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CHAPTER V

THE IMPORTANCE OF NATIONAL POLICY SPACE

The preceding analysis revealed that IIAs need to accommodate different perspectives on the policy priorities in the investment process. The common goal, shared by all parties to IIAs, is to increase the flows of FDI. In addition, home countries (and their investors) seek transparency, stability, predictability and security—and greater market access. And host developing countries, for their part, want to advance their development by increasing the benefits from FDI. To do so, they need to have enough flexibility to use a range of development-oriented policies. In the final analysis, IIAs have to be acceptable to all parties, many in different development situations with widely differing endowments. IIAs therefore need to strike a mutually advantageous balance of rights and obligations between the diverging interests and priorities of various groups of countries.

The concept of "national policy space" and the flexibility it affords to governments to pursue development-oriented FDI policies is the operational bridge between the differing perspectives of host countries, home countries and investors (UNCTAD 2000d). (Although the focus here is on developing countries, developed countries also need policy space to pursue their own national objectives.) Its foundation is the right to regulate, a sovereign prerogative that arises out of a State's control over its own territory and that is a fundamental element in the international legal regime of State sovereignty. Although host countries already limit their regulatory autonomy as a result of liberalization policies—and have their autonomy limited as part of the wider process of economic globalization—IIAs create distinctive issues in this connection. Such international agreements, like other legal texts, are specifications of legal obligations that limit the sovereign autonomy of the parties. Given that international legal obligations generally prevail over domestic rules, tension can arise between the will to cooperate at the international level through binding rules and the need for governments to discharge their domestic regulatory functions.[1] This challenge is not unprecedented: similar issues of the relationship between a country's commitments and its regulatory discretion have arisen in trade agreements (box V.1).

Box V.1. Regulatory discretion in international trade agreements

The scope of a country's regulatory discretion has been debated and litigated in the GATT/WTO system, where the dispute settlement process has been used to review domestic regulatory measures that have an impact on trade. The main instrument for reviewing regulatory discretion in the WTO is found in Article III of the GATT, which contains a non-discrimination (national treatment) obligation as complemented by the exceptions contained in Article XX. Article III provides that internal taxes and regulations must not treat imports less favourably than domestic products in like circumstances. If a domestic regulatory measure is found to discriminate against imports, the regulating government may attempt to justify the discrimination by proving that it is necessary to achieve some legitimate purpose. Article XX exceptions include those necessary to protect public morals; to protect human, animal and plant life or health and those relating to the conservation of exhaustible resources.

It should be noted that this list of policies is "closed" and thus provides limited scope for claiming an exception in many areas in which countries may want to pursue regulatory action. It is also subject to the general requirement that the exception does not constitute a means of arbitrary discrimination or a disguised restriction on international trade. This requirement has been interpreted as introducing a principle of proportionality, in that a country must apply the least trade-restrictive exception compatible with its regulatory policy.

The WTO Agreement on Technical Barriers to Trade explicitly calls for an integrated examination of the purpose of the measures in question and its trade-restricting effects. The Agreement requires a balancing of the degree of

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Box V.1. Regulatory discretion in international trade agreements (concluded)

trade restriction against the regulatory purpose of the disputed measure. Furthermore, the analysis of the regulatory aim is part of the review of the legality of the measure itself, with an illustrative (not closed) list of legitimate objectives. In this context, there is no need first to establish a violation (which requires a conclusive determination of likeness), followed by a review of the regulatory justification by way of exception. The balancing analysis also calls for an appreciation of the trade effects in light of existing less restrictive alternatives and of the risk of non-fulfilment of the regulatory objectives.

The WTO Agreement on Sanitary and Phytosanitary Standards adopts a similar approach to the control of regulatory discretion as the Technical Barriers to Trade Agreement and Article XX of GATT. It affirms the right of WTO members to impose sanitary or phytosanitary measures, provided that they are applied "only to the extent necessary" and that they are based on scientific principles and evidence. Where the scientific evidence is insufficient, members may adopt such measures on the basis of "available pertinent information".

While the GATS recognizes the sovereign right of a country to regulate services for legitimate purposes (box V.2), Article VI seeks to prevent the use of administrative decisions to disguise protectionist measures. Generally applied measures that affect trade in services for which a country has made commitments must be applied reasonably, objectively and impartially. Applications to supply services under such commitments must receive a decision within a reasonable period. The Council for Trade in Services is called on to develop rules to prevent requirements governing qualifications for service suppliers, technical standards or licensing from being unnecessary barriers to trade. Until such rules are ready, governments are to follow (in activities in which they have undertaken specific commitments) the same principles in applying their requirements and standards, so that these do not nullify or impair specific commitments (on market access and national treatment).

Source: UNCTAD.

For investment the right to regulate has recently gained renewed prominence in investment protection from expropriation and in national treatment. It was evoked as a "shield" against an expansive use of expropriation claims by investors that have threatened to encroach on a sovereign government's right to regulate in the public interest, with the possible effect of "regulatory chill". It involves the determination of where the property rights of investors could be legitimately subjected to the regulatory power of governments and where they could not. (This was discussed in IV.C.)

The right to regulate arose concretely in the context of investor-State disputes under NAFTA, particularly in environmental protection. The three member countries of NAFTA adopted in 2001 a "Note of Interpretation of Certain Chapter 11 Provisions" (NAFTA 2001) to clarify the provision governing the minimum standard of treatment to be accorded to foreign investors under the fair and equitable treatment provision in Article 1105 (1). They determined that the NAFTA's standard is the customary international law minimum standard of treatment. The concept of the "right to regulate" was also included in the GATS, the WTO Doha Ministerial Declaration and the draft Multilateral Agreement on Investment (MAI). And it was highlighted in intergovernmental deliberations within the context of UNCTAD's Commission on Investment, Technology and Related Financial Issues (box V.2).

Box V.2. The right to regulate

The language in these instruments is as follows:

The GATS (Preamble):

"Recognizing the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right;" (UNCTAD 1996b, I, p. 287).

WTO Doha Ministerial Declaration (paragraph 22):

"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." (WTO 2001b, p. 5).

Draft Multilateral Agreement on Investment:

Article 3
Right to Regulate [a]

"A Contracting Party may adopt, maintain or enforce any measure that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns, provided such measures are consistent with this agreement..." (OECD 1998a, p. 14).

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As these references suggest—and this is consistent with the sovereign prerogative of States to regulate the entry and behaviour of aliens into their own territories—the right to regulate is broader in its conceptual scope than the specific context in which it recently gained renewed prominence. It is, in effect, the principle on which the notion of "national policy space" and hence flexibility is based.

Ensuring sufficient flexibility is a difficult balancing act. In IIAs it is the result of negotiations in the light of overlapping—but not identical—objectives between home and host countries. It finds expression in the objectives of IIAs, their structure, content and implementation, including through the recognition of the concept of special and differential treatment, and the use of exceptions and the like, to further development goals. Each is considered in turn (UNCTAD 2000d).

Box V.2. The right to regulate (concluded)

UNCTAD Commission on Investment, Technology and Related Financial Issues:

> "Many delegates stressed that policies needed to reflect the special circumstances prevailing in a country and that they should evolve over time. In this context, many delegates underscored the need to ensure sufficient policy space for the pursuit of national policy objectives and the importance of the right to regulate. Specific reference was made to the LDCs' need of special and differential treatment in the context of various international agreements" (paragraph 50).
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> "The right to regulate was relevant in this context, in particular the recognition of the public interest to pursue objectives related to security, health, morals, and so forth. Exceptions were also important, especially those related to balance-of-payments safeguards" (paragraph 57) (UNCTAD 2003j, pp. 14 and 16).

[a] Text as contained in Chairperson's proposed package on Labour and Environment.

A. Objectives of IIAs

Many IIAs incorporate the objective of development among their basic aims, purposes or principles, as a part of their preambular statements or as specific declaratory clauses articulating general principles. For example, the Preamble to the GATS Agreement (which covers FDI in services) includes among its objectives "the expansion of [services] trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries". It also expresses a desire for the "early achievement of progressively higher levels of liberalization of trade in services through successive rounds of multilateral negotiations aimed at promoting the interests of all participants on a mutually advantageous basis and at securing an overall balance of rights and obligations, while giving due respect to national policy objectives". It continues, by expressing a further desire, "to facilitate the increasing participation of developing countries in trade in services and the expansion of their service exports including, *inter alia*, through the strengthening of their domestic services capacity and its efficiency and competitiveness".

The main advantage of such provisions is that they may assist in the interpretation of other substantive obligations, permitting adoption of the most development friendly interpretation. This in turn assists in the promotion of flexibility and the right to regulate by ensuring that the objective of development is implied in all obligations and exceptions thereto—and that it informs the standard for assessing the legitimacy of governmental action under an agreement.

B. Structure

The structure of agreements may reflect development concerns through the application of special and differential treatment for developing country parties. This entails differences in the extent of obligations undertaken by developed and developing country parties, with the latter assuming less onerous obligations, either on a temporary or permanent basis, that are also non-reciprocal. This may be achieved in a number of ways:

- Agreements can distinguish between developed and developing countries, with different obligations for both. MIGA, for example, restricts its investment insurance to investment in developing countries only, listed in an annex to the MIGA Convention.
- Differences may be introduced for stages and degrees of participation by developing country parties, with accession less onerous for them

or allowing for association rather than full commitment to treaty obligations.

Particularly important is the approach to arrive at commitments:

- Under the "negative list" approach, countries agree on a series of general commitments and then list individually all those areas to which these commitments do not apply. For example, the NAFTA parties have agreed to grant the right of establishment; at the same time, each of the parties lists those activities to which this right does not apply. To all other activities, it applies. This approach tends to produce an inventory of all non-conforming measures. It also locks in the status quo.
- Under the (GATS-type) "positive list" approach, countries list commitments they agree to make, and the conditions they attach to them.[2] For example, the GATS parties list all activities that they agree to make subject to the provisions of the Agreement concerning, for example, commercial presence, and the conditions under which this is the case (such as only a certain number of foreign affiliates can be established in a particular industry). The implication is that the same provisions do not apply to all other activities—that is, they remain "unbound". This approach has the advantage that countries can take commitments at their own pace and determine the conditions under which this occurs. For these reasons, the positive list approach is generally regarded as more development friendly than the negative list approach.

In theory, both approaches should arrive at the same result, if countries had the capacity to make proper judgments about individual activities—or, more broadly, about the taking of commitments—at the time of concluding an agreement. In practice, the negative list approach tends to involve greater liberalization. In practice, too, even a positive list approach can lead to liberalization, because negotiations put pressure on countries to assume higher and broader commitments, particularly since those negotiations are bilateral.[3] Under both approaches countries often use various devices to keep options open when scheduling their commitments. Moreover, once a commitment has been made, it is locked in, making it virtually impossible to reverse it.

Table V.1 presents graphically how a broad positive list approach could work for investment should countries decide on modalities to negotiate and should they consider a positive list approach. It is "broad" because it applies not only to activities but also to other issues addressed in IIAs. It is structured along the two main fracture lines that emerged during the analytical discussions in the WTO's Working Group on Trade and Investment:

- National treatment in the pre-establishment phase versus national treatment in the post-establishment phase.

Table V.1. A thought experiment to help analysis—applying the positive list approach to investment

	National treatment in the pre-establishment phase		*National treatment in the post-establishment phase*	
Issue/measure	**FDI**	**Foreign portfolio investment**	**FDI**	**Foreign portfolio investment**
Definition				
National treatment				
MFN				
Fair and equitable treatment				
Transparency				
Nationalization and expropriation				
Home country measures				
Good corporate citizenship				
Dispute settlement (State-State, investor-State)				
Incentives				
Transfer of technology				
Competition policy				
Other				

Source: UNCTAD, based on Eglin 2002.

- FDI versus foreign portfolio investment, financial derivatives and other investment—that is, the scope of an agreement.

In this approach, countries would need to decide, cell by cell, whether they would want to commit themselves and, if so, under what conditions. For example, a country prepared to offer high standards could do so by filling out every cell attaching few conditions to its commitments; a country that wants to commit itself only to certain standards as regards FDI (for example, national treatment in the post-establishment phase) could do so as well, including by attaching the conditions it requires to promote its development. In other words, each country would fill out the table as best suits its own interests. (Certain cells that do not apply would remain empty.) In principle, a party to such an agreement could also refrain from filling out any cell.

A variation of this approach is that certain commitments are taken by all parties for a limited number of issues.[4] Such commitments would be easiest in areas that are important but not particularly sensitive in international investment negotiations—such as MFN treatment and transparency. This approach could be combined with a general commitment to extend, in due course and through negotiations, such stronger commitments to other issues, such as national treatment in the post-establishment phase.

Whatever the approach chosen, the experience of international economic agreements suggests that countries in most cases prefer a gradual approach.

C. Content

As to the substantive content of agreements, the key substantive issues were addressed in the preceding chapter. Central to IIAs, they determine their effect on national policies. For each of them, more development friendly or less development friendly solutions exist. (For example, as discussed earlier, national treatment at the pre-establishment phase—market access—is perhaps the single most difficult issue for developing countries to accept in IIAs.) And given their importance, they require the full attention of negotiators.

When negotiating content, flexibility can also be introduced through various means:

- Flexibility can be ensured by excluding some issues altogether. For example, excluding provisions on incentives from the draft MAI would have allowed countries to have maximum policy flexibility in this area (consistent with other international obligations). Most IIAs exclude taxation issues (covered in double taxation treaties).
- Circumscribing the scope of key provisions—say, by limiting the definition of investment to FDI only.
- Agreements can include provisions of special interest to developing countries, such as those pertaining to transfer of technology or home country measures.
- Various traditional methods can preserve policy space. These range from various kinds of exceptions, reservations, derogations and waivers to transition arrangements that aim to ensure that signatories retain their prerogative to apply non-conforming domestic regulations in certain areas. Examples include exclusions from the non-discrimination principle;[5] safeguards aimed at preserving the right to regulate (box V.3), as in balance-of-payments difficulties; and general exceptions for reasons of public security and order, public health and morality.

Note that the provisions of IIAs interact with one another to complement, clarify, expand, limit or elaborate on the rights and obligations of parties. For example, general exclusion or exception clauses have the effect of limiting the scope of an agreement or modifying the application of its provisions. Similarly, general standards of treatment, such as national treatment or fair and equitable treatment, affect and complement the substance of more specific standards dealing with, for example, operational conditions or expropriation. These interactions offer multiple possibilities for structuring and combining provisions in IIAs to achieve the desired overall balance of rights and obligations, and accommodate diverging country interests (for examples of these combinations, see UNCTAD 2000d).

Box V.3. Emergency safeguard mechanisms in the area of investment

To preserve the right of countries to regulate in the public interest, various safeguards are often used in international agreements. Safeguards, or "escape clauses", are provisions that allow parties to take action otherwise not permitted by an agreement, to cope with exceptional events arising after its adoption. Relevant provisions normally set definite limits, in time and substantive measures, on the action to be taken. The most common situations contemplated in safeguard clauses in IIAs relate to balance-of-payments safeguards.

In trade, if a production sector in a country suffers because of increased imports, the WTO Agreement on Safeguards authorizes WTO members to restrict imports temporarily by imposing higher tariffs or by directly limiting import quantities under certain conditions which may cause or threaten to cause serious injury to the domestic industry that produces like or indirectly competitive products. The main rationale for this provision is that the particular sector in the country should be allowed time to adjust to the new competition from imports.

If similar emergency safeguard mechanisms (ESMs) were included in IIAs, some complex issues would have to be addressed. What conditions would have to be met, and what procedures would have to be observed in order to invoke the ESM in the context of an investment agreement? What would be the equivalent of an import surge in the investment context, and how would one address emergency situations arising, for example, from the "crowding out" of SMEs? Could emergency situations also be considered in case of sudden withdrawal of investment (as opposed to a surge in inflows)? Moreover, since it may be difficult to distinguish between foreign affiliates and domestic firms once the former are established, would an ESM have to focus on new investment only?

The complexities can be seen from the lack of progress on this for trade in services. Article X of the GATS states that: "There shall be multilateral negotiations on the question of emergency safeguard measures based on the principle of non-discrimination. The results of such negotiations shall enter into effect on a date not later than three years from the date of entry into force of the WTO Agreement". Still, after more than seven years of discussions, the Working Party on GATS Rules has failed to produce an agreement. These discussions are relevant to the area of investment, since Mode 3 of trade in services (commercial presence or establishment trade) involves FDI.

So, very few IIAs include ESMs other than those associated with balance-of-payments difficulties. One example is Article 14 of the ASEAN Investment Area Agreement (AIA), which states that:

"1. If, as a result of the implementation of the liberalisation programme under this Agreement, a Member State suffers or is threatened with any serious injury and threat, the Member State may take emergency safeguard measures to the extent and for such period as may be necessary to prevent or to remedy such injury. The measures taken shall be provisional and without discrimination.

2. Where emergency safeguard measures are taken pursuant to this Article, notice of such measure shall be given to the AIA Council within 14 days from the date such measures are taken.

3. The AIA Council shall determine the definition of serious injury and threat of serious injury and the procedures of instituting emergency safeguards measures pursuant to this Article."

Although the ESM in the ASEAN Agreement has never been used, it serves the purpose of providing an assurance to countries that if exceptional consequences seriously or adversely affect their economies as a result of liberalization measures undertaken by them, they could resort to safeguard measures. Liberalization is something that some countries are cautious about in view of the possible impact on domestic industries.

If countries wish to include an ESM when negotiating IIAs, another approach could be along the lines of the Europe Agreements between the EU and various Central and Eastern European countries. In the Europe Agreement with Poland (1991), for example, Article 50 provides for the use of "safeguards" during specified transitional periods if certain industries are undergoing restructuring; are facing serious difficulties; face the elimination or a drastic reduction of the total market share held by Polish companies or nationals in a given sector or industry in Poland or are newly emerging industries in Poland. Safeguard measures (not specified) used shall cease to apply, at the latest two years after the expiration of the first stage or upon the expiration of the transitional period; they relate only to establishments in Poland to be created after the entry into force of such measures and shall not introduce discrimination concerning the operations of Community companies or nationals already established in Poland. The Agreement further notes that Poland shall, prior to the introduction of these measures, consult the Association Council. Upon the termination of the first stage or of the transitional period, Poland may introduce such measures only with the authorization of the Association Council and under conditions determined by the latter.

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D. Implementation of IIAs

The implementation of IIAs can also be designed with flexibility for development as its organizing principle. Two approaches are particularly relevant here: first, the legal character, mechanisms and effects of an agreement, and second promotional measures and technical assistance:

- Whether an agreement is legally binding or voluntary affects the intensity of particular obligations. Indeed, it is possible to have a mix of binding commitments and non-binding "best effort" provisions in one agreement. Thus, development- oriented provisions could be either legally binding or hortatory, depending on the extent to which the parties are willing to undertake commitments in this area. Evidently, "best effort" development provisions are of considerably less value to developing countries than legally binding ones.
- The asymmetries between developed and developing country parties to IIAs can be tackled by commitments addressed to the developed country parties to undertake measures of assistance to the developing and especially LDC parties. A leading example is the technology transfer commitment by developed country parties to the TRIPS Agreement towards LDCs. (The wider issue of home country commitments in IIAs to promote the flow of FDI to developing countries is discussed further in chapter VI.) Such developed country commitments can be complemented by provisions for technical assistance through relevant international organizations. These are particularly important, given the complexity of the subject matter and the limited capacity of many developing countries, and especially the LDCs, to undertake FDI related policy analysis and development, as well as human and institutional development. The last of these also involves assistance to developing countries to attract FDI and benefit more from it.

Box V.3. Emergency safeguard mechanisms in the area of investment (concluded)

A number of features of the approach taken in the Europe Agreements are worth noting. "Serious injury" is not stipulated as a test or condition, nor is "causation" (of the injury or of any of the circumstances specified), nor is "unforeseen developments" or "unforeseeability", nor is "sudden surge in investment or imports". The article simply lists circumstances or situations that would be sufficient to justify, during the transitional period, derogations from a specific obligation. The language also avoids the problem of discrimination by limiting the derogation to companies that have not yet established themselves in Poland. Notification and authorization requirements are intended to prevent protectionist abuse. Many developing countries could identify with the situations listed in Article 50. Moreover, developing countries could enjoy such "safeguards" or derogations only during a transitional period—that is, until their rising incomes and competitiveness led to their disqualification.

Source: UNCTAD.

Beyond that, each IIA is part of a larger set of investment agreements at bilateral, regional, inter-regional and global levels—and addresses a broad range of issues related to investment and the operations of TNCs. When the same parties participate in various agreements, their respective provisions also interact, to complement, elaborate, expand or limit these parties' obligations. It is therefore important, when designing IIAs, to bear in mind this broader context, and ensure that the standards, exceptions and the like that the parties seek to negotiate in agreements would not be modified or otherwise affected by other agreements in ways that were not intended. One example is the question of how investor protection standards interact with the environmental obligations of countries in multilateral environmental agreements.

In case of possible conflict between provisions in different agreements, it is also important to consider how IIAs can ensure their compatibility with conflicting obligations arising from these agreements. In principle, questions of compatibility between agreements are resolved in accordance with the principles set out by Article 30 of the Vienna Convention on the Law of Treaties. When the parties desire to ensure that no conflict of compatibility arises between an IIA and other treaties to which the signatory States may be a party, they can do so by inserting clauses in the agreement expressing this intent. Examples of such clauses include the "regional economic integration organization" clause, which ensures that the benefits of membership of such an organization are not extended to non-member countries that are also partners to the IIA on the basis of the MFN clause, and the preservation of rights clause found in bilateral investment treaties (BITs). Difficult questions remain however in this area, notably the operation of MFN clauses in BITs (box V.4).

Box V.4. The effect of the MFN clause in BITs—the example of performance requirements

The MFN standard in IIAs seeks to prevent discrimination between different foreign investors. It does so by requiring that the foreign investor protected by the standard enjoys treatment no less favourable than that enjoyed by the most favourably treated foreign investor. The application of this standard raises some particular problems for the operation of IIAs. The example of performance requirements is used here to illustrate these problems. The national treatment standard is also discussed so as to give a more complete analysis of how non-discrimination can operate in this context.

The great majority of IIAs, particularly BITs concluded by countries other than the United States or Canada, do not contain specific rules on the use of performance requirements. But such IIAs may nevertheless constrain the flexibility of governments to impose and implement performance requirements. The reason is that virtually all IIAs contain non-discrimination provisions, typically national treatment and MFN treatment. Thus, even if governments are otherwise free to impose performance requirements, they may not do so in a way that treats differently foreign and domestic investors—or foreign investors from different countries—in like circumstances. Such restrictions may, in turn, be subject to conditions and qualifications, described here.

National treatment standard

The national treatment standard (in both the pre- and post-establishment phases) precludes governments from discriminating between foreign and domestic enterprises in like circumstances when they impose performance requirements. A government may impose different performance requirements on investors that are not in like circumstances. This flexibility, however, is not unlimited: "like circumstances" are typically understood to refer to broad, objective characteristics of a business, such as its economic sector, the size of the entity or its geographic location.

So performance requirements could be imposed on foreign investors to ensure compliance with national development policies. These could be specifically geared to the particular benefits hoped to be obtained from their investments, investments that domestic investors may be unable or unwilling to undertake. Equally, preferential treatment of domestic investors could be justifiable on the basis of their actual economic condition—for example, with firms classified as "infant enterprises". The scope of protection thus needs to be determined case-by-case. Discrimination based on "circumstances" related only to the investors' nationality usually violates the national treatment obligations of IIAs.

Governments concluding IIAs often do not take commitments or negotiate to exempt certain activities or certain geographic regions from the market access and national treatment provisions of those agreements—as is the case under the "opt-out" provisions on national treatment in NAFTA, under which even entire industries (such as air transport) can be excluded. Articles XVI and XVII of the GATS allow governments selectively to liberalize particular industries of the economy by way of an "opt-in" provision and then to delimit the scope of national treatment in those industries. In such cases, or where national treatment is restricted in its application, a government could impose different performance requirements on foreign and domestic entities without breaching its treaty obligations to provide national treatment. Outside such situations any performance requirements must be imposed in an even-handed manner on foreign and domestic enterprises that are similarly situated.

MFN standard

The MFN provisions of IIAs have a similar effect. Even if the IIAs to which a country is a party do not preclude the imposition of performance requirements as such, the government will not be able to impose different requirements on investors from different foreign countries that are otherwise in like circumstances. Here, as with national treatment, "like circumstances" refer to neutral characteristics, such as industries, scale of operations, geographic regions and so forth. Where a government intends to discriminate between foreign investors from different countries, it can seek to include an exemption from MFN treatment for particular industries when negotiating an IIA. In most cases, it is difficult to justify such exemptions, but there are cases in which granting more favourable treatment to investors from certain countries is necessary. For example, a common exemption from the MFN standard is the one that permits preferential treatment for fellow members of a regional economic organization. Under the GATS, member countries can exempt specific measures from the MFN provision.

A particular issue that arises in the context of the MFN standard, but not in relation to the national treatment standard, is whether investors from a home country that has concluded a BIT (BIT A) with a host country, without a specific clause prohibiting the use of performance requirements, could nonetheless benefit from such a prohibition in a BIT between the host country and a second home country (BIT B), on the basis

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Box V.4. The effect of the MFN clause in BITs—the example of performance requirements (concluded)

of the MFN obligation in BIT A. Investors from home country A could assert that they have been discriminated against, in violation of the MFN standard, because they are subject to performance requirements that cannot be extended to investors from home country B by virtue of the prohibition against such requirements in BIT B. The success of such a claim would initially depend on establishing that the investors from country A and those from country B are in fact in like circumstances. Assuming this to be so, the next question is whether such a claim can be sustained on the terms of the BITs themselves. This question has not yet been faced or resolved in dispute settlement proceedings under IIAs.

The BIT with each home country is a specifically negotiated instrument. According to the ICSID Tribunal in the case of *Maffezini v Spain* (Case No.Arb/97/7 Decision on Objections to Jurisdiction, 25 January 2000), if the third-party treaty deals with matters not dealt with in the basic treaty applicable between the parties, those matters cannot be transferred to the basic treaty through the MFN clause. But where the third-party treaty does deal with the same subject matter, MFN treatment can apply to extend the better treatment in that treaty to investors under the basic treaty that is under review. Thus, in the Maffezini case, MFN was applied to the procedural question of the scope of the dispute settlement provision in the BIT between the parties. It was held that the MFN clause allowed the application of the higher standard of treatment offered by third-party treaties.

This was a special case. But it opens the issue of whether it is possible to argue that provisions other than procedural provisions might be subject to MFN review. An investor from Country A may seek to use the MFN provision in BIT A and argue, on the basis of Maffezini, that the prohibition of performance requirements in BIT B should also extend to investors from Country A and that it has been denied that protection. This is a question that stands to be determined by reference to the intention of the parties to the BIT, as expressed in the actual terms and text of the agreement—and in the subsequent investment treaty practice of the parties. This was a matter that the Tribunal in Maffezini considered in some detail as regards the approach of the countries concerned, Argentina and Spain, to the scope of dispute settlement clauses in their BIT practice.

Could it be said that, in concluding BIT A, the host country intended the more beneficial investment protection terms that it concluded in BIT B automatically to extend to investors and investments from country A? It is within the discretion of host countries to conclude BITs on more or less favourable terms with different home countries as they see fit. So, in the absence of clear evidence of such an intention, it is unlikely that BIT A could be interpreted on its face to extend the specific prohibition against performance requirements negotiated by home country B in favour of its investors and investments, to those of home country A, which did not negotiate a similar prohibition. The MFN standard does not confer benefits on the investors from country A in view of the substantive scope of BIT A. One case in which such an argument could succeed is where the host country adopts a general policy that prohibits the use of performance requirements, at the national level, or through a long and consistent practice of prohibition of such requirements in its BITs, but still applies such requirements to investors and investments from home country A. Here, there is discrimination as the application of the requirements would not be in accordance with a general policy, and only investors from A are being affected by the imposition of prohibited requirements. So long as the host country continues to apply performance requirements in general, it is free to offer preferential treatment to certain foreign investors if it so wishes.

The foregoing makes it obvious that the application of the non-discrimination provisions of IIAs, and of the MFN standard in particular, has considerable implications for the interactions between different IIAs. The issue needs to be borne in mind in the conclusion, application and interpretation of these agreements.

Source: UNCTAD.

Notes

1 There is no common understanding of the notion of regulation. In the OECD context "regulation refers to the instruments by which governments place requirements on enterprises, citizens, and government itself, including laws, orders and other rules issued by all levels of government and by bodies to which governments have delegated regulatory powers. Economic regulation intervenes directly in enterprise and market decisions such as pricing, competition, market entry or exit. Social regulation protects values such as health, safety, the environment and social cohesion. Administrative regulation concerns government formalities and paperwork, so-called 'red tape'" (OECD 2001c, p. 2).

2 In a sense, the conditions attached to any commitments imply a negative list approach to conditions—unless a country does not take any commitments in the first instance. To quote Oxfam

et al. (2003b, p. 4): "It requires governments to know, in advance, all the possible GATS-incompatible regulations they, or successive governments, might want to use in future in order to list exemptions at the time of making commitments".

3 The matter is further complicated by the fact that most developing countries are only host countries and not (or only marginally so) home countries. In request-offer bargaining situations these countries may therefore not have much to request when it comes to commercial presence.

4 This, for instance, is the case in the GATS.

5 For example, development considerations play a role in the case of Germany's approach in bilateral investment treaties (BITs) to national treatment in the post-establishment phase, insofar as Germany has accepted certain exceptions to the national treatment principle provided that these are undertaken for development purposes only (for example, to develop small-scale industries) and that the measures do not substantially impair investments by German investors (see the BIT between Germany and Papua New Guinea, 1980).