in the round.

China by itself, as the WTO's largest developing country member, has the power to shape negotiating outcomes if it works in cooperation with other East Asian countries around a coalescence of negotiating interests. And East Asian negotiating interests in services are indeed convergent. Despite the very different relative importance of services in different national economies in the region, East Asian countries have a joint interest in ensuring that the smaller developing countries in the region are not picked off individually by larger trading partners such that inconsistent and unsustainable regional outcomes arise.

Nor does the region have any interest in ASEAN fragmentation, including as an accidental by-product of FTA negotiations. Through the services and investment chapters, there is a risk that these will have a haphazard impact on domestic regulatory matters. On the contrary, the region has an interest in regulatory transparency and convergence as a central aspect of ongoing APEC-wide trade facilitation.

In the services negotiations in the WTO, market access and certainty and predictability of that access are the main game. Removing the many gaps between actual and bound policy is the first priority. Binding of the status quo is a valuable demonstration of commitment to reform. Wherever binding of the status quo is possible, no East Asian country has an interest in holding

back – least of all the ASEAN countries, for whom policy competitiveness is critical to regaining the confidence of foreign investors. It should not be impossible, for example, for Indonesia to offer to bind services sector reforms implemented recently as a result of the IMF Structural Adjustment Programme

Any offer on services is, meanwhile, valuable negotiating coin in other areas of the Doha negotiations. An offer on services need not bear resemblance to any external requests from trading partners. Nor need it be associated with any request on the part of the offering country. Offers should reflect domestic assessments of what is in a country's own best economic interests. Autonomous reforms achieved since the end of the Uruguay Round should be bound. The rewards will be many, in domestic economic terms, in fresh investor interest and in heightened bargaining power in other negotiating arenas. Central to the achievement of this agenda is the need for a much greater focus on the effective provision of vital trade policy capacity building, especially for the ASEAN countries and China.

Building regional trade policy capacity

The need for capacity building in order to achieve cooperative progress with the above agenda is clearly very extensive. The Doha Ministerial Declaration asserts supposedly firm commitments in this regard and charges the WTO Secretariat with supporting domestic efforts for mainstreaming trade into national plans for economic development and strategies for poverty reduction in coordination with bilateral donors and other international institutions. So far governments have pledged \$10 million as part of a global trust fund for technical assistance in the Doha Round. APEC in particular will need to give this priority if the GATS negotiations, and the Doha Round as a whole, are to be successful.

Findlay (2003) outlined steps in developing a trade negotiating strategy. The first steps are clear domestic priorities for policy reform and a clear sense of how services trade in particular fits into the overall economic strategy. Experience suggests that it will be difficult for developing countries to resist specific requests by trading partners if this sequence is not followed. If developing countries allow their own policy changes to be driven solely by external pressure, policy reform will tend to be partial and potentially unsustainable, often putting foreigners in privileged market positions. The central focus of trade policy reform, especially in services, must be on putting one's domestic regulatory house in order.

Capacity building in the region should focus on a deep sharing of experience on how to derive an international strategy from a systematic assessment of domestic economic considerations rather than on a technical explanation of current issues on the WTO negotiating agenda. The depth of non-border trade policy reform entailed in services trade liberalisation is resource intensive. It requires commensurately more complex policy planning tools and domestic decision-making processes. It will be very important to continue to share information on such issues, including identification of trade opportunities and impediments.

In terms of international negotiating strategy, the 'main game' is to bind domestic policy reform. There are substantial gains from removing the gap between actual and bound policy practice. Designing and making those commitments does not cost much in terms of the resources consumed in the negotiating process. From this perspective, other aspects of the negotiations, including negotiations on new GATS rules, would have a lower overall priority. Some economies may also wish to use the international negotiating process to help overcome domestic resistance to change in areas which have proven difficult to reform unilaterally. In many respects, there is a virtuous cycle in services liberalisation, since liberalisation itself helps to further build capacity.

Looking ahead: setting benchmarks for the WTO

Irrespective of preparedness or capacity on services trade and investment related issues, East Asian nations are seemingly embarked on an unstoppable process of bilateral FTA trade negotiation. It is critically important to minimise any damage to the multilateral system. One potential solution is to leave the services sectors out of the regional preferential trading arrangement (PTA) negotiation process. This is clearly increasingly impractical, especially from a business perspective. These days, trade is increasingly about trade in services, and this includes trade between developing countries.

The only alternative is to ensure that new bilateral agreements – which seek increasingly to go beyond the WTO agreements and into uncharted territory, chiefly on the services and investment related front – set ambitious problem-solving benchmarks for the WTO rather than, accidentally or otherwise, undermining it. This is the most important trade policy challenge facing not only this region but every other region of the globe.

Unfortunately, the reality of bilateral negotiation is that the larger, more powerful nation tends to win, and the wins reflect the particular market access objectives of that nation, not

necessarily the most liberal outcome from a multilateral perspective. Ensuring that bilateral PTAs negotiated within the region set constructive rather than destructive benchmarks for the multilateral system will require considerable ongoing vigilance.

The GATS rule-making process is unfinished, with issues such as subsidies, safeguards and government procurement yet to be negotiated. There is multilateral controversy about whether new issues such as e-commerce should even be classified as services and hence be covered under the GATS. And the WTO has barely begun on investment and competition policy.

To the extent that PTAs in the region continue to experiment with these issues, they could start to set powerful potential precedents for the WTO. Such precedents will no doubt automatically be described by the participating governments as 'WTO Plus' or 'Beyond WTO' outcomes. But this could prove to be a very misleading description because the negotiating positions in Geneva into which such precedents will tend to lock PTA partners will not necessarily be constructive for the multilateral process. On the contrary, to the extent that future bilateral commitments are in fact 'new', they may have the effect of prejudging and foreclosing the multilateral debate in Geneva, especially if the PTA partners are politically strong players in the WTO. The outcomes would then better be described as 'WTO minus' rather than 'WTO plus'.

The whole idea of a rules-based system is to protect the small and medium-sized countries. The largest, most powerful trading nations cannot set the multilateral trade rules alone. However, to the extent that they can bilaterally pick off in PTAs those countries with different perspectives on negotiating issues in Geneva, they can enhance their overall negotiating power. PTAs offer countries such as the United States a back door route to control of the negotiating agenda in Geneva.

The WTO architecture is based around the General Agreement on Tariffs and Trade, which covers goods trade, and the GATS, which covers trade in services. But the handling of new trade-related issues such as investment and competition policy, both of which are already covered to a degree within the GATS, raises architectural design questions for the WTO system as a whole.

To the extent that PTAs in the region reflect individual countries' negotiating preferences on unfinished rules issues or architectural design issues, such precedents are likely to prove powerful influences on the course of the debate in Geneva. This is likely to be the case, for example, for issues relevant to digital trade, where deep definitional debate remains to be resolved before substantive progress in rules making can be achieved in the WTO. It is equally likely to prove to be the case with respect to investment and competition policy issues – indeed any issues where rule-making in Geneva is still nascent.

Whenever bilateral precedents are set, they risk detracting from the debate in Geneva. Through PTA arrangements, the United States is clearly aiming to build a growing US-oriented negotiating alliance in Geneva, especially on digital issues. There is a danger that Japan will be tempted to follow suit in the agricultural arena.

Therefore, in assessing the regional trend to bilateral PTAs, it will be important not to jump automatically to the conclusion that, if a PTA entails obligations which go 'beyond' the WTO in areas such as services trade, the outcome is necessarily to be applauded. Precisely the opposite could prove to be the case. Vigilance and impartial evaluation will remain essential to the regional trade policy tool kit.

Notes

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- 1 See <<http://www.dfat.gov.au/trade/negotiations/safta/index.html>> for the text of the Singapore–Australia Free Trade Agreement and <http://www.ustr.gov/new/fta/Singapore/consolidated_texts.htm> for the text of the United States–Singapore Free Trade Agreement.
- 2 The first parts of this section are based on material in Findlay (2003).

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United Nations Conference on Trade and Development

World Investment Report

**2004 The Shift Towards
Services**



**United Nations
New York and Geneva, 2004**

CHAPTER VI

NATIONAL AND INTERNATIONAL POLICIES: A COMPLEX AND DYNAMIC INTERACTION

Over the past decade, the number of international agreements covering FDI in services has increased substantially, both in number and geographical scope. They reflect the negotiating parties' interests, bargaining power, technical capabilities, levels of liberalization and specific economic, social and other circumstances. The result is a multilayered and multifaceted network of international rules, with obligations differing in scope and content. Within the context of a broad liberalization trend, these agreements increasingly set the parameters for national policies on services through interaction between national and international policies on FDI in services. This interaction can either be led by autonomous liberalization or driven by IIAs. This complex and dynamic interaction poses challenges for development: while IIAs and autonomous liberalization create an enabling framework for FDI, the former also limit national policy space. This raises questions of how best to achieve development goals and how to strengthen the development dimension of IIAs.

At the bilateral level, the number of BITs covering FDI in services reached 2,265 by the end of 2003, and involved 175 countries. Other agreements covering services FDI include FTAs, RTAs and various types of economic partnership agreements. Services IIAs¹ can be found in all geographical regions, and there are also some inter-regional ones (e.g. the OECD Liberalisation Codes) as well as one at the multilateral level (i.e. the 1994 General Agreement on Trade in Services (GATS)). Reasons of why they are concluded are the desire to attract FDI to advance development (box VI.1), to protect FDI (i.e. to assure foreign investors that their investments, and the environment in which they invest, are reasonably secure) and, increasingly, to facilitate market access and the operations of foreign affiliates.

A. The growing multifaceted network of services IIAs

The discussion here uses a broad definition of international investment agreements (IIAs) as “agreements at the bilateral, regional and multilateral levels that address investment issues” (WIR03, p. 88) with the qualification that the IIAs under review cover, in varying degrees, FDI in services (“service IIAs”). While some of the IIAs deal only with investment (e.g. BITs), others cover a broader range of issues, investment being one of them. Most recent FTAs fall into the second category.

1. The evolving nature of approaches covering FDI in services

Three approaches for IIAs' coverage of FDI in services can be distinguished.²

- The *investment-based approach*, whereby FDI is exclusively covered by the disciplines of the investment chapter of an agreement (e.g. the 1992 North American Free Trade Agreement (NAFTA)³) or where an agreement deals exclusively with investment (e.g. BITs). In both cases, the agreement or the specific chapter covers services and non-services investments without differentiating between them.⁴ (As seen earlier, most FDI is in the services sector.)
- The *services-based approach*, whereby services FDI is exclusively covered by the disciplines of the services chapter of an agreement or by an agreement as a whole (if the latter deals exclusively with trade in

services) and which covers commercial presence as one of the four modes of trading services. Besides the GATS (box VI.2), the 1998 Andean Community Decision 439 and the 1995 ASEAN Framework Agreement on Services are examples of this approach.

- The *mixed approach*, whereby services FDI is covered by both the investment and services chapters of an agreement. An example is the 2002 Japan–Singapore Agreement. Under this approach, in certain cases, a special provision in the investment chapter may rule out the applicability of a particular investment discipline, or more general investment disciplines, to services FDI (see below).

To some extent, these three approaches can be viewed as reflecting the evolution over time of IIAs in relation to services. Thus, the first and earliest approach, the investment-based approach, does not make a distinction between services and non-services investments. This approach is quantitatively dominant, all the more so as BITs – while otherwise following different approaches (box VI.3) – continue to be concluded in large numbers. It can be explained, first, by the absence of any express desire by policy-makers to treat investment in services as conceptually different from investment in other sectors and, second, by the wide coverage of the definition and scope of provisions of such agreements. The second approach reflects the manner in which international

Box VI.1. What difference do services IIAs make?

What is the impact of services IIAs in terms of attracting investment in services and benefiting from it? IIAs can have an impact on FDI flows by influencing one of the principal determinants of FDI – the regulatory framework. These agreements tend to make the regulatory framework more enabling, opening space for the decisive economic determinants to assert themselves. IIAs achieve this by:

- reducing obstacles to FDI through the removal of restrictions on admission, establishment and on the operations of foreign affiliates;
- improving standards of treatment of foreign investors (e.g. by granting them non-discriminatory treatment vis-à-vis domestic or other foreign investors);
- protecting foreign investors through provisions on compensation in the event of nationalization or expropriation, by stipulating procedures for dispute settlement as well as guaranteeing the transfer of funds; and
- providing for a transparent, stable and predictable regulatory framework.

To the extent that the enabling framework is enhanced (be it because of autonomous or of IIA-driven regulatory action) and the economic determinants are attractive to investors, FDI is likely to flow to this sector. By the same token, when the economic determinants are not favorable, substantial investment flows are not likely to materialize. Indeed, as discussed in chapter III, a good part of the growth of services FDI during the past decade

or so has been due to an improved enabling regulatory environment. Most of the improvements have been the result of autonomous decisions, rather than the result of services IIAs (but these decisions tend to become more credible in the eyes of investors through commitments in IIAs).

In contrast to FDI in goods for which RTAs expand the market by facilitating trade among the participating members of the region and hence encourage FDI, market size plays less of a role in the case of services, as most of them are less tradable. By the same token, FDI in services may be less subject to regional strategies of rationalization whereby goods firms consolidate production into one or a few foreign affiliates to service the regional area as a whole, thus reducing FDI.^a Services FDI (like goods FDI) may, however, benefit if a RTA stimulates economic growth.

Thus, it is difficult to ascertain to what extent services IIAs contribute to increased FDI flows in services.^b

And what about the benefits and costs? As discussed in chapter III, services FDI can involve a range of benefits and costs. In most cases, these can be enhanced or mitigated, as the case may be, through appropriate government policies. The issue then becomes whether IIAs enhance or restrict the ability of governments to pursue development-oriented policies – an issue taken up in some detail in *WIR03* (chapters III to VI). From a services-specific perspective, it is discussed further below in this chapter.

Source: UNCTAD.

^a This situation may, however, change with the increasing tradability of services (see chapter IV).

^b For a further discussion, see *WIR03*, chapter III.

Box VI.2. The GATS and FDI in services

The GATS is unique in that it establishes the only set of multilateral rules for services FDI in the context of international services transactions in general. All 147 members of the WTO are bound by the rules of the GATS insofar as they apply specifically to that country. The Agreement covers four modes of services supply, one of which is the supply of services through “commercial presence”, defined as “any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service” (Article XXVIII, lit. d).^a “Commercial presence” is therefore akin to FDI. (The other modes of supply are cross-border supply, consumption abroad and the presence of natural persons.)

The definition of commercial presence in the GATS is narrower than the asset-based approach commonly found in IIAs entered into by both developed and developing countries (UNCTAD 1999b). Also, unlike other services IIAs, the GATS does not contain those disciplines on investment protection that typically constitute central tenets of other IIA regimes (e.g. the GATS does not contain rules that assure foreign investors compensation in the case of expropriation or set the minimum standard of treatment).^b Nor does it explicitly prohibit performance requirements^c or provide for investor–State dispute settlement.

Two key GATS obligations are found in Articles XVI (market access) and XVII (national

treatment). They apply only to those service industries (“sectors” in WTO parlance) and modes of supply in respect of which a WTO member has made “specific commitments” in its schedule. When making a commitment, a member may set out limitations, conditions and qualifications on market access and national treatment with respect to listed industries and modes of supply. Such conditions may include the ability to place restrictions on foreign equity participation, to require joint ventures (or other specific types of legal entity), to require the payment of taxes on the remittances of foreign affiliates, to be able to grant subsidies to domestic service suppliers in specific industries, to limit the use of land by foreign affiliates, to place geographical restrictions on the supply of certain services by foreign affiliates, or to limit the total number of (natural) persons employed in a particular service industry. Accordingly, the impact of the GATS is to a large extent dependent upon the content of members’ commitments and any limitations attached to them.

In pursuance of the objective of the GATS, the Agreement provides for the periodic negotiation of specific commitments through successive rounds of negotiations. The first of these rounds was mandated by the Agreement and subsequently incorporated into the negotiations launched by the 2001 WTO Doha Ministerial Meeting. The process of requests and offers of commitments was underway in mid – 2004. By 9 July 2004, 44 offers (counting the European Communities (15) as one) have been received by the WTO Secretariat.^d

Source: UNCTAD.

^a Note that GATS Article XXVIII also sets out equity thresholds, establishing when juridical persons are “owned” by persons of a member. Specifically, lit. (n) states: “a juridical person is: (i) ‘owned’ by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member; (ii) ‘controlled’ by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions; (iii) ‘affiliated’ with another person when it controls, or is controlled by, that other person; or when it and the other person are both controlled by the same person”.

^b Note, however, that the GATS contains certain disciplines related to investment protection, for example, rules on payments and transfers (i.e. Article XI), rules on the “reasonable, objective and impartial” administration of measures of general application in committed sectors (i.e. Article VI, para.1) or provisions addressing certain cross-border movements of capital (i.e. those set out in footnote 8 to Article XVI).

^c This does not exclude, that members commit themselves in this respect in their schedules. At the same time, Article XIX, para. 2 allows performance requirements attached as conditions to market access and national treatment commitments.

^d “Trade talks on services ‘may last years’”, *Financial Times*, 6 July 2004. For the initial offers, to the extent that they are publicly available, see <http://www.wto.org>.

transactions in services (including commercial presence) were addressed in the context of the GATS negotiations in the Uruguay Round.

The third approach blends the other two approaches by addressing investment, typically in a separate chapter, while simultaneously

enshrining special rules for services FDI (in the context of international service transactions in general) in another chapter. These agreements also increasingly cover a host of other issues, including some that have implications for investment (e.g. competition). A growing number of recent FTAs and RTAs adopt this approach.

Box VI.3. Approaches to BITs and FDI in services

In BITs, services FDI is subject to the same rules as all other types of investment.^a However, not all BITs are identical, although they have much in common (UNCTAD 1998). There appear to be three main approaches: the first could be called the broad, Western Hemisphere approach, promoted most actively by the United States and Canada; the second is the more narrow European approach, mostly followed by European countries;^b and the third is the South-South approach (which is close to the European approach).^c

The Western Hemisphere approach extends *national treatment and MFN obligations* to the pre-establishment phase of investment (while accommodating country-specific exceptions to these obligations), while the other approaches tend to cover only the post-establishment phase. Similarly, the Western Hemisphere approach tends to contain a specific article on prohibited *performance requirements*, while the other approaches may deal implicitly with such requirements, e.g. in so far as they might violate the national treatment or MFN obligations.^d One distinguishing feature of the 2004 United States and Canadian^e model BITs is that they contain provisions not to lower *environmental and labour* standards to attract investment. Further, with

respect to *transparency*, the United States and Canadian model BITs include so-called *a priori* comment and publication procedures, whereas the few European treaties containing transparency requirements limit their applicability to the stage after the adoption of laws and regulations. Some of the distinctive features of the South-South approach involve that they put more emphasis on exceptions (e.g. for balance-of-payments or prudential measures) and the so-called fork-in-the-road clause, i.e. investors must choose between the litigation of their claims in a host country's domestic courts or international arbitration: once made, the choice is final.

Learning from investor-State litigation under NAFTA, the most recent United States and Canadian model BITs clarify the meaning of the articles on *minimum standard of treatment* (including fair and equitable treatment and full protection and security) and *expropriation*.^f So far, this has not been done in European and developing-country BITs, perhaps in part because European and developing countries either have not yet been extensively involved in high profile investor-State litigation, or because awareness about the implications of such cases is only just beginning to emerge.

Source: UNCTAD.

^a However, the 2004 United States model BIT, for example, contains specific obligations for certain service industries (i.e. financial services). See the Treaty between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment, 2004; <http://www.state.gov/documents/organization/29030.doc>.

^b Since the European Commission does not have a mandate to negotiate investment issues on behalf of the members of the Union, European countries continue to conclude separate BITs, which, nevertheless, possess the same basic features.

^c Given the great number of developing countries, it is, of course, difficult to speak about a developing-country approach, especially as far as a number of Latin American countries are concerned. The matter is further complicated by most developing countries having BITs with either North American or European countries.

^d Rules on performance requirements are, however, set out in the 1994 WTO Agreement on Trade-Related Investment Measures (TRIMs).

^e See the 2004 Canadian model BIT, Agreement between Canada and ____ for the Promotion and Protection of Investments, 2004; <http://www.dfait-maeci.gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf>.

^f The relevant rules can be found in Articles 5 and 6 and Annexes A and B of the United States model BIT. More specifically, Annex A emphasizes the parties' shared understanding of customary international law for minimum standard of treatment and expropriation, while Article 5 and Annex B spell out in more detail the meaning of customary international law for "fair and equitable treatment", "full protection of security" and "expropriation".

This mixed approach raises the question of the relationship between the two chapters in an agreement – an issue discussed below.

Naturally, such a categorization must be treated with caution since it looks only at a particular agreement in isolation from other agreements, which together form the legal regime for investment, both in services and non-services, between two or more countries. For example, a services-based approach in a RTA may be complemented by a BIT that also covers services FDI; taken together, they constitute a mixed approach of a different nature. To take another example, this time from the Andean Community, the 1991 Decision 291⁵ deals with investment in general, thereby also covering services FDI; it is complemented by Decision 439 which takes a services-based approach (i.e. covers only services FDI). A similar situation arises in the context of ASEAN. Here, the ASEAN Framework Agreement on Services is complemented by the 1998 (as amended in 2001) Framework Agreement on the ASEAN Investment Area (AIA). While the AIA in its original form did not cover services FDI, in its current form it covers FDI in services incidental to manufacturing, agriculture, fishery, forestry, mining and quarrying.⁶ In parallel, the 1987 (as amended in 1996) ASEAN Agreement for the Promotion and Protection of Investments⁷ applies to services FDI. Together, these agreements, too, constitute a mixed approach. Thus, ultimately, it is necessary to look not only at individual agreements, but also at the overall legal regime established between countries.

2. Salient features

A number of issues arise in light of the three approaches identified above. The treatment of these issues – many of which also apply to goods FDI but are particularly relevant to services FDI – differs across agreements. However, certain tentative general observations can be made.

Structure and organization

As regards structure and organization, agreements following the investment-based approach raise few problems, given that services and non-services investments are not differentiated for the purposes of the investment provisions of the agreements.

Agreements adopting a services-based approach allow addressing the specificities of services FDI. However, this approach requires a determination of whether an investment is a services or a non-services investment, which is sometimes difficult, even for statistical agencies.⁸ Agreements adopting a mixed approach, too, need to determine whether an investment is a services investment or not, and what that means in each case. This can give rise to inconsistencies – an issue discussed below.

Definition of investment

Traditionally, IIAs either contain broad, asset-based or narrow, enterprise-based definitions of investment, with the large majority (especially BITs and FTAs) adopting the former (UNCTAD 1998).¹⁰ IIAs taking the services-based approach (i.e. the ones that cover services investment as “Mode 3/commercial presence” in services trade) are more likely to adopt narrower, enterprise-based definitions than IIAs that do not contain a services chapter. The GATS and the Andean Community Decision 439¹¹ are examples. In addition, some agreements using the mixed approach, for example the 2002 EFTA–Singapore FTA and the Japan–Singapore Agreement, adopt both a narrower, enterprise-based definition of investment in their services chapter¹² and a broader, asset-based definition in their investment chapter.¹³ The implication is that, in spite of the services chapter’s narrower definition of what an investment is, the investment may actually benefit from the broader definition of the investment chapter (e.g. when it comes to the protection of intellectual property rights often covered by the asset-based definition), unless there are specific provisions that provide for a different approach. While this may have far-reaching implications for the scope and breath of an IIA as well as for the obligations countries accept thereunder, it has, thus far, received comparatively little attention from policy-makers, particularly in developing countries.

Linked to the definition and scope of investment covered by an IIA is the question of who should benefit from its provisions. Most of the services IIAs contain special clauses regarding the beneficiaries under the respective agreements, frequently entitled “Denial of Benefits”.¹⁴ These clauses identify those investors and investments that are not eligible for the benefits provided by the respective agreement. Generally, these are enterprises in the

territory of a party but owned or controlled by investors of a *non*-party.¹⁵ Frequently, these clauses, which identify non-eligible investors through a so-called “substantial business operations test”, state that benefits can be denied to an enterprise that is owned and controlled by persons of a non-party, if the enterprise has no substantial business activities in the territory of the party under whose laws it is constituted.¹⁶ The 2003 Mainland–Hong Kong Closer Economic Partnership Arrangement,¹⁷ for example, sets out in detail the criteria for determining whether or not an enterprise has substantive business operations (box II.7). The GATS, too, refers to substantive business operations, but without defining them. While one of these references is in the Article containing definitions for the purpose of the GATS (Article XXVIII, lit. m (i)),¹⁸ the other one refers to economic integration (Article V, para. 6). This provision entitles those service suppliers of WTO members that are established in an economic integration agreement area to the benefits of that agreement if they engage in substantive business operations in one of the parties to that agreement.¹⁹ Thus, it refers to the extension of benefits to third-party companies conducting “substantive business operations” in the context of a very specific set of circumstances (i.e. derogations from GATS disciplines permitted as a result of entering into economic integration agreements).²⁰

Investment liberalization

The principal issue here is whether an agreement covers both pre- and post-entry investment, or post-entry investment only. Certain recent FTAs contain the right of establishment (i.e. cover pre-entry investment), while most BITs, except for recent ones signed by some countries in the Western Hemisphere, apply to post-entry investment only (UNCTAD 1999b). Where the right to establishment is granted (in some BITs and a number of FTAs), this is typically done by extending national treatment commitments at the pre-entry stage. At the regional level, NAFTA takes this approach. While the approach is different in the GATS, the agreement also allows members to grant pre-establishment rights in the context of the commitments they undertake. (Note also the definition of commercial presence under the GATS, which includes the words “establishment” and “acquisition”.) Overall, where countries grant pre-establishment rights, they tend to complement

them with a high number of conditions or limitations.

There are instances in regional groupings, including those comprising developing countries, in which parties agree, in principle, to negotiate future liberalization of services to a degree that goes beyond what has been agreed in the GATS.²¹ The ASEAN Framework Agreement on Services is an example (box II.8).

Investment protection

Most agreements taking the investment-based approach contain core protection disciplines, including national treatment, MFN and fair and equitable treatment. In some agreements, these may be linked to the observance of the international minimum standard of treatment. Equally, agreements normally cover compensation for loss and expropriation, and provide for the free transfer of funds. Agreements taking the services-based approach tend to be less far-reaching as regards investment protection. For example, the GATS does not contain a set of investment protection rules, though it has, for example, a general MFN obligation (subject to exemptions), rules on transfers and payments (Article XI), and other capital transactions (footnote 8 to Article XVI²²), as well as national treatment (the latter subject to limitations) (Sauvé and Wilkie 2000). Agreements not containing strong rules on protection may, however, be complemented by agreements focusing on protection, for example, BITs. On the other hand, agreements taking a mixed approach are likely to contain all the main investor-protection standards and guarantees typically covered in investment-based IIAs. For example, the New Zealand–Singapore and the Japan–Singapore agreements contain the usual liberalization rules in the services trade chapters²³ and the usual investment protection rules in the investment chapter, both of which apply to services FDI.

Performance requirements

The GATS does not explicitly prohibit performance requirements, and the TRIMs Agreement does not apply to services.²⁴ However, since the middle of the 1990s, a number of services IIAs explicitly prohibit the use of certain performance requirements geared towards services (table VI.1), including requirements pertaining to exports, local content, employment,

the supply of a specific region of the world market exclusively from a given territory, the location of regional headquarters and R&D. Such provisions are generally found in IIAs concluded by countries in the Western Hemisphere, starting with NAFTA. Some agreements only prohibit the use of mandatory requirements, while allowing requirements linked to the granting of incentives (box VI.4).²⁵ Sometimes, services IIAs allow countries to retain their ability to use otherwise prohibited performance requirements by entering into reservations.²⁶ However, even in the absence of specific disciplines, national treatment rules and other disciplines (such as those on transparency or MFN treatment) may apply to services-related performance requirements. Thus,

if a party wishes to continue applying performance requirements to foreign affiliates only, it would need to make a specific reservation in its national treatment commitment as well as in relevant annexes dealing with MFN exemptions.²⁷

In some countries, a specific requirement, arising out of the particular nature of some services, is the local presence requirement. This is a kind of duty of establishment which requires a firm to place the business itself within a locally registered and licensed corporate entity. This can be the case, for example, with respect to financial services, where, the need for prudential supervision is difficult to achieve without the

Box VI.4. The GATS and subsidies

Insofar as subsidies affect trade in services, they are measures covered by the general obligations of the GATS, such as MFN and the individual countries' specific commitments, including national treatment. In addition, Article XV of the GATS specifically deals with subsidies. This provision notes that, "...in certain circumstances, subsidies may have distortive effects on trade in services." Negotiations have begun (but with little progress) with the aim of developing "...the necessary multilateral disciplines to avoid such trade-distortive effects." Furthermore, "[s]uch negotiations shall recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area" (Article XV, para. 1).

The GATS thus permits subsidies as such, including subsidies contingent upon the export of services and other investment incentives. However, the MFN obligation applies to subsidies

because they are covered by the definition of "measure". In scheduled industries, national treatment commitments also apply, unless they specifically exclude subsidies. In the service industries for which commitments have been made, and subject to any conditions or qualifications set out in its schedule, a WTO member must administer its subsidy schemes in a manner that accords the services and service suppliers of other members treatment no less favourable than that accorded to its own like services and service suppliers.

However, the fact that a subsidy pertains to a service industry does not necessarily mean that other WTO agreements, and in particular the Agreement on Subsidies and Countervailing Measures (SCM) (WTO 1994d) and the Agreement on Agriculture (WTO 1994a),^a do not apply. For example, the provision by a government of certain subsidized services to producers of goods can also be relevant under the SCM Agreement.

Source: WIR02, p. 210.

^a Annex 2, para. 2 of the Agreement on Agriculture refers to "... expenditures (or revenues foregone) in relation to programmes which provide services or benefits to agriculture or the rural community...". Such programmes "...shall not involve direct payments to producers or processors...". They shall include but not be restricted to: research, pest and disease control, training services, extension and advisory services, inspection services, marketing and promotion services, infrastructural services (including electricity reticulation, roads, market and port facilities, water supply facilities, dams and drainage schemes and infrastructural works associated with environmental programmes). These subsidies fall under the so-called "green box", with the additional requirement (set out in para. 1) that they have "...no, or at most minimal, trade-distorting effects...". While the GATS and the Agreement on Agriculture address different situations, there might be subsidy regimes that can fall under both Agreements (because one and the same subsidy might affect both, trade in services and trade in agricultural products). In such a case, the subsidy – or a specific aspect of a subsidy regime – that is allowed under one Agreement, could still be found to be in violation of the other.

Table VI.1. Examples of services IIAs prohibiting various types of performance requirements pertaining to services, 2004^a

Instrument	Performance Requirement	Locate headquarters for a specific region of the world market	Export a given level or percentage of services	Employment requirement performance	Supply services provided to a specific region of the world market exclusively from a given territory	Act as the exclusive supplier of services provided	R&D	Purchase or use services provided in its territory, or to purchase services from natural or legal persons in its territory	Labour certification, academic certifications or other procedures of similar effect
NAFTA, 1992			X			X		X	
GATS, 1994 ^b									
Croatia–United States BIT, 1996 ^c			X		X	X	X	X	X
Canada–Chile FTA, 1996			X						
El Salvador–Peru BIT, 1996			X		X	X		X	X
Canada–Romania BIT, 1996 ^d								X	
Mexico–Nicaragua FTA, 1997			X			X		X	
Jordan–United States BIT, 1997			X			X	X	X	X
Chile–Mexico FTA, 1999			X			X		X	
Jordan–United States FTA, 2000 ^e									
EU–Mexico FTA, 2000									
Japan–Republic of Korea BIT, 2001		X	X	X	X		X	X	
CARICOM Agreement, 2001									
Japan–Singapore Economic Partnership Agreement, 2002		X			X		X	X	
EFTA–Singapore FTA, 2002			X						
Chile–United States FTA, 2003			X						
Chile–Republic of Korea FTA, 2003			X					X	
Chile–EU Association Agreement, 2003									
CAFTA, 2003 ^f			X		X			X	
Australia–United States FTA, 2004			X		X			X	

Source: UNCTAD.

- ^a Apart from the four performance requirements prohibited by the TRIMs (local content requirement, trade-balancing requirements, foreign exchange restrictions related to foreign exchange flows attributable to an enterprise, and export controls), countries have included other specific prohibitions in agreements. This table is an example of some of the services IIAs that contain express provisions prohibiting certain types of performance requirements that could be considered in relation to services. Note also, that the list of performance requirements given in this table is not exhaustive. Rather, some of the listed agreements contain prohibitions additional to the ones mentioned in this table.
- ^b Depending upon a member's commitments, the GATS market access provision (Article XVI, para. 2, lit. e) may rule out joint venture requirements or requirement for other specific types of legal entity. Similarly, even in the absence of specific disciplines, national treatment rules (again depending upon a member's commitment) and other disciplines (such as those on transparency or MFN treatment) may apply to services-related performance requirements.
- ^c Most of the recent BITs signed by the United States contain clauses prohibiting similar measures as in the Croatia–United States BIT. Other examples are the BITs with Azerbaijan (1997), Bolivia (1998), Lithuania (1998) and Mozambique (1998).
- ^d Most of the recent BITs signed by Canada contain clauses prohibiting similar measures as in the Canada–Romania BIT. Other examples are the BITs with Ecuador (1996), Panama (1996), Egypt (1996), Croatia (1997), Lebanon (1997), Thailand (1997), Uruguay (1997) and Costa Rica (1998).
- ^e Note that Jordan has scheduled a national treatment reservation under Mode 3 for architectural services, engineering services and urban planning and landscape architectural services that specifies that "[f]oreign firms are required to train and upgrade the technical and management skills of local employees".
- ^f Central American Free Trade Agreement.

physical presence of the related assets of the businesses in the markets they serve. A further reason concerns the regulatory authorities' ability to recover assets of suppliers, should the need to do so arise.²⁸ Finally, local presence requirements may be introduced to ensure more developmental benefits for the host country, for example, in terms of creating new jobs. A number of Canadian and United States FTAs, in their services chapters, prohibit signatories from requiring a service provider of the party to establish or maintain a representative office or any form of enterprise in the territory of the other party as a condition of providing services in the territory of that latter party.²⁹

Dispute settlement procedures

There are differences in the types of dispute settlement systems applying to services FDI. While a number of IIAs, in particular BITs and most recent FTAs, contain mechanisms for investor-State dispute settlement, such a mechanism is generally not found in those IIAs – or chapters within them – that take a services-based approach.

To the extent that services FDI is covered by the investment chapter, it may well be subject to investor-State dispute settlement if the obligations of the investment chapter are subject to such a mechanism. This may be the case for investment-based agreements as well as mixed agreements. The 2003 Chile–United States FTA and the 2003 Singapore–United States FTA (both investment-based agreements) have investor-State dispute settlement systems that apply to services FDI (as part of the investment chapter).³⁰ In the case of the 2003 Australia–Singapore FTA³¹ (a mixed agreement), investor-State dispute settlement applies to the investment chapter (covering services FDI), but not to the services chapter (also covering services FDI). Thus, to the extent that services FDI is covered as “Mode 3/commercial presence” in the chapter on trade in services, it may be subject only to the State-State dispute settlement process (or arbitration procedures), as this is the typical dispute settlement mechanism for most such chapters. Slightly different, but related, the GATS, as part of the WTO, contains a mechanism for State-State dispute settlement only.³² The same applies to the 2000 Jordan–United States FTA and the ASEAN Framework Agreement on Services.³³

Thus, as with many other issues, where, or in which chapter, services FDI is covered can determine the type of dispute settlement mechanism applying to it.

Another interesting feature is that some agreements require specific expertise for dispute settlement (panels or other arbitral) tribunals as they deal with industry-specific issues. Financial services are a case in point. Paragraph 4 of the GATS Annex on Financial Services stipulates that “[p]anels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute.”³⁴

Approaches to negotiating commitments

Services IIAs can differ in the method negotiating parties use to arrive at their individual commitments for services FDI. Under the negative list approach, countries agree on a series of general obligations, and then individually list all of those areas in which non-conforming measures are maintained. For example, NAFTA (in its investment chapter, which also covers services FDI) and a number of agreements involving countries of the Western Hemisphere as well as BITs take this approach. In contrast, under the positive list approach, certain obligations apply only to the industries (along with relevant limitations) listed by each country. For example, the GATS, the 1997 MERCOSUR Protocol of Montevideo and the ASEAN Framework Agreement on Services take this approach.³⁵ While, in theory, both approaches can arrive at the same results, and both grant flexibility, there are important differences between them. For example, in terms of the negotiating process, the negative list approach can be administratively burdensome, particularly for developing countries with limited resources. In terms of outcomes, the negative list approach can result in a situation in which future measures may, due to lack of foresight, be inadvertently bound. This could also happen in industries in which, at a later date, governments may need to take development-oriented measures. Given that in many countries certain service industries are yet to be developed and the regulatory framework for the services sector is still evolving, this may, in certain cases, forestall policy flexibility.³⁶

Provisions covering specific service industries

Services IIAs can contain rules for specific service industries. In the WTO, for example, separate texts have been negotiated since the adoption of the GATS on telecommunications, financial services and accountancy services (box VI.5). However, since the completion of negotiations on these three issues, no new texts have been agreed upon.³⁷ While discussions on industry-specific commitments continue, proposals on horizontal approaches cutting across industries have gained prominence in negotiations on domestic regulation (for the European Communities, see WTO Working Party on Domestic Regulation 2003) to allow for a wider and more coherent development of benchmarks.³⁸ NAFTA contains a separate chapter for financial services that also covers FDI, and so do some bilateral United States FTAs.³⁹ Some EU agreements incorporate provisions to allow establishment in maritime transport.⁴⁰ Another industry becoming increasingly prominent is energy-related services. At the same time, agreements tend to exclude (in whole or in part) certain industries from their coverage. Much of air transport, which is governed by long-standing bilateral agreements pre-dating the GATS by many years, is a case in point.⁴¹

Follow-up procedures

Frequently, the conclusion of services IIAs results in the establishment of “ground rules” with several aspects left for further development. In the GATS, this is the case with respect to areas such as domestic regulation, subsidies, government procurement and safeguards, as well as the negotiation of specific commitments. The same applies to services IIAs modelled on the GATS,⁴³ and also to some United States FTAs.⁴³ Also, the ASEAN Framework Agreement on Services contains a commitment towards further liberalization, which is carried out in three-year negotiation cycles (box II.8). Some services IIAs establish commissions or other bodies charged with monitoring the implementation and functioning of the agreements.⁴⁴ They provide a platform to review their implementation and to recommend action if needed. In the case of the GATS, an

“assessment of trade in services” is mandated,⁴⁵ and negotiations would need to be adjusted in light of the results thereof.⁴⁶ Along similar lines, there can be a monitoring of negotiations and the progress undertaken therein. Again, WTO services negotiations serve as an example.⁴⁷

* * *

As observed in chapter V, FDI liberalization in the secondary and primary sectors has advanced considerably. The services sector continues to be characterized by a range of restrictions related to FDI. Services IIAs, in

Box VI.5. Individual service industries in the WTO

WTO texts applying to services have different characteristics and serve various policy purposes. In some instances, such rules elaborate on the obligations of the GATS according to the specificities of individual service industries; this is notably the case of the GATS Annexes on Financial Services and on Telecommunications, whose provisions apply irrespective of any specific commitments. In other cases, for example in telecom services, sectoral disciplines also address matters such as competition-related aspects of trade in services. Such rules can be found in the Reference Paper for Telecommunications, which features a number of pro-competitive regulatory disciplines for voluntary adoption by WTO members through Article XVIII (Additional Commitments). In the case of financial services, sectoral rules address the need to undertake measures for prudential reasons. Some, such as the Understanding on Financial Services, provide a voluntary model for scheduling commitments aimed at a higher overall level of liberalization. In the accountancy sector, provisions negotiated under Article VI, para. 4 (Domestic Regulation) spell out disciplines relating to licensing, qualifications and professional standards. Such disciplines, which, under certain conditions, are scheduled to enter into force at the end of the current round of negotiations, would apply only to those countries that undertake commitments in accountancy services.

Source: UNCTAD, based on various WTO documents.

and by themselves, often reflect only the status quo of liberalization at the national level. However, a number of them can lead to changes in national policies, for example, when they prohibit services-specific performance requirements. Moreover, a few can accommodate further liberalization, by establishing the ground rules for future negotiations. This can go hand-in-hand with efforts to negotiate industry-specific rules, making the international framework for services FDI (and other international services transactions) increasingly complex.

B. Complexities and challenges

The adoption of multilateral rules on services FDI has not halted – or diminished the momentum – for regional or bilateral treaty making. Rather, subsequent to the negotiation of the GATS, services provisions appear increasingly in IIAs across all regions.

This multilayered and multifaceted reality raises a number of policy challenges. While agreements may generally be consistent with or complement each other, there may also be cases of overlap, inconsistencies and gaps that, potentially, give rise to conflicts. Furthermore, in some cases, the complexity and, at times, ambiguity of the rules applicable to services FDI might compromise the clarity of the system, making it difficult to navigate through the resulting web of rules. This is particularly true for countries with insufficient human and institutional capacity to formulate and implement services IIAs.

A specific example of difficulties arising from complexity and ambiguity relates to the scheduling of commitments and reservations. Frequently, negotiations cannot produce the necessary clarity, certainty and comparability in term of commitments; this leaves lacunae that, eventually, may be filled through dispute settlement. A recent example of this is the 2004 WTO case *Mexico–Telecommunications* with respect to telecom services (WTO Dispute Settlement Body 2004). Amongst other issues, this case dealt with the exact meaning of Mexico's entries in its schedule of commitments (particularly, as to what extent Mexico was bound by the Reference Paper). This underlines the

importance of scheduling carefully the commitments that are being made. But this may be a challenge in light of the emergence of *new* services – an issue of particular relevance in the context of this *WIR*.

The complex network of IIAs also raises questions concerning the coexistence of multilateral, regional and bilateral services IIAs, as well as the challenges resulting therefrom (*WIR03*, pp. 93-97). There is, indeed, a need to ensure that rules are consistent with each other and that they complement each other in a mutually supportive way. This is a problem not only of consistency between different international treaty obligations accepted by contracting parties, but also one of consistency in national legal and policy changes made in the process of implementing international obligations.

To avoid the adoption of inconsistent international obligations, a number of services IIAs mirror the provisions of the GATS,⁴⁸ incorporating – by reference – existing or future GATS obligations or, more broadly, affirm their complementarity with the GATS regime.⁴⁹ However, negotiating outcomes can result in inconsistent obligations, possibly leading to a conflict between them. In such a case, conflicts have to be dealt with in accordance with general rules of international treaty interpretation.⁵⁰ When the parties wish to ensure that certain inconsistent obligations remain in force or determine which provisions, in the case of conflict, should prevail, they can expressly provide for this in a conflict-clause provision of the treaty.⁵¹

Inconsistencies can arise, for example, when bilateral or regional agreements covering services investment contain rules granting more favourable treatment to their constituent members as opposed to their external investment partners, thereby deviating from the WTO MFN principle. The GATS (like the GATT) contains a provision permitting economic integration agreements (Article V), provided they meet a series of conditions: for example, that they have substantial sectoral coverage (meaning, among other things, that no mode of supply is excluded *a priori*), and that they provide for the absence or elimination of substantially all discrimination through the elimination of existing discriminatory measures and/or the prohibition of new or more

discriminatory measures. To a certain extent, however, the meaning of this clause is ambiguous.⁵² According to this provision, the requirement to eliminate “substantially” all discrimination (specified in paragraph 1(b)(i) and 1(b)(ii)) depends on the substantial sectoral coverage of a services agreement; this, in turn, depends on the number of industries, the volume of trade affected and the modes of supply. For developing countries, paragraphs 3 (a) and (b) of Article V provide additional flexibility with respect to these compatibility requirements.⁵³

In addition to Article V on economic integration agreements, the GATS allows WTO members to list exemptions to the MFN obligation contained in Article II. Listing MFN exemptions was possible only at the conclusion of negotiations during the Uruguay Round or, for those members that joined later, at the time of accession to the WTO.⁵⁴ The Annex on Article II specifies, however, that exemptions should, in principle, not exceed a period of ten years.⁵⁵ In fact, as of 2001, the list of exemptions from the GATS MFN obligation contained 232 exemptions relating to other IIAs, of which 13 (or 3.1%) pertain to BITs (OECD 2001b).⁵⁶ Besides BITs and investment guarantee agreements, MFN exemptions also cover other measures and policy goals (e.g. health or audiovisual services).

Besides the GATS, virtually all other services IIAs contain MFN obligations. MFN clauses can differ, including in their scope of coverage or in the number of beneficiaries of MFN rights. While the GATS grants MFN rights to all other WTO members, subject to MFN exemptions, under a bilateral IIA only the countries party to the agreement enjoy this right. Note, however, that there may be questions as to which investors are considered investors of a party. Ultimately, the question of MFN consistency is dependent on the type of measure as well as on the breadth of coverage of an MFN clause against which a measure is scrutinized.⁵⁷

In addition to potential conflicts between IIAs arising from the MFN obligation, there can be other inconsistencies between IIAs. It may well be that a country is party to an IIA adopting a positive list approach for services FDI, and is also party to an IIA adopting a negative list approach for services FDI. While it can be assumed that parties intend to negotiate their international commitments for services FDI in a manner consistent with each other,

inconsistencies may still arise. Some IIAs address this by including specific provisions regulating the relationship between the IIA and other international agreements.⁵⁸

Apart from the issue of inconsistency *between* IIAs, inconsistencies can also arise *within* agreements, especially in those taking a mixed approach. To guard against such potential problems, the Australia–United States FTA, for example, explicitly states (Article 11, para.2): “in the event of any inconsistency between this Chapter [the investment chapter] and another Chapter, the other Chapter shall prevail to the extent of the inconsistency”.⁵⁹ Another alternative is to identify specific provisions of the investment chapter that do not apply to FDI in services.⁶⁰

In addition to inconsistencies, the multilayered network of services IIAs may also entail a specific type of externality: certain obligations provided for in bilateral or regional agreements may have effects that go beyond the parties to such agreements. For example, any benefits from an obligation (included in a BIT or a FTA) to publish laws and regulations relating to services FDI are automatically enjoyed by all other interested parties, since the States bound by the transparency requirement in the BIT or a FTA will not typically be able (or willing) to limit the beneficial effects of such an obligation to the other contracting parties. Similarly, an obligation setting forth certain general regulatory standards (whether procedural or substantive in nature) may have spillover effects that go beyond the bilateral or regional agreements through which they are undertaken. For example, the requirement that domestic regulations affecting trade in services (including services FDI) be administered in a reasonable, objective and impartial manner (as included, for example, in Article 28 of the EFTA–Singapore FTA, or in GATS Article VI, para. 4) can benefit all countries,⁶¹ even if they are not parties to the relevant agreements.⁶²

Another example is that some IIAs incorporate obligations whose benefits are not limited to (investors of) the parties to the agreements, but rather extend to investment independently of its origin. In NAFTA-type agreements, the prohibition of certain performance requirements applies to all foreign affiliates in the territories of the parties, irrespective of the nationality of their parent firms.

C. National and international policies: a complex and dynamic interaction

The interaction between services IIAs and national regulations for services is dynamic and complex. This is because rules for FDI in services are constantly evolving, both at the international and national levels. Unlike the liberalization of conditions for FDI in the manufacturing and primary sectors that has already progressed significantly, liberalization in the area of services has only relatively recently begun to play an important policy role (chapter V). In developed countries, services regimes are undergoing significant changes. In particular, such changes result in a further opening of service industries and increased private participation in the provision of what were previously treated as public services (box VI.6). In developing countries, this process is generally less advanced. Many of the rules and regulations for services are not yet fully established, with regulators experimenting, adopting different methods, and ultimately seeking the regulatory approach that best suits the developmental needs of their countries. At the same time, new international disciplines on services are being adopted that serve as parameters for domestic regulatory action. The result of these national and international policy trends is a complex interaction, whereby some of the issues address regulation and go beyond the question of discrimination between foreign and domestic service providers.

Two forms of interaction between services IIAs and national policies are particularly noteworthy. One form is an autonomous-liberalization led interaction, whereby the degree of FDI liberalization and protection in an IIA is determined mainly by the scope and extent of the countries' national policies on services as they appear at the time of negotiations. Thus, the actual level of liberalization inscribed in an IIA reflects either the level of openness already existing in national laws and policies at the time of negotiation, or a level that is below the national regulatory status quo. The results of the services negotiations during the Uruguay Round are an example. During these negotiations, many countries made

commitments (frequently qualified through limitations) that were less open than the level of services liberalization that actually existed at that time in their national policies.⁶³ Other commitments reflected the status quo, such as some of those made during the extended negotiations on financial services and telecoms. But, of course, even such a cautious approach of making commitments at or below the actual level of openness locks in the existing (or part of the existing) national autonomous liberalization. The large majority of services IIAs are of this nature.

Box VI. 6. IIAs and public services

IIAs appear to recognize the need to accommodate the particularities of “public” services (sometimes also referred to as “essential” services). The reason is that many of these services raise special issues of market failure and equitable provision and some are deeply embedded in a country's social, cultural and political fabric. Several services are in the general interest of the public and, indeed, essential for human life (e.g. health and provision of water). Thus, governments face the challenge of ensuring that these services are adequately provided, including to the poor and marginalized members of society. In certain cases, this challenge may even be accompanied by a government's obligation to ensure the progressive realization of certain human rights (UNHCHR 2002, 2003). In their public services policies, governments frequently pursue a number of objectives, e.g. to improve the accessibility and affordability of a given service and to increase the efficiency with which it is supplied, while limiting the expenses to the government and taxpayers. At the same time, however, there is no widely accepted definition of public services. Rather, countries and societies differ in their perception about what are public services.

Some services IIAs seek specifically to accommodate the particularities of public services by explicitly carving out some of them from their scope of application.

The GATS, for example, adopts the notion of “services supplied in the exercise of governmental authority”, excluding these from its scope of application.^a Under GATS Article I, para. 3(c), such services are defined as services

/...

Box VI. 6. IIAs and public services (concluded)

that are neither supplied on a commercial basis, nor in competition with other services.^b Thus, while there might be important overlaps, the notion of “services supplied in the exercise of governmental authority” might differ from what some understand as “public services”. Given this ambiguity,^c a number of WTO members have added limitations, either of a horizontal or of an industry-specific nature, to their services commitments, possibly with a view to retaining policy space for those services that they want to reserve for public or quasi-public management.^d They have chosen to do so, despite the fact that the text of the Agreement does not refer to privatization, nor does it explicitly prevent governments from supplying services to the poor or marginalized or from requiring this of a private operator. It should be noted that there has been no WTO dispute settlement case relating to Article I, para. 3 (c), nor has any member suggested amendment or other modification of that provision.^e

NAFTA, like many other IIAs, also addresses issues related to public services in its

investment chapter.^f More specifically, Article 1101, para. 4 refers to functions and services such as “...law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health and child care”. Thus, unlike the GATS, NAFTA more specifically lists certain service industries. At the same time, NAFTA stops short of the GATS insofar as it does not exclude these services from its scope of application. Rather, the relevant provision in NAFTA states that “[n]othing in this Chapter shall be construed to prevent a Party from providing a service or performing a function such ... as in a manner that is not inconsistent with this Chapter”. The NAFTA parties can enter country-specific carve-outs and reservations. The Canadian reservation in the social services sector, which also covers future measures, is an example.^g

Thus, IIAs differ in their approaches towards public services. Countries need to be careful when negotiating obligations relating to public services, so that their own policy objectives are served best.

Source: UNCTAD.

^a The MERCOSUR Protocol of Montevideo, the CARICOM Agreement, the EFTA–Singapore FTA, the Japan–Singapore Agreement and, to some extent, the Andean Community Decision 439 match the language of the GATS.

^b The GATS does not further define these terms. At the same time, the academic and policy debate has seen considerable discussion about the possible meaning of Article I, para. 3 (c) (e.g. Krajewski 2003).

^c For a discussion of these ambiguities as they may arise in the health sector, and the challenges they bring about, see Mashayekhi, Julsaint and Tuerk (forthcoming).

^d Liechtenstein, Norway, Sweden and Switzerland, for example, exclude the “public works function” from their sanitation services commitments. Similarly, the European Communities, in its schedule, reserves the right to make “services considered public utilities” subject to exclusive rights (emphasis added). Also, the European Communities’ schedule states that “the supply of a service, or its subsidization, within the public sector is not in breach of this commitment”. Similarly, in its 2003 initial offer, the European Communities states that “[t]his offer cannot be construed as offering in any way the privatisation of public undertakings nor as preventing the Community and its Member States from regulating public services in order to meet national policy objectives” (TN/S/O/EEC). Similarly, Brazil makes clear that its “...offer cannot be construed as offering in any way the privatisation of public undertakings nor as preventing Brazil from regulating public and private services in order to meet national policy objectives” (TN/S/O/BRA). Also, the United States states in its initial offer that, “[c]onsistent with GATS Article I.3(b) and (c), this offer applies only to services open to private sector participants, unless otherwise indicated, in the attached draft schedules, and does not include the right to acquire or invest in government monopolies supplying services included within any of the sectors or sub-sectors covered by this offer” (TN/S/O/USA).

^e Note, however, that several other stakeholders have made requests to that effect. See, for example, various motions passed in the United Kingdom by several trade unions, members of Parliament and local authorities <http://www.wdm.org.uk/presrel/current/ukgatspublic.htm>.

^f The 1996 Canada–Chile FTA matches the language of NAFTA.

^g More specifically, Canada’s Annex II reservation (for national treatment, MFN, local presence of senior management and boards of directors, that apply to both cross border services and investment) in the social services industry reads: “Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.”

A second form is an IIA-driven interaction. In such a case, it is the IIA that prompts FDI liberalization and domestic reforms in the services area. Sometimes this is the result of built-in commitments to engage in future rounds of negotiations in which one (if not the only) principal objective is market opening. The GATS provides an example,⁶⁴ as do agreements patterned on it (e.g. the EFTA–Singapore FTA, Article 27, para. 5). Time-bound reservations in IIAs can also drive this interaction: once they expire, domestic regulations need to be adapted. Similarly, pre-commitments under the GATS are examples of the time-bound nature of limitations inscribed in commitments.⁶⁵ The special case of WTO accession agreements can involve commitments to take certain liberalizing steps at a future date. The GATS commitments of China and Taiwan Province of China are examples.

IIA-driven interaction between international and national policies for services FDI can also manifest itself in other areas of policy for services FDI, for example, with regard to transparency. Recent services IIAs tend to contain obligations to publish and make available certain laws and regulations pertaining to FDI (e.g. Article III, para. 1 of the GATS⁶⁶ or Article 192 of the 2002 Chile–EU Association Agreement), as well as obligations to notify the other party (parties) or relevant international bodies of certain new laws and regulations (e.g. Article III, para. 3 of the GATS⁶⁷ or Article L-03 of the Canada–Chile FTA). IIAs can also include obligations requiring independent review of administrative decisions affecting individual investors through judicial, arbitral or administrative tribunals or procedures (e.g. Article VI, para. 2 of the GATS or Article 64, para. 2 of the Japan–Singapore Agreement). In addition, some of the more recent IIAs contain also so-called “a-priori” comment or consultation processes (e.g. Article 19.3, para. 2 of the Singapore–United States FTA).⁶⁸

In some of these scenarios, IIAs may require policy changes at the national level, thus constituting an example of IIA-driven interaction between national and international services policies. However, in other situations such interaction is sought, especially when a government wants to use its membership in an IIA, and the policy changes this requires, as a means of overcoming domestic resistance to

reform, and to make it difficult for subsequent governments to reverse such commitments.⁶⁹

Overall, however, the two types of interaction, whether driven by IIAs or led by autonomous liberalization, cannot always be clearly distinguished for individual agreements. In fact, there may be a situation in which a certain set of transactions is not constrained, and the issue becomes to maintain openness; this may be the case for offshoring. In the end, the specific impact of interaction is usually country-specific and context-specific.

D. Conclusion: striking a development-oriented balance

IIAs covering services FDI are proliferating at the bilateral, regional and multilateral levels. The resulting network of international rules on FDI in services is multifaceted, multilayered and constantly evolving, with obligations differing in geographical scope and substantive coverage. These rules are increasingly setting the parameters for national policies in the services sector.

Services IIAs differ in their approach towards covering services FDI (investment-based, services-based or mixed) and in their substantive provisions. Several services IIAs contain follow-up procedures and separate chapters for certain service industries. While these issues in themselves pose challenges for policy-makers dealing with services, additional challenges arise from the multilayered network of rules, including the need to ensure that rules are consistent with, or complementary to, each other in order to avoid conflicts.

Services IIAs can offer a series of potential benefits. They can provide a stable, predictable and transparent enabling framework for attracting investment and benefiting from it. At the same time, the optimal realization of these potential benefits remains a challenge. Specifically, the challenge is to strike a balance between using IIAs for attracting FDI and benefiting from it on one hand, and preserving the flexibility needed for the pursuit of national development strategies in the services sector on the other.

This challenge is particularly crucial for developing countries for a number of reasons. First, in many of these countries, the services sector is at an early stage of development and rapidly evolving. Second, certain service industries are particularly sensitive, as they are deeply embedded in a country's social, cultural and political fabric. Third, some developing countries do not yet have optimal regulatory systems in place, and policy-makers are experimenting with liberalization and regulation, with a view to building a more competitive services sector through FDI and other means. In the case of the GATS, this challenge is reflected in Article XIX, which sets out the mandate for the negotiation of specific commitments and – in that context – specifically provides that “[t]here shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions [and] progressively extending market access in line with their development situation...”⁷⁰ For LDCs, such flexibility is also affirmed in GATS Article IV, para. 3, which states that “[p]articular account shall be taken of the serious difficulty of the least-developed countries in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs.”⁷¹

In light of the above, it is important that services IIAs retain a degree of flexibility that allows countries to face the specific challenges arising at the interface of the liberalization and regulation of services. IIAs should also accommodate developing countries' efforts to achieve their development-oriented policy objectives. In this context, it is also important to leave room for the sort of trial-and-error process regulators may need in order to identify the policy options best suited to their countries' levels of development. The importance of national policy space has been affirmed in the Sao Paulo Consensus, as adopted at the UNCTAD XI Conference.⁷²

In that context, economic needs tests come into play. For example, when attached to Mode 3 commitments, they could be viewed as a policy tool to achieve an appropriate level of supply, regardless of the origin of the service supplier (OECD 2000b, p. 8). In the context of the GATS, individual countries have used

economic needs tests in connection with certain service industries. There, they are found in commitments in distribution, telecoms, rental services, transport, financial services, courier, medical, dental, environmental, testing and analysis, social and education services (OECD 2000b, p. 7). (However, the absence of agreed criteria for an economic needs test also raises challenges as regards transparency and objectivity.) Similarly, it has been suggested that emergency safeguard mechanisms can provide an additional policy tool. They can give countries the necessary flexibility to respond to unanticipated events devastating to host economies, an issue whose relevance was highlighted by the Asian and Argentinean crises. Such mechanisms can put countries in a comfort zone when locking in international commitments under IIAs.⁷³

IIAs can allow governments to liberalize at a pace and sequence appropriate to their development strategies and to the rapid development of the services economy. Flexibility can be built into an IIA by various means (*WIR03*, chapter V). In particular, the objectives, structure, content and implementation processes of an agreement can be designed in a way that ensures a proper balance between the right to regulate in the interest of development on the one hand, and the progressive liberalization and protection of FDI in the services sector on the other (see also *WIR03*, chapter VI).

The overriding challenge for countries is to find such a development-oriented balance when formulating international policies for services FDI. In the final analysis, the merits of services IIAs from a developing-country perspective must be judged by their ability to create an enabling environment for competitive service industries that help developing countries to integrate in a beneficial manner into the international economic system, with a view towards advancing their development. For this reason, GATS Article IV calls for increasing the participation of developing countries in trade in services, including through “...the liberalization of market access in sectors and modes of supply of export interest to them.” The development dimension has to be an integral part of international agreements covering services – in support of national policies to attract services FDI and to benefit more from it.

* * *

In conclusion, to benefit from an increasingly globalized and interdependent world economy, countries need to strengthen their capabilities for the supply of competitive services. If conditions are right, FDI can help to achieve this. Its most important contribution is in bringing the capital, skills and technology countries need to set up competitive service industries. This applies not only to the new IT-enabled services, but also to traditional services such as infrastructure and tourism. Moreover, as services become more tradable, FDI can help link developing countries to global value chains in services. Such chains comprise international service production networks that are increasingly important to access international markets. At the same time, caution is necessary when attracting FDI in services. For instance, some services (especially basic utilities and infrastructure) may be natural monopolies and hence susceptible to

abuses of market power (whether firms are domestic or foreign). Others are of considerable social and cultural significance; the whole fabric of a society can be affected by the involvement of FDI in those industries. Hence, countries need to strike a balance between economic efficiency and broader developmental objectives.

This is why it matters to have the right mix of policies. In light of the shift towards FDI in services, developing countries face a double challenge: to create the necessary conditions – domestic and international – to attract services FDI and, at the same time, to minimize its potential negative effects. In each case, the key is to pursue the right policies within a broader development strategy. Basic to them is the upgrading of the human resources and physical infrastructure (especially in information and communication technology) required by most modern services. An internationally competitive services sector is, in today's world economy, essential for development.

Notes

- ¹ Unless otherwise indicated, all agreements mentioned in this chapter can be found in UNCTAD 1996b, 2000b, 2001c, 2002c, forthcoming f, and, together with BITs, also at <http://www.unctad.org/iia>. Intra-European Union agreements are not considered here, given the *sui generis* nature of the European integration process.
- ² For a discussion of similar issues, in the context of identifying the implications that possible negotiations on a multilateral investment framework in the WTO would have for the GATS, see Roy 2003.
- ³ Note that NAFTA, while signed in 1992, entered into force in 1994.
- ⁴ Such agreements may also contain a chapter on cross-border trade in services, but by virtue of an express provision, this chapter does not cover the “commercial presence” mode (e.g. NAFTA).
- ⁵ Andean Community, Decision 291, Regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties, 1991, <http://www.sice.oas.org/Trade/Junac/decisiones/dec291e.asp>; it does not, however, contain many of the typical investment obligations.
- ⁶ In addition, Article 2 provides that the AIA “...shall further cover direct investments in such other sectors and services incidental to such sectors as may be agreed upon by all Member States.”
- ⁷ Agreement for the Promotion and Protection of Investments, <http://www.aseansec.org/6464.htm> and <http://www.aseansec.org/6465.htm>.
- ⁸ This is also evident in the GATS, e.g., in the context of “services related to manufacturing consulting” or “services incidental to manufacturing”.
- ¹⁰ Also, there are differences about whether an investment definition covers both pre- and post-establishment, and relates to both existing and *de novo* investment (UNCTAD 1998 and 1999b).
- ¹¹ Article 2 of the Andean Community Decision 439 reads “*Commercial presence*: Any kind of business or professional establishment in the territory of a Member Country for the purpose of providing a service through, for example: The establishment, acquisition or maintenance of a juridical person; or The creation or maintenance of a branch or a representative office” (emphasis in the original).
- ¹² The relevant provisions in Article 22 (d) of the EFTA–Singapore FTA and Article 58, para. 6 (d) of the Japan–Singapore Agreement (similar in language) read: “‘Commercial presence’ means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person; or (ii) the creation or maintenance of a branch or a representative office; within the territory of a Party for the purpose of supplying a service”. Note that the 2000 EFTA–Mexico FTA is different in that its Article 20 defines “commercial presence” as follows: “(i) as regards nationals, the right to set up and manage undertakings, which they effectively control. This shall not extend to seeking or taking employment in the labour market or confer a right of access to the labour market of another Party; (ii) as regards juridical persons, the right to take up and pursue the economic activities covered by the Section by means of the setting up and management

of subsidiaries, branches or any other form of secondary establishment” (footnotes omitted).

¹³ See, for example, Article 37 (b) of the EFTA–Singapore FTA and Article 72 (a) of the Japan–Singapore Agreement.

¹⁴ Alternatively, they are included in the “Definitions” section. While addressing the same issue, these clauses vary in their nature (discretionary or mandatory) and in the criteria they establish for an investment to enjoy the benefits of an agreement. Although the discussion below focuses on cases relating to (non-) substantial business operations, benefits can also be denied for other reasons, e.g. by virtue of the country in which a parent firm is established (for example, because the host country has no diplomatic relations with it).

¹⁵ Some IIAs also allow parties to deny benefits not only to non-party enterprises in the territory of a party, but also to that party’s enterprises in the territory of the other party, if they do not have substantive business operations in the other party. Examples include Article 10.11, para. 2 of the 2003 Chile–United States FTA and Article 11.12, para. 2 of the Australia–United States FTA. In the absence of such a clause there is a possibility for investors’ round-tripping to benefit from an IIA, even if they have no substantive business operations in the other party. This issue was – in part – addressed in the recent 2004 *Tokios Tokelés v. Ukraine* arbitral decision (ICSID 2003).

¹⁶ See, for example, Article 1113.2 of the NAFTA. An interesting example is provided by the New Zealand–Singapore Agreement, which requires an enterprise to engage in substantive business operations in the territory of *one or both parties* (Article 25). The textual interpretation of this provision leads to the conclusion that, for example, a non-party enterprise formally established in Singapore but not engaged in substantive business operations there, would still enjoy benefits afforded by the Agreement if it engages in substantive business operations in New Zealand. It appears that this formulation leaves room for a circumvention of the denial-of-benefits clause.

¹⁷ Mainland and Hong Kong Closer Economic Partnership Arrangement, 2003, <http://www.tid.gov.hk/english/cepa/fulltext.html>.

¹⁸ GATS Article XXVIII, lit. m reads: “‘juridical person of another Member’ means a juridical person which is either: (i) constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member; or (ii) in the case of the supply of a service through commercial presence, owned or controlled by: 1. natural persons of that Member; or 2. juridical persons of that other Member identified under subparagraph (i).”

¹⁹ More specifically, para. 6 of Article V reads: “[a] service supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.”

²⁰ For agreements involving only developing countries, para. 3 (b) of Article V grants some flexibility, allowing more favourable treatment to be provided to juridical

persons owned and controlled by natural persons of the parties. Para. 3 (a) of this Article also provides some flexibility for economic integration agreements involving a developing country, when it comes to meeting the conditions of para. 1. There are, however, questions whether such agreements would at all need to meet the Article V, para. 1, criteria or whether additional flexibility would be granted by the enabling clause (GATT 1979).

²¹ Note that regional agreements typically involve trade-offs across a number of issues.

²² There is, however, some concern raised in the Committee on Trade in Financial Services as regards the possible consequences of further liberalization in Modes 1 and 2, combined with footnote 8 to Article XVI, in particular, whether this could lead to capital account liberalization.

²³ In the Japan–Singapore Agreement, for example, the market access provision (Article 59) is phrased similar to the one in the GATS (Article XVI). The same applies to the Agreement’s national treatment provision. Depending upon the scope of the commitments of the countries, the Agreement could be viewed as granting a right to establishment.

²⁴ Note, however, that, depending upon a member’s commitments, the GATS market access provision (Article XVI, para. 2 lit. e) may rule out joint-venture requirements or requirements for other specific types of legal entities. Note also that the TRIMs Agreement may apply to measures regulating services FDI, for example, when performance requirements applied to services investors affect trade in goods. Requirements for a service provider to source locally the material (goods) needed for the provision of services may serve as an example (e.g. food in the tourism industry, or telecom material for telecom providers).

²⁵ For example, this approach has been followed in many of the BITs entered into by the United States and Canada.

²⁶ See, for example, Articles 1106 and 1108 of the NAFTA. Article 1106 sets out NAFTA’s rules on performance requirements with an exhaustive list of prohibited performance requirements (e.g. export requirements, local content requirements, technology transfer requirements, exclusive services supplier requirements) (para. 1); it clarifies that certain performance requirements are not only prohibited from being mandatory, but also from being linked to the granting of an incentive (para. 2); and it sets out certain exceptions (including environmental exceptions) to these prohibitions (para. 6). Article 1108, in turn, addresses reservations (for non-conforming measures) and exceptions to four of NAFTA’s core investment obligations (i.e. national treatment, MFN treatment, rules relative to performance requirements and senior management and boards of directors). Amongst others, Article 1108 sets out in which Schedules/Annexes to list non-conforming measures. It also states that certain obligations (including performance requirements) shall not apply to existing non-conforming measures maintained by a local government (without the need to list them in a schedule). Note that Annex II NAFTA reservations are broad, including with respect to future measures.

- ²⁷ This was done by several WTO members under the GATS, e.g. with respect to employment requirements, export requirements, local content, technology or training requirements (Ortega 2004).
- ²⁸ As an alternative to local establishment, a country may allow foreign suppliers of services to operate in its markets as long as they provide a suitably large deposit to cover their potential liabilities with an institution within the host country, as determined by the host-country government or a regulatory authority.
- ²⁹ See, for example, Article 1205 of NAFTA and Article H-05 of the 1996 Canada–Chile FTA. As noted above, the Canadian and United States FTAs tend to adopt an investment-based approach and, in their services chapters, to exclude the “commercial presence” mode from their coverage. Nevertheless, even if the said prohibition were to be included in a chapter that does not cover services FDI, it would be relevant for services FDI by its very nature, as it has the potential to affect services FDI.
- ³⁰ Both agreements explicitly state that specific provisions of the services chapter (i.e. market access, domestic regulation, transparency) also apply to services FDI as it is covered by the investment chapter, but – as set out in a footnote to the relevant provision – these obligations are not subject to investor–State dispute settlement (Article 8.2, para. 2 in the case of the Singapore–United States FTA and Article 11.1, para. 3 in the case of the Chile–United States FTA).
- ³¹ Australia–United States Free Trade Agreement, http://www.dfat.gov.au/trade/negotiations/us_fta/final-text/index.html.
- ³² This mechanism is set out in the Understanding on Rules and Procedures Governing the Settlement of Disputes, Annex 2 to the Marrakesh Agreement Establishing the World Trade Organization (WTO 1994b).
- ³³ Note that also the Framework Agreement on the ASEAN Investment Area (AIA) (while, as mentioned above, not applying to services FDI apart from certain industries) only provides for State–State dispute settlement procedures, despite the fact that it does not take a services-based approach. Article 17 of the Agreement provides additionally that a special dispute settlement mechanism may be established for the purpose of this Agreement.
- ³⁴ Other examples (with respect to financial services) include Article 6 of the Australia–Singapore FTA and Article 25 of the European Union–Mexico Decision No 2/2001 of the EU–Mexico Joint Council of 27 February 2001, Implementing Articles 6, 9, 12(2)(b) and 50 of the Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and Its Member States, of the One Part, and the United Mexican States, of the Other Part (hereinafter EU–Mexico Agreement).
- ³⁵ Note that, strictly speaking, the GATS adopts a “hybrid approach”. The negative list features of the GATS can be found in members’ right to enter MFN exemptions, and their right to qualify their (positive list) specific commitments with conditions and limitations.
- ³⁶ In this context, it is interesting to note that some NAFTA reservations (e.g. Annex II) carve out future measures.
- ³⁷ In light of the 2004 WTO case *Mexico–Telecommunications* (WTO Dispute Settlement Body 2004), some countries might become more cautious about developing industry-specific texts.
- ³⁸ This raises the question of whether certain specific industries would benefit from specific benchmarks.
- ³⁹ See Chile–United States FTA (chapter 12 on financial services) and Singapore–United States FTA (chapter 10 on financial services).
- ⁴⁰ See, for example, Article 10 of the EU–Mexico Agreement. Article 10, para. 4 in Chapter II states that “[e]ach Party shall permit to service suppliers of the other Party to have a commercial presence in its territory under conditions of establishment and operation no less favourable than those accorded to its own service suppliers or those of any third country, whichever are the better, and this in conformity with the legislation and regulations applicable in each Party.”
- ⁴¹ In the case of the GATS, certain services related to air transport, as defined in the Annex on Air Transport Services, are excluded from the Agreement. Paragraph 2 of the Annex states that the GATS Agreement “...shall not apply to measures affecting: (a) traffic rights, however granted; or (b) services directly related to the exercise of traffic rights, except as provided in paragraph 3 of this Annex.” Paragraph 3 states that “[t]he Agreement shall apply to measures affecting: (a) aircraft repair and maintenance services; (b) the selling and marketing of air transport services; (c) computer reservation system (CSR) services.”
- ⁴² For example, the ASEAN Framework Agreement on Services, the 2001 CARICOM Agreement (Revised Treaty of Chaguaramas Establishing the Caribbean Community Including the CARICOM Single Market and Economy) and the 1996 Euro-Mediterranean Agreement establishing an association between the European Communities and Morocco.
- ⁴³ With respect to domestic regulation, for example, the services chapter of the United States–Singapore FTA contains language similar to the GATS (Article 8.8, para. 2): “With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, each Party shall endeavor to ensure, as appropriate for individual sectors, that such measures are: (a) based on objective and transparent criteria, such as competence and the ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; and (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.”
- ⁴⁴ An example of such a follow-up mechanism is NAFTA. In July 2001, the trade ministers from the three NAFTA countries, sitting as the “NAFTA Free Trade Commission”, issued a statement on the “interpretation” of provisions, including the minimum standard of treatment, as contained in NAFTA Chapter 11. More specifically, the interpretative statement clarifies in para. 1 of Section B that “[a]rticle 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party”. It also states in para. 2 that “[t]he

concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." See NAFTA Free Trade Commission, "Notes of Interpretation of Certain Chapter 11 Provisions", 31 July 2001; <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>. Based on the experience gained with the application of the minimum standard of treatment provision, some more recent IIAs specifically contain language similar to the interpretative statement. Article 10.4 of the Chile–United States FTA is an example. Indeed, this may reflect a learning process in the formulation of IIAs.

⁴⁵ More specifically, GATS Article XIX, para. 3, states that: "[f]or each round, negotiating guidelines and procedures shall be established. For the purposes of establishing such guidelines, the Council for Trade in Services shall carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of this Agreement, including those set out in paragraph 1 of Article IV [on increasing participation of developing countries]." Such an assessment could also include questions related to the impact the GATS has had, so far, on attracting investment flows. In fact, in a 2001 communication (WTO Council for Trade in Services 2001a) a series of developing countries raised specific questions to be addressed in the assessment exercise. These included the question of whether developing countries have experienced investments in new sectors or whether investments flow only to sectors that have already been developed.

⁴⁶ See para. 14 of the GATS Negotiating Guidelines (WTO Council for Trade in Services 2001b), which states, amongst others, that the assessment "...shall be an ongoing activity of the Council and negotiations shall be adjusted in the light of the results of the assessment. In accordance with Article XXV of the GATS, technical assistance shall be provided to developing country Members, on request, in order to carry out national/regional assessments."

⁴⁷ In para. 15, the Negotiating Guidelines mandate the Council for Trade in Services (in Special Session), when reviewing progress in negotiations, to consider the extent to which Article IV (on increasing participation of developing countries in trade in services) is being implemented and to suggest ways and means of promoting the goals established therein.

⁴⁸ The ASEAN Framework Agreement on Services, the CARICOM Agreement and several European Agreements (e.g. the 1997 Euro-Mediterranean Association Agreement establishing the association between the European Union and Jordan) are cases in point.

⁴⁹ Recital 7 in the Preamble of the ASEAN Framework Agreement on Services reads: "REITERATING their commitments to the rules and principles of the General Agreement on Trade in Services (hereinafter referred to as "GATS") and noting that Article V of GATS permits the liberalising of trade in services between or among the parties to an economic integration agreement". The Singapore–United States FTA states, in para. 3 of Article 8.8 in the services chapter, that:

"[i]f the results of the negotiations related to Article VI, para. 4 of GATS (or the results of any similar negotiations undertaken in other multilateral fora in which both Parties participate) enter into effect, this Article shall be amended, as appropriate, after consultations between the Parties, to bring those results into effect under this Agreement."

⁵⁰ At least two principles should be mentioned in this regard: (1) the principle according to which, with respect to successive treaties relating to the same subject-matter, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty (*lex posterior derogate legi priori*, see Article 30 Vienna Convention on the Law of Treaties (United Nations 1969); (2) the principle according to which the more specific norm prevails over the more general norm (*lex specialis*).

⁵¹ While such a provision may not be contained in the services chapter, it may be, nevertheless, relevant for services FDI. Article 4 of the EFTA–Singapore Agreement, for example, specifically, states that "[t]he provisions of this Agreement shall be without prejudice to the rights and obligations of the Parties under the Marrakesh Agreement Establishing 'the World Trade Organization' and the other agreements negotiated thereunder (hereinafter referred to as "the WTO Agreement") to which they are a party and any other international agreement to which they are a party." A slightly different approach is taken by the Japan–Singapore Agreement. Its Article 6, "Relation to Other Agreements", provides in para.1 that "[i]n the event of any inconsistency between this Agreement and any other agreement to which both Parties are parties, the Parties shall immediately consult with each other with a view to finding a mutually satisfactory solution, taking into consideration general principles of international law".

⁵² It would appear that BITs are not considered economic integration agreements. But it appears that agreements covering all modes (in one chapter or more) need to be notified. On the broader problematique of the clause relating to regional economic integration organizations (REIO clause), see UNCTAD forthcoming g.

⁵³ Article V, para. 3(a) states: "[w]here developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors." Para. 3(b) of the same provision then states: "[n]otwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement."

⁵⁴ Some MFN exemptions might still be taken with regard to certain maritime transport services, before the end of the current negotiations.

⁵⁵ Para. 6 of the GATS Negotiating Guidelines provides, however, that: "MFN Exemptions shall be subject to negotiation according to paragraph 6 of the Annex on Article II (MFN) Exemptions. In such negotiations,

appropriate flexibility shall be accorded to individual developing-country Members.”

⁵⁶ Canada or Poland, for example, are countries that have taken MFN exemptions in the GATS regarding BITs.

⁵⁷ For example, it may be open to discussion whether an investor from country A that has no BIT with country B should be able to benefit from protection under a BIT between country B and country C, where the investor from A establishes a legal presence through an affiliate in C set up specifically to benefit from that BIT, but undertakes no business operations in C.

⁵⁸ Note that, in some cases, such clauses also address the relationship of the IIA with WTO Agreements. For example, Article 4 of the EFTA–Singapore FTA states: “[t]he provisions of this Agreement shall be without prejudice to the rights and obligations of the Parties under the Marrakesh Agreement Establishing the World Trade Organization and the other agreements negotiated thereunder (hereinafter referred to as ‘the WTO Agreement’) to which they are a party and any other international agreement to which they are a party.” Some agreements also contain clauses regulating the relationship between themselves and other non-trade-related agreements, for example environmental and conservation agreements. Article A-04 of the Canada–Chile FTA is an example.

⁵⁹ The same Agreement also addresses this issue in Article 11.2, para. 3, which states that “[t]his Chapter [the services chapter] does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Thirteen (Financial Services).”

⁶⁰ An example is the EFTA–Singapore FTA, in which Article 38, para. 2 in the investment chapter states: “Article 40 (1) [national treatment, MFN] shall not apply to measures affecting trade in services whether or not a sector concerned is scheduled in Chapter III [dealing with “services”].” Article 38, para. 2 sets out which of the national treatment and MFN obligations (those of the services or those of the investment chapter) apply to measures affecting services (including FDI in services) as well as investors and investments in the services area. While several reasons may explain the need to do so, they all relate to the objective to avoid overlap and inconsistencies between chapters in the Agreement. This is particularly important in the case of the national treatment obligation, which differs between the investment and the services chapters, for example in content (“like services” as opposed to investment in “like circumstances”) and in approach to making commitments (positive or negative lists). In fact, in light of the latter, having the investment chapter’s national treatment obligation apply to services investment would nullify the positive list approach adopted in the services chapter.

⁶¹ These parties will, however, not be able to claim a violation of such obligations.

⁶² This may be true even for an obligation to institute judicial, arbitral or administrative tribunals or procedures, thus providing for prompt review and

appropriate remedies for administrative decisions affecting, *inter alia*, services FDI.

⁶³ A similar phenomenon exists in traditional trade negotiations where bound tariffs are frequently higher than actual tariffs.

⁶⁴ A perusal of a number of initial requests submitted by some WTO members in the current round of negotiations reveals that several of the conditions and limitations attached to members’ previous commitments (either on a horizontal or on a Mode-3-specific basis) are requested to be liberalized further.

⁶⁵ By entering into pre-commitments, countries commit themselves today to implement market access and/or national treatment commitments by a pre-determined date in the future.

⁶⁶ GATS Article III, para. 1 reads in part: “[e]ach Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of this Agreement.”

⁶⁷ GATS Article III, para. 3 reads: “[e]ach Member shall promptly and at least annually inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments under this Agreement.”

⁶⁸ On transparency, see UNCTAD 2004h.

⁶⁹ Note, however, that some IIAs, for example the GATS, contain provisions allowing for the modification of commitments (e.g. GATS Article XXI). It is interesting to note that the European Communities has utilized Article XXI in the context of its enlargement process.

⁷⁰ Para. 2 of this provision continues, stating that developing countries, when making access to their markets available to foreign services suppliers, may attach to such access conditions aimed at achieving the objectives referred to in Article IV.

⁷¹ Note, that this point is reiterated in the LDC modalities (WTO Council for Trade in Services 2003).

⁷² More specifically, para. 8 of the São Paulo Consensus states: “The increasing interdependence of national economies in a globalizing world and the emergence of rule-based regimes for international economic relations have meant that the space for national economic policy, i.e. the scope for domestic policies, especially in the areas of trade, investment and industrial development, is now often framed by international disciplines, commitments and global market considerations. It is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space. It is particularly important for developing countries, bearing in mind development goals and objectives, that all countries take into account the need for appropriate balance between national policy space and international disciplines and commitments” (UNCTAD 2004i).

⁷³ For a discussion of safeguards, see *WIR03*, box V.3.

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Working Party of the Trade Committee

**ANALYSIS OF THE ECONOMIC IMPACT OF INVESTMENT PROVISIONS IN REGIONAL TRADE
AGREEMENTS**

OECD Trade Policy Working Paper No. 36

Molly Leshner and Sébastien Miroudot

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ABSTRACT

As countries turn more to regionalism as a means of forwarding co-operation on trade rules and other areas of policymaking, rules on investment are increasingly being incorporated into regional trade agreements (RTAs). We analyse the economic consequences of including investment provisions in trade agreements by creating an index of the extensiveness of investment provisions in RTAs and then using that index in a gravity model framework of trade and investment. The results indicate that investment provisions are positively associated with trade and, to an even greater extent, investment flows. Further, we observe an insignificant effect of bilateral investment treaties on investment flows, suggesting either that substantive investment provisions in RTAs impact trade and FDI flows more profoundly, or that the combination of substantive investment rules and provisions liberalising other parts of the economy jointly impact trade and investment more significantly. The report also includes case studies that confirm that the relationship between investment and other provisions in trade agreements is complex and depends on many factors.

Keywords: Investment, regional trade agreement, gravity model, trade policy, foreign direct investment, bilateral investment treaty, NAFTA, ANZSCEP.

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EXECUTIVE SUMMARY

As countries turn more to regionalism as a means of forwarding co-operation on trade rules and other areas of policymaking, rules on investment are increasingly being incorporated into regional trade agreements (RTAs). The inclusion of rules on policies beyond trade in RTAs is one characteristic of what some call “new regionalism”, a trend that has increased both the complexity and coverage of RTAs in recent years. As a result, it is becoming difficult for policymakers to distinguish the trade effects of RTAs from the effects of other types of provisions on their economies. The relationship between trade and foreign direct investment (FDI) is particularly complex to analyse in the context of RTAs since trade liberalisation can either increase or decrease intra- and extra-bloc FDI depending on country characteristics and firms’ motives for investment.

This report analyses the economic consequences of including investment provisions in trade agreements. First, the paper classifies provisions in all North-South RTAs that contain substantive investment-related rules. Next, the information is used to create an index of the extensiveness of investment provisions in the 24 North-South agreements included in the study. This index does not represent a qualitative assessment of the liberalisation of investment in each RTA, but rather ranks the agreements according to the depth and extensiveness of their investment provisions. We aggregate the different provisions for each RTA with an equal weight to avoid subjectivity in the analysis.

Quantitative analysis is then performed using a gravity model framework of trade and investment to test the impact of investment-related provisions contained in RTAs. The results indicate that investment provisions are positively associated with trade and, to an even greater extent, investment flows. Further, we observe an insignificant result for the variable that represents the existence of a bilateral investment treaty between the country pairs. This suggests either that substantive investment provisions in RTAs impact trade and FDI flows more profoundly, or that the combination of substantive investment rules and provisions liberalising other parts of the economy come together to more significantly impact trade and investment flows. The results are robust to different specifications and estimation methods.

The report also includes case studies that assess on a more detailed level the investment-related provisions in two RTAs representative of “new regionalism”. The analysis of the North American Free Trade Agreement and the Agreement between New Zealand and Singapore on a Closer Economic Partnership presents a more nuanced picture of the investment provisions in these agreements, and helps provide context to the empirical analysis presented in the study. The case studies tend to confirm that the relationship between investment provisions and other provisions in trade agreements is complex and depends on many factors.

ANALYSIS OF THE ECONOMIC IMPACT OF INVESTMENT PROVISIONS IN REGIONAL TRADE AGREEMENTS

I. Introduction

1. Today, almost 40% of all trade can be attributed to international exchanges among members of regional trade agreements (RTAs) (World Bank, 2005). In the last ten years, almost 200 RTAs have been notified to the World Trade Organisation (WTO). Thirty-three new agreements were notified in 2004 alone and 20 more in the first six months of 2005¹. Taking into account the RTAs currently under negotiation or in the process of ratification, analysts expect the number of RTAs in force to grow from 139 in mid-2005 to around 300 in 2008 (Crawford and Fiorentino, 2005).

2. One distinguishing feature of recent RTAs is their wide-ranging coverage and complexity. Tariff reductions are accompanied by provisions on non-tariff barriers (NTBs), customs procedures, sanitary and phytosanitary measures and intellectual property protection. Most of the new agreements cover trade in services and a number of regulatory issues that go beyond multilaterally agreed disciplines – such as government procurement, competition policy and the environment – are also frequently addressed. The proliferation of RTAs between developing and developed countries and their coverage of new policy areas beyond trade is one characteristic of what some call “new regionalism” (Ethier, 1998; Crawford and Fiorentino, 2005).

3. Countries are increasingly incorporating investment, which has traditionally been covered via separate bilateral investment treaties (BITs), in many recent RTAs. Thus, it is not surprising that the number of new BITs has been receding since the mid-1990s, while at the same time the number of RTAs with substantive investment provisions has been rising (Figure 1). Since WTO Members removed investment from the Doha Round negotiating agenda, it is important for policymakers to understand the consequences of including “new” provisions – such as investment – at the regional level. What drives trade and investment flows under new regionalism? How can one classify the investment provisions in North-South RTAs? What are the effects of substantive investment provisions on trade and investment flows? This paper contributes to the existing literature by exploring these questions.

1. Background

4. This paper analyses investment provisions in RTAs between developed and developing countries². The definition of “developing country” used in this paper is derived from how countries define themselves in the context of the WTO, leading to the inclusion of a wide array of agreements between countries at different levels of development³. To our knowledge, this study is one of the first to present a

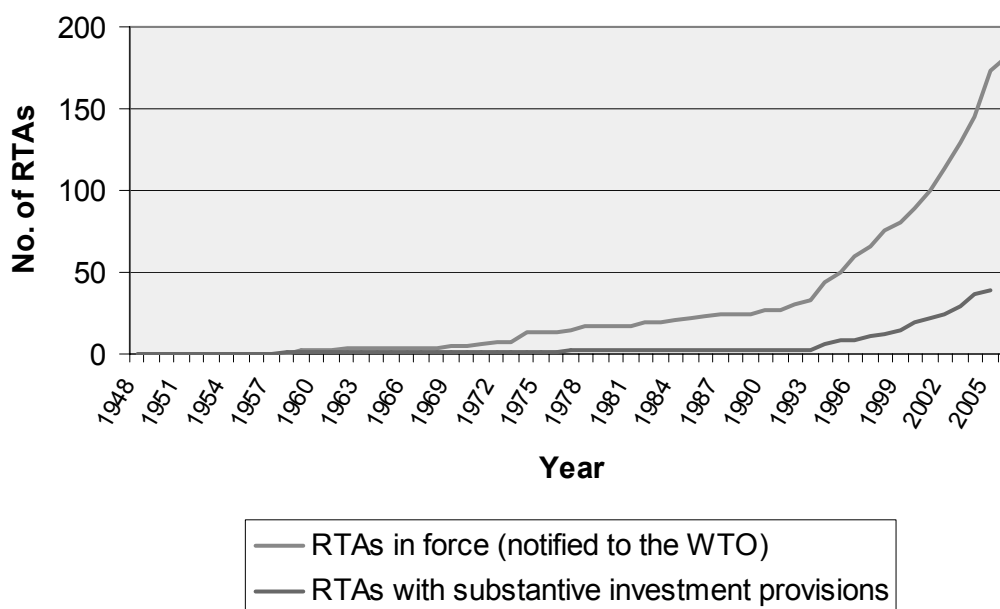
1. A complete list of RTAs notified to the GATT/WTO under GATT Article XXIV, GATS Article V and the enabling clause can be found at www.wto.org/english/tratop_e/region_e/region_e.htm.

2. Additional OECD analysis on investment agreements can be found in “Overview and Novel Features in Recent OECD Investment Agreements” (OECD, 2006).

3. While EC-Romania and EC-Bulgaria would fall under this rubric, they have been moved to the “North-North” category because Romania and Bulgaria are EC accession countries.

metric assessing the extent and depth of investment provisions in all RTAs that have entered into force as of November 2005 and quantitative analysis using such a measure to study the impact of investment-related provisions in RTAs on trade and flows of foreign direct investment (FDI).

Figure 1. RTAs in force and RTAs with substantive investment provisions



Source : WTO and OECD Secretariat.

5. Both North-North and South-South RTAs have been included in the database built for this study and are used in the quantitative analysis in Part III. While only the 24 North-South RTAs identified in Tables 4 and 5 of Annex I have been fully described in Part II, the provisions of all RTAs have been analysed. There are, however, very few North-North trade agreements that include investment provisions⁴. For developed countries, investment provisions are more likely to be found in other international instruments, such as the OECD Code of Liberalisation of Capital Movements or in BITs. And while South-South RTAs increasingly include investment provisions (see Annex III), they are either very recent, currently under negotiation or their investment/services chapters are not yet complete. A scarcity of data also complicates the analysis of South-South investment.

6. Part II focuses on North-South RTAs because it is more consistent to propose a taxonomy of investment provisions in agreements of the same type. With the exception of PATCRA (the free trade agreement between Papua New Guinea and Australia, which is to some degree a precursor to more recent RTAs), all North-South RTAs with investment provisions have been signed within the last ten years, starting with the North American Free Trade Agreement (NAFTA) (1994).

7. Second, since the trade and FDI relationship is ambiguous, the North-South angle lets us assume that these RTAs were signed with an expectation of higher FDI flows from the Northern country to the

4. The Treaty of Rome (founding the European Community), the European Economic Agreement, the European Free Trade Association (EFTA) convention (as updated by the Vaduz Convention in 2001), the Australia-New Zealand Closer Economic Relations agreement (for services only) and the recent bilateral trade agreement between the United States and Australia (AUSFTA).

Southern partner, a hypothesis that we test empirically. A positive relationship can *a priori* be expected between the entry into force of a North-South RTA and trade and FDI flows. The relationship between a rather large developed country and a small developing country can also diminish the role of market-seeking FDI that would increase FDI but adversely affect trade.

8. Only trade agreements with “substantive” investment provisions have been included in the study. While it is difficult to qualitatively judge the degree to which various investment provisions are substantive, there are two cases in which investment provisions were not considered substantive in the context of this study. First, it is common to find a general objective to increase investment in the preamble of many trade agreements. In addition, some RTAs state that they cover investment, but then do not include rules or commitments on investment (for instance, some RTAs state that rules on investment and services will be included at a later stage). These agreements have been excluded from the scope of the study. Alternatively, in the case of an agreement with provisions on investment co-operation and promotion, the inclusion of mechanisms to organise co-operation and promotion meets the “substantive” criteria for including the agreement in the analysis.

2. *The drivers of trade and investment under new regionalism*

9. Trade and investment represent two sides of market access. Yet, while they share many determining factors – such as macroeconomic conditions, factor endowments and the like – there is a complex relationship between trade and FDI in the context of regional trade agreements (Blömstrom and Kokko, 1997).

10. Whether or not trade and investment are substitutes or complements depends on a firm’s market access motive. On one hand, the removal of trade barriers between countries can lower intra-regional FDI when investment is mainly market-seeking or “tariff jumping”. Since RTAs also imply greater regional economic integration, companies with high fixed costs may concentrate their activity in one country and develop trade flows with partner countries rather than open plants in each country. In this sense, one can say that trade substitutes for investment and that the RTA has had a redistributive effect on intra-regional investment patterns. On the other hand, efficiency-seeking investment may increase because freer trade of goods and services enables companies with low fixed costs to localise their activity in different countries and then trade intermediate inputs. In this instance, investment complements trade.

11. The entry into force of a RTA can also affect extra-regional FDI in opposing ways. Higher regional trade barriers may encourage extra-regional market-seeking FDI while discouraging efficiency-seeking FDI. On the other hand, a RTA that does not significantly differentiate between intra- and extra-regional trade barriers should not affect FDI much. Moreover, these relationships may be influenced by differences in the level of development among countries, loose or strict rules of origin, regulatory issues beyond trade policy and the investment climate in each country.

12. While studies on regionalism have flourished, few have attempted to assess the economic impact of new provisions found in a wide range of RTAs. This is in part because agreements are not only numerous, but also because they take a very different approach to incorporating “new” non-trade provisions. Moreover, there are few indicators available that distinguish the different types of agreements, a necessary step for quantitative analysis. Thus, much of the previous work on trade and investment in RTAs has focused either on a description of the investment provisions found in trade agreements (UNCTAD, 2004a; OECD, 2006) or on the econometric analysis of determinants of FDI in which RTAs are included as a dummy variable⁵ (e.g., World Bank, 2005; te Velde and Bezemer, 2004).

5. The “dummy variable” takes the value of 1 if there is a trade agreement between the home and host country and 0 otherwise.

13. Only a handful of studies have investigated the impact of RTAs on trade and investment flows, and even fewer have focused on the impact of investment-related provisions in RTAs. A notable exception is Jeon and Stone (2000), who study the impact of the Association of Southeast Asian Nations (ASEAN) on trade and investment in the Asia-Pacific economies. They find that intra-bloc trade flows increased as a result of ASEAN, but that ASEAN's effect on intra-bloc investment was insignificant. In Stein and Duade's important work (2001), they use a gravity model approach to assess how RTAs and various institutional factors affect investment flows. While Stein and Duade do indeed find a positive effect, the coefficient was also insignificant.

14. These studies set the stage for Adams *et al.* (2003), who also employ a version of the gravity model to analyse whether certain RTAs are associated with net investment creation or diversion. They construct an index of liberalisation to measure the breadth and depth of RTAs. Their "Member Liberalisation Index" includes a category for investment rules. Although its weight in the overall index is quite low (0.05), the category indicates whether a RTA includes provisions prohibiting restrictions on investment (1, highest score), national treatment for investment (0.75), initiatives to reduce restrictions and facilitate investment (0.25) or no provisions (0, lowest score). The index is then used in a gravity model to assess the role of some of the new provisions typical of new regionalism – including investment – in RTAs. Their study shows that non-trade provisions significantly impact investment flows. They also test for creation and diversion effects.

15. Another study by te Velde and Bezemer (2004) uses a similar index and focuses on investment. Their index takes the following values: 0 if no provisions, 1 with some investment provisions in the region (*e.g.*, the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC)), 2 with advanced investment provisions in the region (*e.g.*, ASEAN), 3 with complete investment provisions in the region (*e.g.*, NAFTA), or -1 if more restrictive provisions (*e.g.*, the Andean Community in the 1970s). The authors find a positive relationship between membership in one of the seven regions covered in their study and extra-regional FDI flows.

II. Designing an index of investment provisions in RTAs

1. Analysis and classification of investment provisions

16. The first step in the analysis is to collect all relevant information on substantive investment provisions – for both goods and services – contained in all North-South RTAs in force as of November 2005. Tables 4 and 5 (in Annex I) present the results of the analysis for the 24 agreements that include substantive investment provisions based on six broad categories.

1. Right of establishment and non-discrimination in the pre-establishment phase (national treatment (NT) and most-favoured-nation treatment (MFN));
2. Non-discrimination for post-establishment (NT, MFN);
3. Investment in services (specific provisions on establishment, NT and MFN in services sectors);
4. Investment regulation and protection (provisions on performance requirements, ownership requirements, expropriation, fair and equitable treatment, free transfer of funds and temporary entry and stay for key personnel);
5. Dispute settlement (State-State and State-Investor dispute settlement); and

6. Investment promotion and co-operation (co-operation mechanisms, harmonisation of rules, asymmetries and future liberalisation).

17. These categories cover all types of investment provisions to ensure that we include the relevant RTAs in the analysis. Moreover, the typology used in Tables 4 and 5 builds upon the binary approach taken in most other studies to create a more detailed matrix of investment provisions. The additional detail allows for a more accurate quantitative assessment of the impact of individual provisions as well as their combined effect on trade and investment flows.

18. Many studies in the literature have analysed the different formulations of investment provisions in international agreements (OECD, 2003; OECD, 2006; UNCTAD, 2004a). The following taxonomy draws upon this work and applies it to investment provisions in RTAs. The purpose of this analysis is not to provide a full analysis of the provisions, but rather to lay the foundation for the study of the impact of these provisions on trade and FDI flows.

(i) *Provisions on establishment and non-discrimination in the pre-establishment phase (non-services sectors)*

19. The pre-establishment treatment of investors clearly represents one of the key issues in the investment section of the RTAs considered. The right of establishment provides foreign investors with the most critical market access component – the right to invest in the host country. This right to invest, however, is never absolute. It is limited by the definitions of “investor” and “investment” as well as by a series of exceptions and derogations. To be effective, the right of establishment must be married with provisions on the treatment of foreign investments *after* the investment has been made (post-establishment). Finally, the effectiveness of establishment provisions depends on the existence of remedies to address violations of the pre-establishment principle by the host state.

20. In the first column of the section dedicated to establishment in Table 4, the right of establishment is described through the typology presented below.

- “No” means that no provision in the RTA provides investors with a generic right to set up a permanent presence in the host country. Both parties reserve full control of entry and establishment, which are regulated by domestic laws and regulations. National measures restricting access and establishment can take a variety of forms, such as the screening of FDI, quantitative restrictions, conditional entry or measures relating to ownership and control. But it should also be kept in mind that Table 4 reports only provisions contained in the RTAs analysed and the existence of a “right” of establishment. It does not describe the actual conditions potential investors face in the host country. And, although no commitment is made in the text of the trade agreement, parties could have a fairly liberal investment regime through their domestic regulation or another international investment agreement, as is the case in the US-Jordan RTA and the Euro-Mediterranean Partnership agreements in which several EC Member States have signed BITs with the countries concerned. The absence of pre-establishment provisions also characterises agreements focused on investment promotion and co-operation rather than on investment liberalisation (for example, EC-Tunisia, EFTA-Mexico or US-Jordan).
- “NT” indicates that pre-establishment national treatment is granted to investors. Most RTAs address the right of establishment in the context of the non-discrimination provisions (national treatment and most-favoured-nation). There is often a single national treatment article covering both pre- and post-establishment. The information reported in Column 1 of Table 4 only covers the right of establishment (entry). The concession of national treatment is

particularly effective in liberalising investment as foreign investors can set up operations on an equal footing with domestic investors. It can also represent part of a strategy to deepen economic integration in the future, or to underline the importance of existing investment flows (*e.g.*, Singapore-Japan). This approach is also evident in the EFTA-Chile RTA and on an asymmetrical basis in the Singapore-Australia RTA.

- “MFN+NT” signifies that both national and most-favoured-nation treatment are granted to investors. This approach limits the discretion of the host country to regulate the entry of investment the most. Foreign investors benefit from a right of establishment on the same basis as national investors or, if better, that faced by other investors from countries that have been granted more desirable treatment. Assuming that exceptions are not extensive, this approach allows decisions on investment to be made on purely commercial terms, thus contributing to a more efficient allocation of resources between the two countries. While NAFTA was the first RTA to adopt this model, this type of provision can now be found in several agreements (*e.g.*, Canada-Chile, EC-the Former Yugoslav Republic of Macedonia (FYROM), EFTA-Singapore, US-Singapore, US-Chile, Mexico-Japan, New Zealand-Singapore and EC-Jordan, although in the latter with asymmetric provisions).

21. Given the importance of the right to regulate investment, governments usually circumscribe the right of establishment with a series of exceptions and derogations. General exceptions are often present, including measures relating to the general public interest, such as national security, public health, order and morals. Some agreements also limit the right of establishment to certain industries and specify a positive list together with industry-specific limitations. Other agreements take the approach of liberalising in principle all industries, and then excluding through recourse to a negative list certain sectors from the establishment provisions or applying sector-specific limitations. Column 2 in Table 4 reports information on the type of limitations found in each agreement that contain pre-establishment provisions. The typology used is simple; the column indicates whether there is a positive list of limitations, a negative list or no limitations (“none”).

22. A negative list approach often characterises situations in which few sectors are excluded or only a few limitations are reported, and allows for the automatic inclusion of new sectors in the agreement. A positive list approach can be seen as a first step toward further investment liberalisation by adding sectors to the positive list. Indeed, positive lists are often associated with a clause foreseeing future liberalisation of investment (see Column 27 in Table 5). The EC-Chile RTA follows this model of liberalisation, as does Thailand in its two RTAs with Australia and New Zealand.

23. However, the exact content of the list is important in determining the effects of liberalisation. Depending on which industries are open to foreign competition, distortions in both economies may arise, which could offset the benefits of liberalisation. Table 4 does not report enough information to assess the content of the list of limitations and, technically speaking, the same level of concessions or the same limitations can be identically described by a positive or negative list. Thus, an equal score has been given to positive and negative lists in the index.

(ii) *Provisions on non-discrimination post-establishment (in non-services sectors)*

24. Standards on treatment relating to the post-establishment phase complement the provisions on the right of establishment (entry) of foreign investments. While the extension of national and most-favoured-nation treatment to the pre-establishment of foreign investment is relatively recent, most of the RTAs studied apply these standards to both the pre- and post-establishment phases. The only exceptions to this trend include the EC-Chile and EFTA-Chile agreements, where national treatment is limited to pre-establishment, perhaps because of the existence of bilateral investment agreements between Chile and

some of the EC and EFTA Member States. It is sometimes specified that national or most-favoured-nation treatment applies only “in like circumstances” (as is the case in U.S. agreements).

25. *National treatment.* While the definition of national treatment and the actual situations to which it applies can differ, the underlying principle of national treatment grants foreign investors treatment not less favourable than the treatment granted to domestic investors. Column 3 in Table 4 indicates whether such a clause is included in each RTA. The concession of national treatment is usually qualified by general exceptions and by a negative list of industry-specific exceptions. Only the agreement between the EC and FYROM has no limitations on national treatment⁶. In all of the other agreements – with the exception of Thailand-Australia – a negative list of limitations is provided. The Thailand-Australia RTA adopts a more restrictive approach by applying national treatment only in relation to a positive list of sectors.

26. *Most-favoured-nation treatment.* By granting MFN treatment, the host country commits to according to investors or investments of the other country treatment no less favourable than the treatment granted to investors or investments of any third country. The function of the MFN standard is two-fold; it removes economic distortions by treating all investments in the same way and strengthens the liberalisation process by automatically extending the most liberal treatment to foreign investments covered by agreements containing the MFN clause. Because MFN treatment liberalises investment with a group of countries, it represents an efficient and rapid way to increase FDI. However, MFN clauses at the multilateral level ensure the same treatment for all countries that are party to the multilateral agreement, while at the regional level MFN provisions extend to the bilateral partner only the better treatment that is accorded to a non-party.

27. Among the agreements with post-establishment non-discrimination provisions, more than half include both MFN and national treatment (Column 5 in Table 4). If included, exceptions to the MFN principle are often provided in a negative list⁷ (Column 6).

(iii) *Investment in services sectors*

28. There is only one agreement in Table 4 that excludes investment in services and it is a relatively old agreement. Indeed, most RTAs today include rules on trade in services and, in particular, Mode 3 (commercial presence). Further, since Table 4 presents only agreements with substantive investment provisions, this suggests that provisions on investment are rarely limited to goods and that services liberalisation often embodies both cross-border trade and commercial presence. If an agreement includes a section on trade in services, it is also likely to cover investment.

29. It is not uncommon for the provisions on trade in services via commercial presence (Mode 3) and investment in goods to differ. Column 7 indicates whether the provisions on trade in services through commercial presence are incorporated in the investment section of the agreement – in which case the rules are the same for both goods and services – or whether they are included in a specific services chapter. Seven agreements incorporate investment in services in the investment chapter (e.g., NAFTA), and limit the services chapter to cross-border trade in services. All of the other agreements, with the exception of PATCRA, which does not cover services, treat Mode 3 services trade (commercial presence) in the same section as the other modes of services supply.

6. While this agreement carves out several sectors from the investment chapter (e.g., air transport services, inland waterway transport services and maritime cabotage services), this limited list of exclusions is often found in RTAs that contain investment provisions.

7. The regional economic integration organisation (REIO) exception represents an important and frequent exception to MFN treatment in RTAs. The purpose of this exception is to preserve the preferential treatment inside the regional organisation and avoid problems of free riding.

30. Columns 8 to 13 in Table 4 describe the non-discrimination provisions on pre- and post-establishment. “GATS” indicates that the agreement refers to the WTO’s General Agreement on Trade in Services (GATS). This reference implies that market access and national treatment are granted to services included in a schedule of commitments (positive list) with a general obligation of MFN treatment (and exemptions). The reference to GATS clearly highlights that the RTA does not go further than the multilateral commitments made in the GATS. When there is a positive list of limitations to market access and national treatment, and thus a schedule of commitments specific to the RTA, it is unclear whether the same commitments have been included in the RTA or whether the multilateral and regional commitments differ.

31. A clear pattern emerges in the services section of the table. In RTAs in which investment in services is not distinguished from investment in goods, the negative list approach is the most common. On the other hand, agreements that contain a specific services chapter that covers all modes of services supply are clearly modelled after the GATS with a positive list of commitments for market access and national treatment.

(iv) *Investment regulation and protection*

32. While this category includes provisions of a different nature, they are still clearly relevant to the rights of investors. These provisions limit the ability of governments to impose particular measures on investment, restrict the activities of investors or expropriate their investments. In this section of Table 5, a yes/no approach is adopted in which “yes” generally corresponds to the highest standard. For example, in Column 16 (ownership requirements), only a clear provision prohibiting any type of ownership restrictions takes a “yes” value. If a RTA contains an article on ownership requirements without a general principle of prohibition, the value is coded “no”. These provisions can positively influence the investment climate as, for instance, certain investments have hinged on provisions such as ownership restrictions. Provisions on investment regulation and protection can be found as a package in a small number of agreements, with NAFTA, Canada-Chile and Mexico-Japan including the most extensive “package” of these provisions.

33. *Provisions prohibiting performance requirements* (Column 14). Performance requirements, which are often negotiated during the pre-establishment phase, are requirements imposed on investors that can have trade-restrictive and distorting effects. For example, local content requirements can limit the ability of investing companies to import intermediate goods, which forces them to source locally and could impact productivity and competitiveness. Column 15 indicates whether the RTA goes beyond the WTO Agreement on Trade-Related Investment Measures (TRIMs) in prohibiting performance requirements which are not listed in the agreement⁸. In the table, 7 out of the 24 RTAs prohibit performance requirements and, when they do so, they generally go beyond the TRIMs agreement (6 out of 7).

34. *Specific provision prohibiting ownership requirements* (Column 16). Again, only eight agreements contain such a prohibition (although there is not a perfect match with the eight RTAs prohibiting performance requirements). The rule is, however, limited to investment in services in four agreements.

35. *Free transfer of funds* (Column 17). The free flow of all investment-related transactions and capital movements is a core provision in any investment agreement. Not surprisingly, all RTAs in Table 5 include a provision on the free transfer of funds except PATCRA and US-Jordan. Sometimes, there are

8. The list includes measures that require particular levels of local procurement by an enterprise (“local content requirements”) or that restrict the volume or value of imports that such an enterprise can purchase or use by an amount related to the level of its exports (“trade balancing requirements”).

exceptions or limitations to the rule which are not reported in the table, but which are standard across international investment agreements.

36. *Temporary entry and stay for key personnel* (Column 18). This provision is important because any investment generally implies the movement of key personnel. However, the removal of barriers on the temporary entry and stay of key personnel can be controversial because it touches upon sensitivities in migration law. In some limited cases, a RTA states that the free movement of people and the temporary entry and stay for key personnel derives from this general rule. But in most cases, this provision is specific to investment-related temporary migrations. Half of the agreements in Table 5 include a provision on the temporary entry and stay for key personnel.

37. *Provisions on expropriation* (Column 19). The potential threat of expropriation or nationalisation can discourage investors. As a result, this provision represents a core rule in many investment treaties by providing guidelines that indicate that expropriation can only take place on a non-discriminatory basis and with adequate compensation. In Table 5, 11 out of the 24 RTAs contain such a provision, although provisions on expropriation may exist in other agreements, such as BITs. Rules on expropriation are often included in agreements with the most substantive investment provisions.

38. *Fair and equitable treatment* (Column 20). In contrast to national treatment and most-favoured-nation treatment, which are contingent standards based on the treatment afforded to other groups of investors, the fair and equitable treatment standard is an absolute standard drawn from customary international law. When provided for in the investment regimes of RTAs, fair and equitable treatment is meant to be extended to investments regardless of the treatment afforded to national investments.

(v) *Dispute settlement*

39. This category distinguishes between State-State dispute settlement (Column 21) and State-Investor dispute settlement (Column 22). All RTAs include a mechanism to resolve disputes between States concerning the interpretation and implementation of the agreement, but this mechanism is not specific to investment disputes. Column 21 reports whether State-State dispute settlement is limited to consultations, involves ad hoc arbitration or is resolved through a political body formed by the parties to the agreement.

40. State-Investor dispute settlement may provide a more effective way of implementing investment provisions in a RTA by enabling investors to make claims and defend their interests directly. Column 22 indicates the type of dispute settlement provided. The categories include “*ad-hoc* arbitration”, which involves an independent international arbitrator generally under the rules of the United Nations Commission on International Trade Law (UNCITRAL) and “permanent arbitration”, which generally refers to the International Centre for the Settlement of Investment Disputes (ICSID). State-Investor dispute settlement is provided in 11 of the 24 agreements in Table 5, generally through both UNCITRAL and ICSID but, in two cases, only one option is available.

(iv) *Investment promotion and co-operation*

41. The last category in Table 5 includes investment provisions of a different type. RTAs often include provisions on investment promotion and co-operation if they do not contain provisions on establishment or non-discrimination. These provisions focus on the promotion of investment between partner countries and the harmonisation of certain rules.

42. *Investment promotion* (Column 23). Provisions on investment promotion are common across the RTAs in Table 5 (15 out of the 24 RTAs). These provisions are not limited to RTAs that do not include provisions liberalising investment flows or protecting investors. However, agreements like NAFTA, which

contain relatively extensive provisions in all of the previous categories, do not contain measures on investment promotion (or co-operation).

43. *Investment co-operation mechanisms* (Column 24). The value “yes” in this column indicates that not only have the partner countries agreed to co-operate, but they also detail the kinds of actions they intend to take to organise this co-operation. For example, RTAs sometimes stipulate that the signatories will exchange information or create a specific body or commission.

44. *Harmonisation of rules* (Column 25). Some agreements focusing on co-operation include a general objective to harmonise investment rules and policies. These provisions are generally not very specific about how this harmonisation should occur or the types of rules that should be harmonised.

45. *Any type of asymmetries?* (Column 26). As the RTAs covered are North-South RTAs, one can expect asymmetries in the investment provisions to provide differential treatment in favour of the developing country or to take into account its specific needs. Curiously, when asymmetries exist, the direction of the preferred treatment benefits the developed – rather than the developing – country partner more concretely. In contrast, “soft” asymmetries tend to benefit the developing country.

46. An example of “substantive” asymmetry can be found in the EC-Jordan RTA, in which the EC grants pre-establishment MFN access to Jordanian non-services investment, while Jordan grants MFN and national treatment pre-establishment access to EC investors in non-services sectors. Alternatively, there are examples of “soft” asymmetries that benefit the developing country. In the EC-Tunisia RTA, for instance, the agreement specifies that the EC Member States “attach importance to boosting the flow of direct investment to Tunisia. They agree to expand Tunisia’s access to Community investment promotion instruments in accordance with the relevant Community provisions”. There is no corollary for boosting investment in EC Member States.

47. *Clause foreseeing the future liberalisation of investment* (Column 27). Particularly in agreements with few or no provisions on pre-establishment and non-discrimination, it is common to find a clause on future liberalisation, although it is sometimes limited to Mode 3 services trade. In many cases, it is difficult to determine how these clauses have been implemented, if at all.

2. *Index methodology*

(i) *Numerical values*

48. Based on the information provided in Tables 4 and 5, the elements of each sub-category were coded numerically. The coding was done in the most neutral way possible by normalising the information on a zero-to-one scale, where zero indicates the absence of a given provision and one represents the most FDI-friendly provision in the list of possible options⁹. For example, to assess limitations on establishment, one begins with the universe of possibilities. Table 4 indicates that there are three options: (1) “no” (when no right of establishment is granted), (2) “NT” (when the agreement provides for establishment on a national treatment basis), and (3) “MFN+NT” (when the agreement provides for establishment on a national treatment and most-favoured-nation basis). Using this methodology, the “no” option takes the value of zero (no right of establishment) while the right of establishment on a national treatment and most-favoured-nation basis takes the highest value, which is one. The other option rests at the centre of the zero-to-one interval, and takes a value of 0.50.

9. There is, of course, some approximation in this process because not all agreements perfectly fit the taxonomy described in Table A1. In addition, provisions are sometimes subject to interpretative notes or exceptions which are not fully taken into account in Table A1.

49. For some categories, such as establishment, in which the options include “No”, “NT”, “MFN+NT”, the result with this methodology is not numerically different than if we had used two columns for national treatment and MFN (with a yes/no answer taking the value of zero or one). An agreement with only national treatment (NT) would result in 1 in the first column and 0 in the second. The simple average of the two columns is 0.5, which is precisely the value given to “NT” in the coding system. Since the aggregate index is computed on the basis of a simple arithmetic average, such a choice has no bearing on the results. The subjectivity in the analysis is limited to the number and choice of the different categories in Tables 4 and 5.

50. The entire coding system is presented in Table 1 below, while Tables 6 and 7 (in Annex I) shows the results for the 24 North-South RTAs in the dataset.

Table 1. Coding of investment provisions

Category	Score
<i>Establishment (non-services sectors)</i>	
<i>Right of establishment</i>	
No	0.00
NT	0.50
MFN+NT	1.00
<i>Pre-establishment limitations</i>	
(n/a)	0.00
Positive or negative list	0.50
None	1.00
<i>Non-discrimination (non-services sectors)</i>	
<i>National treatment</i>	
No	0.00
Yes	1.00
<i>Limitations to national treatment</i>	
(n/a)	0.00
Positive or negative list	0.50
None	1.00
<i>Most-favoured-nation</i>	
No	0.00
Yes	1.00

Category	Score
<i>Limitations to most-favoured-nation</i>	
(n/a)	0.00
Positive or negative list	0.50
None	1.00
<i>Investment in services sectors</i>	
<i>Investment in services covered by the RTA</i>	
No	0.00
Yes	1.00
<i>Provisions on establishment</i>	
None	0.00
NT	0.50
MFN+NT / Market access	1.00
<i>Pre-establishment limitations in services</i>	
(n/a)	0.00
Positive or negative list	0.50
None	1.00
<i>National treatment</i>	
No	0.00
Yes	1.00
<i>Limitations to national treatment in services</i>	
(n/a)	0.00
Positive or negative list	0.50
None	1.00
<i>Most-favoured-nation</i>	
No	0.00
Yes	1.00
<i>Exceptions to most-favoured-nation</i>	
(n/a)	0.00
List of exceptions	0.50
None	1.00
<i>Investment regulation and protection</i>	
<i>Provisions prohibiting performance requirements</i>	
No	0.00
Yes	0.50
Yes, beyond TRIMS	1.00
<i>Specific provision prohibiting ownership requirements</i>	
No	0.00
Yes	1.00
<i>Free transfer of funds</i>	
No	0.00
Yes	1.00
<i>Temporary entry and stay for key personnel</i>	
No	0.00
Yes	1.00
<i>Provisions on expropriation</i>	
No	0.00
Yes	1.00

Category	Score
<i>Specific reference to fair and equitable treatment</i>	
No	0.00
Yes	1.00
<i>Investment protection and dispute settlement</i>	
<i>State-Investor dispute settlement</i>	
No	0.00
Ad hoc or permanent arbitration (only one)	0.50
Ad hoc & permanent arbitration	1.00
<i>Investment promotion and co-operation</i>	
<i>Investment promotion</i>	
No	0.00
Yes	1.00
<i>Co-operation mechanisms</i>	
No	0.00
Yes	1.00
<i>Harmonisation of rules</i>	
No	0.00
Yes	1.00
<i>Any type of asymmetries (in favour of the developing economy)</i>	
No	0.00
Yes	1.00
<i>Clause foreseeing the future liberalisation of investment</i>	
No	0.00
Yes	1.00
(Services only)	0.50

(ii) *Creating the final index*

51. After assigning a numerical value to each type of investment provision (Tables 6 and 7), it is necessary to weight them to build an aggregate index. After experimenting with several methods of weighting, a simple average proved to be the most neutral and effective in the empirical analysis¹⁰. The advantage of this methodology is that it represents a simple measure of the extensiveness of investment provisions in the various RTAs. Moreover, we do not impose an *a priori* and subjective view of how various investment provisions should affect trade and investment flows by assigning different weights¹¹.

52. This approach is in line with other composite indexes that include variables in which it is either unclear how to evaluate one of the variable options relative to the others, or if there is no reason to think that equal weights for several variable options do not apply. It should also be kept in mind that the exercise is not a qualitative assessment of the value of each provision per se, but rather a ranking exercise used to obtain an index clearly separating different types of RTAs with investment provisions. Thus, the index is designed to be used in subsequent quantitative analysis and not to assess the quality of each agreement.

10 . In particular, we also used principal component analysis, a type of factor analysis in which each category is weighted according to its contribution to the overall variance in the data, to create an aggregate index score. However, this method was neither the most robust nor transparent.

11 . In light of the importance that some countries place on particular variables, such as national treatment, the Secretariat also experimented with alternative weighting schemes. One such method involves “overweighting” national treatment relative to most-favoured national treatment. These approaches did not improve the results of the index in the models.

The final index is presented in Table 2 and visually in Figure 6 (Annex I), providing a representation of the ranking of the RTAs according to the depth and extensiveness of their investment provisions.

Table 2. Index of investment provisions

RTA	Year into force	Index
Mexico - Japan	2005	0.760
Canada - Chile	1997	0.720
EC - FYROM	2001	0.720
NAFTA	1994	0.680
EC - Jordan	2002	0.640
Thailand - Australia	2005	0.640
United States - Chile	2004	0.640
United States - Singapore	2004	0.640
EFTA - Singapore	2003	0.600
Japan - Singapore	2002	0.580
Thailand - New Zealand	2005	0.580
New Zealand - Singapore	2001	0.500
EFTA - Mexico	2001	0.480
EC - Chile	2003	0.460
Singapore - Australia	2003	0.460
EC - Mexico	2000	0.440
EC - Morocco	2000	0.420
EC - South Africa	2000	0.420
EC - Tunisia	1998	0.420
EC - Egypt	2004	0.380
EFTA - Chile	2004	0.380
EC - Israel	2000	0.360
United States - Jordan	2001	0.260
PATCRA	1977	0.200
<i>Average</i>		<i>0.516</i>

53. The RTA with the highest score is Mexico-Japan (0.760), followed by Canada-Chile and EC-FYROM (0.720), while the lowest score went to PATCRA (0.200). These results simply mean that the trade agreement between Papua New Guinea and Australia has fewer of the investment provisions listed in Tables 4 and 5 than the other agreements, and that the agreement between Mexico and Japan has more of the provisions contained in the tables than the other agreements. If we compare the results from the analysis of North-North and South-South RTAs (see Annex III), the agreement with the highest score is the European Community (Treaty of Rome) with a score of 0.780. On average, North-North and South-South RTAs with investment provisions score lower (0.506 and 0.495, respectively) than North-South RTAs (0.516). It is also worth mentioning that when South-South RTAs include an investment chapter, they contain relatively extensive investment provisions, as evidenced by the small difference between the average index scores in North-North and South-South RTAs.

54. Several interesting patterns emerge from Table 2. For one, all of the agreements signed by the United States are clustered together and score quite high with the exception of US-Jordan, perhaps in part because the United States and Jordan had already concluded negotiations on a bilateral investment treaty prior to the conclusion of the RTA negotiations. In general, NAFTA members have tended to perpetuate the approach to investment set forth in NAFTA, which incorporates substantial provisions on pre- and post-establishment, services and State-Investor dispute settlement (see NAFTA case study in Section IV).

55. The EC agreements are also grouped together, apart from the EC agreements with FYROM, Jordan and Chile. These agreements may be unique for various reasons. For instance, FYROM is an EC accession country candidate, and it makes sense that provisions of all types would be deeper as they represent a step toward closer economic relations. In addition, the EC-Jordan agreement was negotiated within the context of Jordan's accession to the WTO, so other considerations may have played a role in determining the overall framework of the agreement. Chile can also be viewed as a special case as it represents the first time that the EC included provisions on pre-establishment in a RTA with a non-EC accession country.

56. The majority of the EC agreements exclude the right of pre- or post-establishment, which is often included in EC country BITs, and focus significantly on services, using a positive list approach to schedule the liberalisation of services. They also tend to include the same types of provisions, such as rules providing for the free transfer of funds, and exclude investment-specific rules on dispute settlement (investment is covered in the general section on the settlement of disputes).

57. Several of the countries that have concluded RTAs with developed countries, such as Singapore and Chile, tend to conclude agreements with fairly extensive investment provisions (*i.e.*, they tend to fall in the top half of the index chart). In addition, it appears that the more RTAs that a country has signed, the higher the score. This could be a function of the fact that once a country has negotiated a RTA with extensive investment provisions and it has implemented the necessary domestic regulations to accommodate that agreement, it is easier to replicate the provisions with other countries.

58. Further, geography does not appear to determine the extensiveness of investment provisions since, for example, EC-Jordan and EC-Egypt have very different index scores. These patterns tend to suggest that while there is a diversity of provisions on investment in RTAs, many countries seem to follow a loose model that evolves over time. Further, it appears that investment provisions in RTAs are a combination of past experience as well as how far "new" countries are willing to go in following the approach favoured by the larger developed partner.

III. Quantitative Analysis

59. The use of the index of investment provisions in empirical work represents an important next step in the analysis of the relationship between RTAs with substantive investment provisions and trade and investment flows. The quantitative analysis in this section uses both a dummy variable that indicates if the country pairs are party to a RTA with substantive investment provisions as well as the index of investment provisions to build upon the existing gravity model literature. To correctly run the gravity model, the index of investment provisions has also been calculated for North-North and South-South RTAs. The purpose of the quantitative analysis is to assess the relationship between substantive investment provisions and trade and investment flows.

1. Background

60. The gravity model has proven a useful tool in evaluating the determinants of bilateral trade flows between countries. The core of the gravity model rests on the assumption that trade flows between two countries are determined by size (economic mass) and trade-related friction (distance). GDP often serves as a proxy for size, and geographical distance and cultural characteristics, such as sharing a common language, often represent friction.

61. Recently, researchers have sought to fine-tune the gravity model by including additional variables to control for other determining factors of trade flows between countries. The gravity model was first used to study the effects of RTAs on bilateral trade flows in Aitken's (1973) seminal study. Since

then, most studies have included one or more dummy variables to assess the impact of RTAs on trade flows (see, for example, Soloaga and Winters, 1999).

62. However, the gravity model has had a somewhat chequered history. In the past, many researchers voiced concerns about the lack of a theoretical foundation for the gravity model. In addition, scholars questioned the usefulness of using distance as a proxy for trade-related friction given that the trade costs associated with transporting a good over a particular distance are much greater in poor countries than in rich ones (World Bank, 2005). More recent research has shown that a version of the gravity model can be derived from economic theory, and that relative price considerations can be incorporated in a gravity model framework (see Anderson and van Wincoop, 2004). Baldwin and Taglioni (2005) also argue that the gravity model has a more solid theoretical foundation than any other available trade model. Moreover, it remains the most empirically robust model available to describe bilateral trade flows between countries.

63. The empirical significance of the gravity model, coupled with the ability of economists to derive a version of the gravity equation from standard trade theory, has led to something of the model's rebirth among researchers. And because trade and investment flows are determined by many of the same factors, scholars have begun to apply the gravity model to investment flows (see Adams *et. al.*, 2003; Daude *et. al.* 2003; Stone and Jeon, 2000). The quantitative analysis in this section relies upon the gravity model to analyse the determinants of bilateral trade and investment flows between countries in the RTA context, but refines the dummy variable methodology used previously in the literature by extending it to particular provisions in the agreement.

2. *The base models*

64. The versions of the gravity model used in this paper draw upon both the trade and investment literature, but go a step further in the study of the gravity model in the RTA context. Two of the models outlined in this paper include an index that quantifies the extensiveness of investment provisions in various RTAs to try to assess how well investment provisions in RTAs explain trade and investment flows. The paper also seeks to analyse the extent of trade and investment creation and diversion in all North-South RTAs containing investment provisions, borrowing from the approach used by Adams *et. al.* (2003).

65. The base trade model tests the effects of joint GDP, distance, joint GDP per capita, exchange rates (both nominal rates and volatility), bilateral tariffs and various geographical and cultural factors – such as whether or not the two countries share a border, a common official language and a colonial past – on bilateral exports¹². The base investment model uses the same explanatory variables to test their effects on net positive outward FDI flows. According to theory, one expects trade flows – and, in our extension, FDI flows – to be a positive function of joint GDP and cultural factors and a negative function of distance, tariff rates and fluctuations in the exchange rate. We expect joint GDP per capita to be ambiguous as shown in the literature.

66. Joint GDP should associate positively with trade and investment because countries with relatively large markets trade more and are more attractive to investors than countries with small markets. Sharing a border, common language and past colonial relationship should also positively relate with trade and FDI. For one, sharing a border implies less trade friction between countries. Moreover, sharing a common language and a past colonial relationship implies that various cultural factors make certain country pairs more likely to engage in trade and investment. Distance, tariffs¹³ and bilateral exchange rates should act as

12. Joint GDP and joint GDP per capita are used rather than individual GDP because the dataset is based on bilateral pairs (see Box 1). Some specifications presented in Annex IV allow for the inclusion of the GDP of the reporter and partner countries separately.

13. While this is true for trade flows, tariffs have an ambiguous effect on FDI flows.

negative forces on trade and FDI flows. Why? Because tariffs and exchange rate volatility increase trade costs and the farther away two countries are, the more difficult – and often more costly – it is to trade goods and services.

67. Regarding joint GDP per capita, a larger value may indicate a smaller combined population for a given level of GDP and, since a lower population can be expected to exert a dampening effect on trade, the variable could have a negative coefficient (see De Rosa and Gilbert, 2006). However, as an indication of the level of development of the country pairs, the joint GDP per capita can also be expected to have a positive coefficient because wealthier countries tend to trade and invest more than poorer countries. As a result, the combined effect is ambiguous. Annex IV includes a complete description of the variables and the mathematical expressions of each of the models.

68. All of the gravity models specified in this paper use unbalanced bilateral panel data for the period 1990-2004. In line with current conventions, the data on FDI flows is calculated on a net, rather than a gross, basis. (Data on FDI flows from all of the major international sources – OECD, IMF, UNCTAD and the World Bank – are calculated on a net basis because the data is constructed from balance of payments schedules.) This formulation is somewhat problematic in the gravity model framework because negative net flows are “lost” when transformed into natural logarithms. To help alleviate this data problem, we use a Tobit regression approach which allows us to account for the censored nature of the data. A Tobit specification estimates the regression coefficients under the assumption that the dependent variable and the distribution of the residuals are truncated.

69. The trade models are estimated using ordinary least squares (OLS) regression techniques and robust standard errors that are consistent with heteroskedastic conditions. The FDI models are estimated using a Tobit specification. Further, time and country fixed effects are included in both models to control for omitted variables that vary both across time and country¹⁴. The dataset includes country pair data for which more than one observation exists. Annex IV presents alternative regression methodologies to test the robustness of the results.

14. Many scholars suggest that the inclusion of country fixed effects with a time dimension appropriately account for the price resistance terms derived by Anderson and van Wincoop (2004). However, if some of the independent variables also vary by country and by period, the use of time-varying country fixed effects can “overcorrect” for the price resistance terms (see IMF, 2004).

Box 1. Panel data and fixed effects

Panel datasets, such as the one used in the quantitative analysis in this paper, are constructed by collecting cross-country data on a particular variable for more than one period. Our panel dataset is driven by country pair data on trade and FDI flows in 15 different periods (1990-2004). One advantage of using panel data rather than cross-sectional data, which is often used in partial equilibrium models, is that the estimates are much less sensitive to omitted variable bias because they do not assume that one year of data is representative of the long-run equilibrium (Blonigen, 2005).

Fixed effects terms can be used as a powerful econometric technique in panel data models. Fixed effects, also called “unobserved effects”, control for variables that are specific to the variable of interest (in this case, exports and FDI flows). For example, in the model presented in this paper, fixed effects allow us to create one variable specific to each year in the dataset as well as each reporter and partner country. Thus, we include one fixed effect for the year 1997 that controls for any variables particular to that year, such as the East Asian financial crisis. We also include a fixed effect term for each reporter and partner country. Variables such as a measure of the level of investment protection present in an individual country’s investment regime or the amount of red tape required to operate a business is captured in each individual reporter and partner country’s unique fixed effect term.

These “unobserved variables” can be expected to directly affect the dependent variables (exports and FDI flows), so it is important to control for them in the models. A consequence of including these fixed effects terms is that only data that is related to a country pair – such as how far away a given country is from its trading partner – can be included. Other data that is country-specific, such as a measurement of the area of a country, cannot be included because it will be perfectly correlated with the fixed effects terms.

However, researchers should be cautious when using fixed effects terms in gravity models. In a recent paper, Cheng and Wall (2005) show that how researchers specify fixed effects terms in the gravity model can significantly impact the results. They test alternative specifications, including country fixed effects with a time dimension and bilateral pair fixed effects. As a robustness check, the models presented in this paper are also run using these alternative specifications, the results of which are presented in Annex IV.

3. *The RTA variables*

70. The two base models are supplemented with other, RTA-specific variables to analyse the extent to which investment provisions in RTAs can help explain trade (exports) and investment (FDI) flows. Almost all RTA studies that use the gravity model framework employ a dummy variable to analyse the effects of the RTA on trade and, to a lesser extent, FDI flows. This “black box” method, while useful, is also somewhat imprecise. A key value-added of this study is the addition of a dummy variable for agreements with substantive investment provisions and an index of the extensiveness of these investment provisions in RTAs.

71. On an intra-bloc level, a RTA that sets lower tariffs among the signatories should discourage market-seeking or tariff-jumping FDI, leading to an increase in trade and a decrease in investment. But, lower trade barriers may also encourage efficiency-seeking FDI as firms with low fixed costs find it profitable to locate in multiple countries in the bloc and trade intermediate inputs. On an extra-bloc level, if a RTA contains trade preferences that are relatively different *vis-à-vis* the rest of the world, then lower intra-bloc trade barriers may discourage extra-bloc market-seeking FDI in favour of extra-bloc efficiency-seeking FDI. On the investment side, investment provisions should, in theory, positively impact intra-bloc investment and, to the extent that those provisions are applicable to “foreign” firms that establish in one of the RTA signatories, investment from countries located outside of the RTA area. These complex inter-relationships compel researchers to analyse the effects of lower trade barriers and investment liberalisation, protection and promotion via a RTA on both trade and investment to provide a comprehensive analysis.

Regression no. 1: Dummy variables for RTAs with substantive investment provisions and BITs

72. The first dummy variable created indicates whether the country pairs in the dataset belong to a RTA with substantive investment provisions. This method represents a departure from the literature in the sense that this model adds the stipulation that the RTA must contain substantive investment provisions (most studies include a dummy variable that indicates whether a RTA exists between the country pairs). All RTAs – both WTO-notified and un-notified between countries at all levels of development – were analysed across the sample. This variable helps determine, at the most general level, the degree to which RTAs that contain investment provisions can explain trade and investment flows.

73. In addition, since some country pairs have also entered into a BIT, which may include various post-establishment protection and promotion rules, a dummy variable that indicates if the country pairs are party to a BIT is also included. Further, we test whether the combination of a RTA with investment provisions and a BIT affects FDI flows. This variable takes the value of 1 if the country pair is party to both a RTA with investment provisions as well as a BIT and 0 otherwise. In theory, a BIT should be expected to associate positively with FDI. However, the empirical literature is ambiguous, as both small positive and insignificant effects have been reported (see UNCTAD, 1998; Hallward-Driemeier, 2003; Egger and Pfaffermayr, 2004).

74. One expects that the relationships among the variables in the base model will continue to hold – that is, that the distance, border, language, colonial relationship, tariff, joint GDP, joint GDP per capita and exchange rate variables should continue to interact with trade and investment flows in the same way. If RTAs that contain investment provisions are positively associated with trade and investment flows, then we can conclude that additional market access and investor protection are likely related to higher levels of trade and investment. In addition, positive coefficients would indicate that trade complements, more than it substitutes for, investment in the context of RTAs that contain substantive investment provisions. The models are specified mathematically in Annex IV.

Regression no. 2: The index of investment provisions

75. The index of investment provisions transforms the binary nature of the dummy variable created in the first model by first replacing the 1s of the dummy variable with the aggregate index created in the Part II of the paper and then taking the natural log. Because the index measures the relative depth or extensiveness of investment provisions across RTAs, this variable provides more nuanced estimates of the degree to which trade and investment flows can be explained by RTAs that include substantive investment provisions. What matters in the regression is not the actual score of the index, but the relative ranking across agreements. All RTAs with investment provisions – regardless of the level of development of the partner countries involved – are analysed.

76. As with the previous regression, one expects that the relationships among the variables in the base model will continue to hold. In addition, if the index of investment provisions positively relates with trade and investment flows, then we can conclude that additional market access and investor protection are probably related to higher levels of trade and investment. Similarly, a positive coefficient suggests that trade complements investment more than it substitutes for investment in the context of RTAs that contain substantive investment provisions. The models are specified mathematically in Annex IV.

Regression no. 3: Individual RTA dummy variables that measure investment/trade creation and diversion

77. In the third regression, we try to assess trade and investment creation and diversion resulting from the entry into force of the North-South RTAs of interest in this paper. To assess creation and diversion, three variables are created for each of the RTAs in the dataset, which are then included in one

trade and one investment regression. The first RTA variable takes the value of the aggregate index when both the reporter and the partner country are party to the RTA. The second variable takes the value of the aggregate index when the reporter country is party to the RTA, but the partner country is not. The third variable takes the value of the aggregate index when the partner country is party to the RTA, but the reporter country is not. Through this methodology, the model attempts to show if trade and investment creation and diversion are occurring as a result of the entry into force of the North-South RTAs in the dataset.

78. Again, the relationships among the variables in the base model should continue to hold. The variable that takes the value of the index of investment provisions when both the reporter and partner countries are party to the RTA ($\Sigma_{ij}RTA_{ijt}$) will show a positive coefficient if there is a positive relationship between the variable and trade and investment flows (*i.e.*, an increase in intra-bloc trade or investment) and a negative coefficient if the RTA is negatively associated with trade and investment flows (*i.e.*, a decrease in intra-bloc trade or investment). The same logic applies to the variables that represent the reporter's trade with the rest of the world (Σ_iRTA_{ijt}) and the partner's trade with the rest of the world (Σ_jRTA_{ijt}). The literature in this area is sparse, and the few studies that exist do not show strong, significant results for the creation and diversion variables. The models are specified mathematically in Annex IV.

4. *The results*

79. The results from the trade models (first half of Table 3) show that about 91% of the variation in the data can be explained by the variables in the equation (that is, the “goodness of fit” is high). This is unsurprising given the proven robustness of the gravity model in explaining bilateral trade flows between countries and the inclusion of fixed effects. Because the investment models were run under a Tobit specification, we report a pseudo-r²¹⁵ as a corresponding measure of “goodness of fit”. This measure indicates that about 68% of the investment flows in our model are accounted for by variables in the equation. As a robustness check, the investment models were run in the OLS framework used for the trade models reported here (see Annex IV).

80. Further, the traditional gravity model explanatory variables in both models – distance, language and colonial relationship – are all significant and have coefficients within the established range in the literature¹⁶. The exchange rate volatility measure is also negative and significant, as expected, and the joint GDP per capita variable takes a positive and significant coefficient in both the trade and investment models.

81. In the base models, the tariff variable is negative and significant in the trade model, but it is insignificant in the investment model. This result is intuitive – tariffs should negatively affect trade flows, but they have an ambiguous effect on investment flows. Whether the net impact of tariffs on investment is positive or negative depends in part on the motivation of investors – that is, whether trade complements investment more than it substitutes for investment. In this sample, the tariff-related effect is ambiguous.

82. The coefficient for the sum of the logs of GDP did not result as one would expect. The joint market size measure (sumlngdp) is negative and significant in the trade model and insignificant in the investment model (we would expect a positive coefficient). However, in specifications that allow for the

15. We estimate the pseudo-r² value by calculating the r² between the predicted and observed values, a better measure of fit for a Tobit specification than the McFadden pseudo-r² that is generated automatically in many statistical packages.

16. The border variable was insignificant in the investment model. This is not unsurprising, however, as the literature suggests that the border variable is often highly correlated with some of the other gravity dummy variables, such as colonial relationship.

inclusion of the reporter and partner country GDPs separately, we find the expected sign for the coefficient (see Annex IV). The nominal exchange rate variable is insignificant in both models.

83. It is likely that the country fixed effects are picking up some of the effect of the exchange rate and joint GDP variables. This is because while nominal exchange rates, GDP and population do indeed fluctuate yearly, for some countries, the year-to-year changes are not substantial. In these cases, at least some of the effect of nominal exchange rates, GDP and GDP per capita would be captured in the country fixed effects terms. For a robustness check, the results of models using alternative fixed effects specifications are reported in Annex IV. For all of the other specifications, the nominal exchange rate and joint market size variables are significant and take the expected signs and magnitudes.

Table 3. Summary of the regression results - Trade & FDI models

	Dependent variable: Exports			Dependent variable: FDI					
	Base model	Investment index	Investment dummy	Base model	Investment index	Dummy BIT	Investment dummy & dummy BIT	Investment index & dummy BIT	Interaction dummy bit & rta
Distance	-0.964*** (-63.85)	-0.936*** (-57.83)	-0.936*** (-57.84)	-0.956*** (-24.67)	-0.886*** (-21.43)	-0.957*** (-24.56)	-0.886*** (-21.37)	-0.887*** (-21.35)	-0.896*** (-21.48)
Border	0.225*** (4.66)	0.234*** (4.88)	0.234*** (4.89)	0.145 (1.29)	0.158 (1.42)	0.145 (1.30)	0.159 (1.43)	0.159 (1.42)	0.169 (1.51)
Colonial relationship	1.213*** (24.75)	1.221*** (24.95)	1.221*** (24.96)	1.088*** (8.58)	1.104*** (8.72)	1.088*** (8.58)	1.103*** (8.71)	1.104*** (8.72)	1.102*** (8.71)
Common official language	0.420*** (15.19)	0.429*** (15.54)	0.429*** (15.54)	0.502*** (6.79)	0.525*** (7.10)	0.501*** (6.78)	0.524*** (7.08)	0.525*** (7.09)	0.517*** (6.97)
Tariff	-0.183*** (-10.42)	-0.151*** (-7.88)	-0.151*** (-7.90)	0.003 (0.06)	0.086 (1.81)	0.003 (0.06)	0.085 (1.80)	0.085 (1.81)	0.074 (1.56)
Joint market size	-0.583** (-3.11)	-0.555** (-2.96)	-0.555** (-2.96)	-0.704 (-1.38)	-0.642 (-1.26)	-0.709 (-1.39)	-0.650 (-1.27)	-0.648 (-1.27)	-0.640 (-1.25)
Sum of GDP per capita	1.217*** (6.32)	1.196*** (6.22)	1.196*** (6.23)	1.153* (2.20)	1.119* (2.13)	1.158* (2.20)	1.126* (2.15)	1.124* (2.14)	1.120* (2.13)
Nominal exchange rate	-0.017 (-1.66)	-0.019 (-1.84)	-0.018 (-1.85)	-0.019 (-0.72)	-0.024 (-0.91)	-0.019 (-0.71)	-0.024 (-0.90)	-0.024 (-0.90)	-0.023 (-0.84)
Exchange rate volatility	-0.314** (-2.73)	-0.315** (-2.73)	-0.315** (-2.74)	-0.798** (-2.91)	-0.810** (-2.96)	-0.796** (-2.90)	-0.808** (-2.94)	-0.807** (-2.94)	-0.814** (-2.97)
Dummy variable for BITs						0.011 (0.18)	0.011 (0.19)	0.012 (0.20)	-0.028 (-0.44)
Dummy variable for investment provisions			0.190*** (5.36)				0.456*** (4.83)		0.358*** (3.41)
Index of investment provisions		0.014*** (5.24)			0.034*** (4.76)			0.034*** (4.76)	
Interaction between BIT and RTA									0.341* (2.16)
Number of obs.	9027	9027	9027	7258	7258	7258	7258	7258	7258
Adjusted R-squared	0.915	0.915	0.915						
Pseudo R-squared				0.684	0.684	0.684	0.684	0.684	0.684
Log likelihood				-14120.9	-14109.6	-14120.9	-14109.3	-14109.6	-14107.0

Notes: Time and country fixed effects are not reported. All trade regressions were run with robust standard errors under heteroskedastic conditions. Values of t-statistics are in parentheses. Values marked (***), (**), and (*) are significant at the 0.1%, 1% and 5% levels, respectively.

84. The estimates for the BIT dummy variable in the investment models are all insignificant. While this result is not out of line with the literature (see, for example, Hallward-Driemeier, 2003), this study departs from previous ones by testing the effects of RTAs and BITs concurrently. In part, the insignificance of the result could be due to the nature of the provisions. BITs focus on investment protection rather than investment liberalisation, and the empirical analysis presented in Table 13 (Annex IV) suggests that the category of provisions falling under the investment protection umbrella in Table 5 are not significantly associated with FDI flows.

85. The insignificance of the BIT variable could also be a function of coverage. RTAs with substantive investment provisions usually include provisions on services, including Mode 3 services trade. And new investment rules may matter more for services than for goods. The World Bank's (2005) recent study on regionalism notes that a majority of the remaining restrictions on investment may be found in services and natural resources, rather than in goods. As a result, RTAs that include liberalisation mechanisms in services may be the most effective at boosting FDI.

86. Interestingly, the RTA dummy variables behave very similarly in both the trade and investment models. When the dummy variable that indicates the existence of a RTA with substantive investment provisions is added to the trade and investment equations, the percentage of variation explained by the data stays about the same, but the RTA dummy variables are statistically significant with positive coefficients. Thus, one could say that in this sample, the entry into force of a RTA with substantive investment provisions is positively related to trade and net positive FDI flows. The coefficient is higher in the FDI model (0.456) than it is in the trade model (0.190), which is intuitive as one would expect that investment provisions more profoundly affect investment flows than trade flows.

87. Since a dummy variable cannot by itself be interpreted in percentage terms, we use the method of transformation suggested by Kennedy (1981)¹⁷. With this transformation, we estimate that the entry into force of a RTA with substantive investment provisions is associated with a 57.1% increase in FDI flows and a 20.8% increase in exports. To be sure, these estimates need to be treated with caution as dummy variables can also pick up some of the effect of other variables. But the sign and magnitude of these values tends to suggest that substantive investment provisions matter for both trade and investment, and that trade complements, more than it substitutes for, investment in the context of RTAs that contain substantive investment provisions.

88. In both the trade and investment models, the index of investment provisions variable was also positive and significant (0.014 and 0.034, respectively). These coefficients cannot be compared with those obtained for the dummy RTA index variables because the index has been transformed into a continuous variable that has been logged. The coefficient on the RTA index variable is also determined in some measure by the scale of the index (which takes values between 0 and 1), but this does not affect the significance of the results. The model with the investment index shows no change in the pseudo-r² or log-likelihood statistics, providing some degree of comfort that the dummy variable in the previous regression is indeed capturing the impact of investment provisions. The estimates obtained using the more nuanced index approach suggest that agreements with relatively more investment provisions impact FDI flows more profoundly than agreements with fewer provisions.

89. The positive but modest relationship observed between the extensiveness of investment provisions and trade flows is in line with the literature. It indicates that trade and investment are complements rather than substitutes, reflecting more efficiency-seeking than market-seeking FDI. Not surprisingly, the investment index performs better in the investment model. The positive and higher coefficient indicates that RTAs with substantive investment provisions are likely associated with increases in FDI flows. Since the RTA index of investment provisions is a variable that ranks the different agreements, it is difficult to interpret the coefficient directly, and thus it is best to consider the sign and significance of the coefficient (positive and significant at the 0.1% level).

17. Kennedy notes that the correct transformation of a dummy variable is given by the following formula: $\hat{g} = \exp(\hat{c} - \frac{1}{2}\hat{Y}(\hat{c}))-1$, where $\hat{g}$ is the estimated coefficient of the dummy variable on the dependent variable (e.g., exports and FDI), $\hat{c}$ is the coefficient on the dummy variable and $\hat{Y}$ is the variance of $\hat{c}$.

Box 2. Does the year of entry into force matter?

In the different regressions presented, the year of entry into force of the RTA determines the change in the value of the index (from zero to the value found in Table 2). But it is difficult to assess when a RTA with substantive investment provisions begins to impact investment and trade flows. Before the agreement enters into force, the publicity surrounding the negotiations and subsequent signature can influence investment decisions. However, it could also be the case that FDI and trade flows will profoundly change only in the years after the entry into force.

To study whether the year of entry into force is relevant in the analysis, we have run two alternative specifications. The first tests the effect of both the dummy RTA index and the RTA index of investment provisions variables using the signature date of the agreement rather than the date of entry into force. One can argue that investors view the date of signature as a sufficient commitment to policy change and thus begin to trade and invest more than they would have absent a RTA with substantive investment provisions. In the FDI model, the coefficients on both the dummy variable and the RTA index perform better (*i.e.*, higher and more significant coefficients) than when using the date of entry into force (see Table 14 in Annex IV). In the trade model, however, the coefficients are smaller, although still positive and significant.

The second alternative specification tests the impact of the dummy variable and the RTA index variable without taking into account the year of the agreement. In this scenario, the index takes the value of the RTA during all of the years available, even before the entry into force of the agreement. One can argue that, at least for those countries that are not simply extending provisions that they have already granted to others (*i.e.*, a genuine deepening), the actual commitment to policy change occurs in the years spent negotiating the agreement (that is, in the period prior to entry into force). In the FDI model, the coefficients on both the dummy variable and the RTA index variable are smaller, although still positive, and have smaller t-statistics (see Table 14 in Annex IV). In the trade model, the coefficients are about the same as those estimated in the models that use the date of entry into force.

In the investment context, the results suggest that the impact of a RTA with substantive investment provisions is a somewhat gradual process that is at least partly the result of investors anticipating policy change. In the trade context, the results indicate that the anticipation effect is less pronounced, perhaps in part because investment decisions require more of a long-term perspective than the decision to trade. In this way, one would only expect to see changes in the behaviour of traders when the agreement enters into force. Further, the results of the second alternative specification suggest that countries tend to sign RTAs with substantive investment provisions with countries with whom they already significantly trade with and invest in. However, this is not true in all cases, as agreements between large developed partners and relatively smaller partners demonstrate (*e.g.*, EC-Jordan).

90. In the third set of equations (*i.e.*, those in which the 24 RTAs are included as separate variables), the results for trade and investment creation and diversion are somewhat mixed (see Table 11 in Annex IV). Most of the individual RTA variables were not significant, and those that were showed a combination of positive and negative signs. For instance, when the three variables for a given RTA were significant in the trade model, the results generally show both trade creation – that is, a positive coefficient on the $\Sigma_{ij}RTA_{ij}$ variable – and trade diversion for both the reporter and partner countries – a negative coefficient on the Σ_iRTA_{ij} and Σ_jRTA_{ij} variables, respectively.

91. However, this pattern did not hold completely across the dataset. The results for the investment model are more ambiguous than those for the trade model, as most of the RTA-specific variables are not significant. Yet the coefficients that were significant were more often the reporter variable (Σ_iRTA_{ij}), which represents the reporter's investment with the rest of the world. (This could be because the dataset contains a disproportionate number of reporters from developed countries.) Interestingly, the coefficients for this variable tend to be positive, suggesting that investment agreements are also likely to increase investment flows from third countries (whereas investment diversion is often feared). The variable that represents investment creation ($\Sigma_{ij}RTA_{ij}$) between the two countries party to the RTA showed the expected positive sign when the coefficients were significant, and in fact the coefficient for the investment creation variable for Canada-Chile is 0.129, which is significant at the 1% level.

92. The inconclusiveness of the results for some individual RTAs reflects the fact that many agreements in the dataset have been in effect for a short period, and so even if data are available, only a few years of data would be relevant for this analysis. It could also be the case that agreements are not implemented in the same way, and are sometimes formed to foster foreign policy goals as well as for economic reasons. One should not expect all agreements with substantive investment to significantly alter FDI patterns since the decision to invest is made on economic grounds, and trade agreements play only a part of that determination.

IV. Case Studies

93. The index of investment provisions and the quantitative analysis provide insight into how investment provisions are incorporated in RTAs and how those provisions affect trade and investment flows. Another method of analysing investment provisions in trade agreements is to use a case study approach. This section presents two case studies – NAFTA and New Zealand-Singapore – to analyse investment provisions in RTAs from a different perspective. The purpose of the case studies is not to assess the quantitative relationship between the RTAs and trade and investment flows, but rather to take a more detailed look at the investment provisions.

1. The North American Free Trade Agreement

94. The North American Free Trade Agreement (NAFTA) is one of the most famous of all regional trade agreements. In 1991, Canada, Mexico and the United States began negotiating NAFTA, and the agreement entered into force on 1 January 1994. In one sense, NAFTA extended the provisions of the Canada-U.S. Free Trade Agreement to Mexico, but it also expanded the agreement by further liberalising many trade provisions and including new subject areas. NAFTA inspired passionate debate in all three member countries and, as a result, numerous scholars have studied its effects both on the three member countries as well as the rest of the world. This case study briefly analyses the investment provisions in NAFTA and presents evidence from the literature on the overall effect of NAFTA on trade and FDI flows.

(i) The investment provisions

95. One of Mexico's primary goals in negotiating NAFTA was to increase FDI (Esquivel and Tornell, 1997; World Bank, 2003). Since the United States and Canada also strongly encourage the facilitation and protection of investment, NAFTA contains a relatively comprehensive set of investment rules which are set out principally in Chapter 11. NAFTA's Chapter 11 covers investment in both goods and services (except financial services, which are covered in Chapter 14). This approach represents a marked departure from that used in the WTO, which treats trade in services, including Mode 3 commercial presence, as distinct from investment in goods.

96. The definition of investor and investment are key components of any agreement that contains investment rules and NAFTA's definition, while not the most comprehensive, is still widely acknowledged as far-reaching. NAFTA generally defines "investment" in broad terms – for example, enterprises and any associated equity securities and property such as real estate, among others, are covered. However, the agreement covers only certain types of portfolio investment (*e.g.*, some types of loans, debt securities and commercial contracts are not considered investments).

97. Chapter 11 provides for both national and MFN treatment for investors from all of the NAFTA signatories as well as investments made by investors from non-partner countries that are located within NAFTA territory. National and MFN treatment applies equally to both the pre- and post-establishment phases of an investment project, and Chapter 11 requires that NAFTA members provide the *better* of national or MFN treatment. For example, if one of the NAFTA parties provides more favourable treatment

to a third party through a different agreement, the other NAFTA members can benefit from this more favourable treatment through this clause. However, even given the relatively extensive liberalisation present in NAFTA, exceptions to national and MFN treatment can be found with respect to government procurement as well as in certain non-conforming measures at the national level. Other exceptions at the sub-federal levels of government – such as state or local governments – made prior to the entry into force are grandfathered into the agreement.

98. Countries also scheduled further restrictions and exceptions in individual schedules. The United States, for instance, scheduled exceptions in the telecommunications; nuclear energy; agricultural chemicals; mining; transportation and waste water sectors. Canada included exceptions and reservations in sensitive sectors such as uranium mining; fishing; oil; gas; automobile; business service industries; and air transportation. Canada also indicates that pursuant to the Investment Canada Act, non-Canadians are restricted in buying Canadian business under certain circumstances. In addition, Mexico scheduled reservations and exceptions in sectors such as oil; petrochemicals; electricity and nuclear power; telecommunications; transportation; automobile; postal services; fishing; professional services and mining¹⁸. Further, Mexico and Canada also established mechanisms to review proposed investment projects over a certain threshold value, but they have historically approved these projects.

99. Chapter 11 also states that NAFTA members must provide “fair and equitable” treatment, an important provision from a legal perspective because many disputes have hinged on the meaning of this rule. In fact, on 31 July 2001, the NAFTA partners issued a Note of Interpretation to Chapter 11 that defines more concretely the notions of “fair and equitable” treatment and “full protection and security” to mean treatment not above that afforded by the customary minimum standard of treatment prescribed by international law. The Note also indicates that none of the investment-related provisions in NAFTA should be construed to imply an obligation of confidentiality on the part of any party in any dispute brought under Chapter 11 arbitration.

100. Moreover, Chapter 11 bans various common types of performance requirements, such as import, export and domestic content targets as well as obligations to transfer technology, many of which go beyond the prohibitions found in TRIMs. For many of the performance requirements that are not prohibited, as well as for some other types of restrictions, such as ownership limitations, NAFTA provides for an incremental phasing out over a 10-year period. Chapter 11 also includes rules mandating the free transfer of funds among the NAFTA parties, as well as rules prohibiting expropriation of investments, except under circumstances in the public interest and on a non-discriminatory basis pursuant to due process of the law and adequate compensation.

101. Section B of NAFTA’s Chapter 11 sets out the rules governing the resolution of investment-related disputes under the agreement. NAFTA was one of the first RTAs to provide for investor-state dispute resolution. Under these provisions, individual investors may bring a dispute under Chapter 11 first by consultations and negotiations and, if these talks fail, through arbitration under the ICSID Convention, NAFTA’s Additional Facility Rules or the UNCITRAL Arbitration Rules. Articles 1121-1138 stipulate detailed rules governing the facets of investment-related dispute settlement under NAFTA. NAFTA also contains provisions for State-State dispute settlement.

18. Other sectors in which Mexico scheduled limitations include construction; education services; retail establishments selling firearms and ammunition; maquiladoras; artificial explosives, fireworks, firearms, and cartridges; printing and editing and certain categories of land services.

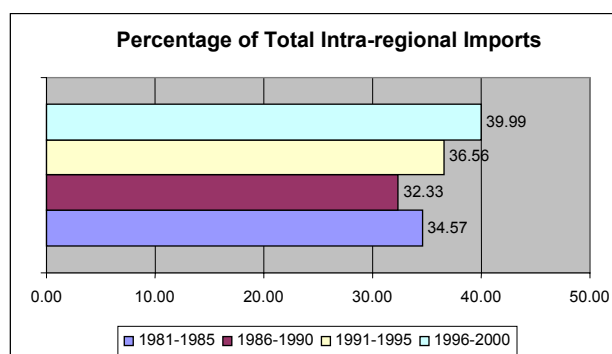
102. The Investor-State component of Chapter 11 has caused much controversy, especially in the United States and Canada. To date, 13 cases have been decided under NAFTA's Chapter 11¹⁹, 9 of which were decided in favour of NAFTA member governments and 4 partially in favour of individual investors. In the cases won by individual investors, a much smaller sum was awarded than was initially petitioned (Brock, 2005).

103. While not included in Chapter 11, NAFTA's provisions on rules of origin (RoO) also affect the locational decisions of investors. The NAFTA RoOs differ across goods, and offer incentives for firms to establish investments or source inputs in the NAFTA region and, in particular, in Mexico (World Bank, 2003). Rules of origin apply in a vertical model of multi-processing manufacturing that are conducted in the same country or, if applicable, in a country party to the regional trade agreement. These rules can negatively affect prospective investors who must invest in manufacturing goods that are either unprofitable or in which the firm does not have a competitive advantage to comply with particular rules of origin (Inama, 2002).

(ii) *Economic analysis*

104. Scholars have studied the economic effects of NAFTA almost since its inception and, on balance, most studies have shown a modest positive effect. For instance, a study commissioned on NAFTA's 10-year anniversary finds that intra-NAFTA trade and FDI increased significantly after the entry into force of NAFTA (Economist, 2004). The import values in Figure 2 support this view, as do the results in the quantitative analysis presented in Section III, which show trade creation among the NAFTA parties. Research by Sen (2003) also finds that NAFTA appears to have contributed to an increase in goods trade among NAFTA members, but that it has had little or no impact on services trade. Sen suggests that the disappointing services numbers could stem from other regulatory barriers to services trade, which are often set at the sub-federal level (e.g., standards established by professional bodies).

Figure 2. Imports in the NAFTA Region



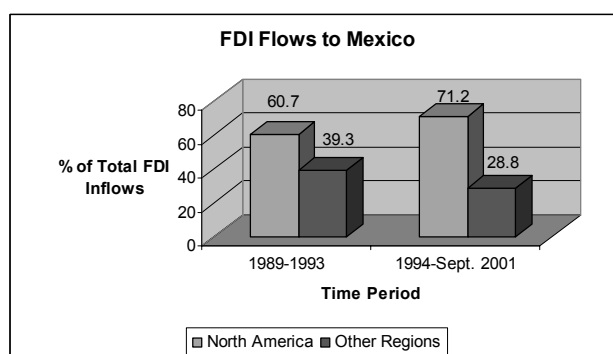
* Source: Adapted from World Bank (2003).

105. Most of the research surveyed shows no significant trade diversion on an aggregate level, although this result contrasts to the results obtained in the gravity model described in this paper (see, for instance, Krueger, 1999; Soloaga and Winters, 2001; Gould, 1998; World Bank, 2003). However, at a disaggregated level, some studies find trade diversion in the textile and apparel sector (see ITC, 1997; Fukao, Okubo and Stern, 2003).

19. There are two cases of *Waste Management, Inc. v. United Mexican States* registered at ICSID; these cases are counted separately for purposes of this paragraph.

106. On a country level, many scholars have studied NAFTA's effects on Mexico in particular. Waldkirch (2003), for instance, uses a firm-level econometric model to study NAFTA's effects on FDI in Mexico during the period 1980-1998. He finds a clear positive effect of NAFTA on FDI in Mexico, and suggests that this positive effect has come almost exclusively from raising investment from Canada and the United States, rather than from other countries wishing to access the NAFTA market. He estimates that between 1994-1998, U.S. and Canadian FDI to Mexico would have been around 42% lower without NAFTA, a substantial figure given that Canada and the United States accounted for two-thirds of all FDI flows to Mexico during this time period. Waldkirch also suggests that vertical specialisation among firms may have contributed to the higher FDI flows to Mexico.

Figure 3. FDI in Mexico



* Source: Adapted from World Bank (2003).

107. The World Bank (2003) also uses econometric analysis to study the effects of NAFTA on FDI in Mexico. They use a 45-country sample during the period 1980-2000 to estimate the effect of a RTA variable on FDI flows in general, and then test how well the estimates fit the actual FDI data for Mexico (they achieve an 85% correlation). They then decompose the variables used in the general econometric model and use the coefficients to determine the share of Mexican FDI that can be attributed to NAFTA. While the authors note that the results need to be taken as illustrative, they estimate that on average, NAFTA increased FDI in Mexico by around 40% a year since 1994, which is very similar to the 42% estimate obtained by Waldkirch (2003). Further, the World Bank suggests that this figure likely underestimates the actual effect of NAFTA because the agreement is probably correlated with the openness variable present in their model.

108. The World Bank then uses a gravity model to test the effects of NAFTA on trade flows among the NAFTA partners. They estimate that without NAFTA, Mexican exports and imports would have been 25-30% and 50% lower, respectively (World Bank, 2003). Alternatively, Krueger (1999) uses a gravity model approach on trade data for the period 1987 to 1997 and finds that other factors, such as exchange rates movements and, in particular, Mexico's unilateral trade liberalisation, had a much more significant impact on trade flows in Mexico than NAFTA.

109. Krueger's research highlights how difficult it is to disentangle the effects of NAFTA with other changes in the domestic and global marketplace. The devaluation of the *peso* during the Mexican financial crisis, among other factors, such as strong growth in the United States, are also likely to have significantly contributed to higher trade flows in the post-NAFTA period. Moreover, Mexico significantly reformed its investment regulations in 1989, followed by further reviews of foreign investments in 1993 and 2001, which removed many barriers to foreign investment. These regulatory changes are likely to have had an important impact on investors.

2. *The Agreement between New Zealand and Singapore on a Closer Economic Partnership*

110. The importance given to investment in the Agreement between New Zealand and Singapore on a Closer Economic Partnership (ANZSCEP) is already visible in the preamble where “trade and investment” are closely associated and quoted together in the list of reasons that motivated the agreement. Defined as a “closer economic partnership”, the agreement is fairly comprehensive and is a good example of “new regionalism” with provisions beyond trade liberalisation on topics such as investment. “Trade and investment” are mentioned five times in the preamble and three times in Article 1, which defines the objectives of the closer economic partnership.

(i) *The investment provisions*

111. Part 5 of the agreement sets the rules for investment in services. The supply of a service through commercial presence is included in the definition of trade in services (art. 16). Market access and national treatment are granted to sectors where specific commitments are made (art. 17 and 18). Following the GATS approach of a positive list with limitations on market access and national treatment, each party has a schedule of commitments (in Annex 2) listing the sectors where commitments are undertaken and limitations or conditions that apply. Part 5 has also GATS-like provisions on domestic regulation and professional qualifications. But contrary to the GATS, there is no MFN clause. However, the role of the MFN clause in a multilateral agreement such as the GATS differs from that found in many bilateral or regional agreements. The MFN clause in GATS ensures that all WTO members are treated equally. A bilateral MFN works differently by extending just to the bilateral partner any better treatment that is accorded to a non-party.

112. Looking at Annex 2, there is a difference in the way the two countries have listed their commitments in services. While Singapore’s list is in the same format as a GATS schedule of commitments (with limitations according to the mode of supply with different columns for market access and national treatment), the New Zealand schedule innovates by adopting a “*sui generis* plain language approach”. Horizontal limitations (that apply to all sectors) are first listed and then follows the list of sector-specific commitments, where a sentence will indicate the absence of limitations rather than the traditional “none” that can be found in a GATS schedule (which can be ambiguous). The objective of this “*sui generis* plain language” approach seems to be to facilitate the understanding of the schedule. For both countries the commitments in the ANZSCEP go beyond their GATS commitments.

113. In addition, the agreement foresees future liberalisation in services and provides for a review of the commitments at least every two years. The APEC objective of “free and open trade in services by 2010” is also clearly stated in article 20. The article even allows for a meeting to review the case of services sectors not fully liberalised by 2010 to find solutions beyond this date. It is clear that both New Zealand and Singapore crafted the services provisions with a liberalisation objective in mind.

114. It is in Part 6 of the agreement that the main provisions on investment can be found. Part 6 applies to all investments, including investment in services. However, art. 26 states that the definition of investment and provisions on MFN, national treatment and standard of treatment of Part 6 do not apply to the supply of services through commercial presence, as specific provisions for services are included in Part 5 described above. The provisions for non-services sectors are not limited to national treatment as in Part 5. Article 28 and 29 allow for, respectively, MFN and national treatment, both pre- and post-establishment. Investors can benefit from the better of MFN or national treatment as the standard of treatment (art. 30). The rest of the provisions contained in Part 6 apply to investment in services as well as in goods. It includes in particular a state-investor dispute settlement by conciliation or by ICSID arbitration.

115. Annex 3 of the agreement contains a list of limitations to MFN and national treatment. The limitations are related in the case of New Zealand to the acquisition of farm land, fishing quotas, the existence of marketing boards or state enterprises in some sectors (and also the Overseas Investment Regime – see below). In addition to the same kind of limitations related to land ownership or sectors with state enterprises, Singapore lists a few sectors in which domestic companies can have more favourable treatment (economic incentives) and requires companies from all sectors to employ a local manager. An important point is that these limitations apply also to investment in services (Mode 3). Annex 3 specifies that “Where a services sector is scheduled under Part 5, the terms, limitations, conditions and qualifications stated therein shall apply to investments in that sector.” For investment in services, the investment chapter thus adds a negative list to the positive list of sectors liberalised²⁰. As in the case of services, the parties agree to review at least every two years the status of their limitations on investment in a view to reducing or removing them.

116. An interesting example of a limitation to national treatment listed by New Zealand in Annex 3 is related to the Overseas Investment Regime. Above a certain threshold, any foreign investment has to be approved by New Zealand. The Overseas Investment Office (formerly called the Overseas Investment Commission) reviews investments under a criterion of “national interest”. This restriction sheds light on the limitations of the index created in this study. As any agreement granting national treatment and MFN pre-establishment with a list of limitations, New Zealand-Singapore obtained 1.0 + 0.5 points in Columns 1 and 2 of Table 6. However, the index does not assess how limiting the restrictions described in the negative lists of the agreements are. The fact that any investment above a certain threshold has to be authorized by the New Zealand Overseas Investment Office could be an important limitation if this institution, for example, was very strict in its decisions or very protective of the New Zealand market. To improve the index, it could be suggested to apply a similar methodology to quantitatively assess to what extent the list of reservations is a barrier to FDI (it could be done in the present case by looking at the threshold that requires an authorisation). But the example of the New Zealand-Singapore agreement shows that this methodology would have not only to look at the provisions but also their implementation (the practice of the Overseas Investment Commission in this case). A much simpler and maybe stronger approach is to avoid any judgement on the content of the lists of reservations (or the positive lists of commitments) as it was done in Part I, with 0.5 points given to establishment with a positive or negative list of limitations.

117. In the case of New Zealand, the Overseas Investment Office does not seem to have a policy aimed at restricting investment. Only 3.7% of total applications were refused in 2004²¹, none from Singapore and none related to non-land investment. The office has been instituted to protect sensitive land (like foreshore, seabed, beds or rivers and lakes) and fishing quotas. No non-land investment application has been declined in the past 20 years. Reports from other countries on the investment climate in New Zealand indicate that the authorisation from the Overseas Investment Office is not a major obstacle to

20. It is interesting to note that agreements where investment in services is covered in a separate chapter on services and have in addition provisions on investment protection, are not agreements with two separate sets of investment rules for goods and services (another example of such an agreement is Thailand-Australia). The architecture adopted is that the investment chapter covers all investments. Only provisions on market access and national treatment, as well as provisions specific to trade in services (like domestic regulation and professional qualifications) are in the services chapter. Provisions on investment protection or state-investor dispute settlement, for example, are in the investment chapter, even when market access and national treatment for investment in services are dealt with in the services chapter. This can be understood as a consequence of the GATS approach taken in services. The GATS is an agreement on trade liberalisation; it has no provisions on investment protection or promotion.

21. Overseas Investment Commission (2005).

FDI²². Singapore has also restrictions regarding the foreign ownership of land, state enterprises and in certain sectors listed in Annex 3 of the RTA.

118. One benefit for Singapore in signing a trade and investment agreement with New Zealand is that by binding the investment regime the threshold requiring consent from New Zealand cannot be reduced. However, the threshold has been augmented following the reform of the foreign investment regime in New Zealand last year. The Overseas Investment Act of 2005 has increased the threshold for acquisition of non-land business assets from NZD 50 millions to 100 millions for all countries.

119. In the index of investment provisions presented in Part 1, the New Zealand-Singapore agreement obtained a score of 1.638. The agreement is among the most extensive in terms of investment liberalisation, with pre- and post-establishment national treatment for goods and services. The absence of a MFN clause in the services chapter is the reason why the agreement lies a little behind NAFTA. Provisions that are absent from the agreement are in the “investment regulation and protection” category. The New Zealand-Singapore RTA has no provisions prohibiting performance requirements²³, no temporary entry and stay for key personnel and no reference to “fair and equitable treatment”. The other agreement signed by New Zealand in Tables 4 and 5, with Thailand, also lacks these three types of rules. However, these provisions can be found in more recent agreements signed by Singapore with other partners, for example in US-Singapore or Japan-Singapore.

(ii) *Economic analysis*

120. As a small but dynamic city-state economy building on free trade, Singapore has signed many RTAs inside and outside of Asia. Not only the number of agreements signed by Singapore is impressive, but also their scope is noticeable, as most of them include provisions on services and investment liberalisation. Investment seems to be a determining factor in Singapore’s RTA strategy. It is not surprising as the economic success and rapid development of Singapore has been based on private foreign investment. Singapore and its small population may not offer an important market for foreign investors, but the country is seen as a hub to serve Asian economies. The country has excellent port infrastructure, and good financial and business services making it the “gateway to Asia”. As a consequence, Singapore has attracted many investments and ranked fifth last year in UNCTAD’s Inward FDI Potential Index. Outward investment is as important for a country with limited land and resources and Singapore outward FDI has increased in Asia (in particular in China).

121. Singapore is negotiating free trade agreements with countries with whom it has very limited trade flows, such as Jordan and Egypt (Reiter, 2004). The rationale for such RTAs could be in investment opportunities, not only from Singaporean firms, but more likely for subsidiaries of multinationals established in Singapore. This is also the case in the ANZSCEP. The New Zealand-Singapore bilateral trade and investment relationship is of a different nature than the other “North-South agreements” listed in Tables 4 and 5. While under the WTO definition we have classified Singapore as a “South country”, the ANZSCEP sets rules for a real two-way investment relationship. Investment flows from the two countries are of the same range but FDI flows from Singapore to New Zealand tend to be higher, as seen in Figure 4, where there are only two years where the investment flows from New Zealand to Singapore are higher.

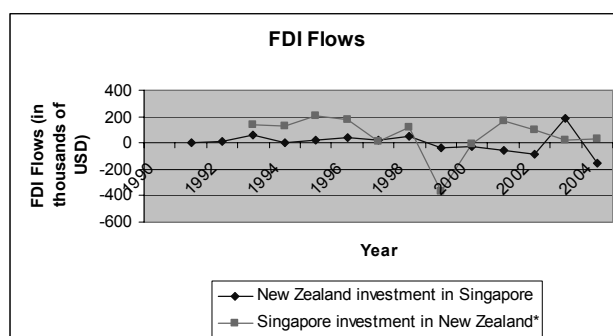
122. FDI flows show no major break after the signature or the entry in force of the ANZSCEP. As FDI determinants are various, Figure 4 cannot give a clear account of the impact of the RTA on investment

22. For example, “Doing Business in New Zealand: A Country Commercial Guide for US Companies”, US & Foreign Commercial Service and US Department of State, 2006.

23. The New Zealand-Singapore agreement thus relies on other international agreements, such as TRIMs, to circumscribe rules related to performance requirements.

flows, especially for a relatively recent agreement. Moreover, 2002-2004 was a period of world decline in FDI flows. The quantitative analysis presented in Part II includes variables and fixed effects that can isolate the impact of the RTA on FDI flows. Although not significant, the coefficient reported in Table 11 for New Zealand-Singapore (variable *nzsln1*) is positive and quite high. It suggests that the agreement has increased FDI flows but this result is not confirmed in the absence of significance of the coefficient. The two negative coefficients for *nzsln2* and *nzsln3* also hint at investment diversion. But again the coefficients are not significantly different from zero. As Singapore is likely to be a “hub” or a “platform” for New Zealand investments in Asia, investment diversion would be the expected outcome (negative *nzsln2*). New Zealand companies investing in Singapore can benefit from the broad network of trade agreements signed by Singapore and export (or invest) through their Singaporean subsidiaries.

Figure 4. FDI flows between New Zealand and Singapore (1991-2004)

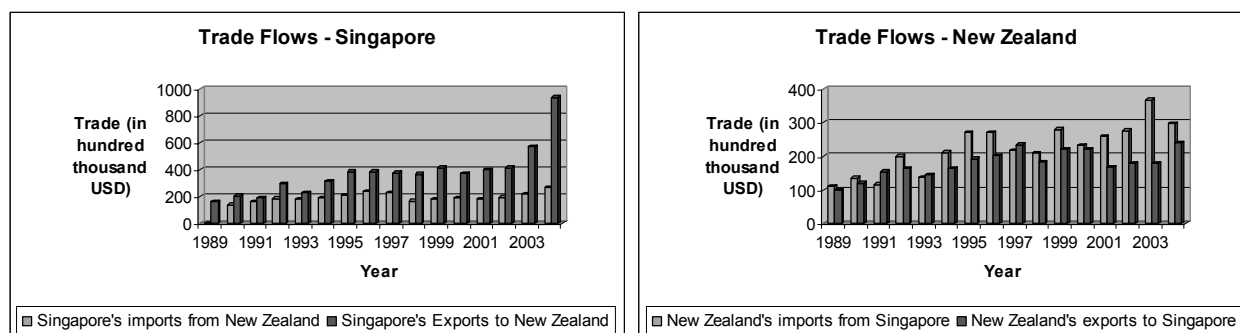


Source : UNCTAD (2005). Mirror data reported by New Zealand to UNCTAD.

123. While there is no significant impact of the ANZSCEP on investment flows between the two countries, it should be mentioned that the quantity of investment is not the only interesting variable. For New Zealand, investment in Singapore is also about productivity growth and technology enhancement. New Zealand has established in Singapore its first overseas technology centre in 2002. The mission of the New Zealand Technology Centre (NZTC) is to assist companies in commercialising their technologies and doing business internationally. It is another dimension of the “hubbing strategy” that would be reflected in a “qualitative” assessment of FDI flows rather than a quantitative study as proposed here.

124. Singapore’s exports to New Zealand have notably increased since the entry into force of the trade agreement (Figure 5). Data are less conclusive for New Zealand’s exports. In the econometric analysis of Part II, there is a significant result for the trade impact of the New Zealand-Singapore RTA. In Table 11, the agreement has a significant trade diverting impact. As investment from New Zealand to Singapore is likely to be of the efficiency-seeking type rather than market-seeking, this result is surprising. The RTA should create more trade between the two countries in the context of a “hubbing strategy” for New Zealand companies. It is as surprising for Singapore’s exports to New Zealand, which have steadily increased as shown in Figure 5. The increase is explained by other determinants than the investment provisions of the RTA. As investment from Singapore in New Zealand is mainly in hotels, house construction, computer retailing and the leisure industry²⁴, a substitution between trade and investment is a possibility. But it would have to be confirmed by further analysis.

24. Investment New Zealand (2003).

Figure 5. Trade flows between New Zealand and Singapore

Source : COMTRADE.

125. The New Zealand-Singapore trade and investment relationship will take a new turn with the entry into force of the Trans-Pacific Strategic Economic Partnership in 2006. This agreement between four APEC members (Brunei, Chile, New Zealand and Singapore) builds on the ANZSCEP and solidifies the objectives of trade and investment liberalisation in the Asia-Pacific region formulated in the Bogor Declaration (1994). The agreement has an open accession clause and is based on APEC's Best Practices for FTAs/RTAs, which encourage countries to go beyond WTO commitments and to explore commitments in areas not covered by the WTO, such as investment.

126. However, the investment chapter of the Trans-Pacific SEP remains to be negotiated (the agreement foresees the beginning of the negotiation no later than two years after the date of entry into force). The agreement signed on 3 June 2005 only covers investment in services in the services chapter. This chapter confirms the ambition of building on the ANZSCEP and going beyond through a lock-in of the commitments between New Zealand and Singapore (now extended to Chile²⁵) and a negative list approach instead of the positive list that was used in ANZSCEP. Exporters (and investors) are free to use either the provisions of the Trans-Pacific SEP or of the ANZSCEP (which remains in force). On services, the Trans-Pacific adds MFN treatment and additional national treatment commitments in sectors not scheduled in the ANZSCEP²⁶. As a concrete example of the benefits of the MFN clause, service providers from New Zealand thus obtain the same commitments as those negotiated in the US-Singapore RTA that entered into force in 2004.

127. The Trans-Pacific SEP will offer to investors of New Zealand and Singapore new opportunities to further invest in the Pacific region, including through their respective subsidiaries. In that sense, the signature of the ANZSCEP before the entry into force of other RTAs in the Asia-Pacific region gives a specific role to the two countries as investment platforms.

V. Conclusion

128. Policymakers are increasingly thinking critically about the impact of the wide-ranging and comprehensive RTAs that are being created under the rubric of new regionalism. This paper presents the findings of work on the quantification of investment provisions in RTAs as a means to analysing their relationship with trade and investment flows. The paper classifies the investment provisions that countries have included in North-South RTAs, briefly reviews how other researchers have assessed the economic

25. The chapter does not apply to Brunei, which has two more years to finalise its commitments.

26. Tax-related services, contact lens practitioners, real estate, aircraft repair and maintenance services, selling and marketing of air transport services, specialty air services and a range of international and non-transportation air services.

consequences of investment provisions in RTAs and presents the findings of original empirical work that analyses the relationship between substantive investment provisions and trade and investment flows. Two case studies complement the quantitative work.

129. Several patterns emerge from the analysis of investment provisions in RTAs. In general, it is somewhat surprising that the average index score for North-South RTAs with substantive investment provisions was the highest, above the averages for both North-North and South-South RTAs. Yet the average index score for the South-South category was higher than one might think, with a difference of only 0.021 compared to the average score for North-South RTAs. It also appears that the approach used to incorporate investment provisions in North-South RTAs is a function of past experience as well as how far “new” countries are willing to go in following the model favoured by the Northern partner.

130. Among OECD countries, one observes differences in the extensiveness and purpose of investment provisions in agreements signed by North American countries, Japan, Australia and New Zealand in contrast to European economies (EC and EFTA countries). Agreements that include rules on establishment, non-discrimination for all kinds of investments (not only Mode 3 trade in services), investment regulation and protection, as well as State-Investor dispute settlement, are found more often in the first group. In addition, the case studies suggest that recent agreements signed by the first group of OECD countries were concluded with a firm goal of widely liberalising both trade and investment.

131. The agreements of the second group often limit provisions on investment to services, reiterating GATS commitments and foreseeing further liberalisation in the future. However, not all EC and EFTA agreements follow this pattern, such as EC-FYROM and EFTA-Singapore, which also have a high index score. This is at least partly due to the fact that many EC countries have concluded BITs with many of their RTA partners which may contain some of these provisions. In the case of EFTA, the agreement with Singapore represents a new generation of agreements with more liberal investment provisions, showing a convergence with the first group of OECD countries identified.

132. While other studies have analysed the increase in trade following the entry into force of a RTA, this paper focuses on the impact of investment provisions. The quantitative analysis suggests that investment provisions in RTAs are positively associated with both trade and investment flows. Moreover, the coefficients indicate that they matter more for FDI flows than for trade flows. This dual positive effect indicates that investment may be more efficiency-seeking than market-seeking, thus acting more as a complement to, rather than a substitute for, trade in the context of RTAs.

133. Further, the study incorporates a dummy variable that represents whether the country pairs are party to a BIT. This variable was included in all of the FDI models, and the coefficient was insignificant. This suggests that either the investment provisions in RTAs impact trade and FDI flows more profoundly, or that the combination of substantive investment provisions and provisions liberalising other parts of the economy work together to more significantly impact trade and investment flows. This result indicates that the impact of the same investment provisions may be different in a trade agreement relative to a BIT. However, the variable that assesses the interaction between the BIT and RTA index dummies shows a positive and significant coefficient, suggesting a complementary relationship between BITs and RTAs.

134. As illustrated by the case studies presented in Part IV, investment provisions in RTAs have appeared in very innovative agreements that have strongly influenced the evolution of regionalism. From an investment perspective, these RTAs tend to go beyond commitments in WTO agreements. In a trade context, the case studies show that the content of the schedules, where sectoral coverage is explicitly defined, represents the best way to compare the commitments in the RTAs relative to those made in the WTO. The case studies reinforce that all of the types of investment provisions included in the index matter

for trade and investment, a result also obtained in the regression analysis of the separate categories of provisions.

135. RTAs are complex agreements that coalesce with underlying economic and political conditions to impact the national, regional and global economy. The policy environment in which a RTA operates is a critical component to facilitating, or hindering, the positive effects that a RTA can have on an economy. Effective implementation also matters. Nonetheless, the results presented in this paper have important policy implications for countries at all levels of development. At its core, the results suggest that substantive investment provisions in RTAs matter for trade and, to an even greater extent, FDI flows. This is good news for developing countries, particularly since North-South agreements tend to include the most extensive investment provisions, and FDI can be an important stimulus for development.

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ANNEX I – Matrix of investment-related provisions

Table 4. Matrix of investment-related provisions in North-South RTAs (Part 1 – Columns 1 to 13)

Agreement	Date of entry into force	Establishment (non-services sectors)		Non-discrimination (non-services sectors)				Investment in services sectors						
		Right of establishment?	Pre-establishment limitations	National treatment?	Limitations to national treatment	Most Favoured Nation?	Exceptions to MFN?	Investment in services covered by the RTA?	Provisions on establishment	Pre-establishment limitations in services	National treatment?	Limitations to national treatment in services	MFN?	Exceptions to MFN?
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
PATCRA	1-Feb-77	No	-	No	-	Yes (4)	-	No	-	-	-	-	-	-
NAFTA	1-Jan-94	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list	Investment section	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list
Canada — Chile	5-Jul-97	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list	Investment section	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list
EC — Tunisia	1-Mar-98	No	-	No	-	No	-	Services section	GATS	GATS	GATS	GATS	GATS	GATS
EC — South Africa	1-Jan-00	No	-	No	-	No	-	Services section	GATS	GATS	GATS	GATS	GATS	GATS
EC — Morocco	1-Mar-00	No	-	No	-	No	-	Services section	GATS	GATS	GATS	GATS	GATS	GATS
EC — Israel	1-Jun-00	No	-	No	-	No	-	Services section	GATS	GATS	GATS	GATS	GATS	GATS
EC — Mexico	1-Jul-00	No	-	OECD	-	No	-	Services section	Market access	Positive list (3)	Yes	Positive list (3)	Yes	None
New Zealand - Singapore	1-Jan-01	MFN+NT	Negative list	Yes	Negative List	Yes	Negative list	Services section	Market access	Positive List	Yes	Positive List	No	-
EC — FYROM	1-Jun-01	MFN+NT	None (2)	Yes	None	Yes	None	Investment section	MFN+NT	None (2)	Yes	None	Yes	None
EFTA - Mexico	1-Jul-01	No	-	OECD	-	No	-	Services section	Market access (3)	Positive list (3)	Yes (3)	Positive list (3)	Yes	None
United States — Jordan	17-Dec-01	No	-	No	-	No	-	Services section	Market access	Positive list	Yes	Positive list	Yes	GATS
EC — Jordan	1-May-02	MFN+(NT) (4)	(Negative list) (4)	Yes	Negative list	(Yes) (4)	(Negative list) (4)	Investment section	MFN+(NT) (4)	(Negative list) (4)	Yes	Negative list	(Yes) (4)	(Negative list) (4)
Japan - Singapore	30-Nov-02	NT	Negative list	Yes	Negative list	No	-	Services section	Market access	Positive List	Yes	Positive list	No	-
EFTA - Singapore	1-Jan-03	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list	Services section	Market access	Positive list	Yes	Positive list	Yes	GATS
EC - Chile	1-Feb-03	NT	Positive list	No	-	No	-	Services section	Market access	Positive list	Yes	Positive list	No	-
Singapore - Australia	28-Jul-03	NT	Negative list	Yes	Negative list	No	-	Services section	Market access	Negative list	Yes	Negative list	No	-
United States - Singapore	1-Jan-04	MFN+NT	Negative list	Yes	Negative List	Yes	Negative list	Investment section	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list
United States — Chile	1-Jan-04	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list	Investment section	MFN+NT	Negative list	Yes	Negative list	Yes	Negative list
EC - Egypt	1-Jun-04	No	-	No	-	No	-	Services section	GATS	GATS	GATS	GATS	GATS	GATS
EFTA - Chile	1-Dec-04	NT	Negative list	No	-	No	-	Services section	Market access	Positive list	Yes	Positive list	GATS	GATS
Thailand - Australia	1-Jan-05	NT	Positive list	Yes	Positive list	Yes	None	Services section	Market access	Positive list	Yes	Positive list	No	-
Mexico-Japan	1-Apr-05	MFN + NT	Negative list	Yes	Negative List	Yes	Negative list	Investment section	MFN + NT	Negative list	Yes	Negative List	Yes	Negative List
Thailand - New Zealand	1-Jul-05	(NT) (4)	(Positive list) (4)	Yes	Negative list	Yes	None	Services section	GATS	GATS	GATS	GATS	GATS	GATS

(1) Only services; (2) Some services sectors excluded or treated in a separate section; (3) Future action proposed; (4) Asymmetric treatment

Table 5. Matrix of investment-related provisions in North-South RTAs (Part 2 – Columns 14 to 27)

Agreement	Investment regulation and protection							Dispute settlement		Investment promotion and cooperation				
	Provisions prohibiting performance requirements?	Prohibition on performance requirements beyond TRIMs?	Specific provision prohibiting ownership requirements?	Free transfer of funds?	Temporary entry and stay for key personnel?	Provisions on expropriation?	Specific reference to fair and equitable treatment	State-state dispute settlement?	State-investor dispute settlement?	Investment promotion?	Cooperation mechanisms?	Harmonization of rules?	Any Type of Assymetries?	Clause foreseeing the future liberalization of investment?
	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)
PATCRA	No	-	No	No	No	No	No	Consultation	No	Yes (4)	Yes	No	Yes	Yes
NAFTA	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	No	No	No	No	No
Canada — Chile	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	No	No	No	No	Yes
EC — Tunisia	No	-	No	Yes	No	No	No	Political & ad hoc	No	Yes	Yes	Yes	No	Yes
EC — South Africa	No	-	No	Yes	No	No	No	Political & ad hoc	No	Yes	Yes	Yes	No	Yes
EC — Morocco	No	-	No	Yes	No	No	No	Political & ad hoc	No	Yes	Yes	Yes	No	Yes
EC — Israel	No	-	No	Yes	No	No	No	Political & ad hoc	No	Yes	No	Yes	No	Yes (1)
EC — Mexico	No	-	No	Yes	No	No	No	Ad hoc	No	Yes	Yes	Yes	No	Yes
New Zealand - Singapore	No	-	Yes (1)	Yes	No	Yes	No	Ad hoc	Perm. arb.	No	No	No	No	Yes (1)
EC — FYROM	No	-	No	Yes	Yes	No	No	Political	No	Yes	Yes	Yes	No	No
EFTA - Mexico	No	-	Yes (1) (3)	Yes	No	No	No	Ad hoc	No	Yes	Yes	Yes	No	Yes
United States — Jordan	No	-	No	No	Yes (1)	No	No	Ad hoc	No	No	No	No	No	No
EC — Jordan	No	-	No	Yes	Yes	No	No	Political & ad hoc	No	Yes	Yes	Yes	Yes	No
Japan - Singapore	Yes	Yes	No	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	Yes	Yes	No	No	No
EFTA - Singapore	No	-	No	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	No	No	No	No	No
EC - Chile	Yes	No	Yes (1)	Yes	No	No	No	Ad hoc	No	Yes	Yes	Yes	No	Yes
Singapore - Australia	No	-	Yes(1)	Yes	Yes	Yes	No	Ad hoc	Ad hoc & perm. arb.	No	No	No	No	No
United States - Singapore	Yes	Yes	No	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	No	No	No	No	No
United States — Chile	Yes	Yes	No	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	No	No	No	No	No
EC - Egypt	No	-	No	Yes	No	No	No	Political & ad hoc	No	Yes	Yes	No	No	Yes
EFTA - Chile	No	-	Yes (1)	Yes	No	No	No	Permanent political	No	No	No	No	No	Yes
Thailand - Australia	No	-	No	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc	Yes	Yes(1)	No	No	Yes
Mexico-Japan	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Ad hoc	Ad hoc & perm. arb.	Yes	Yes	No	No	No
Thailand - New Zealand	No	-	No	Yes	No	Yes	No	Ad hoc	Ad hoc & perm. arb.	Yes	No	No	No	Yes (1)

(1) Only services; (2) Some services sectors excluded or treated in a separate section; (3) Future action proposed; (4) Asymmetric treatment

Table 6. Encoded matrix of investment-related provisions (Part 1)

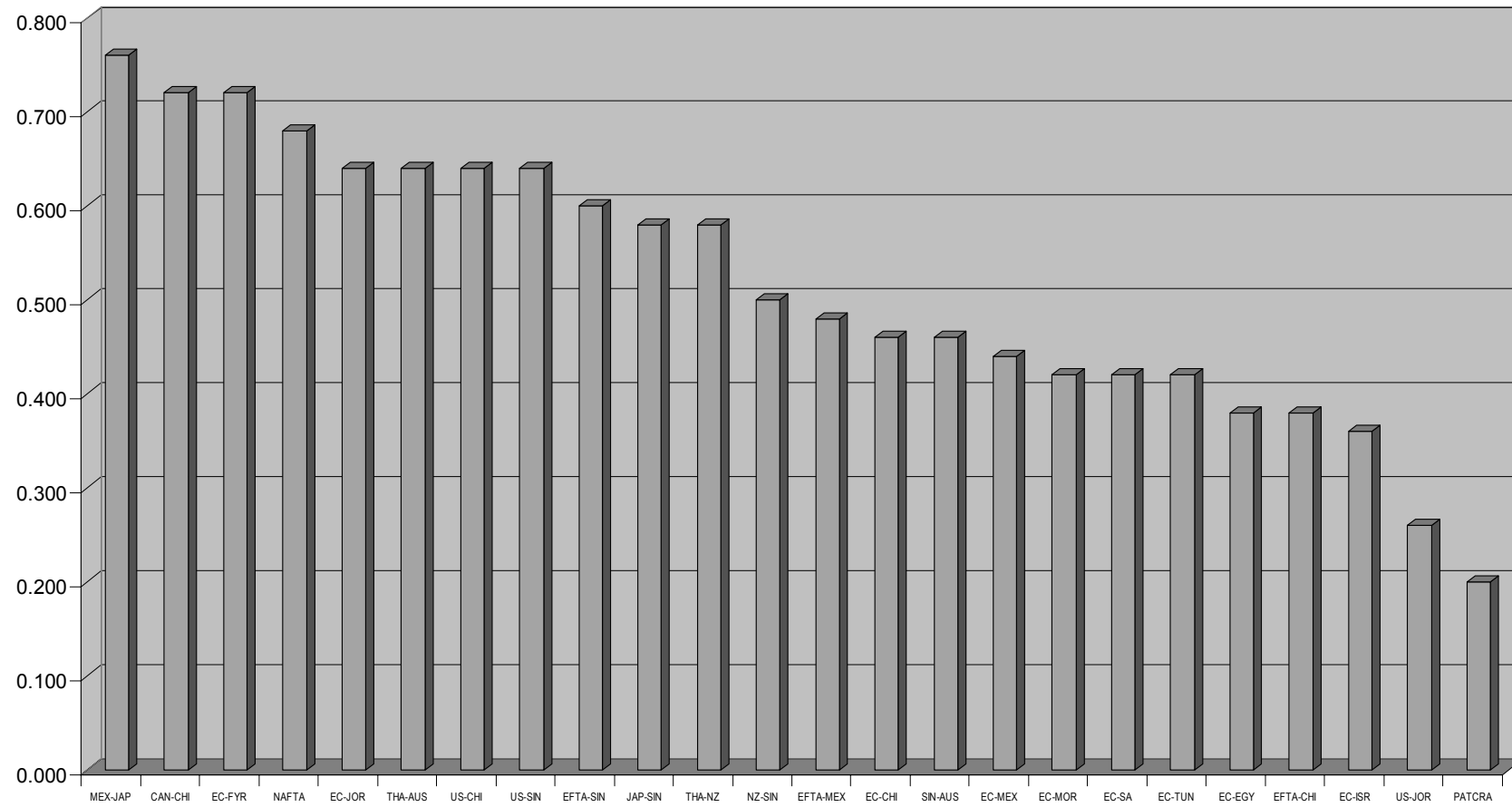
Agreement	Date of entry into force	Establishment (non-services sectors)		Non-discrimination (non-services sectors)				Investment in services sectors						
		Right of establishment?	Pre-establishment limitations	National treatment?	Limitations to national treatment	Most Favoured Nation?	Exceptions to MFN?	Investment in services covered by the RTA?	Provisions on establishment	Pre-establishment limitations in services	National treatment?	Limitations to national treatment in services	MFN?	Exceptions to MFN?
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
PATCRA	1-Feb-77	0.00	0.00	0.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
NAFTA	1-Jan-94	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Canada — Chile	5-Jul-97	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC — Tunisia	1-Mar-98	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC — South Africa	1-Jan-00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC — Morocco	1-Mar-00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC — Israel	1-Jun-00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC — Mexico	1-Jul-00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	1.00
New Zealand - Singapore	1-Jan-01	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	0.00	0.00
EC — FYROM	1-Jun-01	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
EFTA - Mexico	1-Jul-01	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	1.00
United States — Jordan	17-Dec-01	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC — Jordan	1-May-02	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Japan - Singapore	30-Nov-02	0.50	0.50	1.00	0.50	0.00	0.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
EFTA - Singapore	1-Jan-03	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC - Chile	1-Feb-03	0.50	0.50	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
Singapore - Australia	28-Jul-03	0.50	0.50	1.00	0.50	0.00	0.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
United States - Singapore	1-Jan-04	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
United States — Chile	1-Jan-04	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EC - Egypt	1-Jun-04	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EFTA - Chile	1-Dec-04	0.50	0.50	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Thailand - Australia	1-Jan-05	0.50	0.50	1.00	0.50	1.00	1.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
Mexico-Japan	1-Apr-05	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Thailand - New Zealand	1-Jul-05	0.50	0.50	1.00	0.50	1.00	1.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50

Table 7. Encoded matrix of investment-related provisions (Part 2)

Agreement	Investment regulation and protection						Dispute settlement	Investment promotion and cooperation				
	Provisions prohibiting performance requirements?	Specific provision prohibiting ownership requirements?	Free transfer of funds?	Temporary entry and stay for key personnel?	Provisions on expropriation?	Specific reference to fair and equitable treatment	State-investor dispute settlement?	Investment promotion?	Cooperation mechanisms?	Harmonization of rules?	Any Type of Assymetries?	Clause foreseeing the future liberalization of investment?
	(14)	(16)	(17)	(18)	(19)	(20)		(23)	(24)	(25)	(26)	(27)
PATCRA	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.00	1.00	1.00
NAFTA	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
EC — Bulgaria	0.50	0.00	1.00	1.00	0.00	0.00	0.00	1.00	1.00	0.00	0.00	0.00
EC — Romania	0.00	0.00	1.00	1.00	0.00	0.00	0.00	1.00	1.00	0.00	0.00	0.00
Canada — Chile	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	1.00
EC — Tunisia	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	1.00
EC — South Africa	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	1.00
EC — Morocco	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	1.00
EC — Israel	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	0.00	1.00	0.00	0.50
EC — Mexico	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	1.00
New Zealand - Singapore	0.00	1.00	1.00	0.00	1.00	0.00	0.50	0.00	0.00	0.00	0.00	0.50
EC — FYROM	0.00	0.00	1.00	1.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	0.00
EFTA - Mexico	0.00	1.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	1.00
United States — Jordan	0.00	0.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
EC — Jordan	0.00	0.00	1.00	1.00	0.00	0.00	0.00	1.00	1.00	1.00	1.00	0.00
Japan - Singapore	1.00	0.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00
EFTA - Singapore	0.00	0.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
EC - Chile	0.50	1.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	1.00	0.00	1.00
Singapore - Australia	0.00	1.00	1.00	1.00	1.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00
United States - Singapore	1.00	0.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
United States — Chile	1.00	0.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
EC - Egypt	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	0.00	0.00	1.00
EFTA - Chile	0.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.00
Thailand - Australia	0.00	0.00	1.00	1.00	1.00	1.00	0.50	1.00	1.00	0.00	0.00	1.00
Mexico-Japan	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00
Thailand - New Zealand	0.00	0.00	1.00	0.00	1.00	0.00	1.00	1.00	0.00	0.00	0.00	0.50

(1) Only services; (2) Some services sectors excluded or treated in a separate section; (3) Future action proposed; (4) Asymmetric treatment

Figure 6. Index of investment provisions in 24 North-South RTAs



ANNEX II – Countries in the dataset

Afghanistan	Côte d'Ivoire	Lebanon	Samoa
Albania	Denmark	Lesotho	San Marino
Algeria	Djibouti	Liberia	Saudi Arabia
Angola	Dominica	Libyan Arab Jamahiriya	Senegal
Antigua and Barbuda	Dominican Republic	Lithuania	Seychelles
Argentina	Ecuador	Luxembourg	Sierra Leone
Armenia	Egypt	Macedonia (the former Yugoslav Rep. of)	Singapore
Aruba	El Salvador	Madagascar	Slovakia
Australia	Equatorial Guinea	Malawi	Slovenia
Austria	Estonia	Malaysia	Solomon Islands
Azerbaijan	Ethiopia	Maldives	Somalia
Bahamas	Fiji	Mali	South Africa
Bahrain	Finland	Malta	Spain
Bangladesh	France	Marshall Islands	Sri Lanka
Barbados	French Polynesia	Mauritania	Sudan
Belarus	Gabon	Mauritius	Suriname
Belgium and Luxembourg	Gambia	Mexico	Swaziland
Belize	Georgia	Mongolia	Sweden
Benin	Germany	Morocco	Switzerland
Bermuda	Ghana	Mozambique	Syrian Arab Republic
Bhutan	Greece	Namibia	Tajikistan
Bolivia	Grenada	Nepal	Tanzania, United Rep. of
Bosnia and Herzegovina	Guatemala	Netherlands	Thailand
Botswana	Guinea	New Zealand	Togo
Brazil	Guinea-Bissau	Nicaragua	Tonga
Bulgaria	Guyana	Niger	Trinidad and Tobago
Burkina Faso	Haiti	Nigeria	Tunisia
Burundi	Honduras	Norway	Turkey
Cambodia	Hong Kong	Oman	Turkmenistan
Cameroon	Hungary	Pakistan	Uganda
Canada	Iceland	Palau	Ukraine
Cape Verde	India	Panama	United Arab Emirates
Cayman Islands	Indonesia	Papua New Guinea	United Kingdom
Central African Republic	Iran	Paraguay	United States of America
Chad	Iraq	Peru	Uruguay
Chile	Ireland	Philippines	Uzbekistan
China	Israel	Poland	Vanuatu
Chinese Taipei	Italy	Portugal	Venezuela
Colombia	Jamaica	Puerto Rico	Viet Nam
Comoros	Japan	Qatar	Yemen
Congo	Jordan	Romania	Zambia
Costa Rica	Kenya	Russian Federation	Zimbabwe
Croatia	Kuwait	Rwanda	
Cyprus	Lao People's Democratic Republic	Saint Lucia	
Czech Republic	Latvia	Saint Vincent and the Grenadines	

Note: All countries are partner countries; countries in bold are both reporter and partner.

ANNEX III – North-North and South-South RTAs with investment provisions

Table 8. Encoded matrix of investment-related provisions in North-North and South-South RTAs (Part 1)

Agreement	Date of entry into force	Establishment (non-services sectors)		Non-discrimination (non-services sectors)				Investment in services sectors						
		Right of establishment?	Pre-establishment limitations	National treatment?	Limitations to national treatment	Most Favoured Nation?	Exceptions to MFN?	Investment in services covered by the RTA?	Provisions on establishment	Pre-establishment limitations in services	National treatment?	Limitations to national treatment in services	MFN?	Exeoptions to MFN?
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
North-North														
EC (Treaty of Rome)	1958	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Australia - New Zealand	1989	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
EEA	1994	1.00	0.50	1.00	0.50	1.00	1.00	1.00	1.00	0.50	1.00	0.50	1.00	1.00
EC — Bulgaria	1995	0.50	0.50	1.00	0.50	0.00	0.00	1.00	0.50	0.50	1.00	0.50	0.00	0.00
EC — Romania	1995	0.50	0.50	1.00	0.50	0.00	0.00	1.00	0.50	0.50	1.00	0.50	0.00	0.00
EFTA (2002)	2002	1.00	0.50	1.00	0.50	1.00	1.00	1.00	1.00	0.50	1.00	0.50	1.00	1.00
US - Australia	2005	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
South-South														
CARICOM	1973 /97 /01	0.50	0.50	1.00	0.50	0.00	0.00	1.00	0.50	0.50	1.00	0.50	0.00	0.00
Gulf Cooperation Council	1981	0.00	0.50	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
CEEAC (ECCAS)	1985	1.00	0.50	1.00	1.00	1.00	1.00	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Andean Community	1988 /98	0.00	0.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	1.00	0.50	1.00	0.50
MERCOSUR	1991	0.00	0.00	1.00	0.50	1.00	0.50	1.00	0.00	0.00	1.00	0.50	1.00	0.50
CEDEAO (ECOWAS)	1990	0.00	0.00	1.00	0.50	1.00	0.50	1.00	0.00	0.00	1.00	0.50	1.00	0.50
ASEAN	1992 /95 /98	0.00	0.00	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Bolivia - Chile	1993	0.00	0.00	1.00	0.50	1.00	0.50	1.00	0.00	0.00	1.00	0.50	1.00	0.50
COMESA	1994	0.00	0.00	1.00	0.50	1.00	0.50	1.00	0.00	0.00	1.00	0.50	1.00	0.50
Mexico - Columbia - Venezuela	1995	0.00	0.00	1.00	0.50	1.00	0.50	1.00	0.00	0.00	1.00	0.50	1.00	0.50
Mexico - Bolivia	1995	0.00	0.00	1.00	0.50	1.00	0.50	1.00	0.00	0.00	1.00	0.50	1.00	0.50
Mexico - Costa Rica	1995	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Mexico - Nicaragua	1998	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
CARICOM - Dominican Republic	1999	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Chile - Mexico	1999	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
CEMAC (UEAC)	1999	1.00	0.50	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
UEMOA (WAEMU)	2000	0.50	0.50	1.00	0.50	1.00	0.50	1.00	0.50	0.50	1.00	0.50	1.00	0.50
Mexico - Northern Triangle	2001	0.00	0.00	1.00	0.50	1.00	0.50	1.00	1.00	0.50	1.00	0.50	1.00	0.50
Central America - Dominican Republic	2002	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
CARICOM - Cuba	2002	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
Panama - El Salvador	2003	0.50	0.50	1.00	0.50	0.00	0.00	1.00	1.00	0.50	1.00	0.50	0.00	0.00
Mexico - Uruguay	2004	0.50	1.00	1.00	1.00	0.00	0.00	1.00	0.50	1.00	1.00	1.00	0.00	0.00
Chinese Taipei - Panama	2004	0.00	0.50	0.00	0.00	0.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00
Republic of Korea - Chile	2004	0.50	1.00	0.00	0.00	0.00	0.00	1.00	0.50	0.00	0.00	0.00	0.00	0.00
China - Macao, China	2004	0.50	1.00	1.00	1.00	0.00	0.00	1.00	0.50	1.00	1.00	1.00	0.00	0.00
China - Hong Kong, China	2004	0.50	1.00	1.00	1.00	0.00	0.00	1.00	0.50	1.00	1.00	1.00	0.00	0.00
Singapore - India	2005	0.00	0.50	1.00	0.50	0.00	0.00	1.00	0.00	0.50	1.00	0.50	0.00	0.00

Table 9. Encoded matrix of investment-related provisions in North-North and South-South RTAs (Part 2)

Agreement	Investment regulation and protection						Dispute settlement	Investment promotion and cooperation				
	Provisions prohibiting performance requirements?	Specific provision prohibiting ownership requirements?	Free transfer of funds?	Temporary entry and stay for key personnel?	Provisions on expropriation?	Specific reference to fair and equitable treatment	State-investor dispute settlement?	Investment promotion?	Cooperation mechanisms?	Harmonization of rules?	Any Type of Assymetries?	Clause foreseeing the future liberalization of investment?
	(14)	(16)	(17)	(18)	(19)	(20)	(22)	(23)	(24)	(25)	(26)	(27)
North-North												
EC (Treaty of Rome)	0.00	0.00	1.00	1.00	0.00	0.00	0.50	1.00	1.00	1.00	0.00	1.00
EEA	0.00	0.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Australia - New Zealand	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.50
EC — Bulgaria	0.50	0.00	1.00	1.00	0.00	0.00	0.00	1.00	1.00	0.00	0.00	0.00
EC — Romania	0.00	0.00	1.00	1.00	0.00	0.00	0.00	1.00	1.00	0.00	0.00	0.00
EFTA (2002)	0.00	0.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.00
US - Australia	1.00	1.00	1.00	0.00	1.00	1.00	0.50	0.00	0.00	0.00	0.00	0.00
South-South												
CARICOM	0.00	0.00	1.00	0.00	0.00	0.00	0.50	1.00	0.00	1.00	1.00	1.00
Gulf Cooperation Council	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	0.00	1.00	0.00	1.00
CEEAC (ECCAS)	0.00	0.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Andean Community	0.00	0.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
MERCOSUR	1.00	0.00	1.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
CEDEAO (ECOWAS)	0.00	0.00	0.00	0.00	1.00	1.00	0.50	1.00	0.00	1.00	0.00	0.00
ASEAN	0.00	0.00	1.00	0.00	0.00	0.00	0.00	1.00	1.00	0.00	1.00	1.00
Bolivia - Chile	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
COMESA	0.00	1.00	1.00	0.00	1.00	1.00	0.50	1.00	0.00	1.00	1.00	0.00
Mexico - Columbia - Venezuela	1.00	0.00	1.00	1.00	1.00	0.00	1.00	1.00	1.00	0.00	0.00	0.50
Mexico - Bolivia	1.00	0.00	1.00	1.00	1.00	0.00	1.00	1.00	1.00	0.00	0.00	0.50
Mexico - Costa Rica	1.00	0.00	1.00	1.00	1.00	0.00	1.00	1.00	1.00	0.00	0.00	0.50
Mexico - Nicaragua	1.00	0.00	1.00	1.00	1.00	0.00	1.00	1.00	1.00	0.00	0.00	0.50
CARICOM - Dominican Republic	1.00	0.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00	0.50
Chile - Mexico	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	1.00
CEMAC (UEAC)	0.00	0.00	1.00	0.00	0.00	0.00	0.50	0.00	0.00	1.00	0.00	1.00
UEMOA (WAEMU)	0.00	0.00	1.00	0.00	0.00	0.00	0.50	0.00	0.00	1.00	0.00	0.00
Mexico - Northern Triangle	1.00	0.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00
Central America - Dominican Republic	1.00	0.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.50
CARICOM - Cuba	1.00	0.00	1.00	1.00	1.00	1.00	0.50	0.00	0.00	0.00	0.00	0.00
Panama - El Salvador	1.00	0.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
Mexico - Uruguay	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
Chinese Taipei - Panama	1.00	0.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	0.00
Republic of Korea - Chile	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.00	0.00	0.00	1.00
China - Macao, China	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.00	1.00	0.00	0.00	0.00
China - Hong Kong, China	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Singapore - India	1.00	0.00	1.00	1.00	1.00	0.00	1.00	0.00	0.00	0.00	0.00	0.00

Table 10. Index of investment provisions in North-North and South-South RTAs

RTA	Year into force	Index
North-North		
EC (Treaty of Rome)	1958	0.780
US - Australia	2005	0.620
EFTA (2002)	2002	0.560
EEA	1994	0.520
EC — Bulgaria	1995	0.420
EC — Romania	1995	0.400
Australia - New Zealand	1989	0.240
<i>Average</i>		<i>0.506</i>
South-South		
Chile - Mexico	1999	0.720
Mexico - Northern Triangle	2001	0.720
Mexico - Uruguay	2004	0.680
Republic of Korea - Chile	2004	0.680
Central America - Dominican Republic	2002	0.660
Chinese Taipei - Panama	2004	0.640
Panama - El Salvador	2003	0.640
Mexico - Bolivia	1995	0.580
Mexico - Columbia - Venezuela	1995	0.580
Mexico - Costa Rica	1995	0.580
Mexico - Nicaragua	1998	0.580
CARICOM - Dominican Republic	1999	0.560
MERCOSUR	1991	0.560
ASEAN (ASEAN Investment Area & ASEA)	1992 /95 /98	0.540
CARICOM - Cuba	2002	0.500
CEDEAO (ECOWAS)	1990	0.500
CARICOM	1973 /97 /01	0.460
Singapore - India	2005	0.460
UEMOA (WAEMU)	2000	0.420
CEEAC (ECCAS)	1985	0.360
COMESA	1994	0.360
Andean Community	1988 /98	0.320
Gulf Cooperation Council	1981	0.320
Bolivia - Chile	1993	0.280
CEMAC (UEAC)	1999	0.260
China - Macao, China	2004	0.240
China - Hong Kong, China	2004	0.160
<i>Average</i>		<i>0.495</i>

ANNEX IV – TECHNICAL ASPECTS OF THE ESTIMATES PROVIDED IN THE QUANTITATIVE ANALYSIS

This annex provides detail on the variables, different specifications of the gravity model used in the quantitative analysis section and results of alternative regressions to check the robustness of the estimates.

The variables

Bilateral exports (exports): This is the dependent variable in the trade model, and is measured as the value of bilateral exports in thousands of USD from reporter country i to partner country j in year t . Exports are preferable to imports in this specification because we are testing how investment provisions affect outflows. The data on exports comes from the United Nations Statistical Division Commodity Trade Database (Comtrade) for the period 1990-2004.

Bilateral outward FDI flows (fdi): This is the dependent variable in the investment model, and is measured as the bilateral net FDI outflows from reporter country i to partner country j in year t . The data on bilateral positive net outflows comes from UNCTAD's FDIStat Database (2005) for the period 1990-2004²⁷.

Distance (dist): The distance variable represents the second primary variable in the gravity model, and it is a proxy for transportation costs and other types of "friction" between the two trading countries. Distance is measured between the most populous cities²⁸ in reporter country i and partner country j according to the "great circle" method, which uses geographical co-ordinates to measure distance. Data comes from the Centre d'Etudes Prospectives et d'Informations Internationales (CEPII). The expected coefficient is negative.

Language (comlang_off): The language variable takes a binary – *i.e.*, dummy – form to represent whether or not the reporter country i and partner country j share a common official language. The variable takes a value of 1 if country i and country j share a common official language and 0 otherwise. Data comes from CEPII. The expected coefficient is positive.

Border (contig): This variable also takes a dummy form and represents whether or not reporter country i and partner country j share a border. The variable takes a value of 1 if the countries are contiguous and 0 otherwise. Data comes from CEPII. The expected coefficient is positive.

Colonial relationship (col45): This variable is a dummy variable that takes a value of 1 if reporter country i and partner country j have had a colonial relationship since 1945 and 0 otherwise. A colonial relationship is defined broadly as a relationship in which one country has exercised considerable control over the other

27 . The UNCTAD dataset is supplemented with mirror data from the OECD International Direct Investment Statistics Yearbook for the following country pairs: Mexico-Canada, Canada-Mexico, Morocco-EC and Egypt-EC.

28 . While the most populous cities are usually capital cities, there are several countries in which this is not the case: Australia, Benin, Bolivia, Brazil, Canada, Germany, Ivory Coast, Kazakhstan, Nigeria, South Africa, Tanzania, Turkey and the United States.

country's government or the evolution of its institutions. Data comes from CEPII. The expected coefficient is positive.

Bilateral tariff rate (tariff): This variable represents the average applied bilateral tariff rate between reporter country i and partner country j in year t . This variable acts as a proxy for trade liberalisation and is a corollary to the index of investment provisions in the models. Data comes from UNCTAD's Trade Analysis Information System (TRAINS) database (2005). The expected coefficient is negative for trade and ambiguous for FDI because tariffs can either encourage market-seeking and "tariff jumping" FDI or discourage efficiency-seeking FDI.

Market size (sumlngdp): This variable represents the joint market size of reporter country i and partner country j in year t . The variable is created by calculating the sum of the logs of the two individual country's GDP as measured in current USD. One expects a larger country to trade (and invest) more than a smaller country in absolute terms; thus, one can say that trade (and investment) is attracted to larger countries via gravity. Data comes from the World Bank's World Development Indicators Database.

Joint GDP per capita (sumlngdppc): This variable represents the joint GDP per capita of reporter country i and partner country j in year t . To calculate this variable, we add the logs of the two individual country's GDP per capita as measured in current USD. The expected coefficient is ambiguous. Data on GDP and population comes from the World Bank's World Development Indicators Database.

Nominal exchange rate (nomer): This variable represents the nominal bilateral exchange rate of reporter country i and partner country j in year t . This variable is calculated as the yearly average nominal bilateral exchange rate in year t . The variable controls for fluctuations in nominal prices between the bilateral pairs and is expected to have a negative coefficient. Data comes from the International Monetary Fund's International Financial Statistics Database.

Exchange rate volatility (ervol): This variable represents a measure of exchange rate volatility between reporter country i and partner country j . In line with the literature, it is calculated by taking the first difference of the natural log of the bilateral nominal exchange rate and then computing the standard deviation. The variable is a 5-year moving average using monthly data. The expected coefficient is negative. Data comes from the International Monetary Fund's International Financial Statistics Database.

Reporter country fixed effects ($\Sigma\alpha_i$): This term represents the sum of all of the fixed effects variables that control for omitted variables that vary by reporter country i .

Partner country fixed effects ($\Sigma\gamma_j$): This term represents the sum of all of the fixed effects variables that control for omitted variables that vary by partner country j .

Time fixed effects ($\Sigma\lambda_t$): This term represents the sum of all of the fixed effects variables that control for omitted variables that vary by year t .

Error term (ϵ): This term represents the residual error.

The mathematical specifications of the models

Base models

(a) Trade

$$\ln(\text{exports}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

(b) Investment

$$\ln(\text{fdi}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

Dummy variable RTA models

(a) Trade

$$\ln(\text{exports}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \beta_{10}(\text{dummy\_rtai}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

(b) Investment

(i) Single dummy variable

$$\ln(\text{fdi}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \beta_{10}(\text{dummy\_rtai}_{ijt}) + \beta_{11}(\text{dummy\_bit}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

(ii) Interaction term

$$\ln(\text{fdi}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \beta_{10}(\text{dummy\_rtai}_{ijt}) + \beta_{11}(\text{dummy\_bit}_{ijt}) + \beta_{12}(\text{dummy\_rtai}_{ijt} * \text{dummy\_bit}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

where:

RTA with investment provisions (dummy_rtai): This is a dummy variable that takes a value of 1 if reporter country *i* and country *j* are party to a RTA with substantive investment provisions and 0 otherwise. All RTAs between countries at all levels of development were studied to create this variable. Data comes from the analysis performed by the OECD Secretariat in Part II of this paper.

Bilateral investment treaty (dummy_bit): This is a dummy variable that takes the value of 1 if reporter country *i* and partner country *j* are party to a bilateral investment treaty in year *t* and 0 otherwise. All BITs between countries at all levels of development were studied to create this variable. The variable was created by the Secretariat based on data provided by UNCTAD.

RTA index of investment provisions models

(a) Trade

$$\ln(\text{exports}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \beta_{10} \ln(\text{index\_rtai}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

(b) Investment

$$\ln(\text{fdi}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \beta_{10} \ln(\text{index\_rtai}_{ijt}) + \beta_{11}(\text{dummy\_bit}_{ijt}) + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

where:

RTA index with investment provisions (index_rtai): This variable was constructed in two stages. First, the ones of the dummy variable that indicates if reporter country i and country j are party to a RTA with substantive investment provisions were replaced with the value of the aggregate index created in the Part I (the value is zero otherwise). Second, 0.000001 was added to all values before taking the natural log (one cannot take the natural log of zero). RTAs between countries at all levels of development were studied to create this variable. Data comes from the analysis performed by the OECD Secretariat in Part II of the paper.

The third set of RTA models can be expressed as follows:

$$\ln(\text{exports}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \Sigma_{ij} \text{RTA}_{ijt} + \Sigma_i \text{RTA}_{ijt} + \Sigma_j \text{RTA}_{ijt} + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

and

$$\ln(\text{fdi}_{ijt}) = \beta_0 + \beta_1 \ln(\text{dist}_{ij}) + \beta_2(\text{contig}_{ij}) + \beta_3(\text{col45}_{ij}) + \beta_4(\text{comlang\_off}_{ij}) + \beta_5 \ln(\text{tariff}_{ijt}) + \beta_6(\text{sumlngdp}_{ijt}) + \beta_7(\text{sumlngdppc}_{ijt}) + \beta_8 \ln(\text{nomer}_{ijt}) + \beta_9(\text{ervol}_{ijt}) + \beta_{10}(\text{dummy\_bit}_{ijt}) + \Sigma_{ij} \text{RTA}_{ijt} + \Sigma_i \text{RTA}_{ijt} + \Sigma_j \text{RTA}_{ijt} + \Sigma \alpha_i + \Sigma \gamma_j + \Sigma \lambda_t + \varepsilon_{ijt}$$

where:

Creation ($\Sigma_{ij} \text{RTA}_{ijt}$): One variable for each of the 24 North-South RTAs in the sample was created. These variables take the value of the aggregate index for each RTA when both the reporter country i and partner country j are party to the particular RTA and 0 otherwise.

Reporter diversion ($\Sigma_i \text{RTA}_{ijt}$): One variable for each of the 24 North-South RTAs in the sample was created. These variables take the value of the aggregate index for each RTA when the reporter country i is party to the particular RTA and 0 otherwise.

Partner diversion ($\Sigma_j \text{RTA}_{ijt}$): One variable for each of the 24 North-South RTAs in the sample was created. These variables take the value of the aggregate index for each RTA when the partner country j is party to the particular RTA and 0 otherwise.

Data to create these variables comes from the index of investment provisions developed by the Secretariat in Part II of the paper. Only the 24 North-South RTAs of interest in this paper were analysed, but due to data limitations, several variables drop out of the models.

Table 11. Results from the third regression (individual RTAs)

Variables	Coefficient in the FDI model	Coefficient in the trade model
dist	-0.957***	-0.949***
contig	0.204*	0.188***
col45	1.095***	1.169***
comlang_off	0.481***	0.437***
tariff	-0.020	-0.167***
sumlngdp	0.990	-0.177
sumlngdppc	-0.345	0.839***
lnnomer	-0.004	-0.023*
ervol	-0.729**	-0.363**
patcra1	-0.015	0.086***
patcra2	0.380***	0.098**
patcra3	-0.541***	0.626***
nafta1	-0.028	0.049***
nafta2	-0.003	-0.007
nafta3	-0.008	-0.019***
ecbul1	-0.007	0.040
ecbul2	-0.129***	0.006
ecbul3	0.653***	-0.511***
ecrom1	0.029	0.023
ecrom2	0.106***	-0.003
ecrom3	-0.642***	0.508***
canchi1	0.129***	0.010
canchi2	-0.013	0.001
canchi3	0.000	-0.017
ectun1	0.052	0.018
ectun2	0.021**	0.002
ectun3	0.031***	0.003
ecsa1	0.086***	0.037***
ecsa2	-0.045	-0.008
ecsa3	-0.053	-0.059**
ecmor1	0.014	0.052***
ecmor2	0.028	-0.025*
ecmor3	-0.022	-0.068*
ecisr1	-0.104**	-0.037*
ecisr2	0.109***	0.016
ecisr3	0.075	0.112*
ecmex1	0.070*	-0.030*
ecmex2	-0.040	0.028*
ecmex3	0.027	0.014

Variables	Coefficient in the FDI model	Coefficient in the trade model
nzsin1	0.162	-0.056**
nzsin2	-0.022	-0.001
nzsin3	-0.061	-0.009
ecfyr1	0.040	-0.106*
ecfyr2	-0.035*	-0.007
ecfyr3	0.006	-0.008
eftamex1	0.106**	-0.053
eftamex2	-0.024	0.003
eftamex3	-0.008	-0.009
usjor1	0.042*	0.104***
usjor2	-0.013	0.003
usjor3	-0.022	-0.030***
ecjor1	0.000	0.000
ecjor2	-0.038*	0.001
ecjor3	-0.022	-0.005
japsin1	-0.078	0.010
japsin2	-0.010	-0.001
japsin3	0.001	-0.008
eftasin1	0.000	0.061***
eftasin2	0.010	-0.001
eftasin3	0.007	-0.009
ecchi1	0.074*	0.005
ecchi2	0.011	-0.002
ecchi3	-0.019	-0.005
sinaus1	0.000	-0.021
sinaus2	0.015	0.005
sinaus3	0.039	-0.007
ussin1	0.000	0.000
ussin2	0.000	-0.014
ussin3	-0.060	0.085**
uschi1	-0.271***	0.012
uschi2	0.136**	0.007
uschi3	0.124*	-0.057**
ecegy1	0.000	0.000
ecegy2	0.068**	-0.023
ecegy3	0.073	0.058**
eftachi1	0.000	0.000
eftachi2	0.165***	0.001
eftachi3	0.000	0.000

Notes: Time and country fixed effects are not reported. All trade regressions were run with robust standard errors under heteroskedastic conditions. Values marked (***), (**), and (*) are significant at the 1%, 5%, and 10% levels, respectively.

Alternative model specifications

The use of fixed effects in a gravity model framework has created some controversy among researchers. There has been much discussion about the inclusion of country fixed effects, whether country fixed effects should include a time dimension (Mátyás, 1997), and if country pair fixed effects provide greater robustness than individual country fixed effects terms (Anderson and Ferrantino, 2004; Cheng and

Wall, 2005). To test the robustness of the results in the quantitative section, we estimate the trade and investment models with two different fixed effects specifications (see Table 12).

Country fixed effects with a time dimension

In a gravity model using country fixed effects with a time dimension, the fixed effects terms control for any variable that affects a particular reporter country i or partner country j in year t . All of the variables used in the models in the main section of the paper are also used in this model. Time fixed effects terms that control for specific years are also included. However, the results of several Monte Carlo experiments conducted by Anderson and Ferrantino (2004) suggest that modellers should be cautious with this approach as it can lead to “false” positives.

Country pair fixed effects

Country pair fixed effects control for any variables that are specific to the country pair in year t . This implies that all bilateral data, such as a distance, whether or not countries share border, etc., drop out of the models because they are perfectly correlated with the fixed effects terms. Time fixed effects terms that control for specific years are also included. For the gravity models presented in this paper, we must reconfigure the dataset on an individual country basis. To control for market size, we use GDP of reporter country i in year t , GDP of partner country j in year t , the population of reporter country i in year t and partner country j in year t . The bilateral nominal exchange rate (nomer) and exchange rate volatility term (ervol) are also included.

Alternative regression techniques

Because the FDI data is calculated on a net basis, and thus can take negative values, we use a Tobit specification to estimate the FDI model. Table 12 reports the results of the same regressions with OLS. Although coefficients are slightly changed, we do not observe a significant bias and the coefficient of the investment index remains unchanged.

To check for omitted variable bias, we calculated Ramsey’s regression specification error test (RESET) for the OLS estimations in the trade and FDI models. The results indicate that a misspecification and/or non-linearities may exist (*i.e.*, omitted variables may be present). We therefore report estimates for an alternative approach – the fixed effects Poisson regression.

Santos Silva and Tenreyro (2005) and Westerlund and Wilhelmsson (2006) argue that there is a potential bias in the estimation of the log-linear specification of the gravity equation, and they suggest that this bias could particularly affect the coefficients of RTA dummy variables and their interpretation (Santos Silva and Tenreyro, 2003). These authors propose the use of a Poisson pseudo-maximum likelihood estimation technique instead of the standard log-linearised OLS regression. A Poisson regression allows the variables in the equation to take a value of zero, which is not possible in a logged specification. As a result, the Poisson estimation allows us to use the untransformed version of the index of investment provisions, which takes a value of zero when there are no substantive investment provisions in the RTA or when the country pairs have not signed a trade agreement.

Table 12 includes the results of the Poisson estimation (with fixed effects) with the exports of the reporter country as the dependent variable (instead of the log of exports) and the gravity equation in its multiplicative form. The independent variables have been kept logged to compare the coefficients with the other regressions in the table. The Poisson estimation results show quite different coefficients for the main variables of the gravity equation. Distance in particular has a diminished influence, a result that seems to confirm that the log-linear form of the gravity equation could introduce a bias, as suggested by Santos Silva and Tenreyro. The index of investment provisions has a positive and significant coefficient in both

the trade and FDI models in the same range as the OLS regressions. However, the coefficient for trade (0.038) is higher than for FDI (0.025). This could suggest an overestimation of the coefficient of the index in the FDI model (the coefficient reported for the FE within regression is also lower, 0.017) and an underestimation in the trade model.

Table 12. Alternative model specifications

	Dependent variable: Exports				Dependent variable: FDI				
	Time invariant country fixed effects	Time varying country fixed effects	FE within regression (country pair fixed effects)	Poisson regression	Tobit regression	OLS	Time varying country fixed effects	FE within regression (country pair fixed effects)	Poisson regression
Indist	-0.936*** (-57.83)	-0.884*** (-42.57)		-0.540*** (-33.34)	-0.886*** (-21.43)	-0.886*** (-21.62)	-0.866*** (-16.94)		-0.438*** (-377.79)
contig	0.234*** (4.88)	0.233*** (4.16)		0.535*** (14.04)	0.158 (1.42)	0.159 (1.52)	0.082 (0.64)		-0.416*** (-174.06)
col45	1.221*** (24.95)	1.095*** (15.17)		0.526*** (10.85)	1.104*** (8.72)	1.104*** (9.54)	0.913*** (5.50)		0.173*** (32.83)
comlang_off	0.429*** (15.54)	0.421*** (11.93)		0.360*** (13.99)	0.525*** (7.10)	0.526*** (7.30)	0.598*** (6.52)		0.714*** (458.81)
Ingdpr			0.524*** (13.15)					0.337 (1.40)	
Ingdpp			0.764*** (37.15)					0.728*** (5.30)	
Inpopr			-0.445* (-2.07)					-4.257*** (-3.87)	
Inpoppp			-0.727*** (-7.35)					-0.625 (-1.24)	
tariff	-0.151*** (-7.88)	-0.191*** (-5.31)	-0.083*** (-8.60)	-0.163*** (-6.24)	0.086 (1.81)	0.086 (1.76)	0.070 (0.81)	0.048 (0.86)	0.039*** (22.91)
sumlngdp	-0.555** (-2.96)	0.503 (0.00)		-0.550* (-2.42)	-0.642 (-1.26)	-0.639 (-1.29)			-1.592*** (-80.99)
sumlngdppc	1.196*** (6.22)	0.385 (0.00)		1.116*** (4.67)	1.119* (2.13)	1.116* (2.20)			1.478*** (71.37)
Innomer	-0.019 (-1.84)	0.035 (0.93)	-0.023*** (-4.72)	0.024 (1.65)	-0.024 (-0.91)	-0.024 (-0.87)		-0.061 (-1.85)	0.047*** (57.76)
ervol	-0.315** (-2.73)	-2.284*** (-3.64)	-0.132** (-2.92)	-0.462*** (-3.27)	-0.810** (-2.96)	-0.811** (-2.69)	-1.418 (-1.10)	-1.103*** (-3.40)	0.532*** (59.80)
index_rtai	0.014*** (5.24)	0.011** (2.46)	0.013*** (7.71)	0.038*** (9.48)	0.034*** (4.76)	0.034*** (5.03)	0.039*** (3.42)	0.017* (2.05)	0.025*** (109.97)
Number of obs.	9027	9027	9027	9027	7258	7258	7283	7258	7258
R-squared	0.9174	0.9378				0.6839	0.7672		
Adjusted R-squared	0.9150	0.9098				0.6726	0.6221		
R-squared within			0.3891					0.1426	
Log likelihood					-14109.6				
Pseudo R2				0.9567	0.6839				0.7992
Ramsey RESET test (F stat and Prob > F)	130.43 (0.000)	160.69 (0.000)				64.36 (0.000)	33.45 (0.000)		

Notes: Time and country fixed effects are not reported. All trade regressions were run with robust standard errors under heteroskedastic conditions. Values of t-statistics are in parentheses (z-values for the Poisson regressions). Values marked (***), (**), and (*) are significant at the 0.1%, 1% and 5% levels, respectively.

These alternative specifications and regression techniques nonetheless confirm the robustness of the analysis presented in the study since the coefficient on the index of investment provisions is always positive and significant.

Analysis of the impact of different categories of investment provisions

In the regressions presented in Table 13, the index of investment provisions has been decomposed into three components using the same methodology as the aggregation of the categories (*i.e.*, a simple arithmetic average).

- *lninv_lib* describes the provisions related to investment liberalisation. It includes the right of establishment, pre-establishment limitations, market access in services, the free transfer of funds and the temporary entry and stay of key personnel.
- *lninv_protec* corresponds to the protection of investment. It consists of provisions on post-establishment non-discrimination in goods and services, the prohibition of performance requirements and ownership requirements, provisions on expropriation, fair and equitable treatment and State-Investor dispute settlement.
- *lninv_prom* reflects the provisions on investment co-operation and promotion. It includes the last five categories of the index (investment co-operation, co-operation mechanisms, harmonisation of rules, asymmetries and future liberalisation).

The results presented in Table 13 are interesting because the impact of the provisions appears to be quite different for trade than for FDI flows. As far as investment is concerned, the provisions on investment liberalisation are not surprisingly positively correlated with an increase in FDI. However, the provisions on investment promotion and co-operation also show a positive and significant coefficient, although smaller than that obtained for investment liberalisation. It could be the case that because they include future liberalisation, these provisions are a part of the positive relationship found between the index and FDI flows.

The variable describing provisions on investment protection has a negative and significant coefficient. This implies that agreements with a high score in this category of provisions are not associated with higher FDI flows. As the category includes national treatment post-establishment, this result is somewhat surprising as it is usually considered to be an important provision. The analysis should of course be taken with caution as the interaction between the three variables in Table 13 may be influenced by the specification of the model. The three sub-components have a lower significance than the aggregate index.

Turning to the trade model, a very different picture emerges. In contrast to the investment model, the provisions on investment protection matter the most. An interesting explanation could be that these provisions are more likely to influence efficiency-seeking investment. Investors attracted to a larger market or specific resources that could not be found in another country tend to accommodate any constraint or lack of equitable treatment in the host country, whereas investors seeking efficiency gains through off-shore production could select their host country among a list of potential candidates on the basis of protections that can be granted. The negative relationship between provisions on investment liberalisation and trade flows could illustrate the trade-off between investment and trade for companies trying to serve foreign markets.

The results in Table 13 should not be taken too literally as showing the types of provisions that favour or discourage trade and investment. The results depend on the type (and number) of agreements containing the different categories of provisions.

Table 13. Econometric analysis of the impact of different categories of investment provisions

Dependent variable:	lnexports	lnfdi
Indist	-0.935*** (-57.43)	-0.889*** (-21.58)
contig	0.202*** (4.31)	0.186 (1.74)
col45	1.190*** (24.09)	1.139*** (9.67)
comlang_off	0.436*** (15.94)	0.518*** (7.17)
tariff	-0.164*** (-8.44)	0.096* (1.97)
sumlngdp	-0.540** (-2.88)	-0.631 (-1.27)
sumlngdppc	1.181*** (6.14)	1.108* (2.18)
lnnomer	-0.019 (-1.90)	-0.024 (-0.85)
ervol	-0.319** (-2.77)	-0.807** (-2.67)
inv_lib	-0.080*** (-4.63)	0.111** (2.62)
inv_protec	0.119*** (6.24)	-0.101* (-2.23)
inv_prom	-0.027*** (-4.55)	0.024* (2.01)
Number of obs.	9027	7258
R-squared	0.9178	0.6841

Notes: Time and country fixed effects are not reported. All trade regressions were run with robust standard errors under heteroskedastic conditions. Values marked (***), (**), and (*) are significant at the 0.1%, 1%, and 5% levels, respectively.

Table 14. Analysis of the investment index and dummy coefficients according to the year of reference

Dependent variable: Infdi		Coefficient	t	Std error	R-Squared	$\hat{g}$
Dummy variable for investment provisions	Date of entry into force	0.456***	5.10	0.0894	0.6840	57.2%
	Date of signature	0.482***	5.40	0.0893	0.6841	61.4%
	For all years	0.322***	3.63	0.0886	0.6835	37.4%
Index of investment provisions	Date of entry into force	0.034***	5.03	0.0068	0.6839	-
	Date of signature	0.036***	5.35	0.0068	0.6841	-
	For all years	0.024***	3.64	0.0067	0.6835	-
Dependent variable: Inexports		Coefficient	t	Std error	R-Squared	$\hat{g}$
Dummy variable for investment provisions	Date of entry into force	0.190***	5.36	0.0354	0.9174	20.8%
	Date of signature	0.123***	3.52	0.0350	0.9172	13.0%
	For all years	0.199***	5.59	0.0355	0.9174	21.9%
Index of investment provisions	Date of entry into force	0.014***	5.24	0.0027	0.9174	-
	Date of signature	0.009***	3.43	0.0026	0.9172	-
	For all years	0.014***	5.48	0.0027	0.9174	-

Notes: All regressions were run with time and country fixed effects and robust standard errors under heteroskedastic conditions. Values marked (***), (**) and (*) are significant at the 0.1%, 1% and 5% levels, respectively. The $\hat{g}$ statistic represents an interpretation in percentage terms of the coefficient of the dummy variable using the method suggested by Kennedy (1981).

Services Liberalization in the New Generation of Preferential Trade Agreements (PTAs): How Much Further than the GATS?

Martin Roy, Juan Marchetti and Hoe Lim*

* Trade in Services Division, WTO Secretariat. The views expressed are those of the authors alone. They do not necessarily represent the views of the WTO Secretariat and cannot be attributed to it. The authors are grateful for Delphine Naville's assistance, as well as for comments from Rolf Adlung, an anonymous referee, and participants at the World Trade Forum 2006, in particular Americo Beviglia-Zampetti. This paper derives from a larger project on services PTAs, of which some results were presented at the World Trade Forum 2006 in Bern and will be published in the Conference proceedings. E-mails: martin.roy@wto.org, juan.marchetti@wto.org, hoe.lim@wto.org

ABSTRACT

This paper attempts to fill a gap in the trade literature by providing a comprehensive overview of services liberalization commitments in the new generation of preferential trade agreements (PTAs) as compared to prevailing GATS commitments and Doha Round offers. The paper reviews the commitments undertaken by 36 WTO Members (counting the EC as one) under mode 1 (cross-border supply) and mode 3 (commercial presence) in 32 PTAs negotiated since 2000. Among other things, the results suggest that, overall, PTA commitments tend to go significantly beyond GATS offers. Countries that have signed PTAs with the US have made spectacular improvements, but GATS+ commitments are not limited to such agreements. The paper also discusses the potential economic costs arising from these preferential agreements and implications for the role of GATS and for multilateral services negotiations. The paper concludes by exploring possible approaches to overcome the potential downsides of services PTAs, including suggestions for a more pro-active role for the WTO in the surveillance of these agreements.

Services Liberalization in the New Generation of Preferential Trade Agreements (PTAs): How Much Further than the GATS?

The temporary suspension of the WTO Doha Round during the latter half of 2006 coincided not only with renewed calls for shifting priorities to the negotiation of preferential trade agreements (PTAs), but also with the expression of heightened concerns about such course of action.¹ Unlike in any other period since the establishment of the multilateral trading system, all important trading nations are now involved in PTA discussions of one form or another.

In the midst of the recent flurry of PTA activity, this paper attempts to fill a gap in the literature by providing a comprehensive evaluation of the liberalization commitments contained in the recent wave of preferential trade agreements on services. Indeed, the trade literature has tended to limit its examination of services components of preferential trade agreements (PTAs) to the type of rules they contain and to such other characteristics as whether a GATS-type positive listing or NAFTA-type negative listing were used in undertaking commitments.

The paper hopes to make a contribution at the empirical level by comparing the commitments undertaken in PTAs with prevailing GATS commitments, as well as offers in the ongoing Doha Round negotiations so as to assess how much further access is granted under PTAs. The review of recent services PTAs should help shed light on some basic questions: do PTA commitments go further than existing GATS commitments and GATS offers and if so to what extent? What types of PTAs appear to encourage more liberalization (in terms of scheduling approaches, countries involved, etc.)? Do PTAs encourage actual liberalization, i.e., going beyond the status quo? Providing elements of answers to these questions should, in addition, allow for informed reflections on policy implications of these

¹ See, for example: Pascal Lamy, "What now, Trade Ministers?", *International Herald Tribune*, 28 July 2006; Financial Times, "The Pointlessness of partial trade pacts", 16 August 2006; Fred Bergsten, "Plan B for World Trade: Go Regional", *Financial Times*, 16 August 2006; Agence France Presse, "IMF Chief Warns Against Patchwork Trade Deals", 31 July 2006; Le Monde, "Bruxelles veut privilégier les relations commerciales bilatérales", 5 October 2006; Financial Post, "Canada Must Deal with Trade Bilaterally", 31 July 2006; Financial Express, "Doha Collapse: Govt to Pursue Bilateral Talks", 31 July 2006; WTO Reporter, "Brazil Tries to Remain Upbeat on Doha Talks, While Business Clamours for Bilateral Accords", 31 July 2006; WTO (2005), "The Future of the WTO: Addressing Institutional Challenges in the New Millennium", Report by the Consultative Board to the WTO Director-General Supachai Panitchpakdi.

PTAs, including for the Doha services negotiations and the multilateral system more generally.²

The paper is structured as follows. Part I sets the stage by discussing the evolution of services PTAs in recent years as well as these agreements' approaches to services liberalization and their key features. Part II presents the results of our research to provide an overall picture of GATS+ commitments undertaken in the recent wave of PTAs. The paper reviews the commitments undertaken by 36 countries³ under mode 1 (cross-border supply) and mode 3 (commercial presence) in 32 PTAs with services commitments that have been concluded since 2000. The 'value-added' of PTAs is highlighted, among other things, by examining, for each country, the proportion of all services activities that are subject of improved and new commitments in PTAs compared to GATS offers. We also make some observations about the content of the new and improved commitments in PTAs in a number of sectors and presents concrete examples of actual liberalization arising from these arrangements. Part III concludes by summarizing the main findings and making certain observations on economic consequences and on the possible impact of preferential arrangements on the Doha services negotiations. We also suggest, in conclusion, some avenues to limit the downsides of this phenomenon and reinforce multilateralism.

I. The Context

A. Proliferation of Services PTAs

As often pointed out, the number of preferential trade agreements has increased at a great and steady pace since the establishment of the WTO in 1995. Apart from Mongolia, all Members are party to a PTA of one form or another. As of 15 September 2006, 211 notifications to the GATT/WTO have been registered under GATT Article XXIV, the Enabling Clause, and GATS Article V. Eleven hundred and eighteen (118) notifications have

² The paper does not seek to provide a legal evaluation of PTA commitments or to assess whether GATS Article V criteria for preferential trade agreements have been met.

³ Counting the European Communities (15) as one.

been received since 2000, including 88 since 2002, i.e., concurrently with the Doha Round negotiations.⁴

PTAs encompassing services are more novel. Since trade rules on services are a more recent phenomenon (the Canada-US free trade agreement in 1989 and the GATS in 1995 were key precursors), it is understandable that only 44 new PTAs have been notified under GATS Article V. However, notifications for services agreements have grown at a faster pace than others: 37 of these agreements have been notified since the start of the WTO services negotiations in 2000, of which 18 in 2005-2006 and 11 in 2003-2004, during key phases of the Doha Round. Various other agreements have been recently concluded, but are awaiting ratification (e.g., US agreements with Peru and Colombia). Others are currently under negotiation or consideration, with varying prospects for completion, e.g., US-Malaysia, US-Korea, or ASEAN-Australia-New Zealand.

Since 2000 key traditional *demandeurs* in the services negotiations, such as the United States, the EC and Japan have, for the first time, engaged in (services) PTAs beyond their most immediate neighbours (i.e., Mexico and Canada for the US, other European countries for the EC). Other key players – including many developing countries – have followed suit, e.g., India, China, Australia, New Zealand, Chile, Mexico, India, Hong Kong, Switzerland, Norway, Thailand, Malaysia, Korea, Singapore.⁵ As a result, so far, many of the most important advocates of liberalization in the multilateral services negotiations are involved in services PTAs. Governments that are parties to these agreements account for more than 80% of world services trade.⁶ Key absentees in this group include Pakistan and such larger African countries as South Africa or Egypt (Morocco is the only African country involved in this web of agreements). In addition, the involvement of Argentina and Brazil remains limited to Mercosur. Of course, the countries involved in these PTAs do not all have agreements amongst themselves. Services trade relations among larger players still tend to be governed by WTO commitments: the US, China, India, Japan, Brazil or the EC have no PTA ties amongst themselves.

⁴ Jo-Ann Crawford and Roberto V. Fiorentino (2005), The Changing Landscape of Regional Trade Agreements, WTO Discussion Paper No. 8. See also information on PTA notifications on the WTO website: http://www.wto.org/english/tratop_e/region_e/region_e.htm

⁵ Canada, also, had engaged in services PTAs before 2000, if not since then: with the US and Mexico, and with Chile.

⁶ With BOP commercial services trade statistics and taking into account solely extra-EU (25) trade.

Another apparent feature of the recent wave of services agreements is that they most often bring together developing and developed countries; the US-Australia PTA being the only agreement between developed countries since 2000. Agreements between developing economies are more common, e.g., the agreements signed by Mexico and Chile with Central American countries. In general, trade agreements involving at least one developed country tend to include services components (exceptions include agreements notified by the EC with African and Middle Eastern countries), while the majority of trade agreements between developing countries include no services commitments, although that trend now seems to be changing.

It can also be observed that certain countries seem to have played a particularly important role in the spreading of services PTAs, if only by the number of agreements that they have signed: the US, Singapore, and Chile are party to more than five services PTAs.

B. Differing Approaches to Trade Rules for Services in PTAs

In assessing and comparing liberalization commitments undertaken in the recent wave of PTAs, this paper goes through agreements that are based on varying approaches to regulating services trade. While the liberalization commitments of services PTAs have not in the past been the subject of comprehensive assessments, other characteristics of services obligations contained in PTAs have in contrast been discussed extensively.

A key element that distinguishes many services PTAs is the approach to liberalization: traditionally, distinctions have been drawn on the basis of whether they followed a GATS-type or a NAFTA-type approach. The main difference between the two is that the NAFTA is based on a negative-list scheduling modality: everything is liberalized, unless otherwise indicated through lists of reservations. Reservations are typically for existing non-conforming measures (Annex 1) and for future measures (Annex 2). These agreements provide a high degree of transparency since, save for the normally limited number of Annex 2 reservations, the actual level of openness is spelled out, along with an indication of the legal/regulatory framework in place. This is in contrast to the GATS, which adopts a positive-list modality whereby the liberalization obligations only apply to the sectors

listed, which themselves are subject to limitations or conditions inscribed. Nothing specifies whether these limitations are for existing non-conforming measures or for future measures. Moreover, since only "measures" are bound, no indication is given of the relevant laws/regulations, which accentuates the lack of transparency. Unlike the GATS, agreements using a negative list approach typically include a ratchet mechanism whereby any future liberalization of annex 1-type reservations is automatically locked in.⁷

The NAFTA-type and GATS-type agreements also differ in that, in the former, different modes of supply are dealt with in different chapters: disciplines for modes 1, 2 and 4 in a chapter on cross-border trade in services and disciplines relating to mode 3 as part of a chapter on investment for services and non-services activities. Further provisions on temporary movement of natural persons are also typically found in an additional chapter. That modes of supply be covered by different chapters makes no meaningful difference if obligations in these chapters are the same. However, that is not always the case. While both NAFTA's cross-border services and investment chapters each contain a national treatment obligation, neither contains a market access obligation as found in Article XVI of the GATS for certain non-discriminatory quantitative restrictions. NAFTA's cross-border services chapter contains a provision on non-discriminatory quantitative restrictions that is merely of a best endeavours' basis. Investment chapters, which cover commercial presence in services, also do not include disciplines on non-discriminatory quantitative restrictions. In that regard, the GATS therefore goes further.⁸ Apart from liberalization provisions, it also goes beyond GATS by subjecting mode 3 to services-wide disciplines such as domestic regulation, but NAFTA-type agreements exceed GATS-type agreements by subjecting investment in services (including mode 3) to extensive investment provisions, such as on expropriation, minimum standard of treatment, and investor-state dispute settlements procedures.

While various PTAs still follow either the NAFTA or GATS structure (e.g., the agreements involving the European Communities and EFTA follow a GATS model), a number of the PTAs reviewed in this paper have evolved into a combination of the two

⁷ For further details, see: OECD (2002), *The Relationship Between Regional Trade Agreements and the Multilateral Trading System: Services*, Paris; Sherry Stephenson (2002), *Regional Versus Multilateral Liberalisation of Services*, *World Trade Review*, Vol. 1, No. 2, pp. 187-209.

⁸ See OECD (2002), *op. cit.*; Martin Roy (2003), "Implications for the GATS of Negotiations on a Multilateral Investment Framework; Potential Synergies and Pitfalls", *Journal of World Investment*, Vol. 4, No. 6, pp. 963-986.

approaches, the aim being to achieve greater coherence between services and investment disciplines so as to avoid discrepancies in the treatment of investment in goods and services or in the treatment of trade in services under different modes of supply. Combined approaches therefore seek to ensure that services trade under all modes of supply are subject to the same core disciplines and that mode 3 is covered by generic investment disciplines.⁹ In such cases, mode 3 is typically subject to some obligations in both the investment chapter and the services chapter. Unlike in NAFTA, mode 3 is subject to the services chapter's disciplines on non-discriminatory quantitative restrictions, as in GATS (i.e., Article XVI). However, in addition to GATS and like in NAFTA, generic investment disciplines apply to mode 3. A number of the services PTAs reviewed in this paper have adopted variants of such a combined approach, e.g., all the recent PTAs involving the United States, the Australia-Singapore and, to some extent, the Japan-Singapore PTAs.¹⁰ Further details are found in Table 1, which provides information on the characteristics of the agreements reviewed in this paper. In that table, the so-called combined models are those that use a negative-list scheduling modality (like NAFTA-type agreements) and that include a GATS-type market access obligation for mode 3.¹¹

Another notable difference in terms of liberalization modalities between GATS-type and NAFTA-type or combined models relates to air transport. While services chapters of the PTAs reviewed typically carve-out key air transport services (at times along similar lines as GATS and sometimes providing for even less coverage), the investment chapters of relevant

⁹ M. Roy (2003), *op.cit.*.

¹⁰ In US agreements, the services chapter's obligations on market access, domestic regulations, and transparency are typically made to apply to mode 3. However, the US always lodges a broad exception for the market access obligation whose purpose is to ensure that the PTAs do not go beyond its GATS Article XVI obligations.

¹¹ It should be noted that some agreements use different liberalization modalities for financial services than for the rest of sectors. Moreover, the Japan-Philippines agreement also innovates in that Philippines' schedule of commitments, which follows a positive-list approach, incorporates a feature typically found in

PTAs, where national treatment applies to mode 3, do not exclude any particular service sector from the outset and therefore apply to all air transport services as to any other sector, subject of course to specific reservations listed in relevant annexes.¹²

agreements using a negative-list approach: a provision of the services chapter specifies that limitations attached to commitments in identified sub-sectors of the schedule will be limited to existing non-conforming measures.

¹² A few negative-list type agreements exclude certain activities exclusively reserved to the state, which are listed in a separate annex. (e.g., Mexico in its agreement with Japan).

Table 1: Preferential Trade Agreements Reviewed

PTA	Entry into Force	Date of Signature	WTO Notification	Negative or Positive List? ¹³	GATS-type Market Access Obligation for M3? ¹³	Date of Latest Offer in GATS Negotiations
New Zealand – Singapore	Jan. 2001	Nov. 2000	Sept. 2001	Positive List	Yes	NZ: June 2005 (r) SING: May 2005 (r)
EFTA – Mexico ¹⁴	Jul. 2001	Nov. 2000	Aug. 2001	Positive List	Yes	SWI: June 2005 (r) ICE: May 2005 (r) NOR: June 2005 (r) LIE: May 2005 (r) MEX: June 2005 (r)
EC – Mexico ¹⁴	Mar. 2001	Oct. 2000 ¹⁵	June 2002	Positive List	Yes	EC: June 2005 (r) MEX: June 2005 (r)
Chile – Costa Rica	Feb. 2002	Oct. 1999 ¹⁵	May 2002	Negative List	No (neither for mode 1)	CHL: June 2005 (r) CR: April 2004 (i)
Japan – Singapore	Nov. 2002	Jan. 2002	Nov. 2002	Positive List, except that Japan uses a negative list for NT for mode 3.	Yes	JAP: June 2005 (r) SING: May 2005 (r)
Singapore – Australia	Jul. 2003	Feb. 2003	Oct. 2003	Negative List	Yes	SING: May 2005 (r) AUS: May 2005 (r)
US – Chile	Jan. 2004	June 2003	Dec. 2003	Negative List	Yes	US: May 2005 (r) CHL: June 2005 (r)
US – Singapore	Jan. 2004	May 2003	Dec. 2003	Negative List	Yes	US: May 2005 (r) SING: May 2005 (r)
Chile – El Salvador	June 2002	Oct. 1999 ¹⁵	Mar. 2004	Negative List	No (neither for mode 1)	CHL: June 2005 (r) SAL: Nov. 2004 (i)
Republic of Korea – Chile	April 2004	Feb. 2003	April 2004	Negative List	No (neither for mode 1)	KOR: May 2005 (r) CHL: June 2005 (r)
EC-Chile	Mar. 2005	Nov. 2002	Nov. 2005	Positive List	Yes	EC: June 2005 (r) CHL: June 2005 (r)
EFTA – Singapore	Jan. 2003	June 2002	Jan. 2003	Positive List	Yes	SWI: June 2005 (r) ICE: May 2005 (r) NOR: June 2005 (r) LIE: May 2005 (r) SING: May 2005 (r)
China – HKC	Jan. 2004	Sep. 2003, with supps. in Aug. 2004 and Oct. 2005	Jan. 2004	Positive List (for China)	Yes	CHN: July 2005 (r)
China – Macao China	Jan. 2004	Oct. 2003, with supps. in Oct. 2004 and Oct. 2005	Jan. 2004	Positive List (for China)	Yes	CHN: July 2005 (r)
EFTA – Chile	Dec. 2004	June 2003	Dec. 2004	Positive List	Yes	SWI: June 2005 (r) ICE: May 2005 (r) NOR: June 2005 (r) LIE: May 2005 (r) CHL: June 2005 (r)

¹³ This describes the general approach taken in the agreements, although some agreements take a different approach for financial services than for other sectors (see Part II.A of the paper).

¹⁴ These agreements only contain commitments on financial services at this time.

¹⁵ This represents the date of signature of the agreement (including services obligations), but the services commitments were negotiated afterwards.

(r) = revised offer; (i) = initial offer. Information as of 1 January 2007.

PTA	Entry into Force	Date of Signature	WTO Notification	Negative or Positive List? ¹³	GATS-type Market Access Obligation for M3? ¹³	Date of Latest Offer in GATS Negotiations
US – Australia	Jan. 2005	Aug. 2004	Dec. 2004	Negative List	Yes	US: May 2005 (r) AUS: May 2005 (r)
Thailand – Australia	Jan. 2005	Jul. 2004	Jan. 2005	Positive List	Yes	THA: October 2005 (r) AUS: May 2005 (r)
Panama – El Salvador	April 2003	Mar. 2002	April 2005	Negative List	No (neither for mode 1)	PAN: April 2003 (i) SAL: Nov. 2004 (i)
Japan – Mexico	April 2005	Sep. 2004	April 2005	Negative List	No (neither for mode 1)	JAP: June 2005 (r) MEX: June 2005 (r)
US – Bahrain	Aug. 2006	Sep. 2004	Sep. 2006	Negative List	Yes	US: May 2005 (r) BAH: May 2005 (r)
US – Oman	-----	Jan. 2006	-----	Negative List	Yes	US: May 2005 (r) OMN: Jan. 2006 (i)
US – CA + DR	Mar. 2006	Aug. 2005	Mar. 2006	Negative List	Yes	US: May 2005 (r) GUA: Aug. 2003 (i) DR: Oct. 2004 (i) NIC: June 2005 (i) HND: Sept. 2005 (r)
US – Morocco	Jan. 2006	June 2004	Jan. 2006	Negative List	Yes	US: May 2005 (r) MOR: June 2005 (i)
US – Peru	-----	April 2006	-----	Negative List	Yes	US: May 2005 (r) PER: June 2005 (r)
Japan – Malaysia	Jul. 2006	Dec. 2005	Jul. 2006	Positive List	Yes	JAP: June 2005 (r) MAL: Dec. 2005 (r)
Korea – Singapore	Mar. 2006	Aug. 2005	Feb. 2006	Negative List	No	KOR: May 2005 (r) SING: May 2005 (r)
US – Colombia	-----	Feb. 2006 (conclusion of negotiations)	-----	Negative List	Yes	US: May 2005 (r) COL: June 2005 (r)
Singapore – India	-----	June 2005	-----	Positive List	Yes	SING: May 2005 (r) IND: Aug. 2005 (r)
Singapore - Jordan	Aug. 2005	May 2004	Jul. 2006	Positive List	Yes	SING: May 2005 (r) JOR: Sep. 2004
Japan - Philippines	-----	Sep. 2006	-----	Positive List, except that Japan also uses a negative list for NT for investment in services.	Yes	JAP: June 2005 (r) PHI: May 2005
Mercosur (6 th Round)	Dec. 2005	Dec. 1997 ¹⁵	Dec. 2006	Positive List	Yes	BRA: June 2005 (r) ARG: April 2003 URY: June 2005 (r) PRY: March 2003
ASEAN Framework Agreement on Services (5 th Package)	-----	Dec. 2006	-----	Positive List	Yes	PHI: May 2005 SING: May 2005 (r) THA: Oct. 2005 (r) IDN: Feb. 2005 MAL: Dec. 2005 (r)

Overall, PTAs appear to offer limited value added over GATS disciplines with respect to the rules areas, e.g., safeguard mechanism, disciplines on subsidies or domestic regulation.¹⁶ Exceptions include the additional rules found in the additional chapters containing disciplines on telecom and financial services, additional transparency provisions, as well some sector-specific provisions relating to recognition in certain agreements, an issue that might merit further study. Most PTAs reviewed also include comprehensive sets of disciplines on government procurement, but these are not specific to services and are self-contained in their own chapter.¹⁷ Accordingly, the most significant variance between PTAs and the GATS, as well as among PTAs, may well rest on the liberalization commitments that are undertaken, which may of course be influenced by the structure or modalities of market opening provisions, as discussed above. Oddly, this is, however, the aspect that has been less extensively explored so far.

II. Overview of the value-added of PTAs over existing GATS schedules and offers.

A. *The project and the methodology*

In attempting to provide a comprehensive overview of the liberalization commitments of the recent wave of PTAs, this paper has reviewed schedules and lists of reservations on services contained in 32 preferential trade agreements. It reviews all those PTAs with services commitments that have entered into force and been notified to the WTO under GATS Article V since the start of the services negotiations in 2000.¹⁸ In addition, so as to provide more information on the ongoing flurry of services PTAs, the paper has also added

¹⁶ See S/WPGR/W/46 for information on rules on subsidies in RTAs. See S/WPGR/W/4 and addendum 1 for similar information in relation to emergency safeguard measures.

¹⁷ For information on disciplines in RTAs on government procurement in services, see: S/WPGR/W/49, S/WPGR/51.

¹⁸ As of 1 May 2006. Some of these recent agreements have not been reviewed here because they do not include services liberalization commitments, but provide for future negotiations, e.g., US-Jordan, New Zealand-Thailand, CARICOM (which as of 1 May had not completed its proposed liberalization programme regarding trade in services). China's commitments in its PTAs with Macao and Hong Kong have been reviewed, although not those of the latter two WTO Members since the agreements binds them not to introduce any new discriminatory measures in various sectors, but does not include a schedule of commitments or lists of reservations as such. Commitments in the EFTA-Mexico and EC-Mexico PTAs are limited at this time to financial services. We have not reviewed the EU enlargements or Europe Agreements since these are integration arrangements more than typical trade agreements.

some of the recent PTAs that, even if not notified, have been signed and/or ratified.¹⁹ The agreements reviewed, along with some relevant information such as date of notification, are listed in Table 1. As highlighted in Table 2, the paper therefore reviews the PTA commitments undertaken by 36 WTO Members (counting the EC-15 as one).

Given the relative complexity of services agreements (different modes of supply, types of barriers, and liberalization modalities), it is not an easy task to provide an overview of the state of commitments and to capture the overall extent of improvements. To assess PTA commitments, we have focused, in the first instance, on sector coverage. This captures the breadth of commitments across all services sectors, highlighting for example how many sectors have been left without any binding whatsoever. However, while improvements in the sectoral breadth of commitments represents one important way in which PTAs can go beyond GATS, another key aspect relates to the depth of commitments, i.e., the actual level of access bound for the sectors committed. In order to provide an overview of the depth of PTA commitments, we have, as a second step, identified each sector where improvements to the depth of commitments were provided, but without trying to rank or quantify the quality of each particular improvement. This allows to provide an aggregate picture of the extent to which, out of the universe of services sectors, countries have undertaken new commitments (expansion of sectoral coverage) and improved the level of bindings for already committed sectors (depth of commitments). Additional details on the depth of commitments is best provided through a country-by-country or sector-by-sector qualitative analysis.

Given the size of the task involved - matching more than a thousand pages of GATS schedules and offers and a similar amount of not readily comparable pages of PTA commitments -, the paper solely looks at modes 1 (cross-border trade) and 3 (commercial presence). Mode 2 commitments are typically liberal and comparing PTA commitments under this mode might provide little additional insights. While mode 4 liberalization commitments represent high stakes for many countries, they are typically crafted along somewhat different parameters than modes 1 and 3 and are also subject to specific disciplines. This aspect was therefore left for another day as it may merit a paper of its

¹⁹ While the paper aimed to be as comprehensive as possible, new PTAs keep springing up almost every month.

own.²⁰ Nevertheless, modes 1 and 3 are estimated to amount to more than 80% of world services trade.²¹

In capturing the value-added of the recent wave of services PTAs, we felt it important to compare their liberalization commitments not only to WTO Members' existing GATS commitments, which, for the most part, were negotiated more than 10 years ago, but also to services offers submitted in the Doha negotiations so far.²² Do PTA commitments go beyond not only GATS existing commitments, as they would naturally be expected to do, but also beyond GATS offers, and to what extent?

So as to provide the most accurate and relevant picture overall, the approach chosen was to look at each of the more than 150 sub-sectors comprising the universe of services activities to see whether, for each particular sub-sector and mode, the PTA commitments improved upon the GATS offer, either by binding a new service sub-sector (i.e., the sector was not included in the GATS schedule nor the offer or was "unbound" for the relevant modes of supply) or by improving upon the GATS binding for that sub-sector (e.g., removing a limitation and therefore providing for binding at a higher level of liberalization). The research undertaken thus permits to indicate, for each Member, the proportion of total services sub-sectors improved (through either new bindings or better ones) in comparison with the GATS offer. The same exercise is done to assess the value-added of GATS offers over GATS commitments currently in force, so as to have a point of comparison in assessing the extent to which PTAs make advances. Of course, although such type of indicators provide useful information and allow for an overall snapshot for analytical purposes, they should not be used to assess, in isolation, the value of any individual country's PTA or GATS commitments. While the methodology proposed aims at providing the most accurate and comprehensive global picture, the overall quality or value-added of commitments for the two

²⁰ On the treatment of mode 4 in RTAs, see: OECD (2002), *Labour Mobility in Regional Trade Agreements*, Paris.

²¹ WTO (2005), *International Trade Statistics* 2005, Geneva.

²² For an overview of GATS offers, see: Rolf Adlung and Martin Roy (2005), "Turning Hills into Mountains? Current Commitments under the GATS and Prospects for Change", *Journal of World Trade*, Vol. 39, No. 6, pp. 1161-1194.

modes of supply reviewed also depends on the precise content of each particular commitment. These aspects, which cannot easily be summarized across agreements, are explored in the following Part. More details about the methodology are found in Box 1.

Table 2: Cross-Tabulation of Countries and PTAs

		Other Parties to PTAs Reviewed																														
		Australia	Bahrain	Chile	Colombia	Costa Rica	Dominican Rep.	EFTA	El Salvador	European Communities	Guatemala	Honduras	Hong Kong, China	India	Indonesia	Japan	Jordan	Korea, Rep.	Macao, China	Malaysia	MERCOSUR	Mexico	Morocco	New Zealand	Nicaragua	Oman	Panama	Peru	Philippines	Singapore	Thailand	United States
WTO Members whose Commitments Are Reviewed	Australia																															
	Bahrain																															
	Chile																															
	China																															
	Colombia																															
	Costa Rica																															
	Dominican Rep.																															
	EFTA (Iceland, Liechtenstein, Norway, Switzerland)																															
	El Salvador																															
	European Communities																															
	Guatemala																															
	Honduras																															
	India																															
	Indonesia																															
	Japan																															
	Jordan																															
	Korea, Rep. of																															
	Malaysia																															
	MERCOSUR (Brazil, Argentina, Uruguay, Paraguay)																															
	Mexico																															
	Morocco																															
	New Zealand																															
	Nicaragua																															
	Oman																															
	Panama																															
	Peru																															
	Philippines																															
	Singapore																															
Thailand																																
United States																																

BOX 1: Details about the Methodology

- In producing estimates for each country, we have compared the commitments undertaken in all services sub-sectors, in the light of the Services Sectoral Classification List (MTN.GNS/W/120), as well as the GATS Annex on Financial Services, the maritime model schedule for maritime auxiliary services, and the GATS Annex on Air Transport Services.
- The universe of services sectors has been split up so as to permit the most precise assessment: 152 sub-sectors for mode 3 and 142 for mode 1. Some sub-sectors were excluded from our comparison of commitments under mode 1 because they appear of quite limited relevance or simply not technically feasible, e.g., building cleaning, storage warehousing. This aimed to ensure that results did not overestimate the improvements made in negative-list agreements, where all sectors are liberalized unless provided otherwise. Overall, reviewing each country's existing GATS commitments, GATS offer, and PTA commitments for each sub-sector for these two modes of supply amounts to more than 30,000 observations.
- When presenting country-specific data summarizing advances made through PTAs, we have compared, for each particular sector, the commitments included in the latest GATS offer with the best commitments undertaken in any of the PTAs to which the country was party. In compiling data on the proportion of new/improved commitments in PTAs, we did not factor in situations where PTA commitments fall short of GATS schedules/offers.
- The paper only reviews improvements over GATS schedules/offers in relation to liberalization obligations (i.e., market access and national treatment) and not improvements with regard to additional commitments (Article XVIII of the GATS).²³ MFN provisions and exceptions were similarly not reviewed.
- Improvements to horizontal commitments (limitations applying to all scheduled sectors) were also assessed. However, in the charts, we did not automatically reflect such improvements in all sub-sectors so as not to overestimate the number of sectors whose levels of bindings were improved. We nevertheless did take horizontal limitations into account in order to ensure that differences between bindings in GATS and in PTAs were not simply a matter of whether a restriction was listed in horizontal or sectoral sections. The large majority of PTA commitments reviewed did not provide for improvements to horizontal commitments. Those that did - notably Australia, Chile, Honduras and New Zealand - only provided 'horizontal' improvements in relation to mode 3.
- This overview only assesses whether new bindings have been included in PTAs or existing ones improved. A new commitment/binding occurs when a bound level of access is given for a sub-sector that had not previously been subject to the liberalization obligations (e.g., it was not included in the schedule/offer) or for a particular mode of supply that had been left "unbound". An improved commitment is when the level of binding/commitment for a particular sub-sector and mode is made more liberal: either one goes from a partial commitment (i.e., a commitment with some market access limitation) to a full commitment (i.e., a commitment without any market access limitation) or from a partial commitment to a better partial commitment (i.e., with lesser limitations). The overview does not attempt to rank or quantify the value of the specific commitments undertaken.

²³ Article XVIII provides that countries can use the last column of their schedules to undertake commitments on measures not falling within the scope of the liberalization obligations, e.g., additional regulatory disciplines for telecommunications.

- Assessing the extent to which PTAs provide for new and improved bindings necessarily involves a degree of value judgement, especially when comparing commitments framed under a positive-list approach and others under a negative-list one. Therefore, the overview does not in any way amount to a legal evaluation of commitments.

B. Presentation of the results.

Chart 1 presents the results for each country reviewed for mode 3 while Chart 2 (found in the Annex) does the same for mode 1. By looking at the proportion of new and improved commitments for each country, the charts illustrate the value-added of each country's PTA commitments over their latest GATS offer.

So as to give a point of comparison, the charts illustrate (through the bars labelled "GATS"), the value-added of each country's latest GATS offer over their existing GATS schedules. The bottom part of the bars shows the proportion of sub-sectors in the GATS schedule that is not improved upon by the offer. The lighter part above represents the proportion of sub-sectors already bound in the GATS schedule that have been improved upon by the GATS offer. The striped part further above shows the proportion of sub-sectors where new commitments are proposed in the GATS offer. The upper part of the bars represent the proportion of sub-sectors that remain uncommitted in both GATS schedules and GATS offers.

Along similar lines, the bars labelled "PTA" provide an overview of how much PTA commitments add to GATS offers. The bottom part of the bars shows the sub-sectors committed in GATS schedules/offers that have not been improved through PTAs. The lighter part above represents the sub-sectors in the GATS schedule/offer that are further improved upon by the PTA (i.e., the PTA provides a more liberal binding than in the GATS offer by, for example, not including an economic needs test or a foreign equity limitation). The striped part further above shows the sub-sectors where the PTA provides for new bindings for the relevant mode, i.e., a level of liberalization is bound where there were no commitments whatsoever in the GATS schedules/offers. The upper part of the bars represent the proportion of sub-sectors that remain uncommitted in both GATS schedules/offers and PTAs. In other words, the "value-added" of the PTAs over the GATS offers is captured in the lighter

and striped parts of the bars. The bars labelled "GATS" represent the "value-added" of the GATS offer over the current GATS commitments in the same manner.

The results show that, overall, PTA commitments tend to go significantly beyond GATS offers in terms of improved and new bindings. The proportion of new/improved commitments is generally much greater in PTAs (compared to GATS offers) than in GATS offers (when compared to existing GATS commitments). There is, however, much diversity among the countries reviewed. Some countries exhibit spectacular improvements in their PTA commitments. Among them are countries that have signed a PTA with the United States, i.e., Bahrain, Central American countries, Chile, Colombia, Dominican Republic, Morocco, Oman, Peru, and Singapore. Most of these generally had mode 1/mode 3 bindings in their GATS schedules/offers in less than half of all services sub-sectors and have experienced giant leaps in terms of sector coverage: on average, they have PTA commitments for both modes of supply in more than 80% of all services sub-sectors.

Those with a higher number sectors already bound in their GATS schedules/offers have improved the level of binding for a good proportion of them. For example:

- Morocco has undertaken new bindings under mode 1 in 94 sub-sectors (66% of the total) and under mode 3 in 80 sub-sectors (53%). In addition, it improved a number of sector-specific commitments contained in its GATS offer: 23 under mode 3 (15%) and 12 under mode 1 (8%);
- Singapore, under mode 3, went beyond its GATS offer by improving the level of commitment in 45 sub-sectors (30%) and making new commitments in 63 sub-sectors (41%).
- The Dominican Republic, which had mode 1 commitments in its GATS schedule/offer in 26% of sub-sectors has increased this proportion to 89% in its PTA.
- Even if starting from a higher level of commitments in its GATS schedule/offer, Australia, regarding mode 3, improved the level of commitment in 27 sub-sectors

included in its GATS schedule/offer (18%) and undertook new commitments in 33 sub-sectors (22%).

CHART 1 (1/2): Proportion of Sub-Sectors with New and Improved Commitments under Mode 3, per WTO Member
 (when comparing the GATS offer to the GATS schedule ("GATS") and the PTA commitments to the GATS offer ("PTA"))

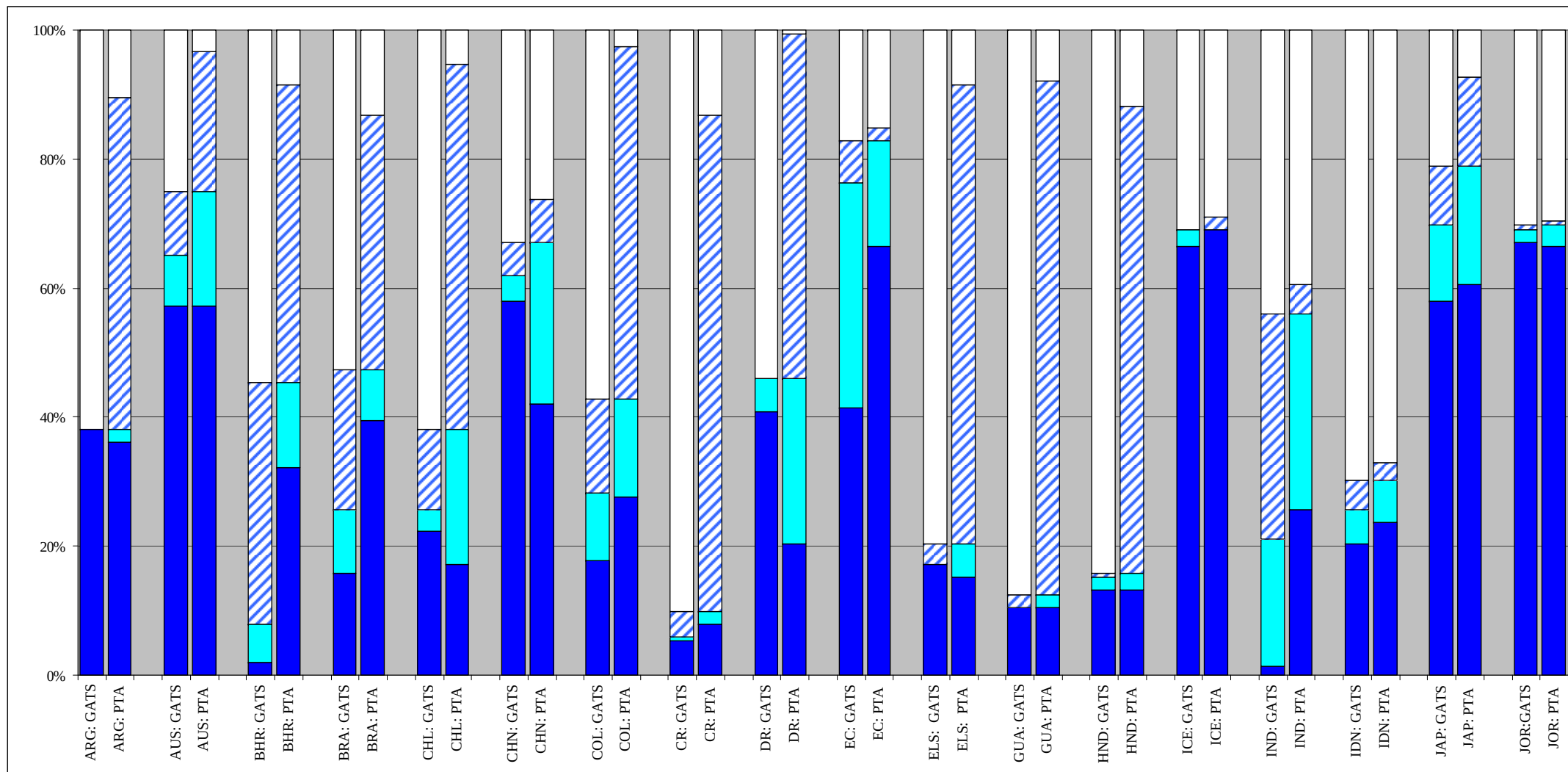
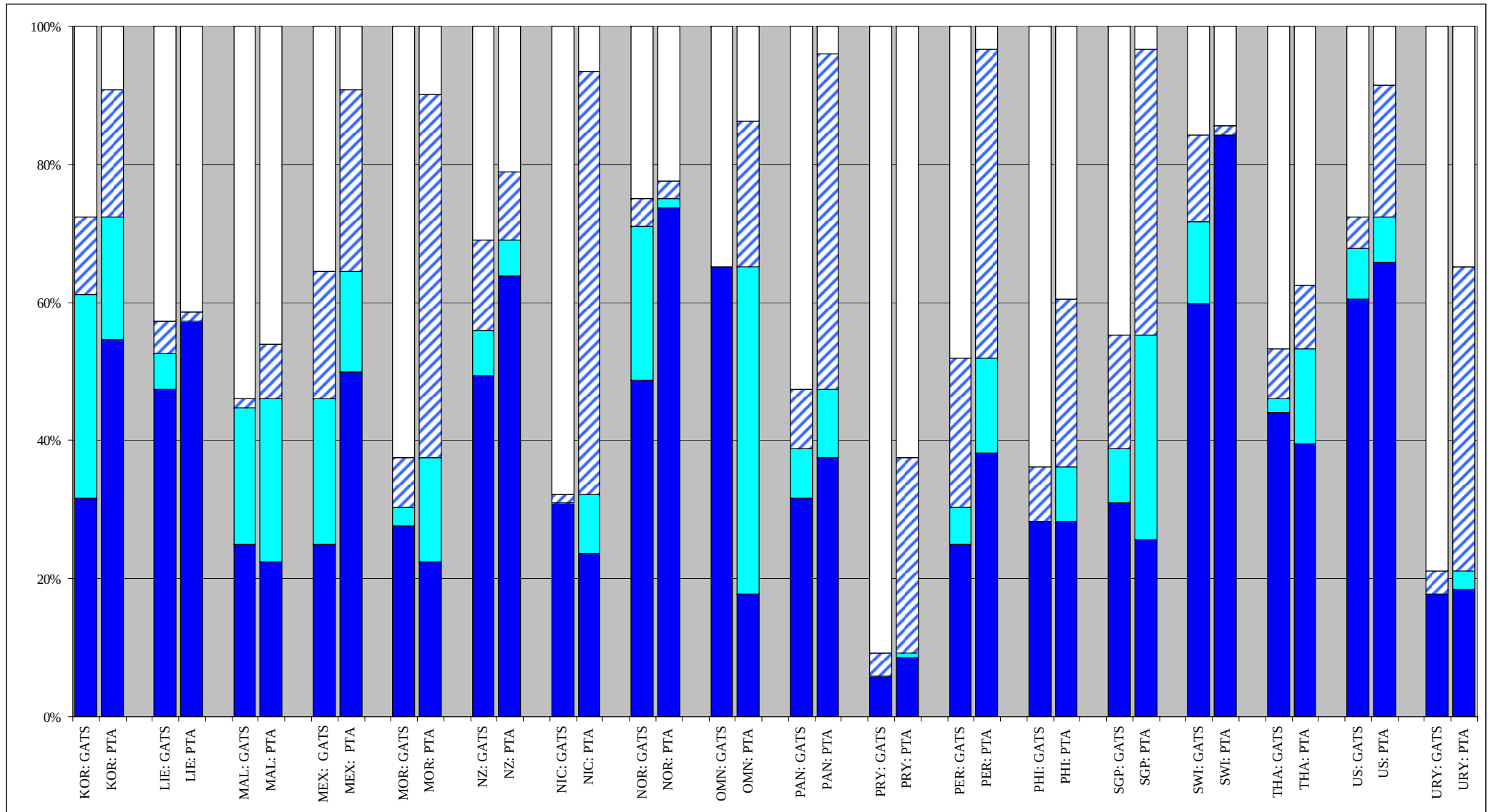


CHART 1 (2/2)



Examples of the types of new/improved PTAs commitments for some of these countries include:

- Australia: bindings going beyond GATS span a wide array of sectors, for example: the scope of the investment review provisions are reduced and spelled out; improved commitments on legal services, on retailing (no limitation with regard to the dispensing of pharmaceuticals), on tourism (through the removal of a commercial presence requirement for travel agencies/tour operators services), and on financial services (in particular through permitting branching for life insurance); new commitments on courier services and audiovisual services; and improved and new commitments in relation to rail transport services. Various of these improvements over GATS were contracted in Australia's PTA with the US, but not others. Australia's PTA with Singapore also includes a number of commitments that go beyond the GATS offer, but the one with Thailand tends to simply reflect existing GATS commitments and not to include the improvements that Australia has proposed in its GATS offer.
- Singapore: one of the leaders in propagating services PTAs, Singapore has followed a positive-list approach with India, EFTA, New Zealand, Japan, Jordan and ASEAN, and a negative-list approach in its PTAs with the US, Korea and Australia. The commitments it has taken in the latter three agreements tend to go further than the others, especially the PTA with the US and, to a lesser extent, that with Australia. There is, overall, much diversity in the commitments undertaken by Singapore in its various PTAs. Examples of PTA commitments going beyond the GATS schedule/offer include: new commitments, although with various limitations, on legal services (only for the US and Australia), including with additional explicit phase-in liberalization in the PTA with the US; new and improved commitments for various sub-sectors under "Business Services"; new commitments on courier services (except in the PTAs with India, Korea, Jordan and ASEAN) and on maritime freight transport, as well as some other services relating to maritime transport; improvements to commitments on basic telecom (no ownership restriction for facilities-based services) in most PTAs; new commitments on retailing services in all PTAs, although limits attached vary; new commitments on a number of air transport services, depending on the PTA; and a

number of improved commitments in financial services (e.g., removal of foreign equity limits on insurance), including explicit phase-in liberalization in PTA with the US.²⁴

- Chile: Another champion of PTAs, Chile has followed a positive list approach with the EC and EFTA, and a negative list approach with Costa Rica, El Salvador, Korea, and the US. In general, Chile's commitments in PTAs improve on the country's GATS commitments in sectors such as professional services, courier services, telecommunications, construction services, financial services, maritime services, and services auxiliary to all modes of transport. Chile's PTA commitments go even further than the offer submitted to the WTO in some professions and business services (particularly with regard to mode 1). The commitments undertaken by Chile in its PTA with the US go further than the others in key sectors such as professional services; telecommunications, by allowing access to its local market; and financial services, by allowing more services to be supplied on a cross-border basis, and by allowing US insurance companies to establish as branches.

Even if not engaged in a PTA with the US, other countries, such as Mexico²⁵, Panama, Japan, and Korea, exhibit a significant proportion of improved/new commitments in PTAs in both modes of supply, although the extent of the improvements vary and are not as consistently spectacular. Nevertheless, for example, Mexico increased the proportion of sectors covered by mode 3 commitments from 65% in the GATS offer to 91% in PTA commitments; while Panama had less than half of sectors (42%) covered by mode 1 commitments in its GATS offer, it had committed almost all (91%) in PTAs. Of course, even if NAFTA was not reviewed in this paper, Mexico's commitments in the subsequent PTAs reviewed here might reflect in good part what had been done with the US and Canada in the 1990s. China and India also provide improvements in a notable number of sectors, although these tend to take the form of improvements to sectors already committed under GATS schedules/offers rather than new bindings, and are mostly limited to mode 3. PTA commitments of Mercosur countries, Brazil and Argentina in particular, which had relatively few GATS commitments, provide for a high proportion of new sector bindings in both modes

²⁴ On Singapore's PTA strategy, see: S.M. Thangavelu and Mun-Heng Toh (2005), "Bilateral 'WTO-Plus' Free Trade Agreements: The WTO Trade Policy Review of Singapore 2004", World Economy, Vol. 28: 9.

²⁵ Mexico's commitments in NAFTA entered into force well before the period reviewed here.

of supply, although these new commitments at times contain a number of restrictions (e.g., audiovisual services).

In contrast, Charts 1 and 2 also show that some other countries seem to have provided for more limited proportion of new/improved bindings on modes 1 and 3 compared to GATS offers, such as Malaysia, Thailand, Indonesia, and the Philippines, or EFTA countries. Malaysia, for example, had, pursuant to its GATS schedule/offer, no mode 1 commitments in 58% of all services sub-sectors. That proportion decreased by less than 5% in its PTA commitments. Of course, it needs to be recalled that this is only one indicator of the value-added of PTA commitments that serves to highlight general trends in these two modes of supply, but not to define or rank the specific quality and value of a given country's commitments. The value of PTAs as a whole may also hinge on the types of mode 4 commitments obtained from the counterparts, as well as, obviously, the overall benefits stemming from non-services aspects of the agreement.

Examples of the types of new/improved PTAs commitments for these other countries include:

- Japan: Improvements in the PTAs mostly take the form of new bindings in a number of sub-sectors, principally within 'Transport Services' and 'Business Services'. Improvements to sub-sectors contained in the GATS offer include the expansion of product coverage in distribution services. The PTA with Singapore tends to have less commitments than Japan's agreements with Malaysia, the Philippines and Mexico; the latter contained improvements that were included in the GATS offer, while the PTA with Singapore more often tends to simply reflect commitments in the GATS schedule. This may be explained by the fact that the PTA with Singapore was concluded in 2002, while those with Mexico, Malaysia and the Philippines were signed between 2004 and 2006.
- European Communities: the PTA with Chile, which was signed in 2002, tends to include, in many cases, commitments at a lower level than what had been offered in the GATS negotiations afterwards. Areas where the PTA goes further pertain to certain improvements - often limited to certain Member States - in relation to research

and development services, legal services, distribution, maritime transport, and telecommunications.

- India: Starting from a low level of bindings in its existing GATS schedule for these two modes (less than a quarter of sectors bound under mode 3 and less than 10% for mode 1), various new sectoral bindings were proposed in GATS offers. GATS+ commitments in the PTA with Singapore essentially take the form of improvements in relation to mode 3 for sectors already committed in the GATS schedule/offer. Many of these improvements took the form of the removal of the requirement for foreign investors with prior collaboration in the sector to obtain approval from the Foreign Investment Promotion Board. This requirement which was included in virtually all the sub-sectors offered by India has, except for construction and distribution, been removed from the PTA. In addition, very specific improvements are also made in financial services, for example, three Singapore banks are allocated a separate quota of 15 branches over 4 years, over and above the quota for all foreign banks. On the other hand, it can be noted that some commitments in the PTA are worse than the offer. In telecommunications, for instance, the foreign equity limitation for voice mail, on-line information and database retrieval, and enhanced/value added services is 51%, even if a higher percentage had been offered in the Doha services negotiations.
- United States: While they do not provide for spectacular deviations, PTA commitments go beyond the GATS schedule/offer in a number of sectors. In financial services, new commitments are undertaken under mode 1 for insurance intermediation and with respect to certain portfolio management services. Other GATS+ commitments include new commitments on repair and maintenance of vessels, on certain port-related activities, as well certain improvements in relation to air, road, rail, and auxiliary transport services. PTAs also provide, among other things, for new commitments on R&D services. The US uses the same list of reservations (Annex 1 and Annex 2) in all its PTAs, except in relation to cable television and maritime-related services, where some PTA partners get better treatment than others. Like the GATS offer, PTAs have not made headway in some of the most difficult areas for the US, in particular key maritime transport services.

Overall, while much diversity was found, the overview suggests that many PTAs go well beyond GATS offers in terms of sector coverage (i.e., commitments in new sub-sectors), but also levels of commitments, as suggested by the proportion of sub-sectors where commitments in GATS schedules/offers were improved. Many PTAs have gone a long way to correct the generally low level of sector coverage in Members' existing GATS commitments and the modest quality of offers in the Doha Round. In the case of mode 3, the average proportion of all sub-sectors subject to market access and national treatment commitments for the countries reviewed went from 50% in the GATS offers to 81% in PTAs. For mode 1, sector coverage similarly jumped from 35% to 68%. Furthermore, the occurrence of significant GATS+ commitments in PTAs is not limited solely to countries of a certain level of development or those of a certain size, or even to countries that are parties to PTAs involving developed countries.

From Charts 1 and 2, we see that the general trend of PTA commitments going significantly beyond GATS offers is relevant for both modes of supply. The only exceptions are India and China, which have tended to concentrate their PTA efforts on mode 3 more than cross-border supply.

From this overview, it also appears that negative-list agreements have yielded greater proportions of new/improved liberalization bindings, although this is due in good part to the fact that the US, which consistently uses this approach, has been involved in PTAs with countries that have exhibited strong results. Those countries – mentioned above – that have on average shown a lesser proportion of new/improved commitments in PTAs have all used a positive-list scheduling approach. This is not to say, however, that all positive-list agreements have led to lesser commitments than negative-list ones. For example, China's commitments in its agreements with Hong Kong and Macao, based on a positive-list, provides for many improvements that appear to provide for concrete new commercial opportunities, in particular in professional services, audiovisual, construction, distribution, and in maritime, air, road and auxiliary transport services.²⁶ One can nevertheless note that some countries that have concluded agreements of both types, such as Singapore and Australia, have undertaken greater commitments in the negative-list ones.

In terms of sector focus, the review of commitments suggests that value-added of PTAs is fairly widespread across sector groupings. In sectors such as audiovisual, postal-courier, distribution, maritime transport, and auxiliary transport, a good number of countries reviewed undertook commitments for the first time through PTAs. In others sectors, such as financial services and telecommunications, where most countries reviewed had at least some commitments in their GATS schedules/offers, the PTA advances naturally took the form of improvements to existing commitments (more than half of countries reviewed went further than their GATS offers in these sectors). PTAs provide for advances both for sectors that had tended to attract less offers in the GATS (e.g., audiovisual, road, rail, postal-courier), as well as for sectors that already had been more popular targets in GATS offers, e.g., professional, financial services. One exception is health services, where PTA commitments do not appear to go very significantly beyond what is contained in GATS offers.

C. Significance of New and Improved Commitments in Selected Sectors.

A closer look at a number of sectors (i.e., financial services, distribution, audiovisual, telecommunications, education, and professional services) highlights that, even if there is diversity in terms of the commitments taken by different Members within each sector, overall, the new and improved sectoral bindings in PTAs provide for significant levels of openness and well exceed the offers made in the context of the Doha Round in terms of the depth of commitments. This is illustrated by the fact that commitments secured in PTAs generally match or even exceed the objectives sought by WTO Members in their plurilateral requests for these sectors²⁷ and that PTAs often induce, as explored in the next section, 'real' liberalization. These trends hold both for the selected sectors that are the subject of a high number of multilateral commitments (e.g., financial services, telecommunications) as well as for those that have tended to attract less WTO commitments, such as audiovisual, distribution and education.²⁸ The assessment of the level of access provided through the GATS+

²⁶ See also Agata Antkiewicz and John Whalley (2005), "China's New Regional Trade Agreements", *World Economy*, Vol. 28: 10.

²⁷ Plurilateral negotiations is a process envisaged in the Hong Kong Ministerial Declaration. While plurilateral requests have not been notified to the WTO Secretariat nor circulated to the whole WTO membership, various internet sites, e.g., from NGOs or business associations, provide copies of such requests. See, for example, <http://www.uscsi.org/wto/crequests.htm>.

²⁸ In discussing, further below, PTA advances in selected sectors, we focus on the countries that have made relevant GATS+ commitments. It should nevertheless be recalled that in some sectors, certain countries have remained without commitments in their PTAs, e.g., EC or EFTA in audiovisual services or Malaysia in distribution services.

commitments also underscores the stark difference between the commitments adopted by countries that signed agreements with the US - where the depth of commitments secured seems greater - and those that did not.

In the case of *financial services*, some PTAs have excluded the sector from its coverage (e.g. Chile-El Salvador; Chile-Costa Rica; Chile-Korea); while others have promised to review the situation after the entry into force of the PTA (e.g. Chile-EFTA). Other PTAs include the sector within the scope of the agreement, but have nevertheless avoided to make liberalization commitments for the time being (e.g. AFAS), or have promised to include the sector in the schedules of commitments in future rounds of negotiation (e.g. Thailand-Australia). Commitments under PTAs have prioritized the liberalization of supply through commercial presence. Foreign equity limitations have been generally barred from these agreements, with the exceptions of India, Malaysia, Morocco, and Thailand.²⁹ Some progress has been made with regard to the elimination of restrictions on the form of legal entity through which foreign financial institutions can access local markets, although subsidiaries continued to be preferred over branches by some developing countries participating in these PTAs. On the other hand, with only few exceptions (basically the US PTAs and the Panama-El Salvador PTA), the agreements reviewed have not led to very significant improvements in bindings for cross-border trade in financial services.

The US is the only trading partner that has made significant progress in eliminating restrictions on the juridical form of financial services suppliers, by prompting important commitments to allow branching in Chile (life and non-life insurance), Australia (non-life insurance), El Salvador (all insurance services), Honduras (all insurance services), Colombia (insurance and banking), Costa Rica (insurance), Dominican Republic (direct insurance and reinsurance), Guatemala (insurance and banking), Morocco (life and non-life insurance), and Nicaragua (insurance). The same goes for cross-border supply of financial services, where countries having signed agreements with the US have all gone beyond the requirements of the WTO Understanding on Commitments in Financial Services in this area by adding commitments on the cross-border supply of insurance intermediation (broking and agency) and of portfolio management services by asset management firms to mutual funds. Overall,

²⁹ Thailand has no commitments on financial services in its agreements with Australia.

PTA commitments largely match the commitments sought at the WTO in the plurilateral request for the sector, both for commercial presence and cross-border supply.

Although benefiting from the sound basis provided by the far-reaching commitments already made at the WTO, which were the result of the most successful sectoral negotiation so far, PTA negotiations on **telecommunications** have certainly allowed to close the gap between the commitments and the actual practice, which had continued to evolve towards further liberalization after the 1997 multilateral negotiations. Most of the countries examined made commitments in their respective PTAs, covering all telecommunications services (both basic and value added services), and with fewer limitations than those listed at the WTO. For example, the cross-border supply of basic telecommunication services has been generally bound with no limitations in the PTAs examined, with only few exceptions (e.g. China, Costa Rica, India). In some of these cases, improvements on the multilateral commitments appear quite significant, e.g., Chile allowed US suppliers access to its market for local basic services; in Colombia, resale of international telecommunication traffic will be permitted as of 2007; Nicaragua and Honduras will completely eliminate the exclusivity for their respective incumbents by the end of 2005; Bahrain will eliminate the two-operator limit on the number of mobile telecommunication suppliers by the end of 2005; Panama had committed to eliminate its monopoly on basic telecommunication services by January 2003.

In the case of the sectors with fewest multilateral commitments (audiovisual, distribution and education), PTAs have brought a number of significant advances in terms of new commitments, which are also in contrast with the limited results achieved so far through Doha Round offers. Most of those advances take the form of commitments taken by some developing countries that had no – or only limited – commitments at the WTO.

In **distribution**, a number of countries which had no GATS commitments in the sector (nor had made offers except for one) such as Bahrain, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Morocco, Nicaragua, Paraguay and Uruguay undertook PTA commitments across all aspects of distribution services (retailing, wholesale trade, franchising, commission agents' services). Except for the two Mercosur countries, these new commitments provide either for full openness (Guatemala, Chile, Nicaragua) or for a few circumscribed limitations. They are exempt from the barriers felt to

be most important for this sector, such as limitations to foreign equity participation, economic needs tests, and broad and numerous product exclusions. In addition, a number of developing countries which already had some GATS commitments in the sector made significant improvements to their bindings in the sector, including China, Singapore, Brazil and Thailand.

In the case of **audiovisual** services, traditionally a difficult sector in multilateral negotiations, PTAs have provided for significant advances. Not surprisingly, most advances are found in the agreements signed with the US, which is the main *demandeur* and home to leading international suppliers. Each of the US's PTA partners, all of which had no audiovisual commitments at the WTO (nor offers for all except one), have undertaken commitments in the various areas of audiovisual services, i.e., movie-related, TV and radio-related, and sound recording, although often with many limitations. In general, the commitments undertaken by the US's PTA partners tend to have less restrictions attached to their commitments in movie-related services (production, distribution, projection) and sound recording than in services related to TV and radio. While a few of the US PTA partners have maintained market access restrictions in relation to movie-related services (apart from discriminatory subsidies, which are typically permitted in US-type agreements), none of these PTAs allow the imposition of restrictions on the number of cinema theatres or their level of foreign equity participation. More restrictions, including content quotas, are maintained in relation to services relating to television and radio, although more liberal access is often granted where the US likely has more interests, e.g., satellite TV, foreign programming for cable TV, and interactive audio/video services. Overall, PTA commitments secured through US PTAs generally exceed the objectives sought by the group of WTO *demandeurs* on audiovisual services in their plurilateral request, which does not even touch upon television/radio-related services. Certain commitments undertaken by Members not party to PTAs with the US also include notable improvements over those undertaken or offered in the GATS (e.g. China, Korea, Mexico, and Panama). Not surprisingly, in agreements having the European Communities as partner, the sector has even been excluded from the scope of the services chapter.

Some significant improvements have been recorded in **education** services, another sensitive sector that has attracted a relatively low number of GATS commitments and offers.

Most GATS+ commitments in the sector have been undertaken by countries that have contracted a PTA with the US. All of these countries, many of which had no or only very limited GATS bindings on education, undertook better education commitments in their PTAs than in their GATS schedules/offer. For example, a few (El Salvador, Guatemala and Oman) took PTA commitments across all five education sub-sectors without limitations.³⁰ Others also took PTA commitments across all education sub-sectors without other restriction than a reservation allowing to maintain existing or undertake new restrictions in relation to public education.³¹ Countries falling within this group include Bahrain, Colombia, Dominican Republic, Morocco, Nicaragua and Peru. PTA commitments undertaken by some countries that have not negotiated with the US also provide for improvements (e.g., Argentina, Brazil, Paraguay, Thailand, Panama), although of a more modest nature overall. PTA commitments for a good number of the countries reviewed tend to meet the objectives of the WTO plurilateral request, namely, full commitments in private 'higher education' and private 'other education services' both for mode 1 and 3.

With respect to *professional services*, developing countries that have signed PTAs with the US often took new/improved commitments in architecture, engineering and accountancy services with no or few limitations, although there are exceptions (e.g., Morocco which has nationality requirements; El Salvador and Costa Rica have residency requirements; Nicaragua requires to supply accounting services through a local firm). Commitments on legal services (e.g., host country law), as well as on medical and dental services, tend to provide for less openness. With few exceptions, commitments on medical and dental services are often qualified by a reservation allowing future restrictions on health to the extent that these are social services maintained or established for a public purpose/interest. GATS+ commitments for other developing countries tend to be more limited overall, although they still improve over GATS offers. For example, India improved upon its GATS schedule/offer in various sub-sectors, although it left legal services uncommitted; Panama took new and improved commitments under mode 3 across all professions, but left mode 1 uncommitted; China relaxed various limitations under mode 3, including for legal, and medical and dental services; Argentina and Uruguay undertook a number of new bindings

³⁰ Services chapters of US-type agreements also include an exclusion for "services provided in the exercise of governmental authority".

³¹ Such Annex II-type reservation typically covers public education services to the extent that these are social services maintained or established for a public purpose/interest.

without limitations for either modes, in a wide array of professional services; Brazil also made a number of improvements, in particular through new bindings without limitations under mode 1. For developed countries, there are fewer improvements overall as they often start from a higher level of bindings in the GATS.

D. Actual Services Liberalization Across Sectors

It is very difficult to identify with exactitude the extent to which all the trade agreements reviewed lead to real liberalization, i.e., to the removal of applied restrictions. In their PTAs, some countries might have bound the status quo, i.e., the applied regime, or less. Others might have decided, in some instances, to withdraw certain restrictions and, accordingly, not to list them as reservations or limitations in the agreement. Agreements do not indicate whether the level of openness guaranteed was already applied, or not, before the agreement came about, and since when. One could only ascertain the level of actual liberalization induced by trade agreements by going through the laws and regulations of each country so as to compare the applied regime before and after the conclusion of the agreements.

Having said that, trade agreements will sometimes specifically provide for the phasing-out of applied restrictions over time. Although it is possible that, in some cases, the trade agreement itself might not be directly responsible for such liberalization, since governments might have decided on a liberalization timetable prior to the bilateral negotiations and simply used the PTA to lock in such a timetable, in a way, such commitments may be considered as "evidence" of actual liberalization. Indeed, whether prompted or not by the agreement itself, the country will now have to stick to that liberalization timetable and, therefore, liberalization will ensue. The PTAs reviewed contain a number of such phase-out commitments. Table 3 lists a number of examples. One notes that the group of countries assuming such commitments is fairly widespread. Most phase-out commitments have been contracted by countries as part of a PTA with the United States, although not exclusively. Financial services and telecommunications are the sectors that seem to have attracted most of these cases, although other sectors are also represented. Finally, for those countries that are party to more than one of the reviewed PTAs, it appears

that the phasing-out commitments had sometimes not been undertaken with all negotiating partners.

TABLE 3: Examples of Commitments Providing for the Phasing-In of Liberalization

	Sectors	PTA Commitments Providing for Phasing-out of Restrictions in Place	In PTAs with
Australia	Financial services	Foreign life insurers will be allowed to operate branches.	US and Singapore
Bahrain	Business services	Local presence requirements to be phased-out within 3 years from the date of entry into force of the agreement for advertising; car rental; consultancy and management; and debt collection. For accounting, financial auditing and bookkeeping, architectural and engineering, and services incidental to mining, it will be within 7 years of the date of signature. Branching and entity restrictions in advertising and publishing to be phased-out within 5 years of date of entry into force.	US
	Telecommunications	The existing 2 operator limit on the number of mobile telecommunication suppliers to expire by 31 December 2005.	US
	Construction	Local presence requirements to be phased-out within 3 years from the date of entry into force of the agreement.	US
	Financial services	Foreign insurers will be able to acquire new non-life insurance licenses, with no restrictions, beginning 6 months after the date of entry into force of the agreement.	US
	Tourism	Local presence requirements for travel agencies and tour operators, and travel guide services to be phased-out within 3 years from the date of entry into force of the agreement.	US
	Transportation	Local presence requirements, including for maritime, road and rail transport services, to be phased-out within 3 years from the date of entry into force of the agreement.	US
Chile	Financial services	Foreign insurance companies to be allowed to supply marine, aviation and transport insurance one year after entry into force of the agreement on a cross border basis.	US and EC
		Foreign insurance companies to be allowed to establish branches in Chile no later than 4 years after the date of entry into force of the agreement.	US
		Asset management by mutual funds, investment funds, and foreign capital investment funds, to be allowed as of entry into force of the agreement, while management of voluntary savings plans will be allowed as of 1 March 2005.	US
China	Professional services	Wholly owned operations in architectural, engineering, integrated engineering, and urban planning and landscape architectural services to be permitted as from December 2006.	Hong Kong and Macao
Colombia	Telecommunications	Resale of international telecommunications traffic to be permitted as from 2007.	US
	Financial services	Financial companies to be allowed to establish branches no later than 4 years after entry into force of the agreement. Companies will also be allowed to provide cross-border supply of portfolio management services to collective investment schemes no later than 4 years after	US

	Sectors	PTA Commitments Providing for Phasing-out of Restrictions in Place	In PTAs with
		entry into force of the agreement	
	Audiovisual services	There will be no restrictions on the number of subscription television concessions at the zonal, municipal and district level once the current concessions at those levels expire and in no case beyond 31 October 2011. Quotas for broadcasting of locally-produced programming on free-to-air national television services on weekends/holidays to be reduced from 50% to 30% from 1 February 2009.	US
Costa Rica	Telecommunications	Will allow the following telecommunications services to be supplied directly to the customer: i) private network services, no later than 1 January 2006; ii) internet services, no later than 1 January 2006; and iii) mobile wireless services, no later than 1 January 2007.	US
	Financial services	Will fully liberalize the insurance sector and eliminate the existing monopoly in several phases. Upon entry into force of the agreement foreign insurance companies will have access to the insurance sector on a cross-border basis. After 2008, establishment in Costa Rica, including through branching, will be permitted but restrictions on third party auto liability and on workers compensation will continue until 2011, after which the sector will be fully liberalised.	US
Dominican Republic	Financial services	Foreign life and non-life insurance companies to be allowed to establish branches no later than 4 years after entry into force of the agreement. Currently, collective investment schemes are not regulated in the Dominican Republic. Non-established financial institutions (other than a trust company) will be allowed to provide investment advice and portfolio management services to collective investment schemes located in its territory, as soon as these schemes are regulated.	US
El Salvador	Financial services	Foreign insurance companies to be allowed to establish branches no later than 3 years after entry into force of the agreement.	US
Guatemala	Financial services	Foreign life and non-life insurance companies, as well as brokers and agents, to be allowed to establish branches no later than 4 years after entry into force of the agreement. Currently, collective investment schemes are not regulated in Guatemala. Non-established financial institutions (other than a trust company) will be allowed to provide investment advice and portfolio management services to collective investment schemes located in its territory, as soon as these schemes are regulated.	US
Honduras	Telecommunications	Basic telecom services to be fully liberalised by 24 December 2005. Additional mobile operators may also be authorized as from December 2005.	US
Morocco	Financial services	Foreign life and non-life insurance companies to be allowed to establish branches not later than 4 years after entry into force of the agreement. Apart from reinsurance brokerage, foreign insurance companies will be permitted to supply marine, aviation and transport insurance 2 years after entry into force of the agreement on a cross-border basis.	US
Nicaragua	Telecommunications	Monopoly on basic telecommunication services to be eliminated as of 13 April 2005.	US
	Financial services	Foreign insurance companies to be allowed to establish branches 4 years after entry into force of the agreement. However, members of the Board of Directors must be residents in Nicaragua.	US

	Sectors	PTA Commitments Providing for Phasing-out of Restrictions in Place	In PTAs with
Oman	Distribution	Full foreign ownership of retail enterprises worth more than \$1 million to be permitted as from 2011.	US
Panama	Telecommunications	Monopoly on basic telecom services to be eliminated by January 2003.	El Salvador
Singapore	Business services	Existing Singaporean laws to be modified so as to relax conditions under which US law firms are permitted to provide legal services.	US
		Foreign power companies will be allowed to supply electricity to non-household consumers in two phases: phase 1 will be two months after the electricity market opens in the second half of 2002; and phase II will be six months after phase I. In the final phase, scheduled for implementation by 2003, retail sale to the remaining consumers (mainly household consumers) will be fully opened.	
		For architectural services, the requirement of "residency" in Singapore shall be phased out by April 2005. The requirement that not less than two-thirds of the directors of a corporation be Singapore registered or allied professionals shall be reduced to 51 % by April 2005.	Korea
	Financial services	Current ban on new licenses for full-service banks will be lifted within 18 months, and within 3 years for "wholesale" banks that serve only large transactions. Licensed full-service banks will be able to offer all their services at up to 30 locations in the first year, and at an unlimited number of locations within 2 years. Locally incorporated subsidiaries of US. banks can apply for access to the local ATM network within two and a half years. Branches of US banks get access to the ATM network in 4 years.	US
Thailand	Tourism, education and maritime transport	As from January 2005, equity participation of up to 60% (subject to certain criteria) by Australian investors/service suppliers is allowed in major restaurants or hotels, tertiary education institution specialising in science and technology and located outside Bangkok, and certain maritime cargo services.	Australia
Peru	Financial services	Foreign non-life insurance companies are allowed to supply marine, aviation and transport insurance 2 years after the entry into force of the agreement. Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services may also be provided on a cross-border basis 2 years after the entry into force of the agreement.	US

III. Conclusion: Implications and What To Do about Multilateralism?

A. How much further than the GATS ?

This paper assessed the extent to which liberalization commitments in the recent wave of PTAs go further than the GATS. Overall, preferential agreements have provided important advances when compared to GATS schedules and more surprisingly, GATS offers. Many PTAs provide for a high proportion of new bindings in sectors that had remained uncommitted and improved bindings in sectors that were already committed in the GATS schedules/offers. These advances are further underscored by what would appear to be deeper and more meaningful commitments.

Firstly, countries that have used negative-list approaches have bound at least the existing level of openness/restrictions for the large majority of sectors. Such predictability is key in attracting investment, but is also important for cross-border trade: it locks-in existing openness and pre-empts protectionism in this fast expanding area.³² Binding the status quo also has the advantage of putting the negotiations directly on a better footing to achieve some real liberalization, instead of losing time negotiating away the margin between commitments and the applied regime. In addition, the comparison of GATS and PTA commitments has also highlighted that PTAs using a negative-list approach tend to yield a bigger proportion of GATS+ commitments. This is due in good part to the fact that the US always uses such approach. All those PTAs that tended to show lesser proportions of new/improved commitments used a positive-list approach. Secondly, a closer look at the PTA commitments suggests that key advances have been made regarding the depth of commitments, as illustrated by the number of pre-liberalization commitments and the fact that in many cases the GATS+ commitments secured in PTAs roughly match or exceed the objectives of plurilateral requests for relevant sectors. In addition, the high number of PTA improvements on existing GATS bindings suggest either that the commitments in the schedule/offer did not reflect the applied regime or, if they did, that the improved PTA commitments induced actual liberalization and new commercial opportunities.

³² Aaditya Mattoo and Sacha Wunsch-Vincent (2004), "Pre-Emptying Protectionism in Services: the WTO and Outsourcing", Journal of International Economic Law 7: 765-800.

The review of agreements also suggests that the US is getting very important services commitments from its PTA partners and that it consistently obtained better commitments than others from the same countries. The US has obtained very significant access in various services where its industry sees particular interest, e.g., financial services, express delivery, distribution, audiovisual.

The general picture of improvement tends to confirm the relatively limited breadth and depth of commitments in the GATS and in offers, but also goes against some expectations that PTAs offered little more than the GATS. The picture is nevertheless nuanced, as there are areas where the value-added of PTAs is more limited. For one, a number of the countries that are not involved in PTAs with the US – although not all – appear to provide for a more limited set of GATS+ commitments. Second, a number of the larger countries - especially the developed ones - tend not to go as far beyond GATS as many of the smaller economies, especially developing ones. This might be explained by the imbalance between negotiating partners and by the fact that at least some of the larger countries, particularly developed ones, have less room to improve their GATS schedule/offer than others, at least for the two modes of supply reviewed here. This can also suggest that smaller and developing countries, when negotiating with larger and/or developed countries, perceive their gains as lying in other areas, likely preferential access in goods trade. Third, as a result, the most protected services activities in larger, especially developed countries, remain, despite some improvements on the fringes, largely unaffected by PTAs, e.g., audiovisual for EFTA and the EC, maritime transport and certain professional services for the US, and cross-border trade in a number of financial services for a variety of countries. Fourth, as noted at the outset, while most of the largest countries have become involved in services PTAs, they do not have PTAs amongst themselves (i.e., China, US, Japan, EC, India, Brazil). To this day, the multilateral system still remains the main avenue for these countries for resolving services trade issues and negotiating future disciplines.

B. Costs of PTAs and Implications for the Multilateral Trading System

These findings lead us to make a number of observations in relation to possible implications of this phenomenon, in particular for the multilateral trading system.

There are a number of reasons why preferential arrangements in services could potentially be less harmful than in goods trade. One reason is that reducing barriers to trade does not lead to a loss of revenue as is the case for tariff reductions.³³ Another one is that the nature of services regulations is such that once removed for one country, many services restrictions will not continue to be applied to others, at least beyond the short-term. Indeed, many services restrictions are embedded in regulatory regimes and governments will often not put in place different regulatory regimes for different supplier countries. While the propensity to extend *de facto* the preferences granted in PTAs to others is likely greater, a number of measures - especially the more restrictive ones and in particular for mode 3 - can nevertheless easily be applied on a preferential basis: foreign equity limits and restrictions on establishment (e.g., limits on the number of suppliers through ENTs on the granting of licenses).

Preferential deals can bring benefits to participants by allowing them to undertake important reforms leading to the removal of costly domestic restrictions. Those countries that have negotiated with the United States may have used domestic support flowing from preferential goods access to the US market to overcome resistance to reforming protective policies in some services areas. Nevertheless, the findings of this paper beg the question as to why countries undertook such commitments in PTAs and not in the GATS? First, the political impetus often driving bilateral trade agreements might have helped to overcome important impediments to multilateral services liberalization, i.e., the resource implications for smaller countries of negotiating disciplines in such a complex and far reaching area (four different modes, many different types of trade barriers, etc.); and institutional resistance and/or disengagement from those many non-trade ministries responsible for services trade policy-making.³⁴ Second, services exporters might perceive their commercial gains more clearly in the relatively more simple bilateral deals in comparison with multilateral negotiations with more than a hundred countries, especially if they get preferential access over their competitors from other service-exporting countries. This added simplicity in terms of the identification of export interests is also likely to be attractive to political representatives. Third, disappointment with the Doha services negotiations, as well as

³³ Marion Jansen (2006), "Services Trade Liberalization at the Regional Level: Does Southern and Eastern Africa Stand to Gain from EPA Negotiations?", WTO Staff Working Paper, May 2006.

³⁴ See Adlung and Roy (2005), *op.cit.*; Alejandro Jara and Carmen Domínguez (2006), "Liberalization of Trade in Services and Trade Negotiations", *Journal of World Trade*, Vol. 40, No. 1, pp. 113-127.

concerns about free-riding, might have encouraged some countries to use PTAs to meet their desire to bind an applied regime of openness or encourage some further reforms.

Preferential trade agreements are sometimes depicted as having no significant downsides since, for parties to these, some liberalization is better than none. However, services PTAs can also have significant costs:

1. Preferential access in services can engender important costs for non-parties because it may provide lasting advantages to first movers that might be hard to reverse through subsequent extension of access to other countries. This results from the limited number of suppliers that can naturally operate in certain services markets (e.g., financial services, telecoms); location-specific sunk costs of production are important in many sectors.³⁵ Unlike for goods, subsequent extension of the preferences to other countries with more efficient producers might not necessarily be sufficient for these to enter the market occupied by the suppliers benefiting from first-mover advantages.
2. Preferential access in services as a result of PTAs likely occurs more often than might be expected or detected: the amount of discretion sometimes involved in the granting of licenses makes it difficult to assess whether decisions directly result, or not, from PTA commitments, especially for activities where there are no GATS commitments whatsoever. Such advantages can be a factor that makes PTAs more interesting for participants and that helps explain why the proliferation of PTAs sometimes appears like a competitive race.
3. Concerns in the goods area about a spaghetti (or noodle) bowl of multiple and differing rules of origin do not arise to the same extent in services. Rules of origin in services PTAs are often liberal: anyone established in a party's territory - even if owned by foreigners - benefits from the PTA, except in special circumstances.³⁶ A notable exception relates to the agreements signed by China where the rules of origin are more stringent, e.g., the need to have had substantive business operations in the country for at least 3 years. In services, the costs associated with the complexity

³⁵ Carsten Fink and Aaditya Mattoo (2004), "Regional Agreements and Trade in Services: Policy Issues", Journal of Economic Integration, 19(4): 742-79.

arising from differing regulations might relate not so much to rules of origin but rather to the levels of market access granted. Not only are market access commitments in services much more complex than tariff lines, but the review of PTAs has highlighted that certain countries take different commitments in different PTAs. The review also revealed that some countries had, in some instances, listed restrictions in their PTAs that they had not scheduled in their GATS schedules.

4. Another possibly important - although more difficult to assess - consequence of the proliferation of PTAs relates to its implications for future liberalization at the multilateral level, where, it is generally agreed, gains would be greater than through preferential deals. Gains from multilateralism flow, among other things, from multilateralizing the liberalization undertaken bilaterally, but also from addressing restrictions that cannot be (agricultural subsidies) or at least have not yet been (remaining restrictions of the largest economies) dealt with at the bilateral or plurilateral levels. In many ways, the extent of PTA advances over GATS offers raises questions about the role and relevance foreseen for the GATS.

- For one, it may well be that the negotiations of PTAs have to some extent diverted resources and attention away from the Doha services negotiations.³⁷ Many of those countries that have made the most new and improved commitments in their PTAs appear to be countries that have, in comparison, made rather modest offers, often to supplement already modest GATS commitments. In that respect at least, this seems to contradict the so-called domino theory (whereby freer trade in PTAs would eventually lead to further liberalization at the multilateral level). One can hope that this gap results from diverted attention/resources that are temporary and that the 'domino' effect will have an impact with some delay, but there are also risks that this does not materialize as smaller countries wish to preserve the preferred access that they obtained to larger markets, such as the US's. However, PTAs, once

³⁶ For example: the established foreign enterprise has no substantial business activities in the party's territory. This is to avoid that non-parties benefit from PTA commitments by setting up mail-box operations.

³⁷ For an illustration of how resource-intensive PTA negotiations are, at least in the case of the US, see United States General Accounting Office (2004).

implemented, also generate vested interests that want to maintain their preferential access, although possibly more so in the goods area.³⁸

- Furthermore, some of those that have made impressive qualitative jumps in their PTA commitments continue to take defensive positions in the multilateral setting, e.g., invoking limited resources or other difficulties to justify limited offers or engagement in the services negotiations. There is a clear disconnect between practice and discourse.
- In addition, given the large gap between PTA commitments and GATS offers for a number of countries, one wonders whether the ongoing PTA hyper-activity has not incited some Members to make minimal offers so as to have further negotiating chips (i.e., bindings) to offer in various PTA negotiations. Some may have thought that they would have been pressured to go beyond an ambitious offer because a PTA partner would expect to get more than would be given to non parties. One can therefore wonder whether those services offer in the Doha Round that are far from matching PTA services commitments result not only from tactical considerations across Doha negotiating areas, but also from: attention/resources diverted to PTAs, tactical considerations leading countries not wanting to lose negotiating chips, and/or the strength of vested interests wanting to prevent an erosion of preferences.
- There is a risk that the success of certain big *demandeurs* in obtaining significant commitments in PTAs reduce somewhat their appetite for multilateral negotiations on services. While the services market access package that they can hope to get through the WTO is still large because there are many important WTO economies with which it does not have PTAs, the size of these potential 'gains' naturally diminish with each PTA that is concluded. This may be accentuated if the success of certain big *demandeurs* incites other key trading powers to join or intensify the PTA race out of concerns that competitors are gaining important market access at their expense. Further, the more countries offer services commitments in PTAs,

³⁸ See Crawford and Fiorentino, op.cit.

the less they might use these as bargaining chips in the WTO so as to convince services exporter countries to address agricultural subsidies. In other words, by offering at the WTO what they have offered in PTAs, wouldn't developing countries get much more in return?

C. *How to Reinforce Multilateralism?*

What might be solutions to try to ensure that downsides of PTAs are minimized and that multilateralism is reinforced? It goes without saying that the possible distortion and complexity arising from the diversity of different liberalization schedules would be reduced if levels of bindings were improved at the multilateral level. There is ample room to manoeuvre across the WTO membership. So as to provide impetus to the negotiations, those involved in PTAs could conditionally offer a level of services commitments closer to the one they agreed to in PTAs. For the WTO membership as a whole, including those Members that have not been so involved yet in preferential services arrangements, the extent of GATS+ commitments in PTAs provides a glimpse of positive outcomes that could emerge from the Doha Round, in contrast with the gloomy picture transpiring from offers on the table so far.

Furthermore, much more transparency should be sought through the WTO.³⁹ Firstly, with a view to provide an impetus to ongoing GATS negotiations, more could be done, in line with this paper (but also for other modes of supply), to look into the content of the GATS+ commitments of PTAs in relevant sectors. Secondly, a more ambitious proposal would focus on providing better surveillance of the implementation of the preferential agreements. A proper transparency mechanism regarding implementation would aim to provide a clearer picture as to whether the access granted was being implemented on a non-preferential basis or not, *de jure* and *de facto*. More than a general notification exercise, a more appropriate model might rather be along the lines of China's transitional review mechanism, according to which China has an obligation to provide information on policies affecting trade in services (e.g., changes to laws and regulations, state of play of licensing applications), information which is subsequently reviewed by Members in the specialized WTO bodies overseeing the

³⁹ It can be noted that the WTO Negotiating Group on Rules has adopted a new transparency mechanism for all regional trade agreements, which would be implemented on a provisional basis. Under the

issues at hand.⁴⁰ The same obligation could be imposed on WTO Members having signed PTAs including services obligations and commitments. Only with such kind of information would it be possible to better assess any possible trade diversion since disaggregated trade statistics, by sub-sector, mode of supply and trading partner, are hard to come by in services. For example, information could be provided on the number of licenses - and the nationality of the suppliers that have applied for them - that had been accepted or rejected in a given sector.

After all, if PTAs are to reinforce the multilateral system through "competitive liberalization" and WTO Members are committed to multilateral rules, greater transparency can only be beneficial.

Decision, the WTO Secretariat, on its own responsibility and in full consultation with the parties, shall prepare a factual presentation of the RTA.

⁴⁰ According to Annex 1A of its Protocol of Accession to the WTO, China has been requested to provide annual information on such matters as: (a) regularly updated lists of all laws, regulations, administrative guidelines and other measures affecting trade in each service sector or sub-sector indicating, in each case, the service sector(s) or sub-sector(s) they apply to, the date of publication and the date of entry into force; (b) China's licensing procedures and conditions, if any, between domestic and foreign service suppliers, measures implementing the free choice of partner and list of transport agreements covered by MFN exceptions; (...) and (e) foreign and domestic suppliers in sectors where specific commitments have been undertaken indicating the state of play of licensing applications on sector and sub-sector levels (accepted, pending, rejected). See the Protocol on the Accession of the People's Republic of China (WTO document WT/L/432).

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Abbreviations

Country Abbreviations in Charts 1 and 2:

ARG: Argentina
AUS: Australia
BHR: Bahrain
BRA: Brazil
CHL: Chile
CHN: China
COL: Colombia
CR: Costa Rica
DR: Dominican Republic
EC: European Communities (15)
ELS: El Salvador
GUA: Guatemala
HND: Honduras
ICE: Iceland
IDN: Indonesia
IND: India
JAP: Japan
JOR: Jordan
KOR: Republic of Korea
LIE: Liechtenstein
MAL: Malaysia
MEX: Mexico
MOR: Morocco
NZ: New Zealand
NIC: Nicaragua
NOR: Norway
OMN: Oman
PAN: Panama
PER: Peru
PHI: Philippines
PRY: Paraguay
SGP: Singapore
SWI: Switzerland
THA: Thailand
URY: Uruguay
US: United States

ANNEX: Chart 2 (1/2): Proportion of Sub-Sectors with New and Improved Commitments under Mode 1, per WTO Member
 (when comparing the GATS offer to the GATS schedule ("GATS") and the PTA commitments to the GATS offer ("PTA"))

