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**comercio internacional**

**T**rade and investment rules:  
Latin American perspectives

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## Abstract

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Latin American countries rank among those that have displayed the greatest amount of rule-making activism towards foreign direct investment in recent decades. The region has witnessed a steady opening of investment regimes. Alongside domestic (or autonomous) investment regime liberalization, Latin American countries have engaged in a large number of international negotiations dealing with investment matters. Virtually all of them are today members of the World Trade Organization, are party to one or more regional integration agreements featuring comprehensive disciplines on the protection and liberalization of foreign investors and their investments, and are parties to numerous bilateral investment treaties.

This paper depicts the changing international landscape of investment rule-making from a Latin American perspective. It does so by looking first at the recent evolution of investment rules at the bilateral, regional and multilateral levels, pointing out differences and synergies between these closely intertwined processes and the role that Latin American countries have had in shaping them. Against the backdrop of repeated failures at developing a comprehensive set of investment disciplines at the multilateral level, the paper reviews the main arguments that have been recently advanced in favor and against global rules for investment. The paper dissects the main reasons why investment fell off the negotiating agenda of the Doha Development Agenda at the WTO. It concludes by drawing a number of policy lessons regarding the most optimal institutional settings in which to pursue various elements of investment rule-making and sketches a few forward-looking scenarios on investment rule-making at the multilateral level.



## Introduction

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Investment rules governing cross-border investment flows usually consist of rules on treatment and protection of foreign direct investment (FDI) contributing to what is generally referred to as the “investment climate”. Investment rules exist at the bilateral, regional and multilateral level. The question of how investment rules affect investment decisions has long generated heated policy debates. In general terms, a stable and transparent investment climate can be in the interest of investors when they were previously disadvantaged by unpredictable investment conditions. It is not clear whether this would lead to additional FDI or simply to more comfort for the investor. The predictability of the investment climate may be enhanced when domestic policies are enshrined or locked into international treaties. Much will also depend on existing treatment. If treatment of existing investors is already good in practice, new rules will do little by way of generating new investment flows or a better investment climate, other than offering greater long-run security. Empirical evidence that addresses the effects of individual investment provisions on induced FDI remains scant and results largely indeterminate.

Against this background, host country governments have exhibited differing attitudes towards international investment rule-making. Latin American countries are probably among those that have shown the greatest activism. In the recent past, triggered in particular by the debt crisis of the 1980s, Latin American nations have recognized the importance of increased foreign investment flows into their economies. FDI can, at least partly, compensate for sources of capital that may otherwise become unavailable from international lenders in circumstances of heightened macro-economic turmoil. As a

result, the region has witnessed a steady opening of investment regimes. Alongside domestic (or autonomous) investment regime liberalization, Latin American countries have engaged in a large number of international negotiations. Virtually all of them are today WTO Members, are party to one or more free trade other integration agreements, and are signatories of numerous bilateral investment treaties.<sup>1</sup>

This paper depicts the changing international landscape of investment rule-making from a Latin American perspective. The paper is structured as follows. Sections 2 and 3 review pertinent investment rules at the multilateral, bilateral and regional levels. Section 4 provides an overview of the main arguments that have been advanced in favor and against investment rule-making. Section 5 explores some of the reasons why investment fell off the negotiating agenda of the Doha Round. Section 6 concludes by drawing a number of policy lessons and sketches a number of forward-looking scenarios on investment rule-making at the multilateral level.

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<sup>1</sup> Brazil is one exception in this latter respect, as it has signed numerous bilateral and regional investment treaties and agreements, including in the context of the Mercosur, none of which have yet to be ratified by its Congress.

## I. WTO disciplines

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Multilateral rule-making on investment has a troubled history. The investment chapter of the 1948 Havana Charter was one of the main reasons for the downfall of the proposed International Trade Organization project. In the General Agreement on Tariffs and Trade (GATT) that survived, no further investment-related negotiations took place until the Uruguay Round negotiations in the mid 1980s.

Several other attempts at crafting a global investment regime would prove stillborn, including most spectacularly the proposed Multilateral Agreement on Investment (MAI) initiative launched within the Organization for Economic Cooperation and Development in the late 1990s. The MAI represented a major attempt at crafting a multilateral (if far from universal) regime for investment. Finally, and most recently, efforts to include investment negotiations proper within the negotiating purview of the World Trade Organization (WTO) have proven deeply contentious, contributing significantly to the derailment of the December 2003 ministerial meeting in Cancun. As part of the price to pay for imparting forward momentum to the stalled Doha Development Agenda, WTO Members agreed in July 2004 that foreign investment would (alongside two other so-called “Singapore Issues” – trade and competition and transparency in government procurement) be taken off the WTO negotiating table for the duration of the current Doha Development Agenda.

Accordingly, in terms of legally-binding multilateral rules, what survives the multiple initiatives of the past half century are the rules that were agreed in the Uruguay Round of trade negotiations,

concluded in 1994. Of these, the most important elements are the Agreement on Trade-Related Investment Measures (TRIMs), the Agreement on Subsidies and Countervailing Measures (ASCM), the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), and the Understanding on the Settlement of Disputes (DSU). In what follows, we briefly review the salient investment-related dimensions of such WTO disciplines.

## **1. Agreement on trade-related investment measures**

The stated objectives of the Agreement on Trade-Related Investment Measures (the TRIMs Agreement) include not only the promotion of the expansion and progressive liberalization of world trade but also the facilitation of investment across international frontiers.<sup>2</sup> The TRIMs Agreement prohibits the application of certain investment measures related to trade in goods to enterprises operating within the territory of a Member. It should be noted that the TRIMs Agreement is concerned with discriminatory treatment of imported and exported goods and is not specifically concerned with the treatment of foreign legal or natural persons. Thus, the basic substantive provision in Article 2 of the TRIMs Agreement prohibits the application of any trade-related investment measure that is inconsistent with the GATT's provisions on national treatment or the elimination of quantitative restrictions. Its scope is thus limited to measures affecting cross-border investment in goods-producing industries. An Illustrative List annexed to the Agreement identifies certain measures that are inconsistent with Article III:4 (National Treatment) or Article XI:1 (Prohibition of Quantitative Restrictions) of GATT 1994.

These cover essentially the following types of measures: local content requirements, trade-balancing requirements, foreign exchange balancing requirements and restrictions on exportation. The Agreement bans not only TRIMs that are obligatory in nature, but also those whose compliance is necessary in order to obtain an advantage. As noted above, it applies only to investment measures related to trade in goods and does not cover measures affecting trade in services. Measures concerning service industries are addressed by the GATS, which does not contain explicit rules dealing with TRIMs, although these may be subject to specific negotiated commitments.

While the measures illustrated in the Annex frequently arise in the context of foreign investment policies, there is nothing in the TRIMs Agreement to suggest that these rules do not apply equally to measures imposed on domestic enterprises. The disciplines of the TRIMs Agreement focus on discriminatory treatment of imported and exported products and do not govern the issue of entry and treatment of foreign investment. For example, a local content requirement imposed in a non-discriminatory manner on domestic and foreign enterprises is inconsistent with the TRIMs Agreement because it involves discriminatory treatment of imported products in favour of domestic products. The fact that there is no discrimination between domestic and foreign investors in the imposition of the requirement is irrelevant under the TRIMs Agreement.

Article 5 of the TRIMs Agreement contains provisions for notification of, and for according transitional periods for the elimination of, trade-related investment measures inconsistent with the Agreement. With regard to transition periods, developed, developing and least-developed countries were given, respectively, two, five and seven years from the date of entry into force of the WTO Agreement to eliminate notified TRIMs (article 5.2). Furthermore, upon request, the transition period could be extended for developing and least-developed countries that demonstrate particular difficulties in implementing the provisions of the Agreement (article 5.3). After protracted discussions, such an extension was granted to Argentina, Colombia, Malaysia, Mexico, Pakistan,

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<sup>2</sup> See TRIMs Agreement Preamble.

the Philippines, Romania and Thailand until the end of 2003, subject to certain criteria, such as the submission of a phase-out plan for the TRIMs measures in question.

Export performance requirements are another type of performance requirement often imposed on foreign investors. For various domestic economic policy reasons, these force foreign affiliates to export a larger share of the local output than might otherwise be a firm's preferred choice. Neither the TRIMs Agreement nor any other WTO rules forbid the imposition on foreign investors of requirements to export a minimum amount of domestic production.

An important GATT dispute settlement panel ruling clarified this point in 1984.<sup>3</sup> The panel considered a complaint by the United States regarding certain types of undertakings which were required from foreign investors by the Canadian authorities as conditions for the approval of investment projects. These undertakings pertained to the purchase of certain products from domestic sources (local content requirements) and to the export of a certain amount or percentage of output (export performance requirements). The Panel concluded that the local content requirements were inconsistent with the national treatment obligation of Article III:4 of the GATT but that the export performance requirements were not inconsistent with GATT obligations.<sup>4</sup> The Panel emphasized that at issue in the dispute before it was the consistency with the GATT of specific trade-related measures taken by Canada under its foreign investment legislation and not Canada's right to regulate foreign investment *per se*.

This panel decision confirmed that existing obligations under the GATT were applicable to performance requirements imposed by governments in an investment context in so far as such requirements involve trade-distorting measures. At the same time, the panel's conclusion that export performance requirements were not covered by the GATT also underscored the limited scope of existing GATT disciplines with respect to such trade-related performance requirements.

The subsequent Uruguay Round negotiations did not change the situation depicted above. The coverage of WTO rules is basically limited to the requirements included in the TRIMs Illustrative List and does not extend to export performance requirements. However it is important to stress that a requirement to export is inconsistent with Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures, if it is combined with a subsidy within the meaning of Article 1 of that Agreement (see below).

## 2. Agreement on subsidies and countervailing measures

The provision of investment incentives, widespread in both developed and developing countries, is a particularly important element of the legal framework for foreign investment. Investment incentives could be defined as measurable economic advantages afforded to specific enterprises or categories of enterprises by (or at the behest of) governments, in order to encourage them to behave in a certain manner. This would include the decision to invest in the host country rather than elsewhere. Incentives take many different forms and can be classified in various ways.

One useful classification can be to distinguish between: (i) financial incentives; (ii) fiscal incentives; (iii) subsidized services; and (iv) market privileges. Financial incentives involve the provision of funds directly to firms to finance new foreign investment or certain operations. That is, the host government pays for some of the investment cost through a grant or subsidized credit without demanding a commensurate equity stake.

Fiscal incentives are provisions designed to reduce the tax burden for foreign investors, for example tax holidays (sometimes exceeding 10 years), reduction in the standard corporate income

<sup>3</sup> See Canada - Administration of the Foreign Investment Review Act ("FIRA") (BISD 30S/140, 1984).

<sup>4</sup> In particular the panel stated "there is no provision in the General Agreement which forbids requirements to sell goods in foreign markets in preference to the domestic market" (BISD 30S/164).

tax rate, accelerated depreciation, and duty drawbacks and exemptions from import duties on raw materials, intermediate inputs and capital goods.<sup>5</sup> Subsidized services include the provision of land, designated infrastructure and government services at less-than-commercial prices. Market privileges include different measures designed to enhance the profitability of FDI by biasing the market competition in favor of the investing firm. For example, investors may receive preferential access to government contracts; guarantees against further entry, for example in services sectors requiring government licenses (telecommunications, banking, etc.); a special regulatory treatment; guarantees of protection against import competition or preferential treatment with regard to the import of certain products.<sup>6</sup>

The Agreement on Subsidies and Countervailing Measures (ASCM) defines the concept of "subsidy" and establishes disciplines on the provision of subsidies. This is of particular relevance for FDI policy, as certain investment incentives granted by governments are subsidies as defined by the ASCM. The definition contains three basic elements: a financial contribution (ii) by a government or any public body within the territory of a Member (iii) which confers a benefit.<sup>7</sup> All three of these elements must be satisfied in order for a subsidy to be deemed to exist.

At least some types of measures in each of the categories referred to above are subsidies as defined in Article 1 of the ASCM. That is, they can involve a financial contribution by a government or public body and could confer a benefit. Fiscal incentives, for example, would generally fall within the ASCM definition of "government revenue ... otherwise due [that] is foregone or not collected (e.g. fiscal incentives such as tax credits)". Financial incentives, such as the direct provision of funds through grants and subsidized credits, would generally meet the ASCM definition of a "government practice [that] involves a direct transfer of funds (e.g. grants, loans and equity infusion ...)". Finally, the provision of subsidised services would appear to be a subsidy as defined by the ASCM. In particular, the provision of such items as land and infrastructure at less than market prices would appear to fall within the definition of "a government providing goods or services other than general infrastructure, or purchasing goods".

To the extent that such incentives are provided on a "specific" basis, as defined in Article 2 of the ASCM, they also would be subject to the ASCM's provisions. The basic principle is that only subsidies that distort the allocation of resources within an economy should be subject to discipline. Where a subsidy is widely available within an economy, such a distortion in the allocation of resources is presumed not to occur. Thus, only "specific" subsidies are subject to the ASCM's disciplines. There are four types of "specificity" within the meaning of the ASCM: (i) enterprise specificity: a government targets a particular company or companies for subsidization; (ii) industry specificity: a government targets a particular sector or sectors for subsidization; (iii) regional specificity: a government targets producers in specified parts of its territory for subsidization; and (iv) prohibited subsidies: a government targets export goods or goods using domestic inputs for subsidization. Thus, the two categories of prohibited subsidies are: export subsidies and import substitution subsidies.

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<sup>5</sup> In an action brought in WTO by Member Countries of the European Union against the United States on the tax treatment of export income through foreign sales corporations, the Dispute Settlement Body made it clear that the prerogative of taxation rests with the sovereign Government – what to tax or not to tax; how much to tax etc. However, having set up a system of tax rules, exemption given in support of export sales that amounts to export subsidy is what runs afoul of WTO obligations (United States – Tax Treatment for "Foreign Sales Corporations": Report of the Appellate Body, WT/DS108/AB/R, p.31).

<sup>6</sup> For example, in some countries manufacturers of cars with assembly operations that meet local content requirements are entitled to import cars produced elsewhere at preferential rates.

<sup>7</sup> Besides clear-cut cases such as cash grants, the issue of benefit will be more complex in other instances including the granting of loans, equity infusions or the purchase by a government of a good. Although the ASCM does not provide complete guidance on these issues, the Appellate Body has ruled that the existence of a benefit is to be determined by comparison with the market-place (i.e., on the basis of what the recipient could have received in the market). See WTO panel on Canada - Measures Affecting the Export of Civilian Aircraft, WT/DS70/R, para. 9.112; the WTO Appellate Body endorsed this ruling (WT/DS70/AB/R, paras. 149-161).

Investment incentives meeting the definition of a subsidy, and granted contingent upon exportation of goods produced (or to be produced) by an investor are prohibited under the ASCM. A detailed list of export subsidies is annexed to the ASCM. The Illustrative List of Export Subsidies, provided in Annex I to the ASCM includes direct and indirect subsidies linked to exports, such as services in their production, transport and marketing, as well as associated export credit and insurance schemes. Also prohibited is the full or partial remission of direct taxes and social welfare charges or special direct tax deductions that are not also available to production for domestic consumption. Exemption or remission of indirect taxes must not exceed the level of such taxes paid on production or sale for domestic consumption, e.g., VAT rebates must not exceed the normal VAT rate.

A number of other "specific" investment incentives other than those meeting the definition of prohibited subsidies also are geared toward enhancing export competitiveness and are subject to the disciplines of the ASCM. That is, even if not prohibited, incentives that meet the definition of a specific subsidy and that cause "adverse effects" as defined by the ASCM potentially are subject to compensatory action (they are "actionable").

Most subsidies, especially production subsidies, may fall in the "actionable" category. Actionable subsidies are not prohibited, but are subject to challenge, either through multilateral dispute settlement or through countervailing action, in the event that they cause adverse effects to the interests of another Member. There are three types of adverse effects. First, there is injury to a domestic industry caused by subsidized imports in the territory of the complaining Member. This is the sole basis for countervailing action. Second, there is serious prejudice. Serious prejudice usually arises as a result of adverse effects (e.g., export displacement) in the market of the subsidizing Member or in a third country market.<sup>8</sup> Thus, unlike injury, it can serve as the basis for a complaint related to harm to a Member's export interests. Third, there is nullification or impairment of benefits accruing under the GATT 1994. Nullification or impairment arises most typically where the improved market access presumed to flow from a bound tariff reduction is undercut by subsidization.

It is interesting to note that the underlying concepts of the ASCM are oriented toward trade in goods and may not in all cases be easily applied to investment incentives, in particular locational incentives. The ASCM is concerned with goods flows, which by definition occur only after the investment has been made. Two areas, "adverse effects" and remedies, illustrate this point. Under the ASCM, adverse effects of subsidization are defined in terms of distortions of trade flows of subsidized goods. That is, the extent to which subsidies increase the level of exports from, or reduce the level of imports into, the subsidizing country, and thereby harm producers of like goods in another country. In the context of investment, because the granting of an incentive generally predates production, often by a considerable period, such an after-the-fact measurement of adverse effects is unlikely to exercise discipline over the provision of investment incentives. A similar issue arises in the context of remedies. By the time production and export activities have commenced, incentives aimed at attracting the investment often will have ended. In this situation, neither a recommendation to withdraw or modify a subsidy, nor the application of a countervailing duty to the exported goods, would be likely to "undo" or to change an investment that already has been made.

The ASCM recognizes three categories of developing country Members: least-developed Members, Members with a GNP per capita of less than \$1000 per year which are listed in Annex

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<sup>8</sup> The ASCM provisions pertaining to "serious prejudice" refer directly to investment incentives. In particular, Annex IV, which provides guidance for calculating whether the total ad valorem rate of subsidization of a product is sufficient to give rise to a presumption of serious prejudice, includes subsidies to firms in "start-up situations", that is where financial commitments have been made for product development or construction of facilities, but where production has not yet begun.

VII to the SCM Agreement, and other developing countries. The first two categories are exempted from the prohibition on export subsidies. Other developing country Members have an eight-year period (by end of 2002) to phase out their export subsidies (and they cannot increase the level of their export subsidies during this period). However, the ASCM provides for the possibility of extending the 8-year time transition period. A Ministerial Decision on this matter was adopted in 2001 providing for a specific procedure for such extension on an annual basis until 2007.

With respect to import-substitution subsidies, LDCs have eight years and other developing country Members five years to phase out such subsidies. There is also more favorable treatment with respect to actionable subsidies. For example, certain subsidies related to developing country Members' privatization programs are not actionable multilaterally.

### **3. The general agreement on trade in services**

The General Agreement on Trade in Services (GATS) subjected one of the most important and fastest growing components of world trade to multilateral disciplines for the first time. Acknowledging one of the defining characteristics of trade in services, namely the frequent need for proximity between suppliers and consumers, hence for commercial presence, the GATS contains the single largest number of investment-related provisions found in the Final Act of the Uruguay Round. Such provisions relate both to matters of investment liberalization and investment protection, albeit with differing degrees of comprehensiveness.

The Agreement rests on three pillars. The first is a framework of obligations, some of which, such as transparency or most-favored nation treatment, are applicable to all Members and all service sectors in a general manner (i.e. as is typically the case for trade in goods under the GATT), while others apply only to those sectors, sub-sectors and sub-sectors listed in a positive manner in Members' schedules of GATS commitments. The second pillar involves national schedules of commitments on market access and national treatment in specific service sectors or modes of supply. These are to be the focus of periodic negotiations aimed at their further liberalization. The third pillar consists of a number of annexes addressing sectoral (financial services, telecommunications, air transport) or horizontal (MFN exemptions, movement of service suppliers) specificities.

The GATS defines trade in services as consisting of four modes of supply, one of which (Mode 3) is the "supply of a service by a service supplier of one member through commercial presence in the territory of another Member". Commercial presence is defined as consisting 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 representative office.

While the definition of commercial presence used in the GATS covers matters relating to both pre and post establishment and applies to both existing and de novo investments, its scope remains significantly narrower than the asset-based definition of investment often encountered in bilateral investment treaties and in the newer generation of regional trade agreements featuring comprehensive investment disciplines (such as the NAFTA).

Determining the ultimate scope of the GATS, including with regard to commercial presence, involves the interplay of a number of parameters. While coverage of the GATS is universal in scope (all services are covered except those supplied in the exercise of governmental authority and the bulk of air transport services), specific commitments on market access and national treatment as well as number of framework disciplines—for instance those pertaining to payments and transfers, apply only to sectors and to modes of supply on terms inscribed in Members' schedules. The scope of the Agreement is further circumscribed by the (one-off and theoretically time-bound) ability of Members to lodge exemptions against the most-favored treatment obligation.

The mode of supply against which the largest number of specific commitments have been undertaken under the GATS, including by developing countries, is that relating to commercial presence. Of relevance from an investment liberalization point of view is the fact that the commercial presence commitments scheduled by Members are linked to complementary commitments under the movement of supplier mode which provide temporary entry privileges to intra-company transferees that are essential to the establishment/operation of a commercial presence (i.e. managers, executives and specialists).

That the GATS has generated a positive liberalization dynamic for investment is perhaps less than fully surprising when one considers the establishment-related nature of much "trade" in services. The decision to schedule commitments by mode of supply may, however have resulted in fewer commitments on the cross-border movement of services and service supplier's by providing Member countries with what could be called an "architectural" incentive to impose on foreign service suppliers TRIM-like requirements to establish a commercial presence as a pre-requisite for supplying services in their territories. A further concern arising from the approach to scheduling used under the GATS relates to transparency. While the scheduling approach yields a fair degree of transparency in sectors subject to specific commitments (hence that are listed positively in Members' schedules and including measures taken at sub-federal level), it provides no information whatsoever on sectors or modes of delivery not inscribed in national schedules. This is yet again a potentially serious architectural shortcoming when one considers the nature and origin of many impediments to trade and investment in services, i.e. regulatory barriers applied at both the national and sub-national level.

The GATS does not enshrine an investor's right to establish a commercial presence. Such presence, instead, is conditioned by the terms inscribed in national schedules. The core investment-liberalizing provisions of the GATS comprise Articles II (Most-Favored-Nation Treatment), XVI (Market Access) and XVII (National Treatment). Of the three, Article II is the only obligation applicable to all Members and to all service sectors. Market Access is not defined under Article XVI. Rather, agreement was reached on six categories of measures, which unless specified in national schedules, are prohibited in principle. These six categories define in effect what is meant by market access under the GATS. Two such categories relate more specifically to commercial presence: (i) those that limit the type of legal entities through which a foreign service supplier may supply a service (e.g. branches vs. subsidiaries) and (ii) those that impose limitations on the level or value of foreign capital participation (e.g. foreign equity limitations). A footnote to Article XVI specifies that where a Member schedules a commitment under the commercial presence mode of supply, it commits itself as well to allowing related transfers of capital into its territory. The article is, however, silent as regards the treatment of capital outflows (such as liquidation proceeds) related to a commercial presence.

National Treatment for foreign service and service suppliers is defined as treatment no less favorable than that accorded to like domestic services and service suppliers. Article XVII(National Treatment) codifies the recognition that such treatment may not always be identical to that applying to domestic firms, so long as it does not worsen the competitive conditions faced by foreign suppliers.

Unlike the TRIMs or TRIPs Agreements, the GATS allows Members to maintain existing non-confirming measures. In sectors where specific commitments are undertaken, such measures must be inscribed in Members' national schedules. Members retain the freedom to adopt new discriminatory measures in sectors that are either not inscribed in their schedules (though on a MFN basis) or in sectors subject to MFN exemptions. The GATS also provides that a foreign service supplier established in a party to an economic integration agreement may benefit from preferential treatment.

The GATS contains both general exceptions (including measures relating to direct taxation and double taxation agreements) and security exceptions similar to those applicable to trade in goods under the GATT. The Agreement foresees future discussions aimed at assessing the need for disciplines on emergency safeguards for services as well as future negotiations on trade-distorting subsidies in the services area. Eleven years of post-Uruguay Round discussions on these issues have yielded little tangible progress to date, suggesting a revealed preference for regulatory inaction on both fronts.

The GATS does not contain provisions dealing directly with matters of investment screening and performance requirements, both of which may be subject to terms and conditions inscribed in national schedules.

The Agreement calls for Members to ensure that monopoly suppliers in their territories behave consistently with their MFN obligations and specific commitments and do not abuse their dominant positions when competing outside their statutory scope. The GATS applies a “substantial business operation” test in determining who qualifies for the Agreement’s benefits and, in the case of commercial presence, focuses as well on ownership (defined as involving more than 50% equity interest) and control (defined as the power to name a majority of directors or to legally direct the actions of an enterprise). The Agreement does not, as such, treat non-controlling foreign minority shareholders as juridical persons of another Member.

The GATS contains fewer and generally weaker provisions relating to matters of investment protection. Disciplines on payments and transfers contained in Article XI are not a general obligation. Under this Article, Members are normally obliged not to restrict international transfers and payments for current transactions in sectors subject to specific commitments, though there are provisions allowing limited restrictions in the event of serious balance-of-payments and external financial difficulties. Where such restrictions are imposed, they would be subject to multilateral surveillance aimed at ensuring that they be applied in a non-discriminatory fashion, be least trade-restrictive in their effects and temporary in nature. Provided a Member does not impose restrictions on capital transactions inconsistently with its specific commitments, the GATS does not affect the rights and obligations of members of the International Monetary Fund under the Articles of Agreement of the Fund.

The GATS contains no provisions relating directly to issues of expropriation and compensation as commonly addressed in bilateral investment treaties and in many regional trade agreements (e.g. provisions dealing with the treatment of foreign investors in cases of expropriation or nationalization, fair-market value compensation, freedom to transfer compensation payments). Nevertheless, compensation through recourse to arbitration aimed at determining compensatory adjustments of equal commercial effect, is foreseen in instances where Members may choose to modify or withdraw a concession under the GATS.

As with the TRIMs Agreement, consultations and the settlement of disputes under the GATS are governed by the WTO's integrated dispute settlement system. Both Agreements provide Members with the right to compensatory adjustments if their benefits are deemed by the WTO's Dispute Settlement Body to have been nullified or impaired.

#### **4. The agreement on trade-related aspects of intellectual property rights**

A consideration of the treatment of intellectual property rights (IPRs) in the Final Act of the Uruguay Round is relevant in assessing the Round's outcome for investment-related matters because provisions aimed at securing and enforcing the protection of IPRs are often embodied in bilateral investment treaties. While the Agreement on Trade-Related Aspects of Intellectual

Property Rights (TRIPs Agreement) contains no provisions addressing directly the treatment of investment, it is widely regarded as a strong, rules-based, agreement likely to generate positive investment protection externalities. The Agreement, indeed, significantly enhances the protection (including through coverage under the WTO dispute settlement system) afforded to firms investing in, producing and trading research- and intellectual property goods and services.

The Agreement recognizes that widely varying standards in the protection and enforcement of intellectual property rights and the lack of a multilateral framework of principles, rules and disciplines dealing with trade in counterfeit goods have been a growing source of tension in international economic relations. The Agreement may also be viewed as a recognition of the fact that the strength or weakness of a country's system of intellectual property protection may have a substantial effect on the kinds of technology likely to be transferred by internationally-active firms, hence be a potentially important determinant of the composition and extent of foreign direct investment.

The TRIPs Agreement addresses five core issues: (i) the applicability of GATT principles (e.g. national treatment, most-favoured-nation treatment) and those of relevant international intellectual property agreements; (ii) the provision of intellectual property rights for copyright, trademarks and service marks, geographical indications, industrial designs, patents, layout designs for integrated circuits, trade secrets, as well as consultations between governments concerning anti-competitive practices in contractual licenses; (iii) procedures and remedies under the domestic laws of Members to ensure that IPRs can be effectively enforced by foreign and national right holders; (iv) provisions for multilateral dispute settlement under the WTO's integrated consultation and arbitration mechanism; and (v) transitional arrangements to phase in the Agreement in accordance with Members' levels of economic development (one year from entry into force of the Agreement Establishing the WTO for developed countries, five years for developing countries and countries in transition, and eleven years for least developed countries.)

## 5. The dispute settlement understanding

As with the TRIPs Agreement, the provisions contained in the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) do not focus specifically on investment related matters. Rather, the DSU is generic in nature and applies to all areas covered by WTO rules, including all investment-related matters subject to Final Act disciplines. Among the central innovations made to the WTO's integrated system for consultations and dispute settlement in the Uruguay Round are: (i) the automatic adoption of panel reports (unless there is a consensus to do so, Members cannot block findings against them (negative consensus)); (ii) the possibility of requesting the review of a panel report by an Appellate Review Body (whose findings are final and binding on Members unless there is a negative consensus; (iii) the possibility of cross-sectoral retaliation (e.g. a Member can take action in the goods area for a violation of the GATS); and (iv) the requirement for Members to establish what the "reasonable time for implementation" will be, which should result in the prompt implementation of panel recommendations.

The stages of dispute settlement foreseen under the DSU are: (i) consultations between Members (i.e. state to state arbitration); (ii) establishment of a panel; (iii) first and second panel hearings based on the exchange of written submissions, (iv) circulation and adoption of the panel report; and (v) on request, review by the Appellate Body. Each stage of the procedure for settling disputes is subject to strict time limits. Such a procedure is not to exceed six to nine months (or twelve months in case of appeal). Failure to comply with panel recommendations provides aggrieved Members with the right to request the imposition (subject to the authorization of Contracting Parties) of commensurate (i.e. commercially "equivalent") trade sanctions. Unless otherwise specified, the DSU allows for retaliation across sectors and areas subject to WTO

discipline. The Final Act of the Uruguay Round contains no provisions allowing for private party (e.g. investor-state) recourse to multilateral dispute settlement, a common feature of bilateral investment treaties and of newer generation regional integration agreements featuring comprehensive investment disciplines.

## **A. Assessing the WTO's treatment of investment**

As the foregoing sections show, the WTO already features a rich harvest of investment-related provisions. This may come as a surprise in light of the determined attempt of many GATT members to eschew a meaningful discussion of investment matters at the outset of the Uruguay Round. That the Marrakesh Agreement establishing the WTO contains as many investment-related provisions -most notably in the TRIMs Agreement and, particularly in the GATS- must be ascribed to the rapidly changing policy environment within which the Uruguay Round took place.

This fertile environment, characterized by a number of far-reaching changes in policy and rule-making approaches which gained currency in a growing number of developed and developing countries, was one the multilateral trading system was able to internalize (if only partially) by the time the Uruguay Round was completed. Among such changes are: (i) a growing recognition of the increasingly complementary relationship between trade and investment in a globalising world economy; (ii) heightened awareness, particularly among developing countries, of the policy signaling benefits to be derived by credible commitments in the areas of trade, investment, and intellectual property protection; (iii) a greater appreciation of the key contribution of services to promoting economy-wide efficiency gains and the central role played by investment as the principle means of securing market access and enhancing the contestability of markets; and (iv) a significant worldwide push towards investment regime liberalisation, often pursued on a unilateral basis and closely tied to efforts aimed at regulatory reform in key sectors (many of which key service sectors such as energy, telecommunications, finance and transportation services).

While the Uruguay Round has set an important precedent by laying down markers with which to develop more comprehensive rules on investment, the limitations of existing provisions must at the same time be borne in mind. For one, the TRIMs Agreement remains extremely limited in scope and is largely attuned to the concerns of an era of policy-making characterized more by suspicion of -and the need to control—foreign investment than by keenness to compete for and attract such investment. WTO rules on investment remain unbalanced given the asymmetry of disciplines applying to performance requirements—the incidence of which tends to fall primarily on developing countries, as opposed to weak disciplines governing the distortive practice of investment incentives, the incidence of which tends to be greater among developed countries.

Moreover, while the GATS negotiations have brought out quite vividly the central importance of investment to trade in services and generated far more by way of commercial presence commitments than had been expected, its treatment of investment-related matters is embodied in provisions that display a number of architectural shortcomings. The latter lack definitional clarity, do not generate adequate transparency; generate limited pressures for liberalization; and afford weak and only indirect protection to investors.

Much, therefore, remains to be done to equip the multilateral trading system with a comprehensive panoply of investment disciplines, and it comes as no surprise that attempts would be made in the post-Uruguay Round era to address such shortcomings. Yet, despite the continued improvements in host country investment climates and policy regimes, attempts at crafting a comprehensive set of multilateral disciplines on investment have met with very limited success. We revert to this policy paradox in this paper's closing section.

## **II. Scope and content of bilateral and regional agreements**

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### **A. Bilateral investment treaties**

Starting in the 1960s, bilateral investment treaties (BITs) have become the most common international instrument dealing with investment protection issues. The number of such treaties has grown manifold, a trend that now engulfs countries at all levels of development. The number of signed BITs stands at some 2300, although only about 1700 are actually in force. The network of BITs grew significantly throughout the 1970s, prompted in large measure by a defensive impulse on the part of home (i.e. capital-exporting) country governments in the wake of the increasing number of expropriations and nationalizations, including in Latin America.

The trend accelerated anew in the 1990s, albeit in a markedly changed policy (and ideological environment), as host country (i.e. capital-importing) governments in developing countries and transition countries sought to exploit the putative signaling properties of BITs. The period saw a significant increase in treaties linking a wider range of country along south-north lines as well, most recently, along south-south lines.

BITs are designed to protect, promote and facilitate foreign investment and constitute to date the most widely used instrument for these purposes. BITs have traditionally been negotiated between developing countries seeking to attract international investment and developed countries as the principal homes to foreign investors.

Developing countries, as hosts to FDI, concluded BITs in order to create a favorable investment climate and in some cases to become eligible to participate in political risk insurance programs run by capital-exporting countries.

The content of BITs has become increasingly standardized over the years and has largely influenced rule-making at the regional level, particularly during the last fifteen years, even if as a consequence of the growth in the sheer number of BITs, the formulation of individual provisions remains rather varied.

There are notable differences between the provisions of BITs signed some decades ago and the more recent ones. A typical BIT's main provisions deal with the scope and definition of foreign investment; admission of investments; national and most-favored-nation treatment; fair and equitable treatment; guarantees and compensation in respect of expropriation; guarantees of free transfer of funds and repatriation of capital and profits; and dispute-settlement provisions, both state-to-state and investor-to-state. The acceptability of investor-state arbitration was significantly advanced by the conclusion in 1965 of the Washington Convention, overturning the practice of sovereign immunity long embedded in the Calvo doctrine.

As noted earlier, perhaps the most relevant new development in international practice of the last few years is the frequency with which developing countries and countries in transition are concluding agreements with each other. In content terms, it bears noting that South-South practice does not depart significantly from the content of BITs concluded along North-South lines.

From an economic perspective, the capital-importing country activism in concluding BITs underscores the keen interest that developing and transition economies have in creating a domestic environment that is conducive to greater FDI inflows. Indeed, the policy and regulatory environment of developing countries plays an important role both in attracting (or discouraging) investment flows and in ensuring that the ensuing benefits are maximized and costs minimized. By contributing to the creation of an investment-friendly regulatory environment and by committing (or signalling a reinforced commitment) to high standards of protection for foreign investment, BITs are generally held to play a positive —albeit limited— role in the promotion of FDI flows and thus to contribute to the economic development of the host country.<sup>9</sup> This of course in as far as FDI can be harnessed to contribute to the realization of the specific development objectives that each individual country has set for itself, while minimizing any attendant costs that the presence of FDI may entail.

However, BITs remain primarily, if not exclusively, investment protection instruments. Over the years there has not been any significant change from their original objectives. It is thus still true that, “a striking feature of BITs 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.”<sup>10</sup>

## 1. Preamble

The preamble, which generally introduces the substantive provisions of BITs, states the objectives of the agreement as mainly referring to economic cooperation between the parties, the importance of foreign investment for economic development and the need to protect such investment.<sup>11</sup> See, e.g., the preamble of the 1992 BIT between Argentina and the Netherlands:

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<sup>9</sup> See M. Hallward-Driemeier (2003), “Do Bilateral Investment Treaties Attract FDI? Only a bit ...and they may bite”, World Bank Policy Research Paper No. 3121, Washington, DC: World Bank.

<sup>10</sup> See P. Robinson, “Criteria to test the development friendliness of international investment agreements”, in *Transnational Corporations*, vol. 7, no.1, April 1998, at p. 84.

<sup>11</sup> See, e.g., the preamble of the 1992 BIT between Argentina and the Netherlands: “... Desiring to strengthen the traditional ties of friendship between their countries, to extend and intensify the economic relations between them, particularly with respect to

“... Desiring to strengthen the traditional ties of friendship between their countries, to extend and intensify the economic relations between them, particularly with respect to investments by the investors of one Contracting Party in the territory of the other Contracting Party. Recognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment of investments is desirable ...”. In US practice, including with Latin American countries, preambles also include references to the protection of health, safety, and the environment, as well as the promotion of internationally recognized labour rights. The title of BITs, which generally mention both promotion (or encouragement) and protection of investment, and their preamble, while not directly creating rights and obligations, are important interpretative tools of any international agreement.

## 2. Scope of application

The main objective of BITs is to protect investment made by investors of one party in the territory of the other party. In order to widen such protection, in current BITs practice there is a marked tendency to use broad, asset-based, definitions of “investment” which include movable and immovable property, intellectual property, as well as equity and other interest in companies.

Most BITs do not distinguish between foreign direct and portfolio investment. Both minority and controlling interests are generally protected.<sup>12</sup> Furthermore, a broad definition may cover new forms of investment that parties did not consider specifically at the time of negotiation.

Some BITs specify that the afforded protection is conditional on the investment being made in accordance with local laws and regulations. This may allow host countries to confine the application of BITs to investment that respond to the country’s policy objectives as embodied in domestic laws and regulations. The same result can and often is pursued through the provisions on admission of investment.

With respect to natural persons, most BITs give protection to persons who are “nationals” of each of the contracting countries concerned. The general practice is then to provide that a natural person possesses the nationality of a State if the law of that State so provides.<sup>13</sup> With regard to legal persons, BITs generally take an expansive approach in terms of the kinds of entities that are meant to be covered. Many treaties, in defining the term “investor” or “investment” or “company”, include legal persons constituted under the law of a party, thus covering companies, as well as other legal entities.<sup>14</sup>

BITs extend protection to companies that are deemed to have the nationality of one of the signatories. Problems arise because in most cases, and increasingly with the spread of multinational

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investments by the investors of one Contracting Party in the territory of the other Contracting Party. Recognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment of investments is desirable ...”.

<sup>12</sup> The US treaty practice provides for an extensive coverage. See, e.g. Art I of the 1991 Treaty between the United States of America and the Argentine Republic concerning the Encouragement and Reciprocal Protection of Investment: “...1. For the purposes of this Treaty, a) “investment” means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes without limitation: (i) tangible and intangible property, including rights, such as mortgages, liens and pledges; (ii) a company or shares of stock or other interests in a company or interests in the assets thereof; (iii) a claim to money or a claim to performance having economic value and directly related to an investment; (iv) intellectual property which includes, inter alia, rights relating to: literary and artistic works, including sound recordings, inventions in all fields of human endeavor, industrial designs, semiconductor mask works, trade secrets, know-how, and confidential business information, and trademarks, service marks, and trade names; and (v) any right conferred by law or contract, and any licenses and permits pursuant to law; ...”

<sup>13</sup> For instance, the 1992 BIT between Argentina and the Netherlands refers, with regard to either Contracting Party, to “natural persons having the nationality of that Contracting Party in accordance with its law.” (Art. 1 (b)(i)).

<sup>14</sup> See, e.g. Art I of the 1991 US-Argentina BIT: “ ... b) “company” of a Party means any kind of corporation, company, association, state enterprise, or other organization, legally constituted under the laws and regulations of a Party or a political subdivision thereof whether or not organized for pecuniary gain, and whether privately or governmentally owned; ...”.

corporations and international production networks, places of incorporation, the location of business activities and/or the nationality of ownership and control often involve multiple jurisdictions. In most instances a multinational corporation operates in a host state through a subsidiary incorporated therein. Such a subsidiary acquires the nationality of the host state and could not avail itself of the diplomatic protection of its home state. A multinational corporation could also choose to do business through an entity incorporated in a third state, whose corporations may not be entitled to the same treatment as the home state companies in the host state.

BITs have in recent years tried to respond to these complications, often by combining the traditional nationality tests or criteria, namely the place of incorporation; the location of the “seat” of the corporation (sometimes referred to as the *siège social*, real seat, or the principal place of management); and the nationality of the shareholders who own or control the corporation. The place of incorporation, organization or constitution of a company is a widely used criteria to determine nationality thanks to its ease of application.<sup>15</sup>

However, if used in isolation, such a test lends itself to granting nationality to a company that has only a formal link with the country of incorporation and does not engage in any substantial or real economic activity there. Indeed, the place of incorporation could be chosen exclusively to enjoy treaty advantages reserved to nationals of signatories.

Such a situation has prompted two main types of responses. Some BITs combine the place of incorporation test with criteria focusing on a company’s “seat”. This test attributes the nationality of the place where the *siège social* is located. The “seat of a company” often refers to the place of effective management decision-making, and as such, while more difficult to determine, reflects a more significant economic relationship between the corporation and the country granting nationality.<sup>16</sup> Other BITs instead include a denial of benefits clause meant to prevent, under certain circumstances, nationals of third countries from obtaining BIT treatment by incorporating in one of the signatory countries. This approach is typical in the practice of the United States.<sup>17</sup>

The country of ownership or control is the most difficult test to administer, but also the most significant in terms of the economic links it presupposes between the company and the country of nationality. It is especially complex in case of public companies whose shares are traded in (potentially several different) stock exchanges. In such cases, the nationality of the owner or of the controlling investor may change quite frequently or easily. This is why the ownership or control test is often employed in conjunction with one of the other two main criteria. According to such a test, the subsidiary, albeit incorporated in the host country, is considered for the purpose of the treaty a foreign national. It acquires the nationality of the parent company.<sup>18</sup> The terms “ownership”

<sup>15</sup> For instance, the 1996 Foreign Investment Protection Agreement (FIPA) between Canada and Panama provides that an investor means: “In the case of Canada: ... ii. any enterprise incorporated or duly constituted in accordance with applicable laws of Canada ... In the case of the Republic of Panama: ... ii. any enterprise incorporated or duly constituted in conformity with the laws of the Republic of Panama.” (See Art. I.h).

<sup>16</sup> For instance, the 1992 BITs between Argentina and the Netherlands considers investors of either Contracting Party “legal persons constituted under the law of that Contracting Party and actually doing business under the laws in force in any part of the territory of that Contracting Party in which a place of effective management is situated.” See Art.1 (b) (ii). A similar approach can be found in the 1993 Venezuela-Argentina BIT, which provides, at Art. 1.1, that “*El término ‘inversor’ designa: (a) toda persona jurídica constituida de conformidad con las leyes y reglamentaciones de una Parte Contratante y que tenga su sede en el territorio de dicha Parte Contratante ...*”.

<sup>17</sup> For instance, the 1995 Honduras-U.S. BIT provides that “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 has no substantial business activities in the territory of the Party under whose laws it is constituted or organized.” (See Art. XII).

<sup>18</sup> For instance, the 1999 BIT between Costa Rica and the Netherlands defines the term “nationals” as comprising “with regard to either Contracting Party the following subjects: ... (ii) legal persons constituted under the law of that Contracting Party which have their seat or domicile in the territory of that Contracting Party; (iii) legal persons constituted under the law of the other Contracting Party but controlled, directly or indirectly, by natural persons as defined in (i) or by legal persons as defined in (ii) above.” (See Art. 1 (b)).

or “control” are not commonly defined in BITs. Some treaties, however, do so in a Protocol.<sup>19</sup>

### 3. Admission and promotion of investment

Under customary international law states have the sovereign right to regulate and prohibit the admission of investment and investors in their territory, in line with their right to admit or not aliens. Current BIT practice follows this approach. Only few BITs confer any right of establishment to investors. In general, treaty protection only comes into play after the investment has been admitted, i.e. in the post-establishment phase. With regard to admission, consolidated BITs practice refers to the need to admit investment in accordance with the laws and regulations of the host country. This may mean that admission can be subject to the fulfilment of special conditions, such as the training of local personnel or the reinvestment of profits.

In parallel most BITs stress, with various formulations, the importance of facilitating or encouraging investment, creating favourable conditions and the like. Other areas that are often mentioned in ‘best endeavour’ terms or subject to domestic legislation, include: the exchange of information on investment opportunities, the dissemination of laws and regulations affecting investment, consultation mechanisms, the granting of work permits to key and technical personnel.

On the other hand, current US and Canadian practice goes beyond the above norms, providing that host countries grant the better of MFN and national treatment with regard to entry and establishment.<sup>20</sup> This right is qualified by an exhaustive list of exceptions usually on a sectoral basis to safeguard interests in specific and sensitive areas.<sup>21</sup> This means that, subject to exceptions agreed to in the treaty, host countries have to treat, with respect to admission, potential investors in the same manner as they treat their own national investors or those from other countries. As a result, prospective investors would also have access to the dispute settlement provisions contained in the BIT with regard to disputes over admission or denial thereof.

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<sup>19</sup> See the 1993 Annex of the Venezuela-Argentina BIT, where it says that with regard to effective control “... *las personas jurídicas que deseen invocar el presente Acuerdo podrían ser obligadas a proporcionar la prueba de dicho control. Serán aceptados entre otros, a título de prueba, los hechos siguientes: 1. El carácter de filial de una persona jurídica de una de las Partes Contratantes. 2. Un porcentaje de participación en el capital de una persona jurídica que permita un control efectivo, tal como en particular, una participación superior a la mitad del capital. 3. La posesión directa o indirecta de derechos de voto, que permitan tener una posición determinante en los órganos directivos de la persona jurídica o influir de otro modo de manera decisiva sobre su funcionamiento.*”

<sup>20</sup> In this respect for instance the 1995 US-Honduras BIT reads at Art. II: “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”).”

<sup>21</sup> See, for instance, the 1995 US-Honduras BIT, which following earlier US practice, provides in the Annex: “1. The Government of the United States of America may adopt or maintain exceptions to the obligation to accord national treatment to covered investments in the sectors or with respect to the matters specified below: atomic energy; customhouse brokers; licenses for broadcast, common carrier, or aeronautical radio stations; COMSAT; subsidies or grants, including government-supported loans, guarantees and insurance; state and local measures exempt from Article 1102 of the North American Free Trade Agreement pursuant to Article 1108 thereof; and landing of submarine cables. Most favored nation treatment shall be accorded in the sectors and matters indicated above. 2. The Government of the United States of America may adopt or maintain exceptions to the obligation to accord national and most favored nation treatment to covered investments in the sectors or with respect to the matters specified below: fisheries; air and maritime transport, and related activities. 3. The Government of the United States of America may adopt or maintain exceptions to the obligation to accord national and most favored nation treatment to covered investments, provided that the exceptions do not result in treatment under this Treaty less favorable than the treatment that the Government of the United States of America has undertaken to accord in the North American Free Trade Agreement with respect to another party to that Agreement, in the sectors or with respect to the matters specified below: banking, insurance, securities, and other financial services. 4. The Government of Honduras may adopt or maintain exceptions to the obligation to accord national treatment to covered investments in the sectors or with respect to the matters specified below: properties on cays, reefs, rocks, shoals or sandbanks or on islands or on any property located within 40 km of the coastline or land borders of Honduras; small scale industry and commerce with total invested capital of no more than US\$ 40,000 or its equivalents in national currency; ownership, operation and editorial control of broadcast radio and television; ownership, operation and editorial control of general interest periodicals and newspapers published in Honduras. Most favored nation treatment shall be accorded in the sectors and matters indicated above. 5. Each Party agrees to accord national treatment to covered investments in the following sectors: leasing of minerals or pipeline rights-of-way on government lands.”

With the exception of the United States and Canada, the general BIT practice (for instance within the European Union) is for treaties not to have any specific impact in terms of the liberalisation of the entry regime for foreign investment. It leaves liberalisation entirely up to the autonomous decision of the host country as set out in its domestic regulation. For their part, the US and Canadian approaches allow for the reciprocal exchange of concessions through the granting of national and MFN treatment, subject to negotiated exceptions.

#### 4. Standards of treatment

In addition to any admission standards, BITs provide for a series of standards of treatment once the investment has been established. In current practice various formulations are used. Many BITs explicitly provide that the host country is to afford investments covered by the treaty with treatment no less favourable than that required by international law. More specifically, many BITs also refer to “fair and equitable treatment”, “full protection and security”, “prohibition of arbitrary and discriminatory measures” and the like. All these are minimum standards of treatment provided under international law. While their content is generally not defined, they may be used in conjunction with other standards and their meaning may need to be determined in the light of the specific circumstances of application.

The notion of fair and equitable treatment appears to be aimed at ensuring the prudent and just application of legal rules (even in the absence of discrimination) and can also provide an auxiliary element for the interpretation of other provisions and for filling gaps in a treaty. The full protection and security standard, or any of the various variations thereof (e.g. “the most constant protection and security”), aims at ensuring that—in line with due diligence—host countries exercise reasonable care to protect investments against injury caused by private parties as well as a result of public action.<sup>22</sup> The prohibition of arbitrary and discriminatory measures refers to the prohibition of actions against foreign investors in general or specific groups of foreign investors.<sup>23</sup> Some BITs include only general language to this effect, while others specify commitments both with regard to most-favoured nation treatment (MFN) and national treatment (NT).

MFN treatment implies that investors and investments of one party will not be treated less favourably in the other party than any third party investor or investment. Thus with regard to post-establishment treatment (once admission has been granted), the MFN provision links the existing BITs concluded by any one country in a network and has the effect of ratcheting up the treatment of all treaty partners’ investors and investments to the highest agreed denominator.

National treatment ensures that the investors and investments of one party will receive from the host party treatment no less favourable than the treatment given to investors and investment of host party.

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<sup>22</sup> Since 2001 there has been an attempt to circumscribe the concepts in order to avoid expansive constructions in the course of arbitration proceedings. Fears of this kind had arisen as a result of several NAFTA dispute settlement cases. The 2004 US model BIT in a way similar to the most recent investment chapters in US FTAs reads: “Article 5: Minimum Standard of Treatment 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. ...”

<sup>23</sup> For instance, the 1992 BIT between the Netherlands and Argentina states at Art. 3: “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. ...”

The coverage of the MFN and NT obligations may also vary depending on whether both investment and investors (or similar terms) are covered. Some qualifications are also added in a number of cases to limit the applications of MFN and NT to investment in “similar” or “like” circumstances. General exceptions relating to public order and national security frequently apply.

Current BIT practice also often excludes from the operation of the MFN clause special privileges granted as a result of regional integration agreements, such as customs unions and free trade areas, and of other bilateral agreements, such as double taxation treaties.<sup>24</sup> Specific exemptions may also be recorded under BITs on a sectoral basis, as recalled above in connection with the US and Canadian practice of extending the better of MFN and NT also to the pre-establishment phase.

As a part of their economic policies, many countries (particularly developing countries) use a wide array of performance requirements either as mandatory conditions for admission or operation of the investment or as voluntary conditions linked to the granting of investment incentives. These may take the form of domestic content requirements and domestic purchase preferences, the “balancing” of imports or sales in relation to exports or foreign exchange earnings, requirements to export products or services, technology transfer requirements, and requirements relating to the conduct of research and development in the host country. Unlike the WTO or the most recent crop of regional trade agreements featuring investment disciplines (see the section below), most BITs do not explicitly restrict the use of performance requirements.

Current US and Canadian practice, with some other examples, departs from this approach and includes a prohibition on performance requirements as a condition of establishing, expanding or maintaining an investment project.<sup>25</sup> The prohibition of performance requirements does not preclude the granting of incentives as an inducement to agree to abide by performance requirements. Any such incentives, however, may be subject to the MFN obligation and thus would have to be offered to all investors covered by BITs including an MFN clause. This would also apply to incentives granted by other BIT partners, unless specifically exempted.<sup>26</sup> However, if the incentive were offered before establishment (e.g. a so-called locational incentive), what is mentioned above with regard to the non-application of NT would also seem to apply.

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<sup>24</sup> See, e.g., the 1994 Jamaica-Argentina BIT, Article 3 (Protection of Investments): “... 2. Each Contracting Party, once it has admitted investments in its territory by investors of the other Contracting Party shall grant full legal protection to such investments and shall accord them treatment which is no less favourable than that accorded to investments by its own investors or by investors of third States. 3. Notwithstanding the provisions of Paragraph 2), of this Article, the treatment of the most favoured nation shall not apply to privileges which either Contracting Party accords to investors of a third State because of its membership in, or association with a free trade area, customs union, common market or regional agreement. 4. The provisions of Paragraph 2) of this Article shall not be construed so as to oblige one Contracting Party to extend to investors of the other contracting Party the benefit of any treatment, preference or privilege resulting from an international agreement relating wholly or mainly to taxation. ...”

<sup>25</sup> For instance, the 1995 US-Honduras BIT provides at Art. VI: “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 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.”

<sup>26</sup> See, e.g., the 1987 BIT between Jamaica and the United Kingdom, Article 3: “... (3) Special incentives granted by one Contracting Party only to its nationals and companies in order to stimulate the creation of local industries are considered compatible with this Article [providing for NT] provided they do not significantly affect the investment and activities of nationals and companies of the other Contracting Party in connection with an investment.”

## 5. Expropriation

In the 1960s and 1970's many developed countries initiated BITs as a way to protect their investments abroad against the growing risk of expropriation, a risk that has greatly subsided in recent years. In current practice, the terms "expropriation" or "nationalization" are generally left undefined in BITs, so that relevant treaty provisions typically apply to actions by a country that substantially impair the value of an investment, regardless of whether they amount to an isolated event or whether they are part of a major structural reform of the economy. Many BITs include broad language, covering measures "tantamount" or "equivalent" to expropriation. Hence, most BITs also apply the expropriation provisions to "indirect expropriations", namely, when the host country takes an action that substantially impairs the value of an investment without necessarily assuming ownership of the investment. Furthermore, most BITs are also understood to apply the expropriation provision to "creeping expropriations". This refers to an expropriation carried out by a series of legitimate regulatory acts over a period of time, whose ultimate effect is to destroy substantially the value of an investment. However, the demarcation between actions that would qualify as illegitimate expropriation as opposed to legitimate policy decisions is obviously difficult to establish and open to dispute, as a growing body of case law under various arbitral mechanism has shown in recent years.

BITs impose certain conditions on expropriation if it is to be considered lawful. This follows general international law, where there is no rule that would bar expropriation of alien property provided that such action is undertaken for a public purpose, in a non-discriminatory manner, in accordance with due process of law and upon prompt payment of compensation. All these conditions are generally stipulated in typical BITs. Thus if a direct or indirect expropriation takes place, compensation is due.

Many disputes have revolved around the amount and modalities of such compensation. The large majority of BITs use the traditional rule that such compensation must be "prompt, adequate and effective" or some variation thereof. Adequacy generally refers to the investment's "market value", "fair market value" or "genuine value" before the expropriation took place and not considering any decrease in value because of the expropriation plans. Unless the value can be determined making recourse to stock exchange valuations, for specific investment projects, e.g. in mining or manufacturing, the present value of expected future earning or the actual funds invested in the enterprise may need to be considered.

The requirement of prompt compensation does not mean immediate payment but indicates, as often explicitly set out in many BITs, that interests accrue from the date of expropriation. Finally, the term "effective" tends to refer to compensation made in freely usable and transferable currencies (or some other financial instruments).

In case of other breaches of obligations, such as NT, MFN or other minimum standards of treatment, no comparable criteria for compensation are generally set out in BITs. With regard to cases of destruction of property due to war and civil disturbances, if some form of compensation is required, for instance in case of negligence, some BITs require that MFN (and sometime also for NT) is applied.

## 6. Transfer of funds

Provisions on the transfer of payments are quite important as they concern a key aspect on which the interests of the host country and the foreign investor may differ. Host countries often prefer that profit be reinvested or otherwise used in the domestic economy. Furthermore, developing countries often incur balance-of-payments difficulties that sudden repatriation of large profits or the proceeds from a sale or a liquidation can worsen. As a result, host countries generally

seek some form of flexibility. However, foreign investors regard the timely transfer of income, capital and other payments as an indispensable requirement to operate and benefit from their investment projects, and to meet their obligations vis-à-vis shareholders, contractors, creditors or licensors.

Virtually every BIT has a provision on the transfer of payments, but there are important differences among them as regards the specific wording of relevant provisions. With regard to the categories of transfers covered, BITs generally address the repatriation of the capital invested, the transfer of returns generated by an investment and dividends to the investor's shareholders, current payments made in relation to an investment (i.e. amounts that may be needed to pay current expenses, the interest and principal on loans, or other obligations incurred by the investor, such as royalties), and proceeds from the sale of all or part of the investment.

Two main approaches are commonly used. The first is to guarantee the free transfer of all payments related to, or in connection with, an investment, accompanied by an illustrative list of covered payments. The second approach is simply to include an exhaustive list the types of payments covered by the transfer provisions. BITs typically guarantee to investors the possibility to transfer payments in a freely convertible currency, without delay and at a specified exchange rate (the official rate, the market rate or some other). Exceptions generally allow for some limited delay in cases of emergencies, such as in cases of insufficient foreign currency reserves. However, exceptions are to be administered on a non-discriminatory basis. In some instances, transfer guarantees are limited by the explicit application of exchange control laws of the host country.

## 7. Dispute resolution

Investment disputes under BITs may involve disputes between one State and investors of the other State, or between the two States parties to the treaty. These are addressed by different provisions. Disputes between purely private parties are normally resolved through recourse to the courts of the State that has jurisdiction, or through commercial arbitration.

With regard to disputes between one party, generally the host country, and investors of the other party, current BIT practice provides for recourse to agreed third-party dispute-settlement mechanisms: consultation and negotiation but above all arbitration. This allows the investors to avoid submitting the disputes to the courts of the host state (which could be perceived as biased) or to ask for the diplomatic protection of its home state. Only a very few BITs require that the investor exhaust local remedies before resorting to arbitration. The advantage of arbitration is that the dispute is handled in an international legal forum, generally removed from political interference and able to deliver a relatively speedy resolution. The methods for resolving disputes between States parties to BITs involving the application or interpretation of the treaty are also typically spelled out in a number of provisions in BITs.

While the provisions regarding State-to-State disputes are generally rather short, calling for ad hoc arbitration in case consultations fail, most BITs contain rather elaborate provisions on the settlement of disputes between an investor and the host country (so-called investor-state disputes). These relate to the composition of an arbitration panel, timeframes, arbitrable disputes, and procedural rules.<sup>27</sup> While current practice contains several variations, the general trend is to give

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<sup>27</sup> Dispute settlement rules are particularly articulated in US practice. For an example of a more concise provision, see, e.g., the 1994 Argentina-Jamaica BIT, Article 9 (Settlement of Disputes Between an Investor and the Host Contracting Party): "1. Any dispute which arises within the terms of this Agreement concerning an investment between an investor of one Contracting Party and 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 to: a. the competent, tribunal of the Contracting Party in whose territory the investment was made, or b. international arbitration according to the provisions of Paragraph 3). 3. Where a dispute has been raised by the investor and the Parties disagree as to the choice of (a) or (b), the opinion of the investor shall prevail. 4. Pursuant to Paragraphs 2) and 3), where an investor or a Contracting Party has submitted a dispute to the aforementioned

investors a choice of arbitral mechanisms through institutions, such the World Bank's International Center for the Settlement of Investment Disputes (ICSID) and its affiliated Additional Facility (for host countries which are not party to the Washington Convention),<sup>28</sup> the International Chamber of Commerce or the various regional arbitration centers, or through reference to other arbitral rules, such as those established by UNCITRAL.

The inclusion in BITs of these various options to conduct arbitration is generally regarded as an expression of consent to arbitration on the part of the host state. Such consent is expressly stated in some cases, such as in US practice. Investors have to provide their own written consent to arbitration. Arbitration awards are then binding on the parties. Arbitration proceedings are confidential, while awards are often published. Participation of *amici curiae* is normally not allowed. Enforcement is usually carried out on the basis of the provisions of the New York Convention.<sup>29</sup>

## B. Investment rules in regional integration agreements

The universe of regional instruments on investment does not reach the proportion of the BIT phenomenon, but is still vast, diverse and growing. As such, regional agreements have also begun to create an intricate web of overlapping commitments. While BITs have a distinct focus on investment protection, regional (and inter-regional) integration agreements (RIAs) are often geared towards investment regime liberalization even though an important number of them also address investment protection issues. In the case of EU RIAs the focus on liberalization is particularly pronounced as core investment protection issues are not within Community competence and are generally addressed in BITs concluded by individual EU Member States.

At the regional level, only a few instruments are entirely devoted to investment, such as the Andean Community's Decision 291 (adopted in 1991). However, a growing number of regional trade agreements have in recent years embedded what are often (and increasingly) comprehensive disciplines on investment. The NAFTA and the MERCOSUR Protocols (albeit less comprehensively and still subject to ratification shortcomings) are examples of such trends.

The general aim of these agreements is to create a more favorable investment climate also through liberalization measures, with a view to increasing the flow of investment within or between regions. As a result, the commonality across the substantive rules is much less marked than in the case of BITs.

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competent tribunal of the Contracting Party where the investment has been made or to international arbitration, this choice shall be final. 5. In case of international arbitration, the dispute shall be submitted either to: 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 D.C. on 18th March, 1965, once both Contracting Parties herein become members thereof. As far as this provision is not compiled with, each Contracting Party consents that the dispute be submitted to arbitration under the regulations of the ICSID Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding Proceedings, or b. an arbitration tribunal set up from case to case in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). 6. If after a period of three months following written notification of the submission of the dispute to arbitration there is not agreement on the selection of a forum under Section 5 (a) or Section 5 (b), the parties to the dispute shall be bound to submit it to the International Centre for the Settlement of Investment Disputes. 7. The arbitration tribunal shall decide in accordance with the provisions of this Agreement, the laws of the Contracting Party involved in the dispute, including its rules on conflict of law, the terms of any specific agreement concluded in relation to such an investment and the relevant principles of international law. 8. The arbitral decisions shall be final and binding for the Parties in the dispute. Each Contracting Party shall execute them in accordance with its laws."

<sup>28</sup> The number of arbitration cases invoking dispute settlement provisions contained in BITs has significantly increased in recent years. For instance, in the period 1 January 2004-30 June 2005 among the 39 new cases instituted before ICSID, 31 relied on BITs dispute settlement provisions. The majority of the cases pending before the Centre (currently 104) involve Western Hemisphere countries.

<sup>29</sup> UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.

Latin American countries have been among the most active pursuing such regional trade agreements, which since the NAFTA typically include investment rules geared towards the twin pursuit of investment protection and liberalization.

Until recently, the US and the European Union represented the most important regional partners as hubs. However, there is now also a growing interest to look towards Asia. In 2004, Mexico concluded the first FTA between Japan and a Latin American country.<sup>30</sup> Chile and China have just completed talks on a free trade agreement; Panama has entered into an agreement with Chinese Taipei, and both Japan, Korea and China are actively considering new integration agreements or means of enhanced economic cooperation, including in the investment field, with Latin American partners.

## 1. Scope and definition

As with the case of BITs, the definitions of terms such as “investment”, “investor”, “control”, “foreign investment” and other related concepts are particularly important as they determine the object to which an instrument’s provisions apply and the scope of their applicability. The manner in which regional instruments deal with such definitions depends primarily on the scope and purpose of each instrument. Instruments oriented towards investment protection tend to have broad and inclusive definitions. Instruments geared towards liberalization at times use relatively narrower definitions of investment, more focused on FDI (and at the exclusion of portfolio investment). For instance, Decision 291 of the Commission of the Cartagena Agreement covers FDI only. Article 45 of the FTA reached in 2000 between EFTA States and Mexico explicitly considers investment to mean “direct investment, which is defined as investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof.”

However, the 1994 North American Free Trade Agreement (NAFTA), which aims at both the protection and liberalization of investment, contains a definition of “Investment” in Article 1139 based on a broad list of assets along with a negative list of certain claims to money, including claims arising from commercial transactions, which are not considered to be investments. The same is true for those agreements that follow the NAFTA approach to liberalization (see below under pre-establishment). Again, a very broad definition is also included in the 2004 Japan-Mexico Economic Partnership Agreement.<sup>31</sup>

The agreements concluded by member countries of the European Union usually define the terms “company” or “legal person” to mean companies set up according to the laws of the parties and having their registered office or central administration or principal place of business within the parties and “establishment” to mean the constitution, acquisition or maintenance of a legal person.<sup>32</sup> Comparable is the approach followed by the 1973 Treaty Establishing the Caribbean Community (CARICOM), as amended by a Protocol adopted in July 1997.<sup>33</sup>

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<sup>30</sup> See the “Agreement between Japan and the United Mexican States for the strengthening of the Economic Partnership”. The purposes of the Agreement are to promote a freer trans-border flow of goods, persons, services and capital between Japan and Mexico. The Agreement also aims to promote a comprehensive economic partnership, which includes competition, improvement of business environment and bilateral cooperation in such fields as vocational education and training and support for small and medium size enterprises.

<sup>31</sup> See Art. 96 (Definitions).

<sup>32</sup> See for instance the 2002 Association Agreement between the EU and Chile, art. 131 (Definitions).

<sup>33</sup> See Protocol II: Establishment, Services, Capital. CARICOM Member States are Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines and Trinidad and Tobago. The Bahamas, a member of the Caribbean Community is not a party to this Protocol. The original Treaty establishing the CARICOM was revised in 2001. The Revised Treaty of Chaguaramas incorporates the provisions of Protocol II.

## 2. Transparency

The 1998 FTA between the Caribbean Community and the Dominican Republic contains, in its annex III on reciprocal protection and promotion of investments at Art. IX, a very limited transparency obligation relating to the commitment to publish all laws, judgements, administrative practices and procedures regarding investment. This approach is followed in a number of regional agreements. However, some recent agreements go further. The 2002 Association Agreement between the EU and Chile provides for the creation of contact points to facilitate communication between the parties (art. 190). Furthermore, “each Party shall provide information and reply to any question from the other Party relating to an actual or proposed measure that might substantially affect the operation of the Agreement”. The 2004 Mexico-Japan Economic Partnership Agreement includes a broad publication requirement, as well as an obligation for each Party to “promptly respond to specific questions from, and provide information to, the other Party” (Article 160).

## 3. Non-discrimination

Treatment of foreign investment refers to two phases. The first phase relates to the treatment accorded to the potential investor before the investment has taken place. This is generally referred to as the ‘pre-establishment’ or admission phase. Commitments in this area generally entail a liberalization of the investment regime and may create certain rights of establishment for persons and companies covered by the agreement. A growing number of recent RIAs aim specifically at liberalizing the admission phase, though subject to sectoral and other exceptions, limitations and/or reservations.

The second phase relates to standards of treatment after entry has been approved: the stage of operation of the investment. The different standards used, namely national treatment, most favored nation treatment, fair and equitable treatment and international minimum standards of treatment, have for the most part already been elaborated in BIT practice. Of these, the first two are referred to as non-discrimination standards and are widely used both in the context of liberalization and of protection. The latter two are more common in agreements, whether bilateral or regional, that aim at the protection of investment.

The investment chapters contained in US, Canadian, Chilean, Japanese, Singaporean and Mexican FTAs generally address both liberalization and protection issues.<sup>34</sup> Regional agreements that address the admission phase usually grant non-discrimination standards also for the operation phase. These agreements will be reviewed below, under pre-establishment.

Many regional agreements now provide both for MFN and national treatment but only post-entry. These include the 1997 Canada-Chile Free Trade Agreement, the 2000 Mexico-Singapore Free Trade Agreement, the 2000 FTA between Mexico and El Salvador, Guatemala and Honduras, the 1995 Mexico-Costa Rica FTA, the 1997 Mexico-Nicaragua FTA, the 1994 Treaty on Free Trade between Colombia, Venezuela and Mexico, the 1998 Chile-Mexico FTA, the 1998 FTA between Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua) and the Dominican Republic.

In the context of the Andean Community, rules aiming at the harmonization of investment policies of member countries towards investment from third countries were first adopted in 1970. The currently applicable regime appears in Decision 291 (1991) of the Commission of the Cartagena Agreement - Common Code for the Treatment of Foreign Capital and on Trademarks,

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<sup>34</sup> With regard to the construction of the ‘fair and equitable’ and ‘full protection and security’ standards, in 2001 the NAFTA Commission concluded that these do not require treatment in addition to or beyond that which is required by customary international law. Such approach has been then integrated in the BIT model as well as in FTAs, such as the 2003 US-Chile agreement and the 2004 CAFTA.

Patents, Licenses and Royalties. This Decision provides that foreign investors “shall have the same rights and obligations as national investors, except as otherwise provided in the legislation of each member country”. It also removes restrictions on access of products produced by foreign enterprises to the benefits from trade liberalization under the Cartagena Agreement. Prior to the adoption of this Decision, such products could benefit from such trade liberalization only if the foreign enterprise undertook to convert itself into a joint or national enterprise.

An important issue in the context of national treatment is the existence in host country domestic regulation of performance requirements, which may specifically affect foreign investment. Some regional agreements, such as the NAFTA, address them in detail. Article 1102(4) of NAFTA forbids local equity requirements. Article 1106(1) proscribes the imposition or enforcement of mandatory requirements and the enforcement of any undertakings or commitments: (1) to export a given level or percentage of goods or services; (2) to achieve a given level or percentage of domestic content; (3) to purchase, use or accord a preference to goods produced or services provided in the territory of a Party or to purchase goods or services from persons in its territory; (4) 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 investment; (5) to restrict sales of goods or services produced or provided by an investment in a Party's territory by relating such sales to the volume or value of exports or foreign exchange earnings of the investment; (6) to transfer technology, a production process or other proprietary knowledge; and (7) to act as the exclusive supplier of the goods produced or services provided by an investment to a specific region or world market. Furthermore, requirements (2), (3) only with reference to goods, (4) and (5) above are also prohibited if applied as conditions for the receipt of an advantage (Article 1106(3)). However, Parties are free to condition the receipt of an advantage on compliance with requirements, in connection with an investment, to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development in their territories (Article 1106(4)).

Similar provisions are also included in the 1997 Canada-Chile Free Trade Agreement (Article G-06), the 1997 Mexico-Nicaragua FTA (Article 16-05), and the 2000 FTA between Mexico and El Salvador, Guatemala and Honduras (Article 14-07), the 2003 US-Chile FTA and the 2004 CAFTA. A prohibition of a wide range of performance requirements is also contained in the 2004 Mexico-Japan Economic Partnership Agreement (Art. 65). On the other hand, the 1994 Treaty on Free Trade between Colombia, Venezuela and Mexico explicitly allows the imposition of requirements to locate production, generate jobs, train workers, or carry out research and development (Article 17-04).

#### **4. Pre-establishment commitments**

If we leave aside the process of European integration, the NAFTA is probably the first regional agreement that has included deep and detailed commitments in the area of pre-establishment with important liberalization effects on the investment regimes of the Parties. In the NAFTA, each Party is required to accord the better of national and MFN treatment to investors of another Party, and to investments of investors of another Party, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments (Articles 1102-1104).

The NAFTA adopts a negative list approach such that the actual coverage of the agreement's investment provisions is determined by the exceptions and reservations provided for in Article 1108 and contained in annexes to the Agreement. Furthermore, the Agreement provides that nothing in the Investment Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure, otherwise consistent with the Chapter, “that it considers appropriate to

ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns” (Article 1114). The same approach is confirmed in more recent US RIAs, such as the CAFTA (Art. 10.11). The NAFTA also provides for a general national security exception (Article 2102).

A number of more recent regional agreements, especially those involving NAFTA signatories, have broadly followed the NAFTA model. This is the case, for example, in the 1997 Canada-Chile Free Trade Agreement, the 2000 Mexico-Singapore FTA, the 2000 FTA between Mexico and El Salvador, Guatemala and Honduras, the 2003 US-Chile FTA and the 2004 CAFTA. Such an approach can also be found in draft investment chapter of the proposed Free Trade Area of the Americas (FTAA) agreement.

The 2004 Mexico-Japan Economic Partnership Agreement also provides for national and MFN treatment with very broad language. The NT commitment is subject to exceptions (Art. 66) listed in annexes to Agreement, which each Party endeavors to reduce or eliminate. A series of general exceptions are also set out.

In 1994, Member States of the MERCOSUR adopted the Colonia Protocol on the Reciprocal Promotion and Protection of Investments within MERCOSUR. This Protocol also provides for MFN and national treatment to investors of the Parties at the admission phase, subject to exceptions in sectors identified in an Annex to the Protocol.

The Treaty Establishing the Caribbean Community, as amended in 1997, prohibits the introduction by member States of any new restrictions relating to the right of establishment of nationals of other member States (Article 35b of the 1997 Protocol). Member States are also required over time to remove restrictions on the right of establishment of nationals of other member States, including restrictions on the setting up of agencies, branches or subsidiaries by nationals of a member State in the territory of another member State (Article 35c). The right of establishment is defined as the right to engage in any non-wage earning activities and to create and manage economic enterprises (Article 35b). Any discrimination of the basis on nationality is also prohibited (Article 38). Member States can apply for a waiver to the requirement to grant the right of establishment (Article 38b). General (including the protection of human, animal and plant life and health) and security exceptions also apply (Articles 38b(bis) and 38b(ter)).

A large number of regional agreements concluded by the European Union include provisions aimed at liberalizing the admission phase. Such agreements focus primarily upon establishment issues by providing for national treatment with regard to the establishment and operation of companies and nationals. The establishment and national treatment obligations are generally subject to conditions and qualifications set out in annexes to the agreements (see art. 132 of the Chile-EU Association Agreement).

## **5. Development provisions**

As with the vast majority of international agreements, regional agreements also contain various exceptions, safeguards and transition periods that in some cases are meant to cater for the different objectives and needs of parties at different levels of development. These qualifications may apply to all substantive provisions and have a particular importance with regard to the standard of treatment, both pre and post entry. These provisions may be of particular importance to Latin American countries. A special category of exceptions also affects the repatriation of funds and will be considered in the following section.

Another set of development-related provisions refers to the notions of investment promotion and facilitation. For instance, the CARICOM Treaty (as amended in 1997) provides for the adoption of measures in a large number of areas, ranging from market intelligence to the

harmonization of company laws.<sup>35</sup> A number of regional agreements contain significant provisions for the exchange of information with regard to investment and strategic alliance opportunities. These include the 1995 Mexico-Costa Rica FTA, the 1997 Mexico-Nicaragua FTA, the 1998 FTA between Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua) and the Dominican Republic, the 2000 FTA between Mexico and El Salvador, Guatemala and Honduras. Some agreements, such as the 1993 Framework Cooperation Agreement between the EEC and the Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama, specifies (Article 8) that “measures shall include: a) seminars, exhibitions and business missions; b) training businessmen with a view to setting up investment projects; c) technical assistance for joint investment. ...”<sup>36</sup>

The Chile-EU Association Agreement goes into even greater details<sup>37</sup> while the 2004 Mexico-Japan Economic Partnership Agreement features a full chapter dedicated to the improvement of the business environment and a specific article focusing on enhanced cooperation in the field of trade and investment promotion. Specific committees are also provided for (Art. 136-139).

## 6. Exceptions and balance-of-payments safeguards

A large number of regional agreements include provisions on free transfers of funds related to covered investments. One example is the 1991 Decision 291 of the Commission of the Cartagena Agreement. This Decision removes restrictions contained in the previous rules on the transfer of funds by obligating member countries to permit foreign investors and sub-regional investors to remit abroad in convertible currency the verified net profits derived from foreign direct investment and the proceeds from the sale or liquidation of such investment. However, it does not address the issue of balance of payments difficulties, which is addressed in a growing number of regional agreements.

In the context of the EU-Mexico Economic Partnership Agreement, Parties agreed that in case of serious balance of payment difficulties, restrictive measures with regard to payments, including the transfer of proceeds from the total or partial liquidation of a direct investment, can be adopted on a non-discriminatory and time-bound fashion.<sup>38</sup> The NAFTA provides for the possibility of adopting measures that restrict transfers in case of serious balance of payment difficulties, subject to a series of conditions (such as avoiding unnecessary damage to commercial,

<sup>35</sup> Article 38 (bis) (Measures to Facilitate Establishment, Provision of Services and Movement of Capital) provides for the adoption of appropriate measures for:

“(a) the establishment of market intelligence and information systems in the Community;  
 (b) harmonized legal and administrative requirements for the operation of partnerships, companies, or other entities;  
 (c) abolition of exchange controls in the Community, and free convertibility of the currencies of Member States;  
 (d) the establishment of an integrated capital market in the Community;  
 (e) convergence of macro-economic performance and policies through the co-ordination or harmonization of monetary and fiscal policies, including, in particular, policies relating to interest rates, exchange rates, tax structures and national budgetary deficits;  
 (f) the establishment of economical and efficient land, sea and air transport services throughout the Community, and  
 (g) the establishment of efficient communication services. ...”

<sup>36</sup> A similar provision is included in the 1993 Framework Agreement for Cooperation between the EEC and the Cartagena Agreement and Its Member Countries, namely, the Republic of Bolivia, the Republic of Colombia, the Republic of Ecuador, the Republic of Peru and the Republic of Venezuela. Less detailed provisions are also contained in the majority of partnership and Association agreement to which the EC is party.

<sup>37</sup> Art. 21 (promoting investment) reads: “...Cooperation will cover in particular the following: (a) establishing mechanisms for providing information, identifying and disseminating investment rules and opportunities; (b) developing a legal framework for the Parties that favours investment, by conclusion, where appropriate, of bilateral agreements between the Member States and Chile to promote and protect investment and avoid dual taxation; (c) incorporating technical assistance activities for training initiatives between the Parties’ government agencies dealing with the matter; and (d) developing uniform and simplified administrative procedures.”

<sup>38</sup> Decision No 2/2001 of the European Union and 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 (2001), Article 31.

economic and financial interest of another Party, not being more burdensome than necessary to deal with the difficulties, as well as being temporary and non discriminatory) (Art. 2104). More recent US RIAs, such as the Chile-US FTA and CAFTA limit the scope of balance of payments exceptions to trade in goods.

The 1994 Treaty on Free Trade between the Colombia, Venezuela and Mexico provides for the possibility of temporarily limiting transfers on a non-discriminatory basis in instances of balance of payments difficulties. Similarly, the 2000 FTA between the EFTA States and Mexico provides, at Article 50, for the possibility to adopt restrictive measures, that “shall be equitable, non-discriminatory, in good faith, of limited duration and may not go beyond what is necessary to remedy the balance of payments situation.” The Mexico-Japan Economic Partnership Agreement also provides for a temporary safeguard both in case of serious balance-of-payments difficulties and “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.” (Article 72).

The 2000 FTA between Mexico and El Salvador, Guatemala and Honduras provides for the possibility of introducing temporary exchange controls in the event of serious balance of payments disequilibrium. Measures have to be compatible with internationally accepted criteria. Similar provisions are included in the 1998 FTA between Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) and the Dominican Republic.

The Treaty Establishing the Caribbean Community, as amended in 1997, provides for rather elaborate rules on restrictions in the event of balance of payments difficulties. Envisaged restrictions extend not only to movement of capital, payments and transfer but also to the right of establishment. They have to be non-discriminatory, subject to periodic consultations, temporary in nature (i.e. not to exceed 18 months) and progressively phased out.

## **7. Consultation and the settlement of disputes**

Some regional agreements provide for the possibility of settling dispute by means of consultation and negotiation, including for instance the Mexico-Japan Economic Partnership Agreement (art. 77), the 2000 FTA between Mexico and El Salvador, Guatemala and Honduras, the 1994 Colonia Protocol on Reciprocal Promotion and Protection of Investments within MERCOSUR and the 1997 EU-Mexico Partnership Agreement. Many of the EU Association Agreements and Partnership and Cooperation Agreements provide for consultation through the body (e.g. cooperation or association councils) entrusted with the monitoring and implementation of the specific agreement. There are also some bilateral agreements, such as the Trade and Economic Cooperation Arrangements between Canada and respectively MERCOSUR (1998) and the Andean Community (1999), and the 1998 US-Andean Community agreement, which have as one of their main purposes the provision of a consultation mechanism in the form of a bilateral body.

NAFTA Articles 1115-1138 contain detailed rules that provide for international arbitration of disputes between a Party and an investor of another Party. An investor may submit to international arbitration a claim that another Party has breached an obligation under Chapter 11 or under certain provisions of the chapter on monopolies and state enterprises and that the investor has incurred loss or damage by reason of, or arising out of, that breach. Article 1122 contains the unconditional consent of the Parties to the submission of a claim to arbitration. The investor can elect to proceed under the International Centre for Settlement of Investment Disputes (ICSID) Convention, the Additional Facility Rules of ICSID or the United Nations Commission of International Trade Law (UNCITRAL) Arbitration Rules. Detailed rules are contained in these

provisions on matters such as the constitution of arbitral tribunals, consolidation of claims, applicable law, nature of remedies, and finality and enforcement of arbitral awards.

A number of regional agreements follow this approach with a number of modifications and with varying degrees of detail, including, for instance, the 1994 Mexico-Costa Rica FTA, 1994 Treaty on Free Trade between Colombia, Venezuela and Mexico, the 1997 Canada-Chile FTA, the 1997 Mexico-Nicaragua FTA, the 1998 Chile-Mexico FTA, the 1998 FTA between Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua) and the Dominican Republic, the 2000 FTA between Mexico and El Salvador, Guatemala and Honduras, the 2003 US-Chile FTA and the 2004 CAFTA,<sup>39</sup> as well as the Mexico-Japan Economic Partnership Agreement. Other regional agreements such as the 1994 Colonia Protocol on the Reciprocal Promotion and Protection of Investments within MERCOSUR also provide for international arbitration of disputes between a Party and an investor of another Party under the ICSID Convention but do not include rules as detailed as those found in the NAFTA or in NAFTA-like agreements.

Some regional agreements contain provisions only for the settlement of disputes arising between the Parties, thus not covering disputes between a Party and an investor of another Party. This is for instance the case of the 1997 EU-Mexico Partnership Agreement, as well as of many other EU Association Agreements and Partnership and Cooperation Agreements, including the EU-Chile Association Agreement which contains detailed arbitration provisions (art. 184-188).

### **C. Assessing bilateral and regional advances in investment rule-making**

Prior to the 1990s, relatively few investment-related provisions appeared in RIAs. Most such provisions were intended to protect property and were found in BITs. Investment-related provisions now commonly appear in RIAs in every region of the world and especially in those involving Latin American countries. Prior to the 1990s, and unlike BITs which had historically tended to associate countries at very different levels of development (i.e. advanced capital exporting nations and poorer host countries), RIAs were negotiated principally among states within the same region and at similar stages of economic development. RIAs now commonly link states in different regions of the world and often seek to integrate economies at very different stages of development.

The number of RIAs with investment-related provisions has increased dramatically since the 1990s. Although inter-regional agreements are becoming more common, the majority of RIAs that have been concluded by states in the Americas are with other states in the region. A large number of states in the Americas are party to at least one RIA, typically modeled after the NAFTA. The CARICOM states, however, have not generally concluded RIAs outside of CARICOM.

Many investment-related provisions in RIAs address the same issues as their counterpart provisions in BITs and relate to compensation for expropriation and guaranteeing a free right of transfers. Although investment protection provisions in RIAs are often similar to those found in BITs, there appears to be greater substantive variance in the content of provisions across RIAs than is the case under BITs. One explanation may be that most states, such as the US, use a model negotiating text for their BITs, which tends to create uniformity across bilateral treaties. The

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<sup>39</sup> Recent US RIAs embed clarifying provisions spelling out the Parties' understanding of what is meant by way of public interest regulation and indirect expropriation. The CAFTA text specifies, for example, that non-discriminatory regulatory actions designed and applied to protect the public welfare do not constitute indirect expropriation "except in rare circumstances." Both the CAFTA and the US -Chile FTA also encourage the development of an appeals procedure for investor-state arbitral decisions. Such provisions attest both to the efficacy of the NGO critique of investor-state rules and, more fundamentally, to the widely acknowledged need for greater precision in legal drafting in an environment characterized by significantly heightened judicial activism. Furthermore, and again as a result of pressure from civil society the arbitration process under the CAFTA is more transparent as hearings and documents are now public and amicus curiae submissions are expressly authorized.

participation of a greater number of states in the negotiation of a number of plurilateral RIAs, and the need to accommodate differing levels of commitment towards investment liberalization, have tended to require greater flexibility and thus more creativity in the drafting of legal provisions.

It remains true however that RIAs have in large measure codified pre-existing BIT practice in respect of investment protection issues. This is so even though RIAs have most recently been used to correct some of the perceived shortcomings of traditional BIT provisions, notably regarding investor-state arbitration over matters of indirect expropriation. In so doing, RIAs can be argued to fulfill their role as laboratories for experimenting (notably in light of evolving jurisprudence) with a number of rule-making advances that proved obstacles to previous attempts at crafting multilateral investment disciplines (notably under the OECD's proposed MAI). Such advances, and the testing grounds RIAs afford them, could facilitate the future adoption of similar multilateral disciplines in a WTO context.

The commonly found provisions in RIAs that go beyond traditional BITs are those that prohibit anti-competitive business practices, protect intellectual property rights, liberalize admission procedures and open up trade and investment in services, including in the form of commercial presence, which is akin to FDI. As in the case of BITs, issues related to taxation and investment incentives are generally absent from RIAs.

RIAs in the Americas have been heavily influenced by the NAFTA, which contains an investment chapter modeled after the provisions of the US BITs, though more elaborate in some respects. The same can also be said of the 2004 Mexico-Japan Economic Partnership Agreement. The European RIAs, including those with Latin American partners, are chiefly concerned with liberalization (post-establishment market access), limiting anti-competitive practices, and protecting intellectual property. The European approach leaves investment protection to BITs concluded by EU Member States. Accordingly, RIAs involving the EU, including those agreed with Latin American countries, do not feature provisions on investor-state dispute settlement.

The fact that RIAs tend to contain greater variation in legal provisions than is the case of BITs does not mean that RIAs are necessarily weaker agreements. Indeed, RIAs demonstrate that it is possible to achieve high standard agreements outside the context of a BIT. Though it remains true that the strongest agreements tend to be bilateral in nature (reflecting in many instances power asymmetries between signatories), RIAs binding on multiple states and providing for high standards of investment protection and liberalization have been successfully concluded.

RIAs also tend to feature a larger number of provisions that take account of the special circumstances of developing countries than is the case under BITs. This is to be expected to some extent, given that some RIAs have only developing countries as parties. Finally, and as noted above, whether limited to developing countries or including countries at different stages of economic development, RIAs appear to offer greater scope than BITs do for experimenting with different approaches to promoting international investment flows.

### **III. Main arguments in investment rule-making debates: Bilateral vs. regional vs. multilateral approaches**

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The advantages and disadvantages of international investment agreements differ depending on whether such agreements are bilateral, regional or multilateral in scope. Advantages and disadvantages can also be viewed from different perspectives, such as those of the host versus home countries, and specifically with regard to the issues covered, the inclusion of development-related provisions, impacts on the regulatory sovereignty of host states, the impact on FDI flows and the bargaining power configuration in negotiations.

One of the main reasons for the popularity of BITs is the fact that they provide flexibility to the host country, affording it the possibility to screen and channel FDI (as admission is generally subject to the respect of domestic laws of the host country), while at the same time extending the necessary protection to foreign investors. However, BITs often involve countries at different levels of development, with asymmetrical bargaining power and negotiating capabilities. Furthermore, available empirical evidence does not suggest a significant impact of BITs on investment flows. Finally, investor-to-State dispute settlement mechanisms, which complement investment protection provisions, may give rise to high costs and liabilities for developing countries, in addition to raising potentially controversial issues relating to the right to regulate in the public interest. The recent spate of litigation involving Argentina is an

obvious case in point, as is the more general trend of heightened judicial activism observed since the late 1990's of late under BIT and RIA treaties.

At the regional level, while investment protection issues are often addressed, international investment agreements tend to have a broader focus, which includes the liberalization of restrictions to entry and establishment of FDI, followed by the reduction of discriminatory operational (post-entry) restrictions. These elements are generally part of wide-ranging agreements addressing a host of other policy areas, from trade liberalization for both goods and services to intellectual property protection. As such, regional integration agreements may provide signatories with more space for trade-offs. However, the broader focus of these agreements, coupled with recourse investor-to-State dispute settlement mechanisms, means that, like BITs, they are hardly immune from the potential public policy controversies relating to investor-state arbitration, as experience under the NAFTA has shown, notably in respect of litigation relating to the alleged confiscatory effects (e.g. indirect expropriation) of environmental or health regulations.

Regional instruments use, even to a larger extent than BITs, all the panoply of traditional international law tools, such as exceptions, reservations, transition periods and the like, to ensure flexibility in obligations so as to cater for the different needs and capacities of parties at different levels of development. From the perspective of developing countries, this together with the growing recognition of the links between trade and investment flows may explain why investment rules are increasingly found in RIAs hitherto primarily concerned with trade issues.

As RIAs addressing investment issues and BITs have multiplied in number, they have also created an intricate web of overlapping commitments. This is one of the main arguments cited in favor of creating a common, multilaterally-agreed, framework for investment that, in the words of the WTO Doha Ministerial declaration, would “secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment”.

Proponents of a unified WTO compact on investment have argued that a new multilateral framework of rules could “lock in” autonomous as well as bilaterally and regionally negotiated liberalization and extend the benefits of such openness on an MFN basis, thus preventing possible policy reversals where liberalization measures have yet to be consolidated.

The counter argument that has been voiced recalls that a multi-layered set of investment rules already exists under BITs and regional instruments, and also at the multilateral level, especially under the WTO's TRIMs Agreement and the GATS.

Existing rules may be far from perfect, but it has generally proven difficult for the “friends” of investment at the WTO to advance proposals suggesting that a clearly superior set of rules could be agreed upon in a WTO framework. Furthermore, the complexity of overlapping investment rules and regulations would likely persist, unless BITs and investment rules in regional instruments were superseded by a multilateral agreement.

At the same time, it remains the case that in the current WTO system an imbalance exists between the treatments enjoyed by investors in service sectors, which are already covered to some extent by GATS rules, and treatment enjoyed by all other (non-service) investors, to which only the TRIMs Agreement may be deemed to apply in a direct manner.

From a development perspective, the question of the appropriate rule-making ‘level’—bilateral, regional or multilateral—cannot be separated from an examination of the actual or potential content of investment rules and commitments. All international investment agreements are instruments of cooperation between countries that are entered into voluntarily. Furthermore, like all treaties, international investment agreements as such are neutral instruments: what counts to determine their impact on the development prospects or regulatory sovereignty of countries is their

content and so far the development-specific content of such agreements at all levels has been rather modest. There is, accordingly, considerable scope for increasing the attention paid to development issues in international rule-making on investment.

This is particularly true in light of the power and negotiating capacity asymmetries that typically characterize multi-issue negotiations where a single undertaking prevails at the end and where great care needs to be exercised in ensuring that the interests of developing countries are properly addressed or preserved.

At the same time, negotiations at the multilateral level offer developing countries greater leverage than do regional or bilateral negotiations, so long as they are able to advance common ideas on substantive issues of importance to them. Moreover, the multilateral level could allow, if adequate capacity-building efforts were put in place, all developing countries to meaningfully participate in the design of new rules, which are otherwise going to be increasingly shaped by a restricted number of key countries participating in bilateral or regional initiatives.

In this regard, it is important that all international investment agreements are shaped so as to allow enough policy autonomy and flexibility. More specifically, the legal obligations entered into should not unduly limit the sovereign right to regulate in the public interest. RIAs (more than BITs) have in recent years gone some way towards clarifying (and generally circumscribing the scope) of a number of investment protection-related provisions that could be deemed to unduly impair the regulatory autonomy of host states.

The quest for policy autonomy on the part of developing countries extends beyond protection matters to issues of admission and treatment, including in respect of support to domestic industries (subsidies and incentives) and performance requirements. While there seems to be an unambiguous collective preference for regulatory inaction on the issue of investment-related subsidies (i.e. investment incentives), the question of disciplines on performance requirements has revealed an interesting paradox. While the latter featured prominently in the Uruguay Round's implementation debate (and the widespread perception of the Round's inequitable treatment of developing countries), it has generated little resistance in the context of RIAs, the great majority of which proscribe a more exhaustive list of measures than that on offer under the TRIMs Agreement.



## IV. Anatomy of failure: Investment and the Doha Development Agenda

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Alongside the failed attempt at agreeing on an OECD-anchored MAI in the late 1990's, the period since the establishment of the World Trade Organization in 1994 witnessed a concerted attempt by a number of WTO Members to place investment more comprehensively within the multilateral trading system's negotiating purview. Such a process, which was initiated in the midst of the MAI negotiations, was launched at the WTO's first Ministerial Conference, held in Singapore in December 1996, and leading to the establishment of a WTO Working Group on the Relationship between Trade and Investment (WGTI).

At the fourth Session of the WTO's Ministerial Conference, held in Doha, Qatar, in November 2001, WTO Members agreed to launch negotiations on foreign investment after the 5th Session of the Ministerial Conference "on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations". In adopting this decision, Ministers recognized "the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade, and the need for enhanced technical assistance and capacity-building in this area."<sup>40</sup> The decision identified a number of subjects that would be the focus of further work in the WGTI until the 5th Session of the

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<sup>40</sup> Ministerial Declaration, adopted on 14 November 2001, doc. WT/MIN(01)/DEC/1, 20 November 2001, paragraph 20.

Ministerial Conference<sup>41</sup> and defined certain basic considerations that would need to be taken into account in negotiations on the envisaged multilateral framework.<sup>42</sup>

While the WGTI's work is widely seen to have been highly pedagogical in character and resulted in an unprecedented level of technical assistance and capacity building being directed towards the investment policy field, it also proved highly contentious. Indeed, of the four so-called "Singapore Issues" discussed by WTO Members since 1996 (the other three were trade and competition, trade facilitation and transparency in government procurement), investment was the subject matter most centrally involved in the derailing of the WTO's September 2003 Cancun Ministerial meeting.<sup>43</sup>

The impasse surrounding investment and its treatment in the WTO system was ultimately resolved in the WTO General Council's July 2004 decision to confine Singapore Issue discussions under the Doha Development Agenda (DDA) solely to the subject of trade facilitation. WTO Members agreed in the July 2004 framework that the three other Singapore issues (including investment) "will not form part of the Work Program set out in that (Doha) Declaration and therefore work towards negotiations on any of these issues will take place within the WTO during the Doha Round". Thus, any further discussions on investment at the WTO for the time being will be limited to work that does not relate to negotiations.

The most immediate fallout from the failed WTO initiative will be to shift the focus of key rule-making initiatives on investment back to the bilateral and regional levels. These will take the form either of BITs or RIAs featuring the extensive array of investment protection and liberalization provisions reviewed in this paper. For countries in the Americas, this entails essentially bilateral agreements insofar as prospects for a hemispheric integration agreement (e.g. the FTAA) no longer seem to hold the promise they once held.

Rule-making progress on investment may well be more feasible at the bilateral and regional levels. This is so for at least two important reasons. A first reason owes to the fact that such negotiations—particularly bilateral ones—are typically characterized by significant asymmetries of economic and political power between capital-exporting and capital-importing countries. A second reason is that BITs and RIAs typically start from a blank page and do not confront the delicate task of reopening existing rules, commitments and the balance of concessions that would inevitably complicate any attempt at fitting new investment rules alongside existing ones in the WTO context.

Discussions on investment at the WTO have highlighted a strange paradox, offering the sight of fierce resistance at the multilateral level by a number of developing countries on a subject matter towards which their unilateral, bilateral or regional policy stances have been starkly different (and considerably more accommodating). Indeed, the burgeoning network of treaties, principally at the bilateral level, reflects a growing willingness and ability on the part of developing countries (in part

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<sup>41</sup> These subjects were: (i) scope and definition; (ii) transparency; (iii) non-discrimination; (iv) modalities for pre-establishment commitments based on a GATS-type, positive list approach; (v) development provisions; (vi) exceptions and balance-of-payments safeguards; (vii) consultation and the settlement of disputes between Members. See WTO (2001), WTO/MIN(01)/DEC/1, paragraph 22.

<sup>42</sup> Paragraph 22 of the Doha Ministerial Declaration states in relevant part: "Any framework should reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest. The special development, trade and financial needs of developing and least-developed countries should be taken into account as an integral part of any framework, which should enable Members to undertake obligations and commitments commensurate with their individual needs and circumstances. Due regard should be paid to other relevant WTO provisions. Account should be taken, as appropriate, of existing bilateral and regional arrangements on investment."

<sup>43</sup> See Hartridge, David (2003), "The Cancun Failure: Why and Where Next?", in WTO Insight, No. 5, Paris: International Chamber of Commerce (29 September); see also Sauvé, Pierre (2004), "Decrypting Cancun", in United Nations, Perspectives from the ESCAP Region After the Fifth WTO Ministerial Meeting: Ideas and Actions Following Cancun, Studies in Trade and Investment No. 51, Bangkok: United Nations Economic and Social Commission for Asia and the Pacific, pp. 16-39.

because of the strongly unilateral character of recent liberalization decisions) to codify existing legal frameworks for international investment at the country level.

Such behavior naturally raises questions as to the “value-added” that could be expected from a framework for investment at the multilateral level, particularly with respect to investment protection. International investment issues are complex and feature an important “horizontal” dimension, in that they can affect industries in a variety of sectors across the economic spectrum, increasingly spanning manufacturing and services in a seamless manner. Such changes point to growing complementarities between investment and trade, including with respect to proliferating global supply chains. A multilateral framework that does not reflect this reality by providing the proper institutional and legal underpinnings for the way in which international commerce unfolds in a globalizing world economy is itself sub-optimal. Over time this risks calling into question the benefits and continued relevance of the existing multilateral framework that has proven integral to the growth of a post-war trading system built on the core principles of transparency and non-discrimination.

The failure of WTO Members to reach agreement on negotiating modalities for investment under the DDA must be assessed against the backdrop of the value-added, coherence and negotiating incentives implicit in the proposals of its WTO advocates as opposed to the respective merits of BITs and RIAs. Simply put: what purpose should a multilateral set of investment rules serve? Should—and can—it aim to go beyond what already exists at the bilateral and regional levels? And is such a body of rules worth having (and “paying” for in negotiating terms) if it turns out to be BIT—or RIA—minus in content, as seems most likely given the considerably greater economic and political diversity of WTO membership and the recent reassertion by many developing countries of the need for greater policy space?<sup>44</sup>

On all the above grounds, and as the July 2004 decision of the WTO General Council ultimately confirmed, what was on offer in the investment area singularly failed to garner widespread support among WTO Members. Such a conclusion can be inferred when one looks at DDA proposals on investment through the prism of the four core components of investment rule-making: (i) protection; (ii) liberalization; (iii) distortions; and (iv) good governance. The table featured in the Annex to this paper summarizes the state of international discussions under each of these components, drawing attention to what are arguably the most appropriate institutional settings in which to envisage collective action responses.

## 1. Investment protection

The rising salience of BITs and of RIAs in the area of investment protection is rooted in solid political economy underpinnings, reflecting negotiating asymmetries between capital exporting and importing nations that explain the far-reaching nature of disciplines that host countries have been increasingly willing (and in some instances forced) to accept. An interesting aspect of the proliferation of BITs is that the growing share of those conducted along South-South lines tend almost without exception to feature the same types of legal provisions as those found in the model agreements of major capital-exporting countries, most notably the United States.

The WTO is arguably not the optimal setting in which to tackle matters of investment protection. WTO Members appear to concur with this viewpoint to the extent that the issue of investment protection never made it as a core agenda item of WGTI discussions. One major reason for this is that one of the distinguishing features of BITs or RIAs featuring comprehensive

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<sup>44</sup> As noted above, the quest for policy space in the investment field is itself paradoxical as it has arisen mostly in the context of WTO negotiations and against the backdrop of the implementation debate burden flowing from the Uruguay Round. Meanwhile, developing countries would appear to have been willingly ceding policy space under BITs (a growing number of which are concluded among themselves) and RIAs.

investment disciplines —recourse to investor-state dispute settlement procedures, to which investors naturally attach considerable importance, is for all intents and purposes not conceivable in a WTO setting. Indeed, the precedent —both legal and, perhaps more importantly, political— that such an instrument would create would likely fuel strong demands for private party recourse to dispute settlement in areas outside of investment, notably in matters of environmental concerns, labour and human rights. This is something the diverse and polarized WTO Membership appears most unlikely to support.

## 2. Investment liberalisation

The WTO is on decidedly firmer ground as regards the core investment liberalization agenda. However, here again, one needs to consider two important facts to which proponents of a WTO agreement appear to have paid insufficient attention. First is the fact that some two-thirds of aggregate annual FDI flows are today directed towards service industries.<sup>45</sup> And second, and perhaps more important from the perspective of the value-added of any new WTO investment rule-making initiative, is that some four fifths of impediments to cross-border FDI also are also found in service industries. Such a trend is graphically depicted in Figure 1, which maps the distribution of non-conforming measures reserved by various country groupings under a sample of negative list agreements surveyed in a forthcoming UNCTAD study.<sup>46</sup>

The predominance of services as the principal locus of investment restrictions —and thus of investment regime liberalization— stands out vividly, with the share of non-conforming measures in services ranging from 76.9 percent in the case of Canada and the United States, 81.6 per cent in the study's Latin American sample countries (Argentina, Brazil, Colombia, Chile, Mexico and Venezuela) and a high of 94.1 percent in the case of transition economies (e.g. Czech Republic, Hungary, Poland).

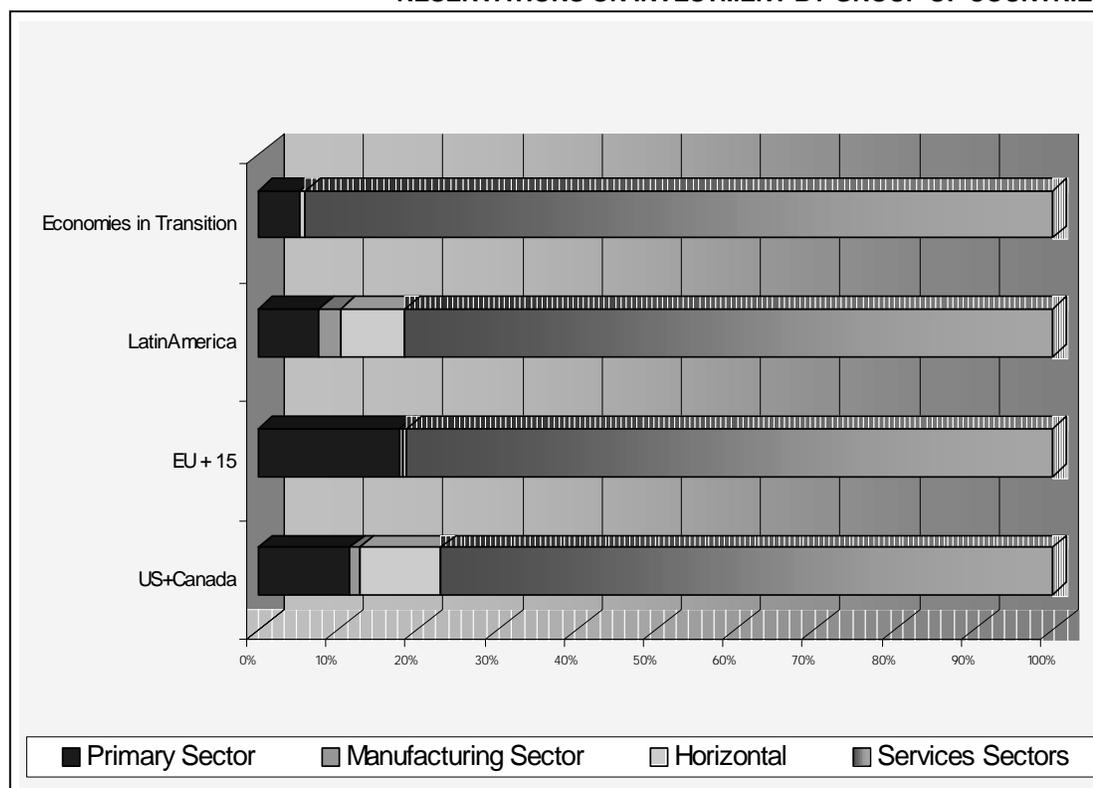
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<sup>45</sup> See UNCTAD (2004), *World Investment Report 2004: The Shift to Services*, Geneva: United Nations.

<sup>46</sup> See Sauvé, Pierre, Martin Molinuevo, and Elisabeth Tuerk (2006), *Revealed Policy Preferences from Reservation Lists in Selected International Investment Agreements*, International Agreements Section, Geneva: UNCTAD.

Figure 1

## RESERVATIONS ON INVESTMENT BY GROUP OF COUNTRIES



Source: Sauvé, Molinuevo and Tuerk (2006).

Figure 1 usefully recalls the relative insignificance of measures restricting cross-border investment activity in manufacturing, as the bulk of non-conforming investment measures relating to goods sectors involve FDI in primary activities such as agriculture, fishing, mining and oil and gas extraction, where entry barriers tend to be more deeply entrenched politically (sometimes in countries' constitutions) than those relating to FDI in manufacturing.

The results depicted in Figure 1 also recall the extent to which the GATS already affords WTO Members an important vector of potential investment liberalization.<sup>47</sup> For this reason, negotiating efforts could usefully be deployed in attempting to make the GATS a more potent vehicle of investment regime liberalisation. This could notably be done by modifying the agreement's approach to scheduling commitments with a view to securing negotiated outcomes that lock in the regulatory status quo rather than allowing Members to maintain a wedge between applied and bound regulatory measures in services trade and investment.

### 3. Investment distortions

As regards collective action responses to investment-distorting measures, the incidence of which tends to affect FDI in manufacturing more than in services, it is important to distinguish

<sup>47</sup> For a fuller discussion of how to enhance the investment liberalization properties of the GATS, see Sauvé, Pierre and Christopher Wilkie (2000). "Investment liberalization in GATS" in Sauvé, Pierre and Robert M. Stern (eds), *GATS 2000: New Directions in Services Trade Liberalization* (Washington DC: Brookings Institution Press), pp. 331-363.

three sub-categories of policy measures. A first category consists of performance requirements, for which a comprehensive ban already exists under the WTO's TRIMs Agreement and whose scope arguably exceeds the limited subset of measures depicted in its Illustrative List of Prohibited Measures. The main challenge in a multilateral context would be to incorporate the TRIMs Agreement by reference in any new WTO investment instrument and to consider its possible extension to investment in services, something a number of RIAs has done. As noted earlier, given the salience of the TRIMs Agreement in the WTO's contentious debate over the implementation burdens flowing from Uruguay Round agreements, such expanded scope cannot be taken for granted even as recent research has begun to document the prevalence of TRIM-like measures in services (Sauvé, Molinuevo and Tuerk, forthcoming).

A second core element of the distortion agenda relates to investment incentives, an area where a growing list of practitioners has emerged in recent years in all regions of the world and which today encompasses a growing number of developing countries. However desirable, not least on equity and coherence grounds, the coverage of investment incentives—the granting of which are often closely related to the imposition of performance requirements—would likely prove daunting in a WTO context if one is to judge by past failures and the revealed policy preference of host country governments for disciplinary inaction in this area.

What's more, the question arises of the most appropriate level at which to tackle such a source of distortions, i.e. regional or multilateral agreements, given the likely greater regional incidence of locational competition between host countries. There has indeed been intense competition within (but significantly less so between) developed and developing countries in trying to attract FDI by using investment incentives. Central and sub-national governments in federal countries make great use of these instruments, particularly in developed countries.

There is little doubt that investment incentives—be they fiscal, financial, or regulatory in nature—can play a decisive role in influencing the ultimate location decisions of some specific investors. They may also lead countries to embark on costly “grant shopping,” resulting in discrimination and distortions in the allocation of productive resources, and costly rent-seeking behavior on the part of investors. Countries with fewer resources may find it difficult to compete on a level playing field with other states using such instruments. Host countries, particularly those with federal structures of government, have traditionally been very hesitant to tackle this issue in international negotiations. They often feel they cannot or should not bind their sub-national entities.

Still, in an optimal scenario, provisions on investment incentives in a multilateral context could address a range of issues related to their scope and codification by degree of distortiveness. Consideration could also be given to the prohibition of (or the hortatory, soft law, encouragement to refrain from) the most distortive types of incentives. The principles of transparency and non-discrimination (MFN treatment and ideally national treatment as under the GATS in scheduled sectors) could also be made to apply to such practices, though progress is likely to prove difficult for obvious political reasons in important host countries.

A third cluster of distortion-related challenges relates not so much to investment measures but to trade policy measures, and involves a range of practices that distort investment decisions away from the equilibrium that would otherwise prevail in their absence. Perhaps the best example of such investment-related trade measures (IRTMs) is the discriminatory, sector-specific, rules of origin found in many free trade agreements. Many such rules have targeted Japanese investors in the past, notably in the automobile sector, with significant trade- and investment-distorting consequences. Such measures are also prevalent in the textiles and clothing sector, and indeed in many sectors subject to host country fears of delocalization and structural competitive weaknesses in domestic industries.

Other significant IRTMs include tariff peaks and tariff escalation, as well the anti-competitive practices made possible under national anti-dumping regimes. An important policy- and rule-making insight arising from the above practices is that all are already subject to multilateral negotiations under various chapters of the Doha Round. This is notably the case of talks pertaining to rules, market access and regional trade agreements, such that their negative incidence on investment could be reduced and/or progressively eliminated without the need for an explicit negotiating mandate on investment at the WTO.

#### **4. Good governance**

Of all the issues linked to what one might call the “good governance” agenda in the investment field, those relating to transparency are arguably the only ones that could reasonably easily be anchored within a WTO investment agreement. Here again, however, one would need to reflect on the efficacy and development implications of relying on dispute settlement and the attendant threat of trade or investment sanctions as a means of enforcing such positive prescriptions.

For all other issues arising under this sub-agenda, which spans subjects as diverse as the fight against corruption, the promotion of home country measures, the advancement of corporate social responsibility, or best practices in investment promotion, legally binding and enforceable hard law responses, *a fortiori* in the WTO, appear ill-suited to the task or unlikely to command much support from the investment community.<sup>48</sup>

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<sup>48</sup> See World Bank (2002), *Global Economic Prospects 2003 - Investing to Unlock Global Opportunities*, Washington, D.C.: The World Bank.



## V. By way of conclusion: Advancing forward-looking scenarios on investment<sup>49</sup>

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This paper aimed at depicting the changing international landscape of investment rule-making from both a Latin American and global perspective. Such a landscape has undergone important transformation in recent years, a process in which countries from the Western Hemisphere have been centrally involved at the bilateral, regional (especially) and multilateral levels.

The fact that extensive investment liberalization has in recent years taken place at the national (unilaterally), bilateral and regional levels without a multilateral framework, and the failure both of the OECD-based MAI negotiations in 1998 and the inability of WTO Members to agree in their July 2004 package on negotiating modalities for investment under the Doha Development Agenda after seven years of WGTI discussions, may suggest that such an initiative is unnecessary or simply too difficult to achieve. However, there can be no denying that the multilateral system suffers from a clear imbalance, lacking “modal neutrality”. That is, “equality of policy treatment regardless of the means by which producers choose to supply a given market —whether through imports, foreign direct investment, temporary presence, or the licensing of domestic producers.”<sup>50</sup>

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<sup>49</sup> This section draws on Sauvé, Pierre, “Multilateral Rules on Investment: Is Forward Movement Possible?”, in *Journal of International Economic Law*, (forthcoming).

<sup>50</sup> Low, Patrick, and Arvind Subramanian. 1996. “Beyond TRIMs: A Case for Multilateral Action?” In *The Uruguay Round and the Developing Countries*, ed. Will Martin and L. Alan Winters. Cambridge: Cambridge University Press.

The globalization of the world economy and the internationalization of production have shown that investment has increasingly become a complement to —rather than a substitute for— trade.<sup>51</sup> Firms today have more choices at their disposal. They can choose which “modality” (trade, FDI, licensing, etc.) to use to maximize access to resources and markets, and, in the process, increase their competitiveness. Firms often combine investment and trade to exploit, in the most optimal manner, the opportunities offered by their “portfolio of locational assets.”<sup>52</sup>

Until recently, bilateral investment treaties (BITs) have been primarily “enabling in character” such that, by themselves, they exert little discernible effect on induced FDI activity to the extent that most of them do not include a market access component. This is particularly true of European BITs. Elsewhere, and more recently, the tendency has been for BITs to increasingly address both the protection and liberalization aspects of host country investment regimes.<sup>53</sup> Such enhanced BITs, like the numerous regional integration agreements featuring comprehensive investment disciplines that have been negotiated in recent years (an increasing number of which involving Latin American countries), have generally been seen by source and host countries alike as likely to exert a positive influence on FDI inflows by speeding up investment liberalization either before the conclusion of the agreement or during its implementing phase.

Absent progress on the WTO front, newer generation BITs, or RIAs that embed comprehensive disciplines on investment, are two important means at the disposal of WTO Members’ in pursuing their policy interests in investment rule-making while providing tangible benefits to home country investors abroad. Indeed, the fact that investment is off the Doha Round’s negotiating agenda means that bilateral and regional initiatives are currently the only feasible avenues for countries to pursue and deepen investment ties with their key trading partners. This can (and perhaps should) be done with a view to progressing the case for —and shaping the ultimate contents of— a possible future set of WTO investment disciplines. In other words, what is done today at the bilateral and regional levels can help shape what could happen tomorrow at the multilateral level.

Apart from the importance of addressing the issue of “modal neutrality” underlined above, a multilateral framework would of essence aim to ensure transparency, predictability and a degree of legal security with regard to domestic FDI regimes. The advent of a multilateral investment framework would not negate the ability of countries to enhance their attractiveness to FDI flows by improving their physical infrastructure (e.g. telecommunications, roads, ports, airports, power), human resources, and technology). These economic determinants play a key role in encouraging foreign firms to invest in a country. In fact, a comprehensive multilateral investment framework would draw attention to these factors, and likely contribute to the pursuit of sounder “enabling” policies and a more efficient allocation of resources, especially if it addresses, in some ways, distorting practices such as investment-related trade measures (e.g. discriminatory sectoral rules of origin in RTAs; tariff peaks and tariff escalation; the anti-competitive effects of contingent protection instruments, and especially anti-dumping regimes).

The objective of “modal neutrality” noted above, and the paradoxical tendency for developing countries to do bilaterally and regionally (sometimes in a highly asymmetrical fashion) what they refuse to do multilaterally (under conditions that are likely to be more favorable to them politically and economically through alliances of like-minded WTO members) are both broadly suggestive that a case can yet be made in favor of comprehensive multilateral investment rules that add value over existing instruments or (most likely) lock in on a non-discriminatory basis what has been agreed at the bilateral and/or regional level, achieve greater overall rule-making coherence,

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<sup>51</sup> For a comprehensive discussion of this issue, see WTO (1996), pp. 52-55.

<sup>52</sup> UNCTAD (1996, p. 97).

<sup>53</sup> UNCTAD (1998, p. 118).

cover investment in both goods and services and provide developed and developing with adequate incentives to negotiate in good faith. The failure observed on investment at Cancun and which the July 2004 package confirmed, owed largely to the fact that the proposals on the negotiating table failed to meet the above tests.

Getting investment back in a comprehensive manner into the WTO system will neither be easy nor occur any time soon. This is all the more so as lack of progress in the Doha Round on issues of greatest interest to developing countries fuel the widespread perception of the developmental inequity of multilateral outcomes. This, together with the growing sense on the part of many developing countries of the limited benefits stemming from adherence to core tenets of trade and investment policy orthodoxy, have in turn fueled interest in preserving policy space, including in the investment field even as such space has continued to be ceded unilaterally as well as in bilateral and regional agreements.

The quest for an ultimate multilateral, WTO-anchored, destination will nonetheless likely be kept in mind and inform the actions of those countries that continue to believe in the desirability of such a rule-making journey. Without prejudging what the future might hold, this paper concludes with a few possible forward-looking scenarios. As it happens, several of the policy interrogations that will determine the final shape and content of a possible future WTO MFI are questions that WTO Members can also reflect upon and address in the context of their ongoing BIT and, especially, RIA negotiations.

Should WTO members one day decide to take up negotiations towards a comprehensive agreement on investment, they would need to determine the scope of that agreement and to address a number of core components. The substantive scope consists of the disciplines of the agreement, including the definition of key terms such as investments and investors, i.e. which investments and which investors would be entitled to benefit from the agreement? Countries would need to assess the impact of these definitions on the provisions of the agreement and an eventual liberalization process. Should the definition of investment include FDI, portfolio investment, real estate and intangible assets? Should it be broad enough to allow for the inclusion of new forms of investment, while providing for the definition of what is not an investment (in order to exclude short-term capital flows)? Should it extend to the pre- and post-establishment phase of an investment or could disciplines follow a variable geometry approach, with a broader definition applying to investment protection matters and a more circumscribed definition (for instance limited to FDI flows only) adopted for purposes of investment liberalization?

Should an eventual investment agreement also apply to commitments made under the GATS in regard to commercial presence and under the TRIMs Agreement in respect of performance requirements? While the definition of commercial presence under GATS Article XXVIII is narrower than that typically found in BITs or in RIAs featuring comprehensive investment disciplines, it does cover pre —and post— establishment investment issues.

The key treatment provisions on national treatment and MFN are another key element of any prospective multilateral agreement on investment. WTO members would need to decide whether to apply the MFN and national treatment provisions across the board to all members and sectors (subject to negative list reservations), or to adopt the GATS approach, i.e. to have an all encompassing MFN provision with temporary exemptions and a conditional national treatment and market access standard, which would apply only to sectors and sub-sectors in which members would voluntarily schedule commitments. The choice of negative or hybrid list approaches to liberalization can have far-reaching implications for future regulatory conduct and the attractiveness of investment rules for many developing country governments.

WTO Members would thus need to assess whether a WTO Agreement on Investment would include commitments to investment liberalization in both goods and services, raising complex questions of architectural overhaul and the treatment of acquired rights (and the attendant balance of benefits) flowing from current agreements.

Another relevant question (including at the bilateral and regional level) is whether the liberalization commitments made by WTO members should reflect the regulatory status quo? Securing such an outcome would entail a potentially significant departure from a long-standing tradition in goods trade under the GATT (for tariff negotiations) that was extended to services under the GATS in the Uruguay Round, whereby countries have traditionally maintained (and exercised) the right to bind less than the status quo.

Any comprehensive investment agreement would also need to address the issue of performance requirements, resulting most likely in the incorporation by reference of disciplines found under the WTO TRIMs Agreement. The question of whether such disciplines should be extended to services would need to be addressed, and would no doubt prove contentious given the recent focus on preserving policy space and the fact that service industries are still nascent in many developing countries.

However desirable, not least on equity and coherence grounds, disciplines on the granting of investment incentives would likely prove more contentious in a WTO setting if one is to judge by past failures and revealed policy preferences in this area. As noted earlier, provisions on investment incentives could nonetheless address issues related to their scope, codification, the prohibition of (or the hortatory, soft law, encouragement to refrain from) some types of incentives. The principles of transparency and non-discrimination (national treatment and MFN treatment) should ideally apply to such practices, though progress is likely to prove difficult for obvious political reasons in important host countries.

An alternative scenario would be to expand the current WTO investment framework without negotiating a comprehensive agreement on investment. Several options are possible in this regard. Given that the bulk of investment restrictions arise in services sectors, WTO members could focus on investment liberalization in the GATS and ensure that the commitments reflect more closely the investment regime in place in each member country (i.e. encourage or mandate the scheduling of status quo commitments for Mode 3 trade). The latter issue is one that WTO Members could require or encourage their BIT or RIA partners to uphold in agreements where a GATS-like, hybrid, approach to scheduling is adopted. Recent examples include RIAs signed by Japan with a number of countries in South-East Asia.<sup>54</sup>

WTO Members could also elect to develop complimentary disciplines on investment in goods to address the market access component of an investment agreement that is currently missing under existing WTO disciplines. This was essentially what proponents of investment in the Doha Round had been arguing for, with decidedly poor results. Such an approach would need to be complemented by efforts at extending to services the disciplines found under the TRIMs Agreement, another arduous task given the prominence of the TRIMs Agreement in the WTO's post-Uruguay Round implementation debate. As well, more explicit multilateral disciplines on investment incentives promoting transparency (and possibly non-discrimination, including on a voluntary, but MFN, basis), could be added to the Agreement on Subsidies and Countervailing Measures and once more possibly extended, in whole or in part, to investment in services.

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<sup>54</sup> Recent Japanese FTAs feature a dual innovation: (i) an obligation to bind the regulatory status quo in investment commitments while keeping with a GATS-type voluntary approach to scheduling sectors in which commitments are made; and (ii) the publication for transparency purposes of non-binding lists of non-conforming measures affecting trade and investment in services.

Another scenario would be for WTO members to negotiate a Plurilateral Agreement on Investment, which would be comprehensive in nature, i.e. covering both investment protection and liberalization and whose benefits would either extend solely to signatories or be concluded and applied on an MFN basis once an acceptable critical mass of cross-border investment activity had been met (as is the case of the WTO's Information Technology Agreement). The European Commission floated the idea of a plurilateral approach for a short while in December 2000, but there were generally few takers, as the establishment of new plurilateral disciplines under the WTO requires the explicit consensus of all Member countries, a situation that never prevailed on the Singapore Issues in general and on investment matters in particular.

A final forward-looking scenario, which WTO members can also seek to pursue at the bilateral and regional levels, would involve a negotiating quid pro quo to be envisaged linking the movement of capital (investment) to that of labor (people).

Such a factor movement-based negotiating bargain would respond to an issue area—the temporary mobility of skilled and semi-skilled workers—that is high on the list of export priorities of a large (and growing) number of developing countries. Worker remittances are, after FDI, the second largest source of external finance in developing countries, and such flows dwarf FDI in a large number of developing countries, particularly poorer ones that tend to attract little by way of FDI inflows.<sup>55</sup> What's more, a capital-labor quid pro quo would also address the paucity of qualified workers that is becoming acute in a number of aging societies. This challenge is particularly important in the case of developed countries given prevailing demographic trends.

There is little doubt that the politics of labor movement are harder to contend with than that those relating to capital mobility, a reality that is equally prevalent in developing countries. Still, despite these challenges and the genuine public policy concerns they give rise to, scope exists for countries to explore in an imaginative way the factor mobility linkages that could be exploited in RIAs (today) and the WTO (tomorrow).

For this to occur, WTO members could mold their RIAs on the tripartite architecture first used in the NAFTA and found in a number of subsequent RIAs (particularly prominent throughout the Americas) that feature a complementary set of disciplines on: (i) cross-border trade in services (modes 1 and 2 of GATS); (ii) generic (i.e. horizontal) disciplines on investment applicable to goods and services in an undifferentiated manner; and (iii) generic disciplines on the temporary entry of business people.

Currently, NAFTA-like agreements focus on four categories of people granted temporary entry privileges under such agreements: (i) business visitors; (ii) traders and investors; (iii) intra-company transferees; and (v) professionals. WTO members could actively seek to add a new category of non-professional essential personnel with a view to extending temporary entry privileges to categories of workers that either do not fit easily the other categories or whose skill level may be somewhat lower but where the demand for such labor may nonetheless be very high (in the catering business; house maids; household assistance; non-professional medical staff; construction workers, etc.). As well, greater efforts could be made to ease the mobility of independent or contract-based workers with a view to de-linking temporary entry commitments from investment flows and its attendant movement of intra-company transferees.

In so doing, countries should strive to enhance the regulatory transparency applying to various economics needs tests relating to temporary entry and ensure that admissible worker categories correspond to genuine export capacities and interests on the part of their trading partners. Efforts should also be deployed to engaging in mutual recognition agreements for licensed

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<sup>55</sup> See World Bank (2005), *Global Economic Prospects 2006 – Economic Implications of Remittances and Migration*, Washington, D.C.: The World Bank.

professionals and facilitating compliance (notably on language issues) with domestic regulatory requirements through vocational and professional training that may be supplied more cost-effectively in the sending countries rather than in receiving ones.

What's more, to assuage rising developing country concerns that developed countries might be tempted both to limit temporary labor mobility—for instance on national security grounds—and also place restrictions on the remote supply of business outsourcing activities conducted in an increasingly competitive fashion over electronic networks (i.e. via mode 1 trade in GATS-speak), countries should consider inserting in their RIAs the precedent-setting pledge not to introduce measures—notably in the field of government procurement—that would restrict the ability of developing country firms to supply business outsourcing services across borders (beyond legitimate policies designed to address concerns over data privacy and to combat fraudulent transactions).

Pursuing a capital-labor mobility agenda is arguably easier to contemplate at the bilateral and regional level than in a WTO setting as negotiators in Geneva would inevitably need to contend with fitting any new investment disciplines into existing agreements, reopen the delicate balance of concessions embedded in them and possibly review the architecture of the WTO family of agreements. This is most clearly the case of the GATS, whose scope would need to be amended (reduced) to dealing exclusively with cross-border trade in services (i.e. Modes 1 and 2) in order for new horizontal agreements to be pursued in the areas of investment (in goods and services) and the movement of people (across all sectors).

Such an overhaul is likely to encounter significant resistance, not least of which among those national ministries responsible for conducting services negotiations as well perhaps from the WTO secretariat itself, whose services “turf” might be viewed as shrinking as a result. Yet the gains in coherence that such a configuration would provide, and its ability to promote win-win outcomes in development terms, are sound enough reasons to try to set useful precedents at the bilateral and regional level in the hope of their subsequent migration to Geneva. Such rule-making approaches are already commonly found among RIAs entered into by countries in the Western Hemisphere.

As this paper has tried to show, the reasons for the current impasse on investment at the WTO are numerous. They involve a complex interplay of procedural, tactical and substantive concerns and involve a paradoxical quest for policy space in multilateral discussions at the same time that such space continues to be ceded in the context of unilateral, bilateral or regional policy initiatives.

The current impasse provides a good opportunity for a thorough and much-needed rethinking of the objectives that negotiations on investment should pursue, including at the regional and bilateral levels, the value-added that any renewed attempt at placing investment on the WTO agenda can hope to achieve, and the parameters within which such discussions should be conducted if they are to balance the interests of home and host countries alike.

## **Annex**

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## Annex

### Collective action agendas on investment

Components of the international policy agenda on investment	Main issues/key considerations	Treatment under existing international arrangements	Treatment under the Doha Development Agenda mandate on investment	Appropriate collective action response
<i>Investment protection</i>	<ul style="list-style-type: none"> <li>Bilateral investment treaties (BITs) and regional integration agreements (RIAs) likely afford a higher overall level of protection to home country investors; limited scope for introducing investor-state arbitration into the WTO</li> </ul>	<ul style="list-style-type: none"> <li>Addressed comprehensively in BITs and RIAs</li> <li>No WTO disciplines deal directly with investment protection matters</li> </ul>	<ul style="list-style-type: none"> <li>Not addressed</li> </ul>	<ul style="list-style-type: none"> <li>BITs and RIAs likely preferred locus of continued rule-making advances</li> </ul>
<i>Investment liberalization</i>	<ul style="list-style-type: none"> <li>Barriers to entry primarily affect investment in services (up to 85% of discriminatory or presence-impeding measures are maintained in service sectors)</li> <li>Foreign investors in manufacturing often accorded better than national treatment by host countries (via investment incentives)</li> </ul>	<ul style="list-style-type: none"> <li>Treated in a number of BITs and more extensively in many RIAs</li> <li>Addressed solely under GATS for investment/commercial presence in services (GATS covers some two-thirds of global FDI flows)</li> <li>No WTO disciplines govern the liberalization of investment in manufacturing, mining or agriculture</li> </ul>	<ul style="list-style-type: none"> <li>Calls for a GATS-like, positive list, approach to liberalization commitments, including in respect of pre-establishment</li> </ul>	<ul style="list-style-type: none"> <li>WTO/GATS already targets a high percentage of investment restrictions (barriers to entry and post-entry operating restrictions)</li> <li>Challenge to strengthen the investment liberalization properties of the GATS, through changes to means of scheduling commitments so as to lock in the regulatory <i>status quo</i></li> </ul> <p>Limited coherence/value-added from a separate multilateral regime for investment in manufacturing</p>

Components of the international policy agenda on investment	Main issues/key considerations	Treatment under existing international arrangements	Treatment under the Doha Development Agenda mandate on investment	Appropriate collective action response
<i>Investment distortions</i>	<ul style="list-style-type: none"> <li>• Performance requirements: e.g. local content or trade-balancing requirements are concentrated in manufacturing</li> <li>• Investment incentives also predominant in manufacturing; distortions arise mainly <i>within</i> regions; limited evidence of incentive-bidding along North-South lines</li> <li>• Investment-related trade measures (IRTMs) tilt forces of comparative advantage in favor of home countries: tariff peaks/escalation, contingent protection instruments, standards-related barriers, discriminatory sectoral rules of origin in RIAs</li> </ul>	<ul style="list-style-type: none"> <li>• Comprehensive disciplines on performance requirements under the TRIMs Agreement</li> <li>• Weak indirect disciplines on the granting of investment incentives via the Agreement on Subsidies and Countervailing Measures (ASCM)</li> <li>• IRTMs subject to various existing WTO disciplines (e.g. anti-dumping; safeguards; TBT; market access negotiations).</li> </ul>	<ul style="list-style-type: none"> <li>• Not addressed, except mandated work on disciplines governing the relationship between regional trade agreements and the multilateral trading system</li> </ul>	<ul style="list-style-type: none"> <li>• Need to clarify the scope of prohibited measures under the TRIMs Agreement and assess its developmental effects</li> <li>• Need to collect data on the nature, country and sectoral incidence of investment incentive schemes; disciplines best addressed at the regional level</li> <li>• Much scope for reducing the distorting effects of IRTMs via traditional market access negotiations and tightening of WTO disciplines on contingent protection and RIAs</li> </ul>
<i>Good governance</i>	<ul style="list-style-type: none"> <li>• Enhancing regulatory transparency</li> <li>• Combating bribery and corruption</li> <li>• Promoting corporate social responsibility</li> <li>• Enhancing corporate governance</li> <li>• Promoting policy dialogue on “best practices” in investment promotion</li> </ul>	<ul style="list-style-type: none"> <li>• Transparency obligations are found in all existing WTO agreements relating to investment (e.g. TRIMs, GATS, TRIPs, GPA, ASCM, DSU)</li> </ul>	<ul style="list-style-type: none"> <li>• Focus on transparency only</li> </ul>	<ul style="list-style-type: none"> <li>• Most governance-enhancing issues are best addressed outside the WTO, through existing agreements and arrangements at both the regional and multilateral levels (e.g. OAS, OECD, UN). Mix of binding and non-binding disciplines; hard vs. soft law approaches; mix of disciplines affecting state and private actors; enforcement via peer review or trade sanctions;</li> </ul>

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<b>Components of the international policy agenda on investment</b>	<b>Main issues/key considerations</b>	<b>Treatment under existing international arrangements</b>	<b>Treatment under the Doha Development Agenda mandate on investment</b>	<b>Appropriate collective action response</b>
				significant scope for expanding developing country involvement through greater capacity building efforts (via World Bank or regional development bank funding)

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