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## CHAPTER VI

# NATIONAL AND INTERNATIONAL POLICIES: A COMPLEX AND DYNAMIC INTERACTION

Over the past decade, the number of international agreements covering FDI in services has increased substantially, both in number and geographical scope. They reflect the negotiating parties' interests, bargaining power, technical capabilities, levels of liberalization and specific economic, social and other circumstances. The result is a multilayered and multifaceted network of international rules, with obligations differing in scope and content. Within the context of a broad liberalization trend, these agreements increasingly set the parameters for national policies on services through interaction between national and international policies on FDI in services. This interaction can either be led by autonomous liberalization or driven by IIAs. This complex and dynamic interaction poses challenges for development: while IIAs and autonomous liberalization create an enabling framework for FDI, the former also limit national policy space. This raises questions of how best to achieve development goals and how to strengthen the development dimension of IIAs.

At the bilateral level, the number of BITs covering FDI in services reached 2,265 by the end of 2003, and involved 175 countries. Other agreements covering services FDI include FTAs, RTAs and various types of economic partnership agreements. Services IIAs<sup>1</sup> can be found in all geographical regions, and there are also some inter-regional ones (e.g. the OECD Liberalisation Codes) as well as one at the multilateral level (i.e. the 1994 General Agreement on Trade in Services (GATS)). Reasons of why they are concluded are the desire to attract FDI to advance development (box VI.1), to protect FDI (i.e. to assure foreign investors that their investments, and the environment in which they invest, are reasonably secure) and, increasingly, to facilitate market access and the operations of foreign affiliates.

## A. The growing multifaceted network of services IIAs

The discussion here uses a broad definition of international investment agreements (IIAs) as “agreements at the bilateral, regional and multilateral levels that address investment issues” (WIR03, p. 88) with the qualification that the IIAs under review cover, in varying degrees, FDI in services (“service IIAs”). While some of the IIAs deal only with investment (e.g. BITs), others cover a broader range of issues, investment being one of them. Most recent FTAs fall into the second category.

### 1. The evolving nature of approaches covering FDI in services

Three approaches for IIAs' coverage of FDI in services can be distinguished.<sup>2</sup>

- The *investment-based approach*, whereby FDI is exclusively covered by the disciplines of the investment chapter of an agreement (e.g. the 1992 North American Free Trade Agreement (NAFTA)<sup>3</sup>) or where an agreement deals exclusively with investment (e.g. BITs). In both cases, the agreement or the specific chapter covers services and non-services investments without differentiating between them.<sup>4</sup> (As seen earlier, most FDI is in the services sector.)
- The *services-based approach*, whereby services FDI is exclusively covered by the disciplines of the services chapter of an agreement or by an agreement as a whole (if the latter deals exclusively with trade in

services) and which covers commercial presence as one of the four modes of trading services. Besides the GATS (box VI.2), the 1998 Andean Community Decision 439 and the 1995 ASEAN Framework Agreement on Services are examples of this approach.

- The *mixed approach*, whereby services FDI is covered by both the investment and services chapters of an agreement. An example is the 2002 Japan–Singapore Agreement. Under this approach, in certain cases, a special provision in the investment chapter may rule out the applicability of a particular investment discipline, or more general investment disciplines, to services FDI (see below).

To some extent, these three approaches can be viewed as reflecting the evolution over time of IIAs in relation to services. Thus, the first and earliest approach, the investment-based approach, does not make a distinction between services and non-services investments. This approach is quantitatively dominant, all the more so as BITs – while otherwise following different approaches (box VI.3) – continue to be concluded in large numbers. It can be explained, first, by the absence of any express desire by policy-makers to treat investment in services as conceptually different from investment in other sectors and, second, by the wide coverage of the definition and scope of provisions of such agreements. The second approach reflects the manner in which international

### Box VI.1. What difference do services IIAs make?

What is the impact of services IIAs in terms of attracting investment in services and benefiting from it? IIAs can have an impact on FDI flows by influencing one of the principal determinants of FDI – the regulatory framework. These agreements tend to make the regulatory framework more enabling, opening space for the decisive economic determinants to assert themselves. IIAs achieve this by:

- reducing obstacles to FDI through the removal of restrictions on admission, establishment and on the operations of foreign affiliates;
- improving standards of treatment of foreign investors (e.g. by granting them non-discriminatory treatment vis-à-vis domestic or other foreign investors);
- protecting foreign investors through provisions on compensation in the event of nationalization or expropriation, by stipulating procedures for dispute settlement as well as guaranteeing the transfer of funds; and
- providing for a transparent, stable and predictable regulatory framework.

To the extent that the enabling framework is enhanced (be it because of autonomous or of IIA-driven regulatory action) *and* the economic determinants are attractive to investors, FDI is likely to flow to this sector. By the same token, when the economic determinants are not favorable, substantial investment flows are not likely to materialize. Indeed, as discussed in chapter III, a good part of the growth of services FDI during the past decade

or so has been due to an improved enabling regulatory environment. Most of the improvements have been the result of autonomous decisions, rather than the result of services IIAs (but these decisions tend to become more credible in the eyes of investors through commitments in IIAs).

In contrast to FDI in goods for which RTAs expand the market by facilitating trade among the participating members of the region and hence encourage FDI, market size plays less of a role in the case of services, as most of them are less tradable. By the same token, FDI in services may be less subject to regional strategies of rationalization whereby goods firms consolidate production into one or a few foreign affiliates to service the regional area as a whole, thus reducing FDI.<sup>a</sup> Services FDI (like goods FDI) may, however, benefit if a RTA stimulates economic growth.

Thus, it is difficult to ascertain to what extent services IIAs contribute to increased FDI flows in services.<sup>b</sup>

And what about the benefits and costs? As discussed in chapter III, services FDI can involve a range of benefits and costs. In most cases, these can be enhanced or mitigated, as the case may be, through appropriate government policies. The issue then becomes whether IIAs enhance or restrict the ability of governments to pursue development-oriented policies – an issue taken up in some detail in *WIR03* (chapters III to VI). From a services-specific perspective, it is discussed further below in this chapter.

Source: UNCTAD.

<sup>a</sup> This situation may, however, change with the increasing tradability of services (see chapter IV).

<sup>b</sup> For a further discussion, see *WIR03*, chapter III.

### Box VI.2. The GATS and FDI in services

The GATS is unique in that it establishes the only set of multilateral rules for services FDI in the context of international services transactions in general. All 147 members of the WTO are bound by the rules of the GATS insofar as they apply specifically to that country. The Agreement covers four modes of services supply, one of which is the supply of services through “commercial presence”, defined as “any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service” (Article XXVIII, lit. d).<sup>a</sup> “Commercial presence” is therefore akin to FDI. (The other modes of supply are cross-border supply, consumption abroad and the presence of natural persons.)

The definition of commercial presence in the GATS is narrower than the asset-based approach commonly found in IIAs entered into by both developed and developing countries (UNCTAD 1999b). Also, unlike other services IIAs, the GATS does not contain those disciplines on investment protection that typically constitute central tenets of other IIA regimes (e.g. the GATS does not contain rules that assure foreign investors compensation in the case of expropriation or set the minimum standard of treatment).<sup>b</sup> Nor does it explicitly prohibit performance requirements<sup>c</sup> or provide for investor–State dispute settlement.

Two key GATS obligations are found in Articles XVI (market access) and XVII (national

treatment). They apply only to those service industries (“sectors” in WTO parlance) and modes of supply in respect of which a WTO member has made “specific commitments” in its schedule. When making a commitment, a member may set out limitations, conditions and qualifications on market access and national treatment with respect to listed industries and modes of supply. Such conditions may include the ability to place restrictions on foreign equity participation, to require joint ventures (or other specific types of legal entity), to require the payment of taxes on the remittances of foreign affiliates, to be able to grant subsidies to domestic service suppliers in specific industries, to limit the use of land by foreign affiliates, to place geographical restrictions on the supply of certain services by foreign affiliates, or to limit the total number of (natural) persons employed in a particular service industry. Accordingly, the impact of the GATS is to a large extent dependent upon the content of members’ commitments and any limitations attached to them.

In pursuance of the objective of the GATS, the Agreement provides for the periodic negotiation of specific commitments through successive rounds of negotiations. The first of these rounds was mandated by the Agreement and subsequently incorporated into the negotiations launched by the 2001 WTO Doha Ministerial Meeting. The process of requests and offers of commitments was underway in mid – 2004. By 9 July 2004, 44 offers (counting the European Communities (15) as one) have been received by the WTO Secretariat.<sup>d</sup>

Source: UNCTAD.

<sup>a</sup> Note that GATS Article XXVIII also sets out equity thresholds, establishing when juridical persons are “owned” by persons of a member. Specifically, lit. (n) states: “a juridical person is: (i) ‘owned’ by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member; (ii) ‘controlled’ by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions; (iii) ‘affiliated’ with another person when it controls, or is controlled by, that other person; or when it and the other person are both controlled by the same person”.

<sup>b</sup> Note, however, that the GATS contains certain disciplines related to investment protection, for example, rules on payments and transfers (i.e. Article XI), rules on the “reasonable, objective and impartial” administration of measures of general application in committed sectors (i.e. Article VI, para.1) or provisions addressing certain cross-border movements of capital (i.e. those set out in footnote 8 to Article XVI).

<sup>c</sup> This does not exclude, that members commit themselves in this respect in their schedules. At the same time, Article XIX, para. 2 allows performance requirements attached as conditions to market access and national treatment commitments.

<sup>d</sup> “Trade talks on services ‘may last years’”, *Financial Times*, 6 July 2004. For the initial offers, to the extent that they are publicly available, see <http://www.wto.org>.

transactions in services (including commercial presence) were addressed in the context of the GATS negotiations in the Uruguay Round.

The third approach blends the other two approaches by addressing investment, typically in a separate chapter, while simultaneously

enshrining special rules for services FDI (in the context of international service transactions in general) in another chapter. These agreements also increasingly cover a host of other issues, including some that have implications for investment (e.g. competition). A growing number of recent FTAs and RTAs adopt this approach.

### Box VI.3. Approaches to BITs and FDI in services

In BITs, services FDI is subject to the same rules as all other types of investment.<sup>a</sup> However, not all BITs are identical, although they have much in common (UNCTAD 1998). There appear to be three main approaches: the first could be called the broad, Western Hemisphere approach, promoted most actively by the United States and Canada; the second is the more narrow European approach, mostly followed by European countries;<sup>b</sup> and the third is the South-South approach (which is close to the European approach).<sup>c</sup>

The Western Hemisphere approach extends *national treatment and MFN obligations* to the pre-establishment phase of investment (while accommodating country-specific exceptions to these obligations), while the other approaches tend to cover only the post-establishment phase. Similarly, the Western Hemisphere approach tends to contain a specific article on prohibited *performance requirements*, while the other approaches may deal implicitly with such requirements, e.g. in so far as they might violate the national treatment or MFN obligations.<sup>d</sup> One distinguishing feature of the 2004 United States and Canadian<sup>e</sup> model BITs is that they contain provisions not to lower *environmental and labour standards* to attract investment. Further, with

respect to *transparency*, the United States and Canadian model BITs include so-called *a priori* comment and publication procedures, whereas the few European treaties containing transparency requirements limit their applicability to the stage after the adoption of laws and regulations. Some of the distinctive features of the South-South approach involve that they put more emphasis on exceptions (e.g. for balance-of-payments or prudential measures) and the so-called fork-in-the-road clause, i.e. investors must choose between the litigation of their claims in a host country's domestic courts or international arbitration: once made, the choice is final.

Learning from investor-State litigation under NAFTA, the most recent United States and Canadian model BITs clarify the meaning of the articles on *minimum standard of treatment* (including fair and equitable treatment and full protection and security) and *expropriation*.<sup>f</sup> So far, this has not been done in European and developing-country BITs, perhaps in part because European and developing countries either have not yet been extensively involved in high profile investor-State litigation, or because awareness about the implications of such cases is only just beginning to emerge.

Source: UNCTAD.

<sup>a</sup> However, the 2004 United States model BIT, for example, contains specific obligations for certain service industries (i.e. financial services). See the Treaty between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment, 2004; <http://www.state.gov/documents/organization/29030.doc>.

<sup>b</sup> Since the European Commission does not have a mandate to negotiate investment issues on behalf of the members of the Union, European countries continue to conclude separate BITs, which, nevertheless, possess the same basic features.

<sup>c</sup> Given the great number of developing countries, it is, of course, difficult to speak about a developing-country approach, especially as far as a number of Latin American countries are concerned. The matter is further complicated by most developing countries having BITs with either North American or European countries.

<sup>d</sup> Rules on performance requirements are, however, set out in the 1994 WTO Agreement on Trade-Related Investment Measures (TRIMs).

<sup>e</sup> See the 2004 Canadian model BIT, Agreement between Canada and \_\_\_ for the Promotion and Protection of Investments, 2004; <http://www.dfait-maeci.gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf>.

<sup>f</sup> The relevant rules can be found in Articles 5 and 6 and Annexes A and B of the United States model BIT. More specifically, Annex A emphasizes the parties' shared understanding of customary international law for minimum standard of treatment and expropriation, while Article 5 and Annex B spell out in more detail the meaning of customary international law for "fair and equitable treatment", "full protection of security" and "expropriation".

This mixed approach raises the question of the relationship between the two chapters in an agreement – an issue discussed below.

Naturally, such a categorization must be treated with caution since it looks only at a particular agreement in isolation from other agreements, which together form the legal regime for investment, both in services and non-services, between two or more countries. For example, a services-based approach in a RTA may be complemented by a BIT that also covers services FDI; taken together, they constitute a mixed approach of a different nature. To take another example, this time from the Andean Community, the 1991 Decision 291<sup>5</sup> deals with investment in general, thereby also covering services FDI; it is complemented by Decision 439 which takes a services-based approach (i.e. covers only services FDI). A similar situation arises in the context of ASEAN. Here, the ASEAN Framework Agreement on Services is complemented by the 1998 (as amended in 2001) Framework Agreement on the ASEAN Investment Area (AIA). While the AIA in its original form did not cover services FDI, in its current form it covers FDI in services incidental to manufacturing, agriculture, fishery, forestry, mining and quarrying.<sup>6</sup> In parallel, the 1987 (as amended in 1996) ASEAN Agreement for the Promotion and Protection of Investments<sup>7</sup> applies to services FDI. Together, these agreements, too, constitute a mixed approach. Thus, ultimately, it is necessary to look not only at individual agreements, but also at the overall legal regime established between countries.

## 2. Salient features

A number of issues arise in light of the three approaches identified above. The treatment of these issues – many of which also apply to goods FDI but are particularly relevant to services FDI – differs across agreements. However, certain tentative general observations can be made.

### Structure and organization

As regards structure and organization, agreements following the investment-based approach raise few problems, given that services and non-services investments are not differentiated for the purposes of the investment provisions of the agreements.

Agreements adopting a services-based approach allow addressing the specificities of services FDI. However, this approach requires a determination of whether an investment is a services or a non-services investment, which is sometimes difficult, even for statistical agencies.<sup>8</sup> Agreements adopting a mixed approach, too, need to determine whether an investment is a services investment or not, and what that means in each case. This can give rise to inconsistencies – an issue discussed below.

### Definition of investment

Traditionally, IIAs either contain broad, asset-based or narrow, enterprise-based definitions of investment, with the large majority (especially BITs and FTAs) adopting the former (UNCTAD 1998).<sup>10</sup> IIAs taking the services-based approach (i.e. the ones that cover services investment as “Mode 3/commercial presence” in services trade) are more likely to adopt narrower, enterprise-based definitions than IIAs that do not contain a services chapter. The GATS and the Andean Community Decision 439<sup>11</sup> are examples. In addition, some agreements using the mixed approach, for example the 2002 EFTA–Singapore FTA and the Japan–Singapore Agreement, adopt both a narrower, enterprise-based definition of investment in their services chapter<sup>12</sup> and a broader, asset-based definition in their investment chapter.<sup>13</sup> The implication is that, in spite of the services chapter’s narrower definition of what an investment is, the investment may actually benefit from the broader definition of the investment chapter (e.g. when it comes to the protection of intellectual property rights often covered by the asset-based definition), unless there are specific provisions that provide for a different approach. While this may have far-reaching implications for the scope and breath of an IIA as well as for the obligations countries accept thereunder, it has, thus far, received comparatively little attention from policy-makers, particularly in developing countries.

Linked to the definition and scope of investment covered by an IIA is the question of who should benefit from its provisions. Most of the services IIAs contain special clauses regarding the beneficiaries under the respective agreements, frequently entitled “Denial of Benefits”.<sup>14</sup> These clauses identify those investors and investments that are not eligible for the benefits provided by the respective agreement. Generally, these are enterprises in the

territory of a party but owned or controlled by investors of a *non*-party.<sup>15</sup> Frequently, these clauses, which identify non-eligible investors through a so-called “substantial business operations test”, state that benefits can be denied to an enterprise that is owned and controlled by persons of a non-party, if the enterprise has no substantial business activities in the territory of the party under whose laws it is constituted.<sup>16</sup> The 2003 Mainland–Hong Kong Closer Economic Partnership Arrangement,<sup>17</sup> for example, sets out in detail the criteria for determining whether or not an enterprise has substantive business operations (box II.7). The GATS, too, refers to substantive business operations, but without defining them. While one of these references is in the Article containing definitions for the purpose of the GATS (Article XXVIII, lit. m (i)),<sup>18</sup> the other one refers to economic integration (Article V, para. 6). This provision entitles those service suppliers of WTO members that are established in an economic integration agreement area to the benefits of that agreement if they engage in substantive business operations in one of the parties to that agreement.<sup>19</sup> Thus, it refers to the extension of benefits to third-party companies conducting “substantive business operations” in the context of a very specific set of circumstances (i.e. derogations from GATS disciplines permitted as a result of entering into economic integration agreements).<sup>20</sup>

### Investment liberalization

The principal issue here is whether an agreement covers both pre- and post-entry investment, or post-entry investment only. Certain recent FTAs contain the right of establishment (i.e. cover pre-entry investment), while most BITs, except for recent ones signed by some countries in the Western Hemisphere, apply to post-entry investment only (UNCTAD 1999b). Where the right to establishment is granted (in some BITs and a number of FTAs), this is typically done by extending national treatment commitments at the pre-entry stage. At the regional level, NAFTA takes this approach. While the approach is different in the GATS, the agreement also allows members to grant pre-establishment rights in the context of the commitments they undertake. (Note also the definition of commercial presence under the GATS, which includes the words “establishment” and “acquisition”.) Overall, where countries grant pre-establishment rights, they tend to complement

them with a high number of conditions or limitations.

There are instances in regional groupings, including those comprising developing countries, in which parties agree, in principle, to negotiate future liberalization of services to a degree that goes beyond what has been agreed in the GATS.<sup>21</sup> The ASEAN Framework Agreement on Services is an example (box II.8).

### Investment protection

Most agreements taking the investment-based approach contain core protection disciplines, including national treatment, MFN and fair and equitable treatment. In some agreements, these may be linked to the observance of the international minimum standard of treatment. Equally, agreements normally cover compensation for loss and expropriation, and provide for the free transfer of funds. Agreements taking the services-based approach tend to be less far-reaching as regards investment protection. For example, the GATS does not contain a set of investment protection rules, though it has, for example, a general MFN obligation (subject to exemptions), rules on transfers and payments (Article XI), and other capital transactions (footnote 8 to Article XVI<sup>22</sup>), as well as national treatment (the latter subject to limitations) (Sauvé and Wilkie 2000). Agreements not containing strong rules on protection may, however, be complemented by agreements focusing on protection, for example, BITs. On the other hand, agreements taking a mixed approach are likely to contain all the main investor-protection standards and guarantees typically covered in investment-based IIAs. For example, the New Zealand–Singapore and the Japan–Singapore agreements contain the usual liberalization rules in the services trade chapters<sup>23</sup> and the usual investment protection rules in the investment chapter, both of which apply to services FDI.

### Performance requirements

The GATS does not explicitly prohibit performance requirements, and the TRIMs Agreement does not apply to services.<sup>24</sup> However, since the middle of the 1990s, a number of services IIAs explicitly prohibit the use of certain performance requirements geared towards services (table VI.1), including requirements pertaining to exports, local content, employment,

the supply of a specific region of the world market exclusively from a given territory, the location of regional headquarters and R&D. Such provisions are generally found in IIAs concluded by countries in the Western Hemisphere, starting with NAFTA. Some agreements only prohibit the use of mandatory requirements, while allowing requirements linked to the granting of incentives (box VI.4).<sup>25</sup> Sometimes, services IIAs allow countries to retain their ability to use otherwise prohibited performance requirements by entering into reservations.<sup>26</sup> However, even in the absence of specific disciplines, national treatment rules and other disciplines (such as those on transparency or MFN treatment) may apply to services-related performance requirements. Thus,

if a party wishes to continue applying performance requirements to foreign affiliates only, it would need to make a specific reservation in its national treatment commitment as well as in relevant annexes dealing with MFN exemptions.<sup>27</sup>

In some countries, a specific requirement, arising out of the particular nature of some services, is the local presence requirement. This is a kind of duty of establishment which requires a firm to place the business itself within a locally registered and licensed corporate entity. This can be the case, for example, with respect to financial services, where, the need for prudential supervision is difficult to achieve without the

#### Box VI.4. The GATS and subsidies

Insofar as subsidies affect trade in services, they are measures covered by the general obligations of the GATS, such as MFN and the individual countries' specific commitments, including national treatment. In addition, Article XV of the GATS specifically deals with subsidies. This provision notes that, "...in certain circumstances, subsidies may have distortive effects on trade in services." Negotiations have begun (but with little progress) with the aim of developing "...the necessary multilateral disciplines to avoid such trade-distortive effects." Furthermore, "[s]uch negotiations shall recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area" (Article XV, para. 1).

The GATS thus permits subsidies as such, including subsidies contingent upon the export of services and other investment incentives. However, the MFN obligation applies to subsidies

because they are covered by the definition of "measure". In scheduled industries, national treatment commitments also apply, unless they specifically exclude subsidies. In the service industries for which commitments have been made, and subject to any conditions or qualifications set out in its schedule, a WTO member must administer its subsidy schemes in a manner that accords the services and service suppliers of other members treatment no less favourable than that accorded to its own like services and service suppliers.

However, the fact that a subsidy pertains to a service industry does not necessarily mean that other WTO agreements, and in particular the Agreement on Subsidies and Countervailing Measures (SCM) (WTO 1994d) and the Agreement on Agriculture (WTO 1994a),<sup>a</sup> do not apply. For example, the provision by a government of certain subsidized services to producers of goods can also be relevant under the SCM Agreement.

Source: WIR02, p. 210.

<sup>a</sup> Annex 2, para. 2 of the Agreement on Agriculture refers to "... expenditures (or revenues foregone) in relation to programmes which provide services or benefits to agriculture or the rural community...". Such programmes "...shall not involve direct payments to producers or processors...". They shall include but not be restricted to: research, pest and disease control, training services, extension and advisory services, inspection services, marketing and promotion services, infrastructural services (including electricity reticulation, roads, market and port facilities, water supply facilities, dams and drainage schemes and infrastructural works associated with environmental programmes). These subsidies fall under the so-called "green box", with the additional requirement (set out in para. 1) that they have "...no, or at most minimal, trade-distorting effects...". While the GATS and the Agreement on Agriculture address different situations, there might be subsidy regimes that can fall under both Agreements (because one and the same subsidy might affect both, trade in services and trade in agricultural products). In such a case, the subsidy – or a specific aspect of a subsidy regime – that is allowed under one Agreement, could still be found to be in violation of the other.



Table VI.1. Examples of services IIAs prohibiting various types of performance requirements pertaining to services, 2004<sup>a</sup>

Instrument	Performance Requirement	Locate headquarters for a specific region of the world market	Export a given level or percentage of services	Employment requirement performance	Supply services provided to a specific region of the world market exclusively from a given territory	Act as the exclusive supplier of services provided	R&D	Purchase or use services provided in its territory, or to purchase services from natural or legal persons in its territory	Labour certification, academic certifications or other procedures of similar effect
NAFTA, 1992			X			X		X	
GATS, 1994 <sup>b</sup>									
Croatia–United States BIT, 1996 <sup>c</sup>			X		X		X		X
Canada–Chile FTA, 1996			X			X			
El Salvador–Peru BIT, 1996			X		X				X
Canada–Romania BIT, 1996 <sup>d</sup>								X	
Mexico–Nicaragua FTA, 1997			X		X		X		
Jordan–United States BIT, 1997			X			X			X
Chile–Mexico FTA, 1999			X					X	
Jordan–United States FTA, 2000 <sup>e</sup>									
EU–Mexico FTA, 2000									
Japan–Republic of Korea BIT, 2001		X	X	X	X		X		
CARICOM Agreement, 2001									
Japan–Singapore Economic Partnership Agreement, 2002		X	X		X		X		
EFTA–Singapore FTA, 2002									
Chile–United States FTA, 2003			X						
Chile–Republic of Korea FTA, 2003			X					X	
Chile–EU Association Agreement, 2003			X					X	
CAFTA, 2003 <sup>f</sup>			X		X			X	
Australia–United States FTA, 2004			X		X			X	

Source: UNCTAD.

- <sup>a</sup> Apart from the four performance requirements prohibited by the TRIMs (local content requirement, trade-balancing requirements, foreign exchange restrictions related to foreign exchange flows attributable to an enterprise, and export controls), countries have included other specific prohibitions in agreements. This table is an example of some of the services IIAs that contain express provisions prohibiting certain types of performance requirements that could be considered in relation to services. Note also, that the list of performance requirements given in this table is not exhaustive. Rather, some of the listed agreements contain prohibitions additional to the ones mentioned in this table.
- <sup>b</sup> Depending upon a member's commitments, the GATS market access provision (Article XVI, para. 2, lit. e) may rule out joint venture requirements or requirement for other specific types of legal entity. Similarly, even in the absence of specific disciplines, national treatment rules (again depending upon a member's commitment) and other disciplines (such as those on transparency or MFN treatment) may apply to services-related performance requirements.
- <sup>c</sup> Most of the recent BITs signed by the United States contain clauses prohibiting similar measures as in the Croatia–United States BIT. Other examples are the BITs with Azerbaijan (1997), Bolivia (1998), Lithuania (1998) and Mozambique (1998).
- <sup>d</sup> Most of the recent BITs signed by Canada contain clauses prohibiting similar measures as in the Canada–Romania BIT. Other examples are the BITs with Ecuador (1996), Panama (1996), Egypt (1996), Croatia (1997), Lebanon (1997), Thailand (1997), Uruguay (1997) and Costa Rica (1998).
- <sup>e</sup> Note that Jordan has scheduled a national treatment reservation under Mode 3 for architectural services, engineering services and urban planning and landscape architectural services that specifies that "[f]oreign firms are required to train and upgrade the technical and management skills of local employees".
- <sup>f</sup> Central American Free Trade Agreement.

physical presence of the related assets of the businesses in the markets they serve. A further reason concerns the regulatory authorities' ability to recover assets of suppliers, should the need to do so arise.<sup>28</sup> Finally, local presence requirements may be introduced to ensure more developmental benefits for the host country, for example, in terms of creating new jobs. A number of Canadian and United States FTAs, in their services chapters, prohibit signatories from requiring a service provider of the party to establish or maintain a representative office or any form of enterprise in the territory of the other party as a condition of providing services in the territory of that latter party.<sup>29</sup>

### Dispute settlement procedures

There are differences in the types of dispute settlement systems applying to services FDI. While a number of IIAs, in particular BITs and most recent FTAs, contain mechanisms for investor-State dispute settlement, such a mechanism is generally not found in those IIAs – or chapters within them – that take a services-based approach.

To the extent that services FDI is covered by the investment chapter, it may well be subject to investor-State dispute settlement if the obligations of the investment chapter are subject to such a mechanism. This may be the case for investment-based agreements as well as mixed agreements. The 2003 Chile–United States FTA and the 2003 Singapore–United States FTA (both investment-based agreements) have investor-State dispute settlement systems that apply to services FDI (as part of the investment chapter).<sup>30</sup> In the case of the 2003 Australia–Singapore FTA<sup>31</sup> (a mixed agreement), investor-State dispute settlement applies to the investment chapter (covering services FDI), but not to the services chapter (also covering services FDI). Thus, to the extent that services FDI is covered as “Mode 3/commercial presence” in the chapter on trade in services, it may be subject only to the State-State dispute settlement process (or arbitration procedures), as this is the typical dispute settlement mechanism for most such chapters. Slightly different, but related, the GATS, as part of the WTO, contains a mechanism for State-State dispute settlement only.<sup>32</sup> The same applies to the 2000 Jordan–United States FTA and the ASEAN Framework Agreement on Services.<sup>33</sup>

Thus, as with many other issues, where, or in which chapter, services FDI is covered can determine the type of dispute settlement mechanism applying to it.

Another interesting feature is that some agreements require specific expertise for dispute settlement (panels or other arbitral) tribunals as they deal with industry-specific issues. Financial services are a case in point. Paragraph 4 of the GATS Annex on Financial Services stipulates that “[p]anels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute.”<sup>34</sup>

### Approaches to negotiating commitments

Services IIAs can differ in the method negotiating parties use to arrive at their individual commitments for services FDI. Under the negative list approach, countries agree on a series of general obligations, and then individually list all of those areas in which non-conforming measures are maintained. For example, NAFTA (in its investment chapter, which also covers services FDI) and a number of agreements involving countries of the Western Hemisphere as well as BITs take this approach. In contrast, under the positive list approach, certain obligations apply only to the industries (along with relevant limitations) listed by each country. For example, the GATS, the 1997 MERCOSUR Protocol of Montevideo and the ASEAN Framework Agreement on Services take this approach.<sup>35</sup> While, in theory, both approaches can arrive at the same results, and both grant flexibility, there are important differences between them. For example, in terms of the negotiating process, the negative list approach can be administratively burdensome, particularly for developing countries with limited resources. In terms of outcomes, the negative list approach can result in a situation in which future measures may, due to lack of foresight, be inadvertently bound. This could also happen in industries in which, at a later date, governments may need to take development-oriented measures. Given that in many countries certain service industries are yet to be developed and the regulatory framework for the services sector is still evolving, this may, in certain cases, forestall policy flexibility.<sup>36</sup>

### Provisions covering specific service industries

Services IIAs can contain rules for specific service industries. In the WTO, for example, separate texts have been negotiated since the adoption of the GATS on telecommunications, financial services and accountancy services (box VI.5). However, since the completion of negotiations on these three issues, no new texts have been agreed upon.<sup>37</sup> While discussions on industry-specific commitments continue, proposals on horizontal approaches cutting across industries have gained prominence in negotiations on domestic regulation (for the European Communities, see WTO Working Party on Domestic Regulation 2003) to allow for a wider and more coherent development of benchmarks.<sup>38</sup> NAFTA contains a separate chapter for financial services that also covers FDI, and so do some bilateral United States FTAs.<sup>39</sup> Some EU agreements incorporate provisions to allow establishment in maritime transport.<sup>40</sup> Another industry becoming increasingly prominent is energy-related services. At the same time, agreements tend to exclude (in whole or in part) certain industries from their coverage. Much of air transport, which is governed by long-standing bilateral agreements pre-dating the GATS by many years, is a case in point.<sup>41</sup>

### Follow-up procedures

Frequently, the conclusion of services IIAs results in the establishment of “ground rules” with several aspects left for further development. In the GATS, this is the case with respect to areas such as domestic regulation, subsidies, government procurement and safeguards, as well as the negotiation of specific commitments. The same applies to services IIAs modelled on the GATS,<sup>43</sup> and also to some United States FTAs.<sup>43</sup> Also, the ASEAN Framework Agreement on Services contains a commitment towards further liberalization, which is carried out in three-year negotiation cycles (box II.8). Some services IIAs establish commissions or other bodies charged with monitoring the implementation and functioning of the agreements.<sup>44</sup> They provide a platform to review their implementation and to recommend action if needed. In the case of the GATS, an

“assessment of trade in services” is mandated,<sup>45</sup> and negotiations would need to be adjusted in light of the results thereof.<sup>46</sup> Along similar lines, there can be a monitoring of negotiations and the progress undertaken therein. Again, WTO services negotiations serve as an example.<sup>47</sup>

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As observed in chapter V, FDI liberalization in the secondary and primary sectors has advanced considerably. The services sector continues to be characterized by a range of restrictions related to FDI. Services IIAs, in

#### Box VI.5. Individual service industries in the WTO

WTO texts applying to services have different characteristics and serve various policy purposes. In some instances, such rules elaborate on the obligations of the GATS according to the specificities of individual service industries; this is notably the case of the GATS Annexes on Financial Services and on Telecommunications, whose provisions apply irrespective of any specific commitments. In other cases, for example in telecom services, sectoral disciplines also address matters such as competition-related aspects of trade in services. Such rules can be found in the Reference Paper for Telecommunications, which features a number of pro-competitive regulatory disciplines for voluntary adoption by WTO members through Article XVIII (Additional Commitments). In the case of financial services, sectoral rules address the need to undertake measures for prudential reasons. Some, such as the Understanding on Financial Services, provide a voluntary model for scheduling commitments aimed at a higher overall level of liberalization. In the accountancy sector, provisions negotiated under Article VI, para. 4 (Domestic Regulation) spell out disciplines relating to licensing, qualifications and professional standards. Such disciplines, which, under certain conditions, are scheduled to enter into force at the end of the current round of negotiations, would apply only to those countries that undertake commitments in accountancy services.

Source: UNCTAD, based on various WTO documents.

and by themselves, often reflect only the status quo of liberalization at the national level. However, a number of them can lead to changes in national policies, for example, when they prohibit services-specific performance requirements. Moreover, a few can accommodate further liberalization, by establishing the ground rules for future negotiations. This can go hand-in-hand with efforts to negotiate industry-specific rules, making the international framework for services FDI (and other international services transactions) increasingly complex.

## B. Complexities and challenges

The adoption of multilateral rules on services FDI has not halted – or diminished the momentum – for regional or bilateral treaty making. Rather, subsequent to the negotiation of the GATS, services provisions appear increasingly in IIAs across all regions.

This multilayered and multifaceted reality raises a number of policy challenges. While agreements may generally be consistent with or complement each other, there may also be cases of overlap, inconsistencies and gaps that, potentially, give rise to conflicts. Furthermore, in some cases, the complexity and, at times, ambiguity of the rules applicable to services FDI might compromise the clarity of the system, making it difficult to navigate through the resulting web of rules. This is particularly true for countries with insufficient human and institutional capacity to formulate and implement services IIAs.

A specific example of difficulties arising from complexity and ambiguity relates to the scheduling of commitments and reservations. Frequently, negotiations cannot produce the necessary clarity, certainty and comparability in terms of commitments; this leaves lacunae that, eventually, may be filled through dispute settlement. A recent example of this is the 2004 WTO case *Mexico–Telecommunications* with respect to telecom services (WTO Dispute Settlement Body 2004). Amongst other issues, this case dealt with the exact meaning of Mexico's entries in its schedule of commitments (particularly, as to what extent Mexico was bound by the Reference Paper). This underlines the

importance of scheduling carefully the commitments that are being made. But this may be a challenge in light of the emergence of *new* services – an issue of particular relevance in the context of this *WIR*.

The complex network of IIAs also raises questions concerning the coexistence of multilateral, regional and bilateral services IIAs, as well as the challenges resulting therefrom (*WIR03*, pp. 93-97). There is, indeed, a need to ensure that rules are consistent with each other and that they complement each other in a mutually supportive way. This is a problem not only of consistency between different international treaty obligations accepted by contracting parties, but also one of consistency in national legal and policy changes made in the process of implementing international obligations.

To avoid the adoption of inconsistent international obligations, a number of services IIAs mirror the provisions of the GATS,<sup>48</sup> incorporating – by reference – existing or future GATS obligations or, more broadly, affirm their complementarity with the GATS regime.<sup>49</sup> However, negotiating outcomes can result in inconsistent obligations, possibly leading to a conflict between them. In such a case, conflicts have to be dealt with in accordance with general rules of international treaty interpretation.<sup>50</sup> When the parties wish to ensure that certain inconsistent obligations remain in force or determine which provisions, in the case of conflict, should prevail, they can expressly provide for this in a conflict-clause provision of the treaty.<sup>51</sup>

Inconsistencies can arise, for example, when bilateral or regional agreements covering services investment contain rules granting more favourable treatment to their constituent members as opposed to their external investment partners, thereby deviating from the WTO MFN principle. The GATS (like the GATT) contains a provision permitting economic integration agreements (Article V), provided they meet a series of conditions: for example, that they have substantial sectoral coverage (meaning, among other things, that no mode of supply is excluded *a priori*), and that they provide for the absence or elimination of substantially all discrimination through the elimination of existing discriminatory measures and/or the prohibition of new or more

discriminatory measures. To a certain extent, however, the meaning of this clause is ambiguous.<sup>52</sup> According to this provision, the requirement to eliminate “substantially” all discrimination (specified in paragraph 1(b)(i) and 1(b)(ii)) depends on the substantial sectoral coverage of a services agreement; this, in turn, depends on the number of industries, the volume of trade affected and the modes of supply. For developing countries, paragraphs 3 (a) and (b) of Article V provide additional flexibility with respect to these compatibility requirements.<sup>53</sup>

In addition to Article V on economic integration agreements, the GATS allows WTO members to list exemptions to the MFN obligation contained in Article II. Listing MFN exemptions was possible only at the conclusion of negotiations during the Uruguay Round or, for those members that joined later, at the time of accession to the WTO.<sup>54</sup> The Annex on Article II specifies, however, that exemptions should, in principle, not exceed a period of ten years.<sup>55</sup> In fact, as of 2001, the list of exemptions from the GATS MFN obligation contained 232 exemptions relating to other IIAs, of which 13 (or 3.1%) pertain to BITs (OECD 2001b).<sup>56</sup> Besides BITs and investment guarantee agreements, MFN exemptions also cover other measures and policy goals (e.g. health or audiovisual services).

Besides the GATS, virtually all other services IIAs contain MFN obligations. MFN clauses can differ, including in their scope of coverage or in the number of beneficiaries of MFN rights. While the GATS grants MFN rights to all other WTO members, subject to MFN exemptions, under a bilateral IIA only the countries party to the agreement enjoy this right. Note, however, that there may be questions as to which investors are considered investors of a party. Ultimately, the question of MFN consistency is dependent on the type of measure as well as on the breadth of coverage of an MFN clause against which a measure is scrutinized.<sup>57</sup>

In addition to potential conflicts between IIAs arising from the MFN obligation, there can be other inconsistencies between IIAs. It may well be that a country is party to an IIA adopting a positive list approach for services FDI, and is also party to an IIA adopting a negative list approach for services FDI. While it can be assumed that parties intend to negotiate their international commitments for services FDI in a manner consistent with each other,

inconsistencies may still arise. Some IIAs address this by including specific provisions regulating the relationship between the IIA and other international agreements.<sup>58</sup>

Apart from the issue of inconsistency *between* IIAs, inconsistencies can also arise *within* agreements, especially in those taking a mixed approach. To guard against such potential problems, the Australia–United States FTA, for example, explicitly states (Article 11, para.2): “in the event of any inconsistency between this Chapter [the investment chapter] and another Chapter, the other Chapter shall prevail to the extent of the inconsistency”.<sup>59</sup> Another alternative is to identify specific provisions of the investment chapter that do not apply to FDI in services.<sup>60</sup>

In addition to inconsistencies, the multilayered network of services IIAs may also entail a specific type of externality: certain obligations provided for in bilateral or regional agreements may have effects that go beyond the parties to such agreements. For example, any benefits from an obligation (included in a BIT or a FTA) to publish laws and regulations relating to services FDI are automatically enjoyed by all other interested parties, since the States bound by the transparency requirement in the BIT or a FTA will not typically be able (or willing) to limit the beneficial effects of such an obligation to the other contracting parties. Similarly, an obligation setting forth certain general regulatory standards (whether procedural or substantive in nature) may have spillover effects that go beyond the bilateral or regional agreements through which they are undertaken. For example, the requirement that domestic regulations affecting trade in services (including services FDI) be administered in a reasonable, objective and impartial manner (as included, for example, in Article 28 of the EFTA–Singapore FTA, or in GATS Article VI, para. 4) can benefit all countries,<sup>61</sup> even if they are not parties to the relevant agreements.<sup>62</sup>

Another example is that some IIAs incorporate obligations whose benefits are not limited to (investors of) the parties to the agreements, but rather extend to investment independently of its origin. In NAFTA-type agreements, the prohibition of certain performance requirements applies to all foreign affiliates in the territories of the parties, irrespective of the nationality of their parent firms.

## C. National and international policies: a complex and dynamic interaction

The interaction between services IIAs and national regulations for services is dynamic and complex. This is because rules for FDI in services are constantly evolving, both at the international and national levels. Unlike the liberalization of conditions for FDI in the manufacturing and primary sectors that has already progressed significantly, liberalization in the area of services has only relatively recently begun to play an important policy role (chapter V). In developed countries, services regimes are undergoing significant changes. In particular, such changes result in a further opening of service industries and increased private participation in the provision of what were previously treated as public services (box VI.6). In developing countries, this process is generally less advanced. Many of the rules and regulations for services are not yet fully established, with regulators experimenting, adopting different methods, and ultimately seeking the regulatory approach that best suits the developmental needs of their countries. At the same time, new international disciplines on services are being adopted that serve as parameters for domestic regulatory action. The result of these national and international policy trends is a complex interaction, whereby some of the issues address regulation and go beyond the question of discrimination between foreign and domestic service providers.

Two forms of interaction between services IIAs and national policies are particularly noteworthy. One form is an autonomous-liberalization led interaction, whereby the degree of FDI liberalization and protection in an IIA is determined mainly by the scope and extent of the countries' national policies on services as they appear at the time of negotiations. Thus, the actual level of liberalization inscribed in an IIA reflects either the level of openness already existing in national laws and policies at the time of negotiation, or a level that is below the national regulatory status quo. The results of the services negotiations during the Uruguay Round are an example. During these negotiations, many countries made

commitments (frequently qualified through limitations) that were less open than the level of services liberalization that actually existed at that time in their national policies.<sup>63</sup> Other commitments reflected the status quo, such as some of those made during the extended negotiations on financial services and telecoms. But, of course, even such a cautious approach of making commitments at or below the actual level of openness locks in the existing (or part of the existing) national autonomous liberalization. The large majority of services IIAs are of this nature.

### Box VI. 6. IIAs and public services

IIAs appear to recognize the need to accommodate the particularities of “public” services (sometimes also referred to as “essential” services). The reason is that many of these services raise special issues of market failure and equitable provision and some are deeply embedded in a country's social, cultural and political fabric. Several services are in the general interest of the public and, indeed, essential for human life (e.g. health and provision of water). Thus, governments face the challenge of ensuring that these services are adequately provided, including to the poor and marginalized members of society. In certain cases, this challenge may even be accompanied by a government's obligation to ensure the progressive realization of certain human rights (UNHCHR 2002, 2003). In their public services policies, governments frequently pursue a number of objectives, e.g. to improve the accessibility and affordability of a given service and to increase the efficiency with which it is supplied, while limiting the expenses to the government and taxpayers. At the same time, however, there is no widely accepted definition of public services. Rather, countries and societies differ in their perception about what are public services.

Some services IIAs seek specifically to accommodate the particularities of public services by explicitly carving out some of them from their scope of application.

The GATS, for example, adopts the notion of “services supplied in the exercise of governmental authority”, excluding these from its scope of application.<sup>a</sup> Under GATS Article I, para. 3(c), such services are defined as services

/...

### Box VI. 6. IIAs and public services (concluded)

that are neither supplied on a commercial basis, nor in competition with other services.<sup>b</sup> Thus, while there might be important overlaps, the notion of “services supplied in the exercise of governmental authority” might differ from what some understand as “public services”. Given this ambiguity,<sup>c</sup> a number of WTO members have added limitations, either of a horizontal or of an industry-specific nature, to their services commitments, possibly with a view to retaining policy space for those services that they want to reserve for public or quasi-public management.<sup>d</sup> They have chosen to do so, despite the fact that the text of the Agreement does not refer to privatization, nor does it explicitly prevent governments from supplying services to the poor or marginalized or from requiring this of a private operator. It should be noted that there has been no WTO dispute settlement case relating to Article I, para. 3 (c), nor has any member suggested amendment or other modification of that provision.<sup>e</sup>

NAFTA, like many other IIAs, also addresses issues related to public services in its

investment chapter.<sup>f</sup> More specifically, Article 1101, para. 4 refers to functions and services such as “...law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health and child care”. Thus, unlike the GATS, NAFTA more specifically lists certain service industries. At the same time, NAFTA stops short of the GATS insofar as it does not exclude these services from its scope of application. Rather, the relevant provision in NAFTA states that “[n]othing in this Chapter shall be construed to prevent a Party from providing a service or performing a function such ... as in a manner that is not inconsistent with this Chapter”. The NAFTA parties can enter country-specific carve-outs and reservations. The Canadian reservation in the social services sector, which also covers future measures, is an example.<sup>g</sup>

Thus, IIAs differ in their approaches towards public services. Countries need to be careful when negotiating obligations relating to public services, so that their own policy objectives are served best.

Source: UNCTAD.

- <sup>a</sup> The MERCOSUR Protocol of Montevideo, the CARICOM Agreement, the EFTA–Singapore FTA, the Japan–Singapore Agreement and, to some extent, the Andean Community Decision 439 match the language of the GATS.
- <sup>b</sup> The GATS does not further define these terms. At the same time, the academic and policy debate has seen considerable discussion about the possible meaning of Article I, para. 3 (c) (e.g. Krajewski 2003).
- <sup>c</sup> For a discussion of these ambiguities as they may arise in the health sector, and the challenges they bring about, see Mashayekhi, Julsaint and Tuerk (forthcoming).
- <sup>d</sup> Liechtenstein, Norway, Sweden and Switzerland, for example, exclude the “public works function” from their sanitation services commitments. Similarly, the European Communities, in its schedule, reserves the right to make “services *considered* public utilities” subject to exclusive rights (emphasis added). Also, the European Communities’ schedule states that “the supply of a service, or its subsidization, within the public sector is not in breach of this commitment”. Similarly, in its 2003 initial offer, the European Communities states that “[t]his offer cannot be construed as offering in any way the privatisation of public undertakings nor as preventing the Community and its Member States from regulating public services in order to meet national policy objectives” (TN/S/O/EEC). Similarly, Brazil makes clear that its “...offer cannot be construed as offering in any way the privatisation of public undertakings nor as preventing Brazil from regulating public and private services in order to meet national policy objectives” (TN/S/O/BRA). Also, the United States states in its initial offer that, “[c]onsistent with GATS Article I.3(b) and (c), this offer applies only to services open to private sector participants, unless otherwise indicated, in the attached draft schedules, and does not include the right to acquire or invest in government monopolies supplying services included within any of the sectors or sub-sectors covered by this offer” (TN/S/O/USA).
- <sup>e</sup> Note, however, that several other stakeholders have made requests to that effect. See, for example, various motions passed in the United Kingdom by several trade unions, members of Parliament and local authorities <http://www.wdm.org.uk/presrel/current/ukgatspublic.htm>.
- <sup>f</sup> The 1996 Canada–Chile FTA matches the language of NAFTA.
- <sup>g</sup> More specifically, Canada’s Annex II reservation (for national treatment, MFN, local presence of senior management and boards of directors, that apply to both cross border services and investment) in the social services industry reads: “Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.”

A second form is an IIA-driven interaction. In such a case, it is the IIA that prompts FDI liberalization and domestic reforms in the services area. Sometimes this is the result of built-in commitments to engage in future rounds of negotiations in which one (if not the only) principal objective is market opening. The GATS provides an example,<sup>64</sup> as do agreements patterned on it (e.g. the EFTA–Singapore FTA, Article 27, para. 5). Time-bound reservations in IIAs can also drive this interaction: once they expire, domestic regulations need to be adapted. Similarly, pre-commitments under the GATS are examples of the time-bound nature of limitations inscribed in commitments.<sup>65</sup> The special case of WTO accession agreements can involve commitments to take certain liberalizing steps at a future date. The GATS commitments of China and Taiwan Province of China are examples.

IIA-driven interaction between international and national policies for services FDI can also manifest itself in other areas of policy for services FDI, for example, with regard to transparency. Recent services IIAs tend to contain obligations to publish and make available certain laws and regulations pertaining to FDI (e.g. Article III, para. 1 of the GATS<sup>66</sup> or Article 192 of the 2002 Chile–EU Association Agreement), as well as obligations to notify the other party (parties) or relevant international bodies of certain new laws and regulations (e.g. Article III, para. 3 of the GATS<sup>67</sup> or Article L-03 of the Canada–Chile FTA). IIAs can also include obligations requiring independent review of administrative decisions affecting individual investors through judicial, arbitral or administrative tribunals or procedures (e.g. Article VI, para. 2 of the GATS or Article 64, para. 2 of the Japan–Singapore Agreement). In addition, some of the more recent IIAs contain also so-called “a-priori” comment or consultation processes (e.g. Article 19.3, para. 2 of the Singapore–United States FTA).<sup>68</sup>

In some of these scenarios, IIAs may require policy changes at the national level, thus constituting an example of IIA-driven interaction between national and international services policies. However, in other situations such interaction is sought, especially when a government wants to use its membership in an IIA, and the policy changes this requires, as a means of overcoming domestic resistance to

reform, and to make it difficult for subsequent governments to reverse such commitments.<sup>69</sup>

Overall, however, the two types of interaction, whether driven by IIAs or led by autonomous liberalization, cannot always be clearly distinguished for individual agreements. In fact, there may be a situation in which a certain set of transactions is not constrained, and the issue becomes to maintain openness; this may be the case for offshoring. In the end, the specific impact of interaction is usually country-specific and context-specific.

## D. Conclusion: striking a development-oriented balance

IIAs covering services FDI are proliferating at the bilateral, regional and multilateral levels. The resulting network of international rules on FDI in services is multifaceted, multilayered and constantly evolving, with obligations differing in geographical scope and substantive coverage. These rules are increasingly setting the parameters for national policies in the services sector.

Services IIAs differ in their approach towards covering services FDI (investment-based, services-based or mixed) and in their substantive provisions. Several services IIAs contain follow-up procedures and separate chapters for certain service industries. While these issues in themselves pose challenges for policy-makers dealing with services, additional challenges arise from the multilayered network of rules, including the need to ensure that rules are consistent with, or complementary to, each other in order to avoid conflicts.

Services IIAs can offer a series of potential benefits. They can provide a stable, predictable and transparent enabling framework for attracting investment and benefiting from it. At the same time, the optimal realization of these potential benefits remains a challenge. Specifically, the challenge is to strike a balance between using IIAs for attracting FDI and benefiting from it on one hand, and preserving the flexibility needed for the pursuit of national development strategies in the services sector on the other.



This challenge is particularly crucial for developing countries for a number of reasons. First, in many of these countries, the services sector is at an early stage of development and rapidly evolving. Second, certain service industries are particularly sensitive, as they are deeply embedded in a country's social, cultural and political fabric. Third, some developing countries do not yet have optimal regulatory systems in place, and policy-makers are experimenting with liberalization and regulation, with a view to building a more competitive services sector through FDI and other means. In the case of the GATS, this challenge is reflected in Article XIX, which sets out the mandate for the negotiation of specific commitments and – in that context – specifically provides that “[t]here shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions [and] progressively extending market access in line with their development situation...”.<sup>70</sup> For LDCs, such flexibility is also affirmed in GATS Article IV, para. 3, which states that “[p]articular account shall be taken of the serious difficulty of the least-developed countries in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs.”<sup>71</sup>

In light of the above, it is important that services IIAs retain a degree of flexibility that allows countries to face the specific challenges arising at the interface of the liberalization and regulation of services. IIAs should also accommodate developing countries' efforts to achieve their development-oriented policy objectives. In this context, it is also important to leave room for the sort of trial-and-error process regulators may need in order to identify the policy options best suited to their countries' levels of development. The importance of national policy space has been affirmed in the Sao Paulo Consensus, as adopted at the UNCTAD XI Conference.<sup>72</sup>

In that context, economic needs tests come into play. For example, when attached to Mode 3 commitments, they could be viewed as a policy tool to achieve an appropriate level of supply, regardless of the origin of the service supplier (OECD 2000b, p. 8). In the context of the GATS, individual countries have used

economic needs tests in connection with certain service industries. There, they are found in commitments in distribution, telecoms, rental services, transport, financial services, courier, medical, dental, environmental, testing and analysis, social and education services (OECD 2000b, p. 7). (However, the absence of agreed criteria for an economic needs test also raises challenges as regards transparency and objectivity.) Similarly, it has been suggested that emergency safeguard mechanisms can provide an additional policy tool. They can give countries the necessary flexibility to respond to unanticipated events devastating to host economies, an issue whose relevance was highlighted by the Asian and Argentinean crises. Such mechanisms can put countries in a comfort zone when locking in international commitments under IIAs.<sup>73</sup>

IIAs can allow governments to liberalize at a pace and sequence appropriate to their development strategies and to the rapid development of the services economy. Flexibility can be built into an IIA by various means (*WIR03*, chapter V). In particular, the objectives, structure, content and implementation processes of an agreement can be designed in a way that ensures a proper balance between the right to regulate in the interest of development on the one hand, and the progressive liberalization and protection of FDI in the services sector on the other (see also *WIR03*, chapter VI).

The overriding challenge for countries is to find such a development-oriented balance when formulating international policies for services FDI. In the final analysis, the merits of services IIAs from a developing-country perspective must be judged by their ability to create an enabling environment for competitive service industries that help developing countries to integrate in a beneficial manner into the international economic system, with a view towards advancing their development. For this reason, GATS Article IV calls for increasing the participation of developing countries in trade in services, including through “...the liberalization of market access in sectors and modes of supply of export interest to them.” The development dimension has to be an integral part of international agreements covering services – in support of national policies to attract services FDI and to benefit more from it.

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In conclusion, to benefit from an increasingly globalized and interdependent world economy, countries need to strengthen their capabilities for the supply of competitive services. If conditions are right, FDI can help to achieve this. Its most important contribution is in bringing the capital, skills and technology countries need to set up competitive service industries. This applies not only to the new IT-enabled services, but also to traditional services such as infrastructure and tourism. Moreover, as services become more tradable, FDI can help link developing countries to global value chains in services. Such chains comprise international service production networks that are increasingly important to access international markets. At the same time, caution is necessary when attracting FDI in services. For instance, some services (especially basic utilities and infrastructure) may be natural monopolies and hence susceptible to

abuses of market power (whether firms are domestic or foreign). Others are of considerable social and cultural significance; the whole fabric of a society can be affected by the involvement of FDI in those industries. Hence, countries need to strike a balance between economic efficiency and broader developmental objectives.

This is why it matters to have the right mix of policies. In light of the shift towards FDI in services, developing countries face a double challenge: to create the necessary conditions – domestic and international – to attract services FDI and, at the same time, to minimize its potential negative effects. In each case, the key is to pursue the right policies within a broader development strategy. Basic to them is the upgrading of the human resources and physical infrastructure (especially in information and communication technology) required by most modern services. An internationally competitive services sector is, in today's world economy, essential for development.

## Notes

- <sup>1</sup> Unless otherwise indicated, all agreements mentioned in this chapter can be found in UNCTAD 1996b, 2000b, 2001c, 2002c, forthcoming f, and, together with BITs, also at <http://www.unctad.org/iia>. Intra-European Union agreements are not considered here, given the *sui generis* nature of the European integration process.
- <sup>2</sup> For a discussion of similar issues, in the context of identifying the implications that possible negotiations on a multilateral investment framework in the WTO would have for the GATS, see Roy 2003.
- <sup>3</sup> Note that NAFTA, while signed in 1992, entered into force in 1994.
- <sup>4</sup> Such agreements may also contain a chapter on cross-border trade in services, but by virtue of an express provision, this chapter does not cover the “commercial presence” mode (e.g. NAFTA).
- <sup>5</sup> Andean Community, Decision 291, Regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties, 1991, <http://www.sice.oas.org/Trade/Junac/decisiones/dec291e.asp>; it does not, however, contain many of the typical investment obligations.
- <sup>6</sup> In addition, Article 2 provides that the AIA “...shall further cover direct investments in such other sectors and services incidental to such sectors as may be agreed upon by all Member States.”
- <sup>7</sup> Agreement for the Promotion and Protection of Investments, <http://www.aseansec.org/6464.htm> and <http://www.aseansec.org/6465.htm>.
- <sup>8</sup> This is also evident in the GATS, e.g., in the context of “services related to manufacturing consulting” or “services incidental to manufacturing”.
- <sup>10</sup> Also, there are differences about whether an investment definition covers both pre- and post-establishment, and relates to both existing and *de novo* investment (UNCTAD 1998 and 1999b).
- <sup>11</sup> Article 2 of the Andean Community Decision 439 reads “*Commercial presence*: Any kind of business or professional establishment in the territory of a Member Country for the purpose of providing a service through, for example: The establishment, acquisition or maintenance of a juridical person; or The creation or maintenance of a branch or a representative office” (emphasis in the original).
- <sup>12</sup> The relevant provisions in Article 22 (d) of the EFTA–Singapore FTA and Article 58, para. 6 (d) of the Japan–Singapore Agreement (similar in language) read: “‘Commercial presence’ means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person; or (ii) the creation or maintenance of a branch or a representative office; within the territory of a Party for the purpose of supplying a service”. Note that the 2000 EFTA–Mexico FTA is different in that its Article 20 defines “commercial presence” as follows: “(i) as regards nationals, the right to set up and manage undertakings, which they effectively control. This shall not extend to seeking or taking employment in the labour market or confer a right of access to the labour market of another Party; (ii) as regards juridical persons, the right to take up and pursue the economic activities covered by the Section by means of the setting up and management

- of subsidiaries, branches or any other form of secondary establishment” (footnotes omitted).
- <sup>13</sup> See, for example, Article 37 (b) of the EFTA–Singapore FTA and Article 72 (a) of the Japan–Singapore Agreement.
- <sup>14</sup> Alternatively, they are included in the “Definitions” section. While addressing the same issue, these clauses vary in their nature (discretionary or mandatory) and in the criteria they establish for an investment to enjoy the benefits of an agreement. Although the discussion below focuses on cases relating to (non-) substantial business operations, benefits can also be denied for other reasons, e.g. by virtue of the country in which a parent firm is established (for example, because the host country has no diplomatic relations with it).
- <sup>15</sup> Some IIAs also allow parties to deny benefits not only to non-party enterprises in the territory of a party, but also to that party’s enterprises in the territory of the other party, if they do not have substantive business operations in the other party. Examples include Article 10.11, para. 2 of the 2003 Chile–United States FTA and Article 11.12, para. 2 of the Australia–United States FTA. In the absence of such a clause there is a possibility for investors’ round-tripping to benefit from an IIA, even if they have no substantive business operations in the other party. This issue was – in part – addressed in the recent 2004 *Tokios Tokelés v. Ukraine* arbitral decision (ICSID 2003).
- <sup>16</sup> See, for example, Article 1113.2 of the NAFTA. An interesting example is provided by the New Zealand–Singapore Agreement, which requires an enterprise to engage in substantive business operations in the territory of *one or both parties* (Article 25). The textual interpretation of this provision leads to the conclusion that, for example, a non-party enterprise formally established in Singapore but not engaged in substantive business operations there, would still enjoy benefits afforded by the Agreement if it engages in substantive business operations in New Zealand. It appears that this formulation leaves room for a circumvention of the denial-of-benefits clause.
- <sup>17</sup> Mainland and Hong Kong Closer Economic Partnership Arrangement, 2003, <http://www.tid.gov.hk/english/cepa/fulltext.html>.
- <sup>18</sup> GATS Article XXVIII, lit. m reads: “‘juridical person of another Member’ means a juridical person which is either: (i) constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member; or (ii) in the case of the supply of a service through commercial presence, owned or controlled by: 1. natural persons of that Member; or 2. juridical persons of that other Member identified under subparagraph (i).”
- <sup>19</sup> More specifically, para. 6 of Article V reads: “[a] service supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.”
- <sup>20</sup> For agreements involving only developing countries, para. 3 (b) of Article V grants some flexibility, allowing more favourable treatment to be provided to juridical persons owned and controlled by natural persons of the parties. Para. 3 (a) of this Article also provides some flexibility for economic integration agreements involving a developing country, when it comes to meeting the conditions of para. 1. There are, however, questions whether such agreements would at all need to meet the Article V, para. 1, criteria or whether additional flexibility would be granted by the enabling clause (GATT 1979).
- <sup>21</sup> Note that regional agreements typically involve trade-offs across a number of issues.
- <sup>22</sup> There is, however, some concern raised in the Committee on Trade in Financial Services as regards the possible consequences of further liberalization in Modes 1 and 2, combined with footnote 8 to Article XVI, in particular, whether this could lead to capital account liberalization.
- <sup>23</sup> In the Japan–Singapore Agreement, for example, the market access provision (Article 59) is phrased similar to the one in the GATS (Article XVI). The same applies to the Agreement’s national treatment provision. Depending upon the scope of the commitments of the countries, the Agreement could be viewed as granting a right to establishment.
- <sup>24</sup> Note, however, that, depending upon a member’s commitments, the GATS market access provision (Article XVI, para. 2 lit. e) may rule out joint-venture requirements or requirements for other specific types of legal entities. Note also that the TRIMs Agreement may apply to measures regulating services FDI, for example, when performance requirements applied to services investors affect trade in goods. Requirements for a service provider to source locally the material (goods) needed for the provision of services may serve as an example (e.g. food in the tourism industry, or telecom material for telecom providers).
- <sup>25</sup> For example, this approach has been followed in many of the BITs entered into by the United States and Canada.
- <sup>26</sup> See, for example, Articles 1106 and 1108 of the NAFTA. Article 1106 sets out NAFTA’s rules on performance requirements with an exhaustive list of prohibited performance requirements (e.g. export requirements, local content requirements, technology transfer requirements, exclusive services supplier requirements) (para. 1); it clarifies that certain performance requirements are not only prohibited from being mandatory, but also from being linked to the granting of an incentive (para. 2); and it sets out certain exceptions (including environmental exceptions) to these prohibitions (para. 6). Article 1108, in turn, addresses reservations (for non-conforming measures) and exceptions to four of NAFTA’s core investment obligations (i.e. national treatment, MFN treatment, rules relative to performance requirements and senior management and boards of directors). Amongst others, Article 1108 sets out in which Schedules/Annexes to list non-conforming measures. It also states that certain obligations (including performance requirements) shall not apply to existing non-conforming measures maintained by a local government (without the need to list them in a schedule). Note that Annex II NAFTA reservations are broad, including with respect to future measures.

- <sup>27</sup> This was done by several WTO members under the GATS, e.g. with respect to employment requirements, export requirements, local content, technology or training requirements (Ortega 2004).
- <sup>28</sup> As an alternative to local establishment, a country may allow foreign suppliers of services to operate in its markets as long as they provide a suitably large deposit to cover their potential liabilities with an institution within the host country, as determined by the host-country government or a regulatory authority.
- <sup>29</sup> See, for example, Article 1205 of NAFTA and Article H-05 of the 1996 Canada–Chile FTA. As noted above, the Canadian and United States FTAs tend to adopt an investment-based approach and, in their services chapters, to exclude the “commercial presence” mode from their coverage. Nevertheless, even if the said prohibition were to be included in a chapter that does not cover services FDI, it would be relevant for services FDI by its very nature, as it has the potential to affect services FDI.
- <sup>30</sup> Both agreements explicitly state that specific provisions of the services chapter (i.e. market access, domestic regulation, transparency) also apply to services FDI as it is covered by the investment chapter, but – as set out in a footnote to the relevant provision – these obligations are not subject to investor–State dispute settlement (Article 8.2, para. 2 in the case of the Singapore–United States FTA and Article 11.1, para. 3 in the case of the Chile–United States FTA).
- <sup>31</sup> Australia–United States Free Trade Agreement, [http://www.dfat.gov.au/trade/negotiations/us\\_fta/final-text/index.html](http://www.dfat.gov.au/trade/negotiations/us_fta/final-text/index.html).
- <sup>32</sup> This mechanism is set out in the Understanding on Rules and Procedures Governing the Settlement of Disputes, Annex 2 to the Marrakesh Agreement Establishing the World Trade Organization (WTO 1994b).
- <sup>33</sup> Note that also the Framework Agreement on the ASEAN Investment Area (AIA) (while, as mentioned above, not applying to services FDI apart from certain industries) only provides for State–State dispute settlement procedures, despite the fact that it does not take a services-based approach. Article 17 of the Agreement provides additionally that a special dispute settlement mechanism may be established for the purpose of this Agreement.
- <sup>34</sup> Other examples (with respect to financial services) include Article 6 of the Australia–Singapore FTA and Article 25 of the European Union–Mexico Decision No 2/2001 of the EU–Mexico Joint Council of 27 February 2001, Implementing Articles 6, 9, 12(2)(b) and 50 of the Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and Its Member States, of the One Part, and the United Mexican States, of the Other Part (hereinafter EU–Mexico Agreement).
- <sup>35</sup> Note that, strictly speaking, the GATS adopts a “hybrid approach”. The negative list features of the GATS can be found in members’ right to enter MFN exemptions, and their right to qualify their (positive list) specific commitments with conditions and limitations.
- <sup>36</sup> In this context, it is interesting to note that some NAFTA reservations (e.g. Annex II) carve out future measures.
- <sup>37</sup> In light of the 2004 WTO case *Mexico–Telecommunications* (WTO Dispute Settlement Body 2004), some countries might become more cautious about developing industry-specific texts.
- <sup>38</sup> This raises the question of whether certain specific industries would benefit from specific benchmarks.
- <sup>39</sup> See Chile–United States FTA (chapter 12 on financial services) and Singapore–United States FTA (chapter 10 on financial services).
- <sup>40</sup> See, for example, Article 10 of the EU–Mexico Agreement. Article 10, para. 4 in Chapter II states that “[e]ach Party shall permit to service suppliers of the other Party to have a commercial presence in its territory under conditions of establishment and operation no less favourable than those accorded to its own service suppliers or those of any third country, whichever are the better, and this in conformity with the legislation and regulations applicable in each Party.”
- <sup>41</sup> In the case of the GATS, certain services related to air transport, as defined in the Annex on Air Transport Services, are excluded from the Agreement. Paragraph 2 of the Annex states that the GATS Agreement “...shall not apply to measures affecting: (a) traffic rights, however granted; or (b) services directly related to the exercise of traffic rights, except as provided in paragraph 3 of this Annex.” Paragraph 3 states that “[t]he Agreement shall apply to measures affecting: (a) aircraft repair and maintenance services; (b) the selling and marketing of air transport services; (c) computer reservation system (CSR) services.”
- <sup>42</sup> For example, the ASEAN Framework Agreement on Services, the 2001 CARICOM Agreement (Revised Treaty of Chaguaramas Establishing the Caribbean Community Including the CARICOM Single Market and Economy) and the 1996 Euro-Mediterranean Agreement establishing an association between the European Communities and Morocco.
- <sup>43</sup> With respect to domestic regulation, for example, the services chapter of the United States–Singapore FTA contains language similar to the GATS (Article 8.8, para. 2): “With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, each Party shall endeavor to ensure, as appropriate for individual sectors, that such measures are: (a) based on objective and transparent criteria, such as competence and the ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; and (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.”
- <sup>44</sup> An example of such a follow-up mechanism is NAFTA. In July 2001, the trade ministers from the three NAFTA countries, sitting as the “NAFTA Free Trade Commission”, issued a statement on the “interpretation” of provisions, including the minimum standard of treatment, as contained in NAFTA Chapter 11. More specifically, the interpretative statement clarifies in para. 1 of Section B that “[a]rticle 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party”. It also states in para. 2 that “[t]he

- concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." See NAFTA Free Trade Commission, "Notes of Interpretation of Certain Chapter 11 Provisions", 31 July 2001; <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>. Based on the experience gained with the application of the minimum standard of treatment provision, some more recent IIAs specifically contain language similar to the interpretative statement. Article 10.4 of the Chile–United States FTA is an example. Indeed, this may reflect a learning process in the formulation of IIAs.
- 45 More specifically, GATS Article XIX, para. 3, states that: "[f]or each round, negotiating guidelines and procedures shall be established. For the purposes of establishing such guidelines, the Council for Trade in Services shall carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of this Agreement, including those set out in paragraph 1 of Article IV [on increasing participation of developing countries]." Such an assessment could also include questions related to the impact the GATS has had, so far, on attracting investment flows. In fact, in a 2001 communication (WTO Council for Trade in Services 2001a) a series of developing countries raised specific questions to be addressed in the assessment exercise. These included the question of whether developing countries have experienced investments in new sectors or whether investments flow only to sectors that have already been developed.
- 46 See para. 14 of the GATS Negotiating Guidelines (WTO Council for Trade in Services 2001b), which states, amongst others, that the assessment "...shall be an ongoing activity of the Council and negotiations shall be adjusted in the light of the results of the assessment. In accordance with Article XXV of the GATS, technical assistance shall be provided to developing country Members, on request, in order to carry out national/regional assessments."
- 47 In para. 15, the Negotiating Guidelines mandate the Council for Trade in Services (in Special Session), when reviewing progress in negotiations, to consider the extent to which Article IV (on increasing participation of developing countries in trade in services) is being implemented and to suggest ways and means of promoting the goals established therein.
- 48 The ASEAN Framework Agreement on Services, the CARICOM Agreement and several European Agreements (e.g. the 1997 Euro-Mediterranean Association Agreement establishing the association between the European Union and Jordan) are cases in point.
- 49 Recital 7 in the Preamble of the ASEAN Framework Agreement on Services reads: "REITERATING their commitments to the rules and principles of the General Agreement on Trade in Services (hereinafter referred to as "GATS") and noting that Article V of GATS permits the liberalising of trade in services between or among the parties to an economic integration agreement". The Singapore–United States FTA states, in para. 3 of Article 8.8 in the services chapter, that:
- "[i]f the results of the negotiations related to Article VI, para. 4 of GATS (or the results of any similar negotiations undertaken in other multilateral fora in which both Parties participate) enter into effect, this Article shall be amended, as appropriate, after consultations between the Parties, to bring those results into effect under this Agreement."
- 50 At least two principles should be mentioned in this regard: (1) the principle according to which, with respect to successive treaties relating to the same subject-matter, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty (*lex posterior derogate legi priori*, see Article 30 Vienna Convention on the Law of Treaties (United Nations 1969); (2) the principle according to which the more specific norm prevails over the more general norm (*lex specialis*).
- 51 While such a provision may not be contained in the services chapter, it may be, nevertheless, relevant for services FDI. Article 4 of the EFTA–Singapore Agreement, for example, specifically, states that "[t]he provisions of this Agreement shall be without prejudice to the rights and obligations of the Parties under the Marrakesh Agreement Establishing 'the World Trade Organization' and the other agreements negotiated thereunder (hereinafter referred to as "the WTO Agreement") to which they are a party and any other international agreement to which they are a party." A slightly different approach is taken by the Japan–Singapore Agreement. Its Article 6, "Relation to Other Agreements", provides in para.1 that "[i]n the event of any inconsistency between this Agreement and any other agreement to which both Parties are parties, the Parties shall immediately consult with each other with a view to finding a mutually satisfactory solution, taking into consideration general principles of international law".
- 52 It would appear that BITs are not considered economic integration agreements. But it appears that agreements covering all modes (in one chapter or more) need to be notified. On the broader problematique of the clause relating to regional economic integration organizations (REIO clause), see UNCTAD forthcoming g.
- 53 Article V, para. 3(a) states: "[w]here developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors." Para. 3(b) of the same provision then states: "[n]otwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement."
- 54 Some MFN exemptions might still be taken with regard to certain maritime transport services, before the end of the current negotiations.
- 55 Para. 6 of the GATS Negotiating Guidelines provides, however, that: "MFN Exemptions shall be subject to negotiation according to paragraph 6 of the Annex on Article II (MFN) Exemptions. In such negotiations,

appropriate flexibility shall be accorded to individual developing-country Members.”

<sup>56</sup> Canada or Poland, for example, are countries that have taken MFN exemptions in the GATS regarding BITs.

<sup>57</sup> For example, it may be open to discussion whether an investor from country A that has no BIT with country B should be able to benefit from protection under a BIT between country B and country C, where the investor from A establishes a legal presence through an affiliate in C set up specifically to benefit from that BIT, but undertakes no business operations in C.

<sup>58</sup> Note that, in some cases, such clauses also address the relationship of the IIA with WTO Agreements. For example, Article 4 of the EFTA–Singapore FTA states: “[t]he provisions of this Agreement shall be without prejudice to the rights and obligations of the Parties under the Marrakesh Agreement Establishing the World Trade Organization and the other agreements negotiated thereunder (hereinafter referred to as ‘the WTO Agreement’) to which they are a party and any other international agreement to which they are a party.” Some agreements also contain clauses regulating the relationship between themselves and other non-trade-related agreements, for example environmental and conservation agreements. Article A-04 of the Canada–Chile FTA is an example.

<sup>59</sup> The same Agreement also addresses this issue in Article 11.2, para. 3, which states that “[t]his Chapter [the services chapter] does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Thirteen (Financial Services).”

<sup>60</sup> An example is the EFTA–Singapore FTA, in which Article 38, para. 2 in the investment chapter states: “Article 40 (1) [national treatment, MFN] shall not apply to measures affecting trade in services whether or not a sector concerned is scheduled in Chapter III [dealing with “services”].” Article 38, para. 2 sets out which of the national treatment and MFN obligations (those of the services or those of the investment chapter) apply to measures affecting services (including FDI in services) as well as investors and investments in the services area. While several reasons may explain the need to do so, they all relate to the objective to avoid overlap and inconsistencies between chapters in the Agreement. This is particularly important in the case of the national treatment obligation, which differs between the investment and the services chapters, for example in content (“like services” as opposed to investment in “like circumstances”) and in approach to making commitments (positive or negative lists). In fact, in light of the latter, having the investment chapter’s national treatment obligation apply to services investment would nullify the positive list approach adopted in the services chapter.

<sup>61</sup> These parties will, however, not be able to claim a violation of such obligations.

<sup>62</sup> This may be true even for an obligation to institute judicial, arbitral or administrative tribunals or procedures, thus providing for prompt review and

appropriate remedies for administrative decisions affecting, *inter alia*, services FDI.

<sup>63</sup> A similar phenomenon exists in traditional trade negotiations where bound tariffs are frequently higher than actual tariffs.

<sup>64</sup> A perusal of a number of initial requests submitted by some WTO members in the current round of negotiations reveals that several of the conditions and limitations attached to members’ previous commitments (either on a horizontal or on a Mode-3-specific basis) are requested to be liberalized further.

<sup>65</sup> By entering into pre-commitments, countries commit themselves today to implement market access and/or national treatment commitments by a pre-determined date in the future.

<sup>66</sup> GATS Article III, para. 1 reads in part: “[e]ach Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of this Agreement.”

<sup>67</sup> GATS Article III, para. 3 reads: “[e]ach Member shall promptly and at least annually inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments under this Agreement.”

<sup>68</sup> On transparency, see UNCTAD 2004h.

<sup>69</sup> Note, however, that some IIAs, for example the GATS, contain provisions allowing for the modification of commitments (e.g. GATS Article XXI). It is interesting to note that the European Communities has utilized Article XXI in the context of its enlargement process.

<sup>70</sup> Para. 2 of this provision continues, stating that developing countries, when making access to their markets available to foreign services suppliers, may attach to such access conditions aimed at achieving the objectives referred to in Article IV.

<sup>71</sup> Note, that this point is reiterated in the LDC modalities (WTO Council for Trade in Services 2003).

<sup>72</sup> More specifically, para. 8 of the São Paulo Consensus states: “The increasing interdependence of national economies in a globalizing world and the emergence of rule-based regimes for international economic relations have meant that the space for national economic policy, i.e. the scope for domestic policies, especially in the areas of trade, investment and industrial development, is now often framed by international disciplines, commitments and global market considerations. It is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space. It is particularly important for developing countries, bearing in mind development goals and objectives, that all countries take into account the need for appropriate balance between national policy space and international disciplines and commitments” (UNCTAD 2004i).

<sup>73</sup> For a discussion of safeguards, see *WIR03*, box V.3.