Asia-Pacific Economic Cooperation

Investment Experts Group

International Investment Instruments and their legal Interpretations

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PREFACE

With the basic purpose to encourage foreign direct investment (FDI) flows, over 2000 bilateral investment treaties (BITs) have been concluded to date across the globe. The number of investment treaties increased rapidly over the past 20 years, with an accelerating pace in the past five years. In 2001 alone some 158 new BITs were adopted. In addition, the past decade has seen a rapid increase in regional investment agreements among more than two states, such as NAFTA, ASEAN and the Mercosur.

The Free Trade Agreement of the Americas (FTAA), which also includes an investment chapter in its current draft, and which is presently under negotiation among 34 states, is perhaps the most ambitious existing attempt to unify investment rules.

While all these multilateral agreements are limited to a specific region, no global investment agreement exists to date. Negotiations under the auspices of the Organisation for Economic Co-operation and Development (OECD) to adopt a global agreement on investment were broken off in 1998 in Paris, France.

At the IV Ministerial Conference of the World Trade Organization (WTO), in Doha, Qatar, Ministers referred to the "need for enhanced technical assistance and capacity building in this area" and committed governments to providing such support. In the case of investment, Ministers added that such assistance should include policy analysis and development to evaluate better the implications of closer multilateral co-operation for development policies and objectives, and human and institutional development (Paragraphs 21 and 24 of the Doha Ministerial Declaration).

In this same context, APEC Leaders and Ministers have reaffirmed the importance of WTO-related Capacity Building activities "...as a unique, substantial contribution to strengthening the multilateral trading system".

Following the mandate given by APEC and WTO Ministers, the present work has been conceived and conducted with the aim to strengthen the technical capacity of investment negotiators from APEC members and non-members.

This work comprises specific analysis in particular areas of investment instruments conducted by four of the most recognised academics in the matter.

Professor Muthucumaraswamy Sornarajah, Research Fellow from the National

University of Singapore, explains how several attempts have been made at bringing about a comprehensive code on foreign investment, but they have resulted in failure simply because of the ideological rifts, differences in economic approaches, policy variations and clashes of interests that attend this branch of international law.

Professor Sol Picciotto, from the University of Lancaster Law School, United Kingdom, examines the interaction of investment agreements with other agreements on related aspects of business and economic relations, which affect international investment, in particular Taxation and Restrictive Business Practices. The study concludes with a brief outline of alternative possibilities for a more comprehensive approach to international investment regulation.

Professor Malcolm Bosworth, Senior Economist from the Australian National University, attempts to contribute to the debate over a possible GATS-based investment agreement by examining the strengths and weaknesses of the GATS, especially those aspects that relate to the pre-establishment phase of investment, and identifying some options for avoiding problems if the GATS approach is used for a multilateral investment agreement.

Professor Francisco Orrego Vicuña, from the Law School and the Institute of International Studies of the University of Chile, examines the evolution of the investor-state dispute settlement procedures, with particular reference to those decisions of ICSID tribunals that have influenced a change in perspective, not only in respect of the extent of bilateral investments treaties and related instruments, but also of the very meaning of international law in some respects. In Prof. Orrego's view, the end result of such a process has helped thus far to reach a balance between the right of host States to undertake regulatory functions in the public interest and the right of foreign investors to carry on their business without arbitrary or unlawful interference.

I hope the present effort could achieve the expected results, bring new light and better perspectives to the legal framework of international investment.

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Chapter 1

Chapter 1

Multilateral Instruments on Foreign Investment Prior to Cancun

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MULTILATERAL INSTRUMENTS ON FOREIGN INVESTMENT PRIOR TO CANCUN

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If states were in agreement as to norms that constitute the international law of foreign investment, it would have been possible to bring about a multilateral agreement on foreign investment stating the substantive rules which apply in the area. The fact that no such instrument exists is due to the existence of conflicting approaches to the problem of foreign investment protection and the existence of contending systems relating to the treatment of foreign investment[1]. Several attempts have been made at bringing about a comprehensive code on foreign investment,[1] but they have resulted in failure simply because of the ideological rifts, differences in economic approaches, policy variations and clashes of interests that attend this branch of international law. Most drafts have been made with the objective of providing as much protection as is possible to foreign investment. These have been rejected by the capital importing states. The entry into the picture of non-governmental organisations further complicates the picture. They object to multilateral agreements which concentrate on investment protection exclusively without addressing issues relating to environmental degradation, human rights violations and issues of corporate governance which may be associated with foreign investment. Some of these organisations take the view that development interests of the poor are not addressed through such instruments, which seek only to protect the rights of the rich multinational corporations. The entry of these organisations as major players in the area has complicated the issue of making such agreements further.

1. The first attempt was the foreign investment provisions in the Havana Charter (1948) which contemplated the establishment of an International Trade Organisation. It did not eventuate due to the objection to the provisions by business groups and the eventual refusal of the United States to participate in the process of the establishment of such an organisation. James ES Fawcett, "The Havana Charter" (1949) 5 YBWA 320.

It is relevant to note that non-governmental organisations, which supported the rights of the foreign investors have been active in the field for a longer period of time.[2] Non-governmental organisations opposing the view that the instruments should exclusively concentrate on issues of protection are relatively new to the field. The voices against confining the drafting of investment treaties to investment protection alone have increased as a result of the growing strength of the environmental and human rights groups entering this sphere.[3] These concerns have become more significant in the recent times with the increase in global concern for the environment and human rights.

There have also been instruments which contained rules favouring the interests of the developing states.[4] These have been rejected by the developed states. Most of these came about when there was a movement to curb the power of multinational corporations. There was a period in which these corporations were seen as undermining the sovereignty of states in which they operated. That period also coincided with the movement towards the creation of a New International Order giving greater control over foreign investment to developing states. In that context, codes came to be drafted, notably by a specially created United Nations body, the United Nations Commission on Transnational Corporations (UNCTC). These codes were resisted by the developed states, which put forward a version of a code of their own.

The efforts within the UNCTC to draft a code of conduct did not materialise. The first section of this paper describes these efforts. [5]

2. The International Chamber of Commerce is such a non-governmental organization. In 1972 it drafted Guidelines for International Investments. A private group drafted what came to be known as the Abs-Shawcross Convention on Investment Protection. It was espoused by Germany and submitted to the OECD. For a discussion of the Draft, see Lord Sahwcross, "The Problems of Foreign Investment in International Law" (1961) 102 Hague Recueil 334; for text, see (1968) 7 ILM 117.

3. This phenomenon is new. Though these non-governmental organisations have existed for a considerable time, their concern with the investment field dates probably from the organised protests against the OECD's attempt to formulate a Multilateral Agreement on Investment (1995-1998). The abandonment of the project is at least partly due to the organised protests.

4. There was an attempt to draft a code of conduct on multinational corporations by the now defunct United Nations Commission on Transnational Corporations which failed due to non-acceptance by the developed states.

5. The World Bank study lists the multilateral instruments made up to the date of the study. The inclusion of human rights documents in the list is selective. It includes the Declaration of Human Rights and the European Convention on Human Rights. But, the relevance of these documents is confined to the statement of the right to property only. If the right to property is relevant, a fuller list containing the variations on the statements of this right should have been included. For the list, see World Bank, Legal Framework for the Treatment of Foreign Investment (Vol.1, 1992) pp. 63-72.

Among the more recent efforts to draft instruments on investment are the Guidelines on Foreign Investment proposed by a study group of the World Bank and the Multilateral Agreement on Investment (MAI) attempted by the Organisation for Economic Co-operation and Development (OECD). The Guidelines were drafted in 1992. They were non-binding as the group felt that the time was not ripe for a multilateral binding code on investments. This was despite the fact that in the 1990s, there was a general fervour for the liberalisation of the regime for investments. There was a proliferation of bilateral and regional treaties on investments. The developing countries had for various reasons turned away from the attempt to create a New International Economic Order and were courting foreign investment by granting them high standards of security both through their domestic law as well through investment treaties. The OECD, in that context, thought that the time was ripe to push through a binding code on foreign investment. Its project for a Multilateral Investment Agreement began in 1994 but was soon to run aground as the fervour for liberalisation subsided and the anti-globalisation protests took hold. The MAI became the first target of these protests and the catalyst which enabled the coming together of a diversity of interests opposed to globalisation. Since the failure of the MAI, the focus has now shifted to the World Trade Organisation. The Second Ministerial Conference of the WTO held in Singapore mandated the consideration of an agreement on investment under the auspices of the WTO. The matter was not considered at the Third Ministerial in Seattle where massive demonstrations against the WTO muted consideration of the issue. At the Doha Ministerial, the decision was made to consider the possibility of taking up the subject of investment subject to concerns of development. The drafting of the rules are already mired in conspiracy as a group of developing states have distinct views on the subject. The area covered by this paper is both current and controversial.

The International Norms on Multinational Corporations

The study of multinational corporations in international law is rather recent,[6] though they have been actors on the international scene for

6. For book length treatment of the subject, see Peter Muchlinkski, Multinational Corporations Law (Blackwells, 1995); Cynthia Wallace, The Multinational Enterprise and Legal Control : Host State Sovereignty in an Era of Economic Globalization (Martinus Nijhoff, 2002).

a long period of time. The major trading companies that existed in Europe, such as the East India Company and the Dutch East Indies Company, though they were not multinational corporations in the modern sense, were the progenitors of imperial rule. The modern multinational corporation is better integrated due to superior means of instant communication and more cohesive due to integrated modes of production. They are responsible for all the investment flows that take place.[7] The largest of these multinational corporations command financial assets in excess of those controlled by states. Their role in domestic and international affairs cannot be underestimated. As major repositories of power, they advanced rules and techniques of contractual protection which suited their interests. They have the capacity to influence the course of international events and shape principles of international law.

It has been a defect in the theory of international law that this fact has not been accommodated in theoretical constructs of the law. The idea of the open seas was formulated at the behest of trading companies so as to ensure that they had open access to the seas to favour their maritime trading interests.[8] The system of appointing diplomatic agents for the protection of nationals owes its origins to the system of agents appointed by corporations to look after their commercial interests.[9] Much of India and many African states were ruled by corporations until disorder made their home states step in to assume the role of governance.

State-centred theories of international law have, however, never recognised the fact that trading corporations have been forces within the international system with a capacity to generate international norms of behaviour or at least, have an influence in the shaping of the forms these rules take. It may have been convenient to do so as statehood was a convenient curtain to cloak the activities of these corporations. The power of the companies continued long after the imperi-

7. Technically, every individual is capable of making foreign investments. At least one modern investment dispute arose from an investment made by a single investor. Vacuum Salts v Ghana. But, it is seldom that large investments are made by single investors, though large multinational corporations are often controlled by single individuals or by families.
8. It is no secret that Grotius, who is sometimes credited as being a disinterested founder of international law, was in the employ of the Dutch East Indies Company when he formulated the theory of the freedom of the seas.
9. Arthur Nussbaum, A Concise History of the Law of Nations (1954) p.125.

al states took over from the trading companies and established their sovereignty over the colonies. In the Middle East, oil diplomacy upon which power depended in the twentieth century was pursued as much by the major oil corporations as by their home states.[10] It was evident that the system of investment protection through contractual means was devised largely through the activity of individuals and organisations that were keen on protecting the interests of these corporations. The law that was built up was built up through private means of law making focusing on arbitral awards that result from consensual procedures of decision making and the writings of scholars who were partial to the building up of a system of investment protection through the instrumentality of international law. These were low order norms of international law but nevertheless sufficient to build up a sufficient system of protection.

The power of the old trading corporations like the East India Company pale into insignificance when compared with the power of the multinational corporation in the modern world. The old trading corporation was a dinosaur with a small head and a huge body in the sense that actual control over the subsidiaries in far flung areas could not be exercised by the parent company due to inadequate communication facilities. The control exercised by the parent company over its subsidiaries in the case of a modern multinational corporation is far more effective due to speedier methods of communications and transferring of assets and personnel. The influence that the multinational corporation can exert on states and on the international community is commensurate with the increase in this power. Many multinational corporations command capital assets far in excess of the states in which they operate. It is not difficult to understand that they can affect trends both in international and domestic politics. Because of this extensive power, the protection of the assets of multinational corporations has been addressed both through the exercise of that private power as well as through the public power of their home states which they are able to influence. There has always been a hidden nexus between the private power of multinational corporations and public power of their home states, which is seldom brought out into the open. The need for the regulation of this private power through the

10. Daniel Yergin, The Prize (1991).

instrumentality of international law is a necessary fact which has not been adequately addressed, largely because the existence of such power itself ensures that no control is brought about.[11]

At one stage, the developing countries saw the need to control the power of multinational corporations. They sought to influence the United Nations bodies which they control to formulate rules of conduct for multinational corporations. These efforts were part of the package to bring about the New International Economic Order. These efforts began at a time when the developing states had sufficient cohesion and sufficient confidence in being able to achieve new rules through their unity. The general belief that multinational corporations were undermining the sovereignty of states had a hold in Europe at the time as well. The dependencia theory that the multinational corporations were instrumental in keeping the economies of peripheral states in a state of perpetual dependence still had hold in Latin American states. In that context, it was possible to talk of bringing about binding codes of conduct to regulate the activities of multinational corporations. The circulation of petro-dollars ensured that there was sufficient money available for developing countries. There was a sufficient cohesion among the developing states which acted together through groups like the Non-Aligned Movement and the Group of 77.

It is in that context, that the effort was made by the United Nations Commission on Transnational Corporations (UNCTC)[12] to draft a code of conduct on transnational corporations.

But, the fervour for the New International Economic Order was to diminish. With aid drying up and a loan crisis emerging due to failure to meet payments on the petro-dollar loans, foreign investment capital became the only available capital for economic development. All developing countries began to court each other for the limited foreign

11. Through employment of such devices as soft, non-binding codes and heavy advertising campaigns attention is deflected from the need for control. The very institutions like the OECD which want strong binding measures on foreign investment protection, argue for soft codes for the regulation of the conduct of multinational corporations. On academic support for non-binding codes on conduct of multinational corporations involving the environment and human rights, see

12. The UNCTC was established in pursuance of a study of the problem of multinational corporations. A group of eminent persons was appointed by ECOSOC Resolution 1721 (LIII) to study the problem. The group recommended the setting up of the UNCTC which was established in 1974. The group justified continued interest in the issue on the ground that "certain practices and effects of transnational corporations had given rise to widespread concern and anxiety in many quarters and a strong feeling has emerged that the present modus vivendi should be reviewed at the international level".

investment that was available. Hostility to multinational corporations ended and they began to be heavily courted. Ideological changes also took place with the fall of communism. With the new states resulting from the break up of the Soviet Union embracing free market notions, the competition for foreign investment among the developing countries increased. The ascendance of neo-liberalism speeded the process of liberalisation of trade regimes resulting in the formation of the World Trade Organisation. Though in 1992, the World Bank judged rightly that the world was still not ripe for a binding code on foreign investment and brought out a set of guidelines instead, the OECD just a few years later embarked upon the framing of a binding Multilateral Agreement on Investment.

The picture was to change again. The MAI soon became the focus of protests. They were generated largely by human rights and environmental groups which claimed that the instrument focused entirely on the protection of multinational corporations without addressing the fact that they were also responsible for much of the human rights abuses and environmental degradation that takes place around the world. Around the time, there was also growing disenchantment with globalisation, which had been trumpeted as a force that integrated the world and assured human progress. Suddenly, there was discontent with the process. It was seen as driving a wedge between the poor and rich not only on a global scale but within the developed states themselves. As one commentator put it, the process of globalisation had so divided society on economic scales that the Third World had moved into the first world.[13]

The battles that ensued on the streets of Western capitals whenever the economic organisations connected with neo-liberalism met, signalled the growing opposition to the idea of bringing about regimes on foreign investment that gave protection to multinational corporations without controlling their faults. The counter-groups had organised themselves so effectively that they were able to exert sufficient pressure on their governments to pull out of the negotiations of the MAI.
But, the issue of investments has now been moved into the World Trade Organisation. It is tasked with the formulation of an instrument on investment which will then be fitted into the existing structure of the

13. Caroline Thomas,

WTO with its dispute resolution mechanism. The assurance to the developing world and to the discontents is that the issue of investment will be considered in the context of economic development. Paragraph 22 of the text of the Doha Ministerial Meeting of the WTO assures that this would be done in formulating an instrument. Though work on the process of considering an instrument has begun, there are states which have already come out strongly against the making of such an instrument.

Three principal instruments that have been attempted, all of which resulted in failure, tell the tale of these movements. The first is the OECD's draft code of conduct on multinational corporations. The second is the World Bank Group's non-binding guidelines on foreign investment. The third is the OECD's MAI. The present, ongoing effort is to move the issue into the WTO. The following sections describe the principal features of each of these efforts.

The UNCTC Draft Code on Multinational Corporations

The UNCTC Draft Code on Multinational Corporations, like the OECD's Multilateral Agreement on Investment never received acceptance. But, both are important as they indicate the differences that exist between the states and the conception of what the ideal code for investments would be at both ends. Both documents were drafted at the time when the political climate was favourable to their drafting. The UNCTC's Draft Code was attempted at a time when there was considerable hostility to multinational corporations and there was a cohesion among developing countries to control foreign investment. The OECD's MAI was drafted a time when fervour for liberalisation was at its high point and it came to a halt when it subsided. Both efforts and the contents of the codes that were drafted are described in this chapter along with the intervening attempts. It commences with a description of the UNCTC's Draft Code.

<u>Description of the UNCTC Draft Code</u>

The final version of the draft code contained seventy three paragraphs. But, there were reservations to many of the formulations. The major provisions of the code may be noted.

The preamble

The preamble of the draft code states that the object of the code is to "maximise the contributions of transnational corporations to economic development and growth and to minimise the negative effects of the activities of these corporations". It is clear the code is based on the premise of the Report of Group of Eminent Persons on Multinational Corporations that multinational corporations may promote economic development provided they are harnessed to the economic goals of the state and negative impacts of their investments are avoided. It thus rejects the classical economic theory on foreign investment, that foreign investment, uniformly promotes the economic development of the host state. As a result, the premises on which foreign investment protection has hitherto been built stand rejected. Economic liberalism, which was to gather strength in the 1990s and fuel the move towards the MAI, is also built on the premise that what is good for development deserves protection. The UNCTC's draft code contains an implicit rejection of that argument and therefore presents an ideological counter to the premises on which the developed states have built up their norms on foreign investment protection. The preamble, though not contested by the developed states at the stage of drafting, stands as a rejection of the policy of the developed states in constructing their instruments on foreign investment. It is in marked contrast to other international instruments on investment, like bilateral investment treaties or the ICSID and MIGA Conventions which are prefaced by the classical view that foreign investment is uniformly beneficial to economic development. It recognises the fact there could be investments which have negative effects on development.

Definition

There was some early dispute as the definition of the transnational corporation. The developed states required the inclusion of state corporations in the definition of transnational corporations, whereas developing states preferred that the definition is confined to private corporations. There was consensus on the definition which no includes state corporations within the definition of multinational corporations. This problem is unlikely to arise in an investment instrument which will be concerned with the definition of an investment rather than the character of the entity which makes it.

Respect for national sovereignty

Article 7 of the draft code states that transnational corporations shall respect the national sovereignty of the countries in which they operate and the right of each state to exercise its permanent sovereignty over its natural wealth and resources". The succeeding articles flow from the principle of sovereignty. They seek to spell out the fact that the foreign corporation which operates in the territory of the host state should recognise the sovereignty of the host state. They require foreign corporations to accept and abide by the laws of the host state and ensure that they do not act in any way that is inconsistent with the economic objectives of the host state[14]. The sovereignty of the host state is not absolute for the code later refers to the duty of the state to fulfil in good faith the international obligations that it had undertaken. The qualification is consistent with the reference to sovereignty in the other documents associated with the New International Economic Order. Thus, the Charter of the Rights and Economic Duties also refers to the requirement that international obligation are fulfilled in good faith. But, the content of the international obligations is a matter of controversy. It obviously includes obligations in multilateral and bilateral treaties. But whether it would include contractual agreements between the transnational corporations and their host states and limitations created by customary international law is a matter of dispute[15].

The reference to permanent sovereignty over natural resources draws its origin from a long string of General Assembly resolution which have asserted a state's right to control the exploitation of the natural resources of its territory. The doctrine is too well entrenched now, as a result of its acceptance in constitutional provisions as well as in the new forms of contracts that have been devised so as to reflect the host state's right of control. Though contested, the status of that doctrine to be considered an ius cogens principle has been discussed in the literature.

14. Articles 8-10.

15. S. Tiewul, "Transnational corporations and Emerging Internaitonal Legal Standards" in P De Waart, P Peters and E Denters (Eds.) International Law and Development (1988) 105 at p. 113 suggest that it does include limitations created by customary international law. But, there is a reluctance to spell this out in the code itself. Resolution (1803) (1962) on the Permanent Sovereignty over Natural Resources contained the obligation when it affirmed that "foreign investment agreements freely entered into by or between sovereign states shall b observed in good faith".

The aim of the provision is to ensure that the regulatory space for the host state is kept secure. The problem that has arisen in the later instruments including the possible WTO effort is as to whether an investment instrument which concentrates on giving protection to the foreign investor from governmental interference will not restrict the regulatory space of the host state. This will result in it not being able to channel the investment towards its development objectives or reflect its social and environmental concerns as to how the investment process is effected. The formulation here tilts the balance in favour of regulation. On the other hand, the manner in which provisions of some investment treaties have been employed by arbitral tribunal indicates that there will be a considerable erosion of regulatory space if there is an overweening emphasis on protection. The search for a balance has not been successfully completed.

Renegotiation of contracts

An obligation is created to renegotiate contracts where the contractual equilibrium which existed at the time of the contract has been altered by a fundamental change of circumstances[16]. This is a departure from the hoary doctrine of pacta sunt servanda upon which developed states have placed much store in building up a theory of internationalisation of foreign investment contracts. But renegotiation is more sensible as a technique for avoiding disputes and ensuring that the relationship remains viable in the context of changed circumstances. There is a growing body of opinion which believes that a renegotiation clause should be read into foreign investment contracts of long duration. The inclusion of the duty to renegotiate in the draft code of conduct is consistent with this opinion. The inclusion of the duty to renegotiate contracts in the light of changed circumstances is consistent with this opinion[17]. Again, one can see that the genesis of much of the ideas that underlay the draft code was in the resolutions that accompanied the New International Economic Order and the writings that supported it. To that extent, there was a definite effort

16. Article 12.
17. The Aminoil Arbitration showed the relevance of changed circumstances ad the view that the contract cannot remain unresponsive to changed circumstances. For writings which favour the view that renegotiation should be implied in all foreign investment contracts of long duration, see M. Sornarajah, " The Supremacy of Renegotiation Clauses in International Contracts" (1988) 6 JIA 97; Nagla Nassar, Sanctity of Contracts Revisited (Kluwer, The Hague, 1995)

being made to bring about norms opposed to those that had been hitherto articulated in the area.

Non-interference in domestic affairs

There is a duty imposed on transnational corporations not to interfere in the domestic political activities of the host state. They are also not to influence their home states to intervene on their behalf in a manner inconsistent with their obligation under the Charter of the United Nations and the Declaration on Friendly Relations between States[18]. The inspiration for the articles is the fear on the part of the developing states that transnational corporations will use their economic power to influence domestic politics. There was also the fear that they would induce their home states to interfere with the internal politics of the host states to bring about political climates favourable to them as they did in the past. The role of the old companies in imperial history was well remembered. A contemporary instance of such interference was in Chile which resulted in the overthrowing of the government of President Allende who nationalised the copper mines without paying compensation. The role of foreign corporations as well as their home state in the military coup that ensued and the replacement of the government by a right wing dictatorship favourable to foreign business induced a general fear that the situation could be repeated in other states. There was a feeling that reformist governments which seek to institute economic policies that may be unfavourable to foreign business may meet with a similar fate.

The requirement of non-interference is an established principle of international law. In the Nicaragua Case[19] , the International Court of Justice rejected the American argument that the growing influence of communist power in Nicaragua was a matter which concerned all the regional states. The Court indicated that it was not permissible under international law for one state to dictate the economic system that another state should possess. This, the Court recognised, is a matter entirely for the internal sovereignty of the state. But, the multinational corporation is already present within the state and often it cannot meaningfully participate in business activities unless it acquires and

18. Articles 16-20.
19. [1984] ICJ Rpts 352.

wields some domestic political influence. It is the degree of such political influence that is the question. The fear of the developing states is that the influence that is acquired could be used to ensure that governments partial to the interests of foreign investors are maintained in power. There is also the fear that the home state will use the multinational corporation to influence the course of politics in the host state. From the human rights angle, the fear has been expressed that multinational corporations form alliances with local ruling elites and ensure that governments favourable to business are kept in power even through repression. The issue is the right balance between acquiring the necessary influence to function as an effective business organisation in the host state and interfering in the political affairs of the state.

The draft code seeks to recognise the difficulty posed by this issue. It seeks a reconciliation of the conflict by stating that legitimate activities permitted by the laws and regulations of the host sate are not forbidden. But, the acquisition of the right type of political influence necessary for the multinational corporation to function is not a matter of law or regulation. The question is not adequately addressed by the draft code as it would depend on the circumstances of doing business in each state.

Developed states will be touchy in recognising the rule on non-interference as it is an admission of their past acts of interference through multinational corporations and requires renunciation of future interference. The acceptance of the rule may mean the acceptance of the existence of covert interference in international affairs in the past as well as in the present. States will be unwilling to have such a construction being placed on their acceptance of the rule. As regards future involvement, states will not be keen on evolving principles which could be used against them. The issue of the recognition of the rule of non-interference will pose problems.

Yet, it addresses one of the issues that plagued the drafting of the OECD's MAI, that of unconcern for human rights. The rule of non-interference imposes an obligation on the multinational corporation not to assist in the repression of the people by the ruling elite so as to promote business. To the extent that the rule promotes such an interest, it will have appeal to human rights groups which will campaign for the inclusion of such a rule in a code on investments. But, they may desire that the rule be stated as a more active obligation and not be confined to the passive obligation of mere non-interference.

Since the UNCTC draft code, non-interference in domestic affairs by multinational corporations has been taken further by other instruments. But, they are largely contained in non-binding codes. The OECD Guidelines for Multinational Enterprises requires as a general policy that the multinational corporation have regard to the laws of the host state and abstain from political activities in the host state. The APEC Guidelines also require similar avoidance of political activity.

Abstention from corrupt practices

The use of bribery to achieve the objectives of the aims of the multinational corporation has also caused general concern. Several scandals involving multinational corporations indicated that the practice was widespread. The United States passed legislation against the use of bribery by their nationals in the conduct of foreign business, though the enforcement of that legislation has not taken place due to the feeling that it places American business at a disadvantage[20]. Later amendments have relaxed the heavy penalties that the original legislation contemplated.

The OECD has formulated non-binding codes on illicit payments. The fact that they are non-binding indicate that there is a softer approach to the issue of the guilt of the corrupt practices of multinational corporations. It is an idea that does not sit well with the increasing clamour for the imposition of responsibility for the misdeeds of multinational corporations. It would appear that institutions of the rich states are favouring multinational business by not advocating instruments that impose definite liability on the corrupt practices of multinational corporations. It may smack of double standards that an institution that worked for a binding agreement on investments wants a mere non-binding code of ethics on corrupt practices of multinational corporations.

20. The Foreign Corrupt Practices Act, (1977) 15 USC s.78m.

Domestic legal systems regard bribery as criminal. But, enforcement is lax because developing states are ruled by the same elites which obtain the bribes. Contracts tainted by bribery are regarded as illegal[21]. The draft code creates a definite duty on the part of multinational corporations to refrain from making payments to public officials as a consideration for the performance of their duties and also requires a register of payments made to officials to be kept[22].

Economic and other controls

There follows a series of articles which deal with the economic, financial and social controls that the host state could institute in respect of the activities of the multinational corporation. Many of the areas are provided for in other international instruments. The areas concern issues such as transfer of technology[23], restrictive business practices[24], labour relations[25], transfer pricing[26], consumer protection[27] and environmental protection. Duties are imposed on multinational corporations to avoid harmful practices in the areas identified.

The imposition of these duties recognises the need for the assertion of corporate accountability of the multinational corporation for harm that is caused in the course of its operations. The major criticism of the OECD's MAI was that its accent was entirely on the protection of the multinational corporation without addressing the issue of its social responsibility and accountability for harm[28]. There is increasing litigation addressing issues of corporate fraud, participation in genocide[29],

21. Lemenda Trading Co Ltd v. African Middle East Petroleum Co Ltd [1988] 1 All ER 513.
22. Article 21.
23. On the issue of transfer of technology, UNCTAD had sought to formulate a draft code which also became bogged down as a result of ideological divisions. The code sought accessibility to technology by developing countries and the elimination of restrictive business practices involved in the transfer of technology such as grant-back and tie-in provisions, geographical divisions of markets and export restraints. For the text of the draft code, see UNCTAD, Draft International Code of Conduct on the Transfer of Technology, UN Doc E/1990/94 (1990).
24. The effort to identify and provide for the restrictive practices of multinational corporations has met with a degree of success, at least to the extent that a General Assembly resolution on the subject voted without dissent exists. See generally, M Sornarajah, "Towards and International Antitrust Law" (1982) IJIL 1; J Davidow and L Chiles, "The United States and the Issue of the Binding or Voluntary Nature of International Codes of Conduct regarding Restrictive Business Practices" (1978) 72 AJIL 247.
25 ILO, Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (1977).
26. There is a General Assembly resolution incorporating guidelines on consumer protection. For text, see UN Doc ST/ESA/170 (1986); also see OECD Guidelines for Multinational Enterprises and the Protection of Consumer Interests (1999).
27. The whole area of environmental law burgeoned after the draft code came into existence. On the effect of multinational corporations on the environment, see
28. UNCTAD Series on Issues in International Investment Agreements, Social Responsibility (UNCTAD/ITE/IIT/22, 2001).
29. IBM

participation in torture[30], and environmental harm. In view of these developments, it would seem hollow that a code on multinational corporations should come to be drafted without addressing the issues of responsibility for harm that is caused during the operation of foreign investment. The difficulty of combining foreign investment protection with ideas of social accountability is that such protection will be considerably diluted if combined with notions of accountability. But, for that reason, the issues raised cannot be avoided. An instrument that is made on the basis of foreign investment protection alone will lack credibility.

Disclosure of information

There is a broad disclosure requirement that is imposed in the draft code. It requires information to be given publicly of financial and other matters relating to the operations of the multinational corporations. This may not be too onerous a duty as the company law of most states will require such disclosures to be made. Similarly, the duty to make disclosures is now a feature of many foreign investment codes that require that foreign investment should enter through joint ventures. Many of these codes mandate that feasibility studies of the proposed foreign investment projects should be made. Such feasibility reports should contain full disclosure of information.

Treatment of transnational corporations

This section of the draft code contains four parts which seek to recognise duties owed by the host state to the multinational corporation. Its brevity stands in marked contrast to the manner in which the duties owed by the multinational corporation to the host state are set out. It is, no doubt, a concession to the developed states and their demands for a "balanced code". The question is whether the concessions go far enough to appease the interests of the developed states. The four matters that are included are: the recognition of international legal rules and principles relevant tot he treatment of multinational corporations, the requirement of compensation for nationalisation, a provision on jurisdiction and dispute settlement.

30. Doe v Unocal

The outstanding issues

The draft code has been described above. Though consensus had been reached on many of the provisions in the code, there were issues on which no agreement had emerged. These are referred to as the "outstanding issues" in the successive reports of the Secretary General which have identified and discussed them[31].

The relevance of international law

Developing countries have generally rejected the relevance of international law to the making of foreign investments, except where commitments relating to such investments have been created by treaty. The developed states have, however, adopted a strategy of insulating foreign investment from the scope of domestic law subjecting it to minimum standards of treatment which they claim are required by international law. The dispute between the two groups of states has been stated in the following terms[32]:

The industrialised Western countries insist that the code must unequivocally stipulate the applicability of international law in the relations between the governments and transnational corporations. The developing countries, while recognising that states may have multinational obligations in this area, are reluctant to accept the term "international law" because of its traditional connotations, and have instead proposed a formula calling for states to fulfil, in good faith, their international obligations in this area. The Western countries have however rejected the term "international obligations" or "international legal obligations" on the ground that it does not expressly include obligations founded on customary international law. Some of the developing countries contend with equal fervour that beyond the norms provided in the code, they are unable to recognise "vague" and "imprecise" principles of customary international law in the area of foreign investment"

Since the strategy towards foreign investments in the New International Economic Order was to ensure the primacy of host state

31. UNCTC. Outstanding Issues in the Draft Code of Conduct on Transnational Corporations E/C.10/1985/S/2 (1985).
32. Samuel Asante, "International Codes of Conduct and NIEO" in the Proceedings of the First Yugoslav International Seminar on Legal Aspects of the New International Economic Order (1986) 245 at p.247.

control, the position of the developing countries was to downplay the significance of international law. The argument was that there were no clear doctrines on state responsibility for the treatment of foreign investment because there was opposition, particularly by the Latin American states through the assertion of the Calvo doctrine which asserted the host states right of control over foreign investment. The socialist states had also resisted the relevance of international law to foreign investment. The resolutions of permanent sovereignty over natural resources as well as the Charter of Economic Rights and Duties of States had also asserted the primacy of host state control. Consistent with this view, the developing countries took the position that international law was not relevant to foreign investment. This view was reflected in the early versions of the drat code.

A compromise formulation was adopted in the last version of the draft code. It is contained in the section of the code entitled the "general provisions relating to the treatment of transnational corporations". It stated:

"In all matters relating to the Code, States shall fulfil, in good faith, their international obligations, including generally recognised and accepted legal rules and principles"

This compromise formula will not satisfy the standards of foreign investment protection that developed states seek. The duty is to protect "international obligations". Such obligations will not include the foreign investment agreements, as international obligations can only arise from agreements between states[33]. The developed states would argue that customary law protects obligations arising from such agreements as well. The compromise formula will apply to multilateral and bilateral treaties on foreign investment protection but it is not clear whether it applies to the foreign investment agreements themselves. In this sense, the formulation in the draft code means very little as there is already an international obligation to fulfil treaty commitments. It does not accept the theory that foreign investment contracts become internationalised and are subject to the protection of customary international law.

33. This interpretation was accepted by a group of experts who met at the Hague to consider the draft code. See Report on the Hague Summit on the Unted Nations Code of Conduct on Transnational Corporations (Annexed to UNCTC, Work related to the Code of Conduct on Transnational Corporations E/1989/28 Re.1).

Neither does it accept the view of the developed states that here is a body of customary international law that is relevant to the issue of investment protection. It makes reference only to international obligations, though it recognises that such obligations could arise from "generally recognised and accepted international legal rules and principles". The reference to "generally accepted international legal rules" will permit scope for the recreation of the argument as to whether the claims relating to the existence of a minimum standard of treatment have such wide acceptance in international law as to amount to "generally accepted international rules". The fact is that the existence of an international minimum standard in connection with the protection aliens generally has been consistently opposed by the Latin American states. It has also been rejected by the developing states as a whole because the context of the protection of the assets of foreigners indicate an absence of general acceptance required for these rules to be regarded as having any significance for the purpose of this formulation in the draft code. The draft, even with the compromise formula, will probably not satisfy the developed states.

<u>Non-interference in domestic affairs</u>

The inclusion of a provision of non-interference in domestic affairs also proved to be a contentious issue. This provision is not found in later investment agreements, though the APEC Principles on Investments, a non-binding set of guidelines contained a provision on non-interference in domestic affairs and adherence to the laws of the host state. The OECD Guidelines on Multinational Corporations, another non-binding instrument, also contains a provision on non-interference. But, the UNCTC Draft Code sought to create an affirmative obligation. The formulation had the difficulty that it would have to balance the right of a multinational corporation which has to integrate itself into the local economy, to function within the ordinary economic and political process of the state and direct interference in influencing the course of government within the state. The final formulation in the Draft Code reads:

"Transnational corporations shall not interfere in the internal affairs of host countries, without prejudice to their participation in activities that are permitted by the laws, regulation or established administrative practices of host states"

It is unlikely that observing "laws, regulations or administrative practices of the host states" will provide for the exercising of the influence that is necessary to secure the ordinary business advantages a multinational corporation seeks. There is a divergence between the myth system maintained by the "laws, regulations or administrative practices" which business, both domestic and foreign, should follow in influencing governments and the operational code which demands that other avenues be used in securing these advantages. It is unlikely that the matter can be satisfactorily reduced to a written formula. The general rule of non-interference must be stated, but the drafting of the exception to it is a matter of great difficulty. Too broad an exception will undermine the rule. Too narrow an exception will not satisfy those who insist on its inclusion.

The need for insistence on the rule may diminish as multinational corporations come to be perceived as independent agents acting in their own interests rather than in the interests of their home states. The perception of these corporations as mere purveyors of the interests of their home states will diminish with time when it is seen that they have their own interests to pursue. On occasion, the see advantages in linking themselves with their host states, sometimes even to the detriment of their home states[34]. The importance of the rule is also reduced by the fact that the usual form of entry into most states is through joint ventures with local participation. Where influence is sought to change economic or other policies, the local partner to the joint venture could secure such influence. This would be particularly so where the local partner is a state corporation, in which case the leverage on the government will already exist. The government, in turn, could ensure that the local joint venture partner reflects the policy objectives it has set out for the business. The increase in the number of multinational corporations, the growing ability of the developing states to bargain with them on a competitive basis and the nature of the administrative and other controls that host countries have instituted in overseeing the process of foreign investment are trends which will lessen the scope of political and other interference by multinational corporations. These trends may diminish the significance of the rule of non-interference in the future. Developed countries will come to accept the rule of non-interference and developing countries will see little significance in the

34. An extreme instance is the Angolan civil war where Gulf Oil, an American company, was protected by Cuban forces supporting the government from rebels supported by the United States.

rule as they will have instituted sufficient internal machinery to ensure non-interference.
Multinational corporations are actors on the international scene and have the capacity and power to influence the policy of governments, particularly their policies on international trade. There appear to be no norms preventing multinational corporations from engaging in such international activity. The question of whether host states could exert pressure upon a subsidiary present within its territory in order to ensure that the parent company dons not influence international policies of its home state in a manner hostile to the interests of the host state is also an area in which there are no legal norms.

Permanent sovereignty and international obligations

Another outstanding issue is whether the reference to respect by transnational corporations for the permanent sovereignty of host states over their natural resources should be qualified by reference to international obligations that may have been undertaken in respect of them. As regards treaty obligations relating to natural resources, the need for the rule does not arise as it is well recognised that these rights could be surrendered by treaty between the two sovereign states, unless of course, the view that the doctrine on permanent sovereignty forms a ius cogens principle is recognised. Developing states will seek to establish the idea that permanent sovereignty over natural resources is a principle of ius cogens in international law and is not defeasible even by treaty. Developed states, on the other hand, resist this view and also insist that international obligations could be contained in the foreign investment contract on the basis of which dealings in the natural resources were commenced in the host state by the multinational corporation. The theory of internationalisation of the foreign investment contract is the basis of this argument and the preservation of the obligations created by the contract for the duration of the contract is an aim of the developed states. The right to permanent sovereignty is stated in an unqualified manner in the draft code though there is a reference later in the code to the duty of the host state to respect its international obligations.

The Regional Agreements

Though there are other regional agreements on investments which had been concluded earlier,[35] the one which has attracted the most attention and provided a model for OECD's Multilateral Agreement on Investment is Chapter 11 of the North American Free Trade Agreement. The case law that it has generated and the extensive commentary it has received makes it the most important of the treaties that have been made.[36] The controversy that has surrounded the making of the treaty and the jurisprudence that it has generated will have an impact on the development of the law, though it must be kept in mind that the NAFTA provisions are not necessarily repeated in other investment treaties. There must be caution exercised in using the jurisprudence generated by NAFTA for this reason. It would be unfortunate if the principles that are formulated in arbitrations under NAFTA are used in other arbitrations without having regard to the precise language that is used in the provisions of Chapter 11 of NAFTA.

NAFTA provisions on investment are the same as those which appear in the earlier US-Canada Free Trade Agreement[37]. They are, in turn, no different from the provisions which appear in the American model bilateral investment agreement. To this extent, the treaty contains provisions which are preferred by the United States. They essentially embody the investment protection regime which the United States has developed with consistency over the years. The focus therefore has been on ensuring that there is emphasis on high standards of treatment of foreign investment and its protection. The scope it leaves for sovereign control over foreign investment is limited.

The main features of Chapter 11 of NAFTA may be stated, emphasizing its differences from the normal run of bilateral investment treaties. As indicated, the provisions in Chapter 11 are the same as in the model bilateral investment treaty of the United States. The treaty contains strong treatment provisions. It provides for both pre-entry[38] and

35. Of these, the ASEAN Treaty on the Protection and Promotion of Foreign Investment, 1987 is significant in coverage in that it involves eleven states and scope as it involves compulsory dispute settlement. The later ASEAN Investment Treaty, introducing the concept of an "ASEAN Investor" considerably enlarges the scope of the treaty. The "Asean Investor" defined to include any company incorporated in an ASEAN state is allowed pre-entry rights of establishment and national treatment.

36. Laura Dawson (Ed.) Whose Rights? The NAFTA Chapter 11 Debate (Ottawa, 2002); Howard Mann, Private Rights, Public Problems : A Guide to NAFTA's Controversial Chapter on Investor Rights (2001).

37. For a record of the anxieties of the Canadian negotiating team in relation to the investment provisions of the treaty, see Michael Hart, Decision at Midnight

38. Meaning that the treaty creates a right of establishment in the foreign investor.

post-entry national treatment. It provides for most favoured nation treatment and the better of the national and most favoured nation treatment standards. It asserts an international minimum standard and provides for "full protection and security" of the investment. It provides for the right of repatriation of profits and transfer of funds associated with the investment. It deals with expropriation, defining it widely to include direct and indirect takings and anything "tantamount to an expropriation". It creates strong procedures securing compliance. Though these procedures are not innovative as thought by some American writers[39], the treaty provides for unilateral dispute resolution at the instance of the foreign investor against the host state, if a cause of action is created. It is the first time that a treaty containing two developed states contains such a provision[40]. From this novelty, proceeds the fact that the focus of much of the case law generated under NAFTA has dealt with treatment standards and regulatory takings, thus shifting somewhat the concerns of the law in a new direction. The large proportion of the case law that has arisen under NAFTA has focused on whether interference with rights of the investor on grounds of environmental protection could amount to compensable taking. A view has been stated that the provisions of the treaty have reduced regulatory powers of the state to such an extent that even taking of non-binding policies or positions that have an impact on foreign investment through the depreciation of its value could amount to a taking[41]. Such a view has led to concern among environmental and other groups with the provisions of NAFTA. The jurisprudence under NAFTA has fed this anxiety. There is clear controversy as to the impact of NAFTA. The position regarding regulatory taking in the context of the cases under NAFTA as well as other jurisprudence is considered in the chapter on taking of property.

The ASEAN Agreements: There are other regional agreements on investment besides NAFTA. The ASEAN Investment Protection Agreement (1987) is a significant agreement which creates a system

39. American writers have referred to the dispute resolution mechanism of providing a unilateral remedy to the foreign investor as innovative. This is inexact. Such remedies have been provided in earlier American investment treaties as well as in British and other treaties. The first case in which the remedy was invoked related to the UK treaty with Sri Lanka. AAPL v Sri Lanka. It is however, true to say that it is the first treaty to provide for such a remedy in a treaty that involved two developed states.

40. One fear is that the concerns and the analysis made in accordance with the constitutional standards of property protection in rich states will drive the law in the future. This may be detrimental to the interests of developing countries where different social and political notions of property may be more appropriate.

41. Howard Mann and Konrad Von Moltke, NAFTA's Chapter II and the Environment (1999).

of protection within the ASEAN region. It binds the new members of ASEAN as well and applies to their existing investments if specific written consent for such a purpose has been given. One specific feature of the ASEAN Agreement is that it contemplate the unilateral right of the host state to invoke the dispute settlement provisions of the agreement against the foreign investor.

The first tribunal that was set up under the ASEAN Agreement was in Yaung Chi Oo Ltd v The Republic of Myanmar. The highly dogmatic interpretation of the requirements of the treaty for the invocation of jurisdiction made by the tribunal whittles down the possible scope of the treaty. The Tribunal there, also considered the impact of the later ASEAN Investment Treaty which sought to liberalise the movement of investment within ASEAN. The aim of the treaty was to enable the free movement of investment assets among the ASEAN states. The tribunal thought that the provisions of the treaty were "programmatic", a view that may have accorded with ASEAN trends in the 1980s but not with the trends towards liberalisation that was taking place around the world when the ASEAN Investment Treaty was made. It is unfortunate that the tribunal was not able to interpret the treaty in accordance with the prevailing mood of the times when the treaty was made. This is a set-back to the development of the law in the ASEAN region. There are several other regional arrangements of varying sorts but they do not contain the same degree of protection and liberalisation as are contained in NAFTA and the ASEAN agreements.

The Multilateral Agreement on Investment

The OECD attempted to draft a multilateral agreement on investment in 1995[42]. It was an effort to draft a code among developed countries, which alone sets it out as unique. NAFTA involved two developed states but the MAI involved all the members of the OECD, who are developed states. Some developing states attended the discussions. The strategy was to bring about a multilateral agreement among the developed states and have the developing states accede to it afterwards. Given the ascendancy of neo-liberal tenets in the mid-1990s, it

42. It is generally regarded as having commenced with the G-7 Summit in Halifax in 1995 and ended with the G-7 Summit at Birmingham in 1998

was thought that such a code that emphasised the investment protection rules supported by the developed states could easily be drafted among the developed states first and then, it could be presented as a fait accompli to the developing world. The MAI would then be opened for accession by non-OECD countries. It was also thought that once finished, the code could be taken over by the World Trade Organisation.[43]

The draft MAI is similar in most respects to the investment provisions of NAFTA.[44] In that sense, it also bears resemblance to the American model investment treaties on which NAFTA is based.[45] It was initially drafted in secrecy.[46] But, when the provisions became widely known, it was immediately the target of attack of environmental and human rights groups which objected to the emphasis in the agreement on the protection of multinational corporations without providing for protection against the environmental and human rights abuses they could be capable of. The latter part of the 1990s saw the emergence of disenchantment with economic liberalism and the force of globalisation to which it had given a free rein. The Asian economic crisis also increased fears that unrestricted liberalisation of the international economy may be harmful. There was a cause needed for the outlet of these feelings and the cause against the MAI was the most opportune one that was present. Opposition to the MAI was galvanised on a global scale through the same forces of instant communication that makes globalisation possible. Disparate groups were able to coordinate opposition to the MAI on a global scale. The mounting dissent affected governments of Europe and they began to pull away from the project of drafting the MAI. They did not want to displease their electorates.

43. Though this is referred to, it is difficult to see how the MAI, as drafted, would have meshed in with the WTO. The WTO would, for example, have no competence to deal with such matters as the right of establishment in foreign investors. The OECD was preferred as the effort of the developing countries in watering down the effect of the Trade Related Investment Measures under the WTO had succeeded. Stephen Canner, "The Multilateral Agreement on Investment" (1998) 31 Cornell JIL 657 at pp.656-657. The article also refers to the strategy of final integration of the MAI into the WTO.

44. Rainer Geiger, "Towards A Multilateral Agreement on Investment" (1998) 31 Cornell JIL 467 states an official position on the drafting of the MAI.

45. There were differences but they were not substantial. Because negotiations were not completed, the draft contained different alternative formulations. But, the factors which drove both documents were the same.

46. This is now denied. But, academics found it difficult to get copies when it was being drafted. All contacts with officials concerning the document at the early stages were rebuffed on the ground that the document was secret. This was an early error.

Quite apart from the impact of the opposition, there were cracks within the developed states as to the rules that the MAI should contain. The conflict between the United States and the European Union on the Helms-Burton Act which sought to impose secondary boycotts on European and other companies trading with Cuba was seen as an instance of the United States wanting unilateral rules when it suited its interests. There was also the fear that the advances that had been negotiated within NAFTA may be dismantled if less was negotiated under the MAI. But, there were more direct conflicts such as the desire of Canada and France to protect their cultural industries from American influence. There was a fear that unrestricted free access to markets which MAI intended would lead to the swamping of these industries by the United States entertainment industry. There were internal problems rather than the efforts of the non-governmental organisations by themselves which finally scuttled the MAI. Other incidents also added to the rethink of the viability of the MAI from the point of view of each state's own interest.

Around the time, the Ethyl Case was decided under NAFTA. It concerned an attempt to ban the use of an additive to petroleum, which was suspected of being pollutive and harmful to humans. The sole manufacture of the substance in Canada was an American corporation. It sought to bring a suit on the ground that the consideration of a ban was tantamount to a taking under NAFTA. The case was seen as NAFTA infringing on the power of states to interfere with foreign investment in order to protect the environment or to act in the interests of the health of the people. More broadly, it was seen as limiting the sovereignty of the state to perform essential function relating to the protection of internal values in order to ensure the protection of the interests of the foreign investor. The fears that this case created fuelled the arguments against the acceptance of the MAI.[47]

While the dissension among and within the developed states indicated that fears of losing sovereign control over an intrusive process such

47. The impact of the Ethyl Case is stated by Jan Huner who played a leading role in negotiating MAI in the following terms: "Decisive, because some of the points raised by the environmental groups convinced many Negotiating Group members that a few draft provisions, particularly those on expropriation and on performance requirements could be interpreted in unexpected ways. The dispute between Ehtyl Corporation and the Canadian government illustrated the point that the MAI negotiators should think twice before copying the expropriation provsions of the NAFTA". Jan Huner, "Lessons from the MAI: A View from the Negotiating Table" Halina Ward and Duncan Brack (Ed.), Trade, Investment and the Environment(Earthscan, London, 2001) 242 at p.248.

as foreign investment underlay the downfall of the MAI, the developing countries would have had even greater problems with the formulations in the MAI. Some developing countries did participate in the discussions as observers. Others did offer comments from the sidelines but on the whole, there was an absence of developing country participation. But, the objections of the developing countries could be anticipated from the comments made on the MAI by developing country officials and scholars.[48] The MAI was premised on one view of economic development that foreign investment was so beneficial that its protection was necessary for its flows, which in turn will promote economic growth. One version of the preamble to the MAI spoke of the wish to "establish high standards for liberalisation of investment regimes and investment protection with effective dispute settlement procedures". That singular vision of foreign investment is not accepted by all developing states. Developing states want the ability to be able to chose between the different models and find one which suits them best. Whereas the institutions controlled by the developed countries have the same prescriptions and conditions for development, each developing country would want to assert its own right to choose the model, which it considers best for itself. A regime that the draft MAI sought to impose restricted this choice. That would have made the MAI unpalatable to the developing states.[49]

There were specific provisions in the MAI, which would have been objected to as well. The right of establishment contained in the MAI is at the heart of liberalisation of investment flows. The provision on national treatment applies to both the pre-entry phase as well as to the post-entry phase.[50] This provision would sit uneasily with the screening legislation which most developing states still maintain. They believe that they should have the right to shut out deleterious foreign investment and regulate investment permitted entry so as to maximise and harness the benefits of the investment to the host economy. The opportunity for doing so would be lost if uncontrolled access to foreign

48. A Ganesan, "Development Friendliness Criteria for a Multilateral Investment Agreement" (1997) 6 Transnational Corporations 139. Chen Huiping, "Comments on the MAI's General Principles for the Treatment of Foreign Investors and Their Investments: A Chinese Scholar's Perspective" in E Niewenhuys and M Brus, Multilateral Regulation of Investment (2001) p.67.

49. For accounts of various interests that opposed the MAI, see Sol Picciotto and Ruth Mayne (Eds), Regulating International Business: Beyond Liberalization (Macmillan and Oxfam, 1999).

50. The whole range of activity associated with investment is spelt out and includes "establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition of investment". Chapter III on Treatment of Investors and Investments: National Treatment and Most Favoured Nation Treatment, para. 1.

investment were permitted. In the treaty practice of a large number of states, specific provisions preserve this right. In South-east Asian treaties, only "approved" investments are given treaty protection. In the practice of China, Australia and an increasing number of states, only[51] investments made "in accordance with the laws and regulations of each Contracting Party from time to time in existence" are given protection. Given the existence of this limitation even in the heyday of liberalisation, it is unlikely that the MAI would have made much progress with these states. There were standstill provisions permitting existing reservations from national and most favoured nation treatment of sectors and rollback provisions demanding their final elimination. The European Union issued long pages of such reservations of sectors during the negotiations. Most states focused on the telecommunications and transportation sectors. France and Canada held out for the total exclusion of the cultural industries. The developed states did not exhibit much unity on this core issue of the MAI.

National treatment after entry is also an important feature of the MAI. Again, this would pose problems for a large majority of developing states as they provide infantry industry protection and actively promote local entrepreneurship. A strategy of building up small enterprises within the economy could not be adopted unless extensive sectoral exceptions are made. Developing countries also operate large sectors of the economy through state corporations which are monopolies by definition and control industrial sectors. Privatisation of state corporations is an aim of economic liberalism but it is not an aim which appeals to all. There are increasing reservations expressed about the efficiency levels of post-privatisation economic activity even in developed states. There is also a tendency in developing states as well as in developed states to give ethnic groups preferential treatment on the basis of purely political or historical considerations.[52] It would be difficult to accommodate these constitutional preferences with a system of national treatment for foreign investors. These preferences are not driven by economic considerations on which the premises of liberalism rest. It is inappropriate to regard economic factors alone as the driv-

51. The formula is coming to be used widely. It appears in the more recent treaties of Malaysia and Indonesia.

52. Reference has already been made to the studies of the role of ethnicity in shaping foreign investment rules. In developed states, like Canada and Australia, such preferential treatment is given to the aboriginal people of these states.

ing forces behind policy on foreign investment. There are equitable, historical and other considerations, which a state has to accommodate in fashioning policy on foreign investment.

The MAI also prohibits performance requirements. These are widely employed by the developing countries. The TRIMS instrument of the WTO prohibits certain performance requirements. But, it permits those that developing countries usually employ in regulating foreign investment, such as entry through joint ventures, employment of a specific quota of nationals and a minimum level of equity participation. The MAI attempts a more comprehensive list of prohibited performance requirements and applies to a greater range of activities. The provision prohibits export requirements, domestic content requirements, domestic purchase requirements, tying of imports to value of exports, requirements relating to transfer of technology, territorial exclusivity in export, compulsory location of research and development activities, entry of investment through joint ventures and a requirement to hire local personnel.

These are all requirements that the developing host states impose in the belief that they capture the advantages of foreign investment. The developing countries would have had to dismantle much of their local investment codes to accommodate such a long list of prohibitions within their laws. The exceptions provide seek to capture advantages for developed states rather than cater to the needs of the developing countries.

The dispute resolution provisions of the MAI are longer than those in the usual investment treaties. They provide for both state to state and investor to state arbitration. Like other treaties containing provisions relating to prior consent of the host state, the MAI also provides for advanced consent of contracting parties to arbitration. There is a minor change in that a contracting party may at the time of ratification or accession require the foreign investor to be confined to the remedy of his choice. That is, the foreign investor will have to discontinue other proceedings if he chooses arbitration. This is not a major hurdle from the point of view of the foreign investor as his preferred choice would be arbitration rather than domestic proceedings in the host state. It seems to be a light hearted parody of something akin to the local remedies rule creating the impression of a disadvantage caused to the foreign investor.

There was a group of sections containing general safeguards and exceptions. It commences with the statement that it "shall not apply to Article IV, 2 and 3 (expropriation and compensation and protection from strife)". The exceptions relate largely to war measures and public order situations. That expropriation is saved from even such measures which provide a total justification in customary international law indicates a deviation that will not prove acceptable to many states. It also avoids the issue as to whether a regulatory interference with foreign investment on environmental or human rights grounds should be considered an exception. The other exceptions deal with curtailment of financial flows resulting from the investment on balance of payment grounds which again contain more stringent standards than are contained in bilateral investment treaties.

The MAI resulted in failure for a variety of reasons. There have been various assessments of the causes of its failure. The role of the non-governmental organisations is regarded by some as the reason for the failure.[53] Others regard the MAI as not being strong enough so that the multinational business community did not give it its wholehearted support. Any stronger, the MAI would have broken by itself. The seeds for the failure of the MAI lay in the fact that there was insufficient agreement within the developed world on the norms of investment protection. France broke off first. The incoming Labour government in Britain was concerned about inclusion of environmental safeguards. Canada joined France in its concern with cultural industries.

As much as the NAFTA experience illustrates that the instrument could have a life quite unexpected by the parties and lead to discomfort, the long years of negotiation of the MAI showed the developed states that the rules that they seek to impose on the developing world may prove too uncomfortable to bear when applied to themselves. They could not brook the loss of sovereignty that the MAI entailed. With the

53. Alan Rugman, "New Rules for International Investment : The Case for a Multilateral Agreement on Investment (MAI) at the WTO" in Chris Milner and Robert Read (Eds.), Trade Liberalization, Competition and the WTO (Edward Elgar, 2002) p.176.

failure of MAI, attention has shifted to the possibility of creating an investment instrument under the auspices of the WTO. The impact of the experience with the MAI will last for a considerable time. The debate is no longer about investment protection alone but about the wider implications it has about globalisation. The move of investment into the WTO will be plagued by the fact that the MAI which was the first target of anti-globalisation protests has now moved into the WTO which was its second target at Seattle. The same coalitions that moved against the MAI are still around and will coalesce to work against the acceptance of any measure that is driven by liberal economic theory on foreign investment alone without taking into account factors such as development, poverty, human rights and the environment.[54]

54. M Sornarajah, "The Impact of Globalisation on the International Law of Foreign Investment" Simon Reisman Lecture, 2002, Ottawa, Canada. Published in (2002) Canadian Foreign Policy

Chapter 2

Chapter 2

International Investment Agreements and their Interaction with Related Agreements

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INTERNATIONAL INVESTMENT AGREEMENTS AND THEIR INTERACTION WITH RELATED AGREEMENTS

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We have been asked to examine existing international investment agreements, and the disciplines covered by such agreements, including those disciplines referred to in paragraph 22 of the Doha declaration: `scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance of payments safeguards; consultation and settlement of disputes between members'. As agreed with the Secretariat, the study prepared by Prof. Sornarajah, focuses on international investment protection and liberalisation agreements. My study will, in a complementary manner, examine the interaction of investment agreements with other agreements on related aspects of business and economic relations which affect international investment, in particular Taxation and Restrictive Business Practices.

The first section will discuss the effects of investment agreements on agreements in related areas, and the ways in which the interaction has been dealt with until now.[1] This will be followed by a more detailed general historical outline and analysis of international agreements in one of these areas, taxation. The study will conclude with an outline of alternative possibilities for a more comprehensive approach to international investment regulation.

INTRODUCTION: COORDINATION AND LIBERALIZATION OF BUSINESS REGULATION

Legal arrangements to facilitate international trade and investment have a long history, going back to the last part of the 19th century. International agreements, both bilateral and multilateral, have helped

1. This study will not discuss the interaction of multilateral investment agreements with bilateral or regional investment agreements. These interactions are governed by the MFN clause, usually together with a regional economic integration agreement (REIT) clause, e.g. GATS article V.

to coordinate national regulations in a number of fields, in order to remove obstacles to the internationalization of business, as well as to ensure equitable treatment of business activities.

In relation to trade in goods, the development of networks of bilateral trade agreements, dating back to the Cobden-Chevalier treaty of 1860 between Britain and France (Stein 1984, Lazer 1999), eventually paved the way for the multilateral General Agreement on Tariffs and Trade (GATT) of 1947. This was subsumed into the more comprehensive framework of the World Trade Organization (WTO) established in 1995.[2]

More recently a network of bilateral investment treaties (BITs) has developed, beginning in the 1960s, and then with gathering momentum from the late 1980s (Dolzer & Stevens 1995, UNCTAD 1998).[3] In a number of respects the WTO already also regulates investment, especially through the agreement on Trade-Related Investment Measures (TRIMS), and the General Agreement on Trade in Services (GATS).[4] This provides the rationale for suggestions that it should develop another WTO agreement to cover investment generally, which have been under discussion in its Working Group on Trade and Investment, established at the Singapore Ministerial Meeting of 1996.[5]

Such investment agreements have a relatively narrow focus, although their impact is potentially very wide. They essentially establish obligations of a general character for the protection and non-discriminatory treatment of investments. Consequently, they can potentially impact upon any kind of regulation of all types of business activity. This may

2. In some respects the establishment of the WTO completes the triptych of organizations envisaged by the Bretton Woods conference, filling the gap left by the failure to agree the Havana Charter proposal for an International Trade Organization (ITO), which resulted in the more attenuated GATT agreement.
3. BITs have essentially been negotiated between developed and developing countries, and not among developed countries. The negotiation of BITs was initiated in 1959 by Germany, and then taken up by other European countries. These agreements have been mainly political documents, attempting to strike a compromise with developing country governments anxious to attract foreign investments (Guzman, 1998). In the 1990s, Central and Eastern European countries and some developing countries began concluding such agreements amongst themselves (UNCTAD 1997: 19). There was a significant shift with the publication of the US model BIT in 1980, which broke new legal ground, especially in requiring pre-entry national treatment, although this has been subject to specified exclusions in the treaties which have been concluded. However, comparatively few countries signed up to the US model. The USA previously relied on treaties of Friendship, Commerce and Navigation (FCN), which date back to the 19th century. Some treaties of this type were negotiated after 1945, but developing countries proved reluctant to accept them; the last such treaties were concluded by the US with Togo and Thailand in 1966, and an unsuccessful negotiation was attempted with the Philippines in the early 1970s (Salacuse 1990, Dolzer and Stevens 1995: 4).
4. The four `modes of delivery' covered by the GATS, article I, include `commercial presence'.
5. The Working Group by its 3rd formal meeting in September 2002 completed its review of the seven issues set out for `clarification' by para. 22 of the Doha Ministerial Declaration: see its Report to the WTO General Council of 11 July 2003, WT/WGTI/7.

raise issues about their interaction with other agreements with a more specific focus. Indeed, international agreements to coordinate such more specific aspects of business regulation also in some cases have a long history. This is certainly the case for international agreements on the taxation of income or profits, the development of which is outlined in the second part of this paper. It is therefore important to consider the interaction of agreements for the protection and liberalization of investments with agreements of a more specific character, such as taxation.

A. EFFECTS OF INVESTMENT AGREEMENTS ON RELATED AGREEMENTS

The central aim of investment agreements is to encourage the liberalization and provide for protection of international investments. To this end, they establish obligations on the state parties to treat foreign-owned investments (i) in a non-discriminatory manner, and (ii) according to international law minimum standards for protection of private property. It is beyond the scope of this paper to discuss or analyze the scope of these general standards. It is concerned rather with their implications for national and international arrangements for coordinating related aspects of investment regulation.

1. Effects of Investment Agreements on National Regulation

It is clear that investment protection and liberalization obligations create an impetus for deregulation or regulatory reform in host countries in relation to inward investment. The non-discrimination obligations, to provide National Treatment (NT) and Most-Favoured-Nation Treatment (MFN), establish a broad standard which must be applied to all host state regulations affecting foreign investments covered by the investment treaty. The NT provision may create pre-establishment obligations, and may be supplemented by specific market-access obligations, as in the GATS.[6] These impact most obviously and directly on the various explicit controls on inward investment, such as admission controls, or limitations on corporate ownership (including joint venture laws). However, they also have the potential for much more sweeping

6. GATS art.XVI. In this respect the GATS differs from those BITs (e.g. those based on the US model), and the MAI, which create pre-establishment obligations by means of a broad phrasing of NT to cover establishment and acquisition of an investment, but without a separate specific market-access provision.

effects on any regulations affecting business activities which might be argued to operate even de facto in a discriminatory manner. Similarly, the investment protection obligations may have an effect which goes well beyond restricting the host state's power to nationalize foreign-owned assets, if a foreign investor can argue that host state regulations have reduced the value of its investments.

Indeed, investment agreements can be said to be centrally concerned with coordinating regulation. In this respect it is important to learn from the experience of the development of trade agreements. Although the GATT was initially focused on the removal of border barriers (tariffs and quotas), once these had been substantially reduced attention shifted to non-tariff or regulatory barriers. This is by no means limited to the deliberate use of regulations to hinder market access, but may extend to any regulatory differences which in practice appear as a barrier to those seeking market access. As a result, much of WTO law consists of provisions for reducing or eliminating regulatory differences. These concerns have become more acute as business activities have become more socially `embedded', i.e. concerned with longer-term relationships with customers and not just one-off discrete sales of goods. Regulation is a response to the concerns of customers for the safety, reliability and quality of the goods and services supplied to them. The internationalization of these business activities inevitably entails a process of internationalization of regulation also. This can clearly be seen in the experience of the GATS, that `liberalization in services is largely a negotiation based on divergent domestic regulation' (Matsushita et al. 2003, 229).

Hence, governments must consider very carefully the potential impact of any commitments made under investment agreements on the totality of their business regulatory provisions. This is necessary whether the investment agreement takes a GATS-type positive-list approach, or a negative-list approach such as was envisaged in the OECD's proposed Multilateral Agreement on Investment (MAI). Certainly, the positive-list approach makes it somewhat easier for governments and their regulatory agencies to identify potential regulatory conflicts, at least as concerns sector-specific regulation. In considering whether to make `vertical' commitments for specific sectors (e.g. telecommunications, financial services, or professional services), the regulatory arrangements directly applicable to those sectors can be reviewed, with the involvement of the officials and agencies concerned. This is perhaps more difficult in relation to general `horizontal' commitments, since those responsible for negotiation of investment agreements, while usually knowledgeable about their implications for explicit investment controls, may be unaware of the potential impact on some types of generally applicable regulation. It should also be remembered that this concerns not only existing regulations, but possible future ones, since the obligations in investment agreements apply prospectively and thus limit national state regulatory powers.

Where a potential conflict is identified between an investment treatment commitment and actual or possible future regulations, the state may specify a condition or limitation to that commitment to preserve its regulatory powers. The specific NT and market-access obligations under an agreement such as the GATS apply only to the commitments made in each country's own Schedule, and subject to the conditions and limitations specifically listed. However, these are subject to `standstill' and `rollback', under the provisions of GATS Part IV on Progressive Liberalization. If a government fails to specify a condition when making a commitment which it later finds reduces the effectiveness of some aspect of its regulations, this can only be rectified by a modification of its schedules. Modification is governed by GATS XXI: it cannot take place before 3 years after the commitment takes effect, and is subject to compensatory adjustment by affected states. `Rollback' is expected to take place through `bilateral, plurilateral or multilateral negotiations directed towards increasing the general level of specific commitments undertaken by Members under this Agreement' (GATS XIX.4).

The ability to preserve national regulatory powers is even more restricted if the conflict is with the MFN obligation. The MFN obligation in GATS is unconditional, and states are not permitted to list an MFN exemption when making a specific commitment (GATS XVI.1). However, GATS article II does permit contracting parties to `maintain' a measure inconsistent with its MFN obligation, but such measures must be specifically listed, and must meet the conditions of Annex II. The Annex basically establishes `sunset' provisions supervised by the GATS Council, whereby each MFN-inconsistent measure is subject to a termination date, and all are expected to be phased out within 10 years. The wording of article II implies that a state may not introduce a new MFN-inconsistent measure, even if it has reserved its power to do so by listing such measures.

2. Accommodating Related Agreements by Treaty Interpretation

It should be stressed that a state may find itself in breach of investment protection obligations in an investment treaty even if its incompatible national regulations result from another international treaty obligation. The international law principle of pacta sunt servanda requires states to comply as far as possible and in good faith with all their international obligations. It is only when it is actually impossible to comply with one obligation without being in breach of another that international law rules dealing with conflicts between international obligations apply.

It is sometimes said that in such a case the principle is that the later treaty prevails (the later-in-time rule). However, the relevant provision in the Vienna Convention on the Law of Treaties (art. 30) is more limited than this. It refers to treaties relating to the same subject-matter, and applies only as between states parties to both treaties. In such circumstances, `the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty' (art. 30.3). Thus, for example, if two states which are parties to an investment agreement which includes a MFN clause subsequently negotiate a bilateral treaty granting each others' investors special advantages, they would be obliged to extend these advantages to investors from all the other state parties to the investment agreement. This is for two reasons: (i) the subsequent treaty cannot affect the rights under the earlier treaty of states which are not party to it, and (ii) the two treaties are unlikely to be, at least in formal terms, incompatible.

In fact, a clear incompatibility between treaty obligations is likely to be rare. International law is more frequently concerned with ensuring that states can indeed fulfil all their obligations, by interpreting treaties as far as possible compatibly. This could be seen as the rationale behind the principle of interpretation `generalia specialibus non derogat' (a general obligation cannot countermand a more specific one). This is sometimes considered to contradict the later-in-time rule, but there is no contradiction if it is understood as part of the more general principle, flowing from pacta sunt servanda, that treaty obligations should as far as possible be interpreted to be compatible.

Let us take for example a situation where two states are parties to a bilateral treaty governing income or profits taxation of international investments, and subsequently also become contracting parties in a more general investment agreement with a wider membership. Some types of tax treatment of investments between those states may be considered to be incompatible with the NT principle, even if permitted or even specified by the tax treaty. For example, states which operate a system of integration of individual and corporate income tax may provide shareholders a credit against their income tax liability either notionally or actually related to taxes due on the company's income; but non-resident shareholders may not be entitled to this credit. This arrangement may be agreed in the tax treaty, since both states may prefer to provide an incentive to their own investors for the purchase of shares in domestic companies, and may not wish to give a credit to foreign investors towards a tax liability which they may owe to their home country.

Nevertheless, a non-resident shareholder may complain that this constitutes discriminatory treatment which is contrary to the NT provisions of the investment agreement. Against the investor, the state could argue that the investment treaty does not supersede the earlier tax treaty because (i) the later-in-time rule does not apply, since the treaties do not relate to the same subject-matter, and (ii) the more general NT principle should not be taken to override more specific provisions on taxation. In practice, however, if a complaint is brought under the investment agreement its provisions are very likely to be given priority in any adjudication under that agreement, and the discrimination argument may well be accepted. This would be more likely if the tax treaty did not specifically require that the credit be withheld for non-residents, but simply was silent about payment of the credit to non-residents, so it could be said that there is no conflict of the formal terms of the two treaties.

The substantive question is whether it is indeed discriminatory to provide such a credit to residents (who are liable to tax in the state concerned), and deny it to non-residents (who may be able to claim a credit against their home state tax liability for the foreign tax). It could be argued that it is the role of tax treaties to try to provide as far as possible a neutral tax regime for the international allocation of investment, and arrangements to this end agreed between states after negotiations between their tax authorities should not be overridden by a subsequent investment treaty. However, it is by no means certain that such arguments would be accepted, especially if one considers the experience of adjudication under GATT/WTO, which has only slowly begun to develop some sensitivity to its effects on related regimes (Howse 2000).

Interpretation of investment treaty obligations to accommodate potentially incompatible measures which may result from related agreements may be facilitated by including a reference to such related agreements in the investment treaty's Preamble. This does not automatically preclude an override by the investment treaty, since preambular statements are not directly part of the treaty. However, they are important guides to interpretation of its provisions, and hence may encourage an interpretation which is sensitive to the importance of accommodating potentially conflicting regimes. This was seen in the report of the WTO's Appellate Body in the Shrimp-Turtle case,[7] in which the USA argued that its measures prohibiting importation of shrimp harvested by turtle-unfriendly methods were covered by GATT art. XX exceptions. In considering whether the US measures fell within the exceptions article, the Appellate Body took account as part of the context for interpreting the text both the inclusion in the preamble of the WTO Agreement of text referring to the `objective of sustainable development', and of the reference in the Ministerial Decision to establish a Committee on Trade and Environment to the Rio Declaration on Environment and Development and of Agenda 21. These references to related international agreements were especially important in deciding whether the US measures fulfilled the conditions in the chapeau of the Exceptions article, particularly since Principle 12

7. United States - Import Prohibition of Certain Shrimp and Shrimp Products, Report of the Appellate Body, AB-1998-4, especially paras. 152-155, 168.

of the Rio Declaration specifies that transboundary or global environmental problems should not be addressed by unilateral measures but as far as possible through international consensus.

3. Exclusions and Carve-Outs: Negative Linkages

Accommodation between related regimes is more directly accomplished if the investment agreement includes explicit provisions for dealing with potential conflicts or incompatibilities. These commonly take the form of specific exceptions or exclusions (sometimes referred to as `carve-outs'). Thus, GATS art. XIV provides a number of general exceptions, some of which however are worded in fairly specific terms. These include two in relation to taxation measures. One preserves measures which may be inconsistent with NT commitments `provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members' (XIV.d). The second allows a derogation from the MFN obligation `provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound' (XIV.e). The GATS General Exceptions must comply with the provisions of the introductory paragraph or chapeau of art. XIV (modelled on the equivalent article XX of GATT), that `such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services'.

Such an exception does to some extent clarify how a potential incompatibility should be dealt with. Where the incompatible measures are required by another international agreement between the same parties, the exception in principle allows the other treaty to prevail, in accordance with article 30.2 of the Vienna Convention on the Law of Treaties. However, the measures must fall within the requirements of the exception, including those of the chapeau. By implication, a measure which may be held to fall outside the terms of the exception will be overridden by the investment treaty obligations, at least if it is earlier in time. Thus, by providing a specific exclusion, the contracting parties to the investment agreement may be taken to consider that its provisions should override any measures of a similar kind which are not covered by the exclusion.

In practice, considerable ambiguity may remain about the status of incompatible obligations despite the inclusion of a specific exception. This can be seen in relation to the specific exceptions for taxation in GATS XIV referred to above. Despite these exceptions, the US tabled a long list of MFN exemptions to its GATS obligations, under GATS art. II. These included a very general exemption for all sectors in relation to : `measures permitting less favourable taxation for citizens, corporations or products of a foreign country based on discriminatory or extraterritorial taxes, more burdensome taxation, or other discriminatory conduct'.

The fact that the US was the only party to table such an exemption is intriguing. It may be that other states did not identify any potential incompatibilities between any actual or potential taxation measures and the MFN obligation. This would indicate that there are significant divergences between the understanding of member states of the scope of the article XIV exceptions regarding taxation. Alternatively, the USA may be the only WTO member that wishes to retain the power to take taxation measures (including measures pursuant to an international agreement) which might be incompatible with the GATS MFN obligation.

The GATS also provides a more specific exclusion to prevent a complaint of breach of a NT obligation in respect of any measure that falls within the scope of an international agreement between the states concerned related to the avoidance of double taxation (GATS XXII.3). In the event of a disagreement as to whether the measure does fall within the scope of such an agreement, the GATS Council must refer the issue to arbitration.

By comparison with the GATS, the MAI proposals included a more sweeping `carve-out' for taxation measures:

`Nothing in this Agreement shall apply to taxation measures, except as expressly provided in paragraphs 2 to 5 below'.[8]

8. The MAI Negotiating Text as of 14 February 1998, section VIII.

The draft did envisage that the protections against expropriation would cover taxation measures. However, the sweeping nature of the carve-out for taxation measures from both NT and MFN obligations indicates that the MAI negotiators had identified some significant potential incompatibilities. These will be discussed further below.

In addition to taxation, both the GATS and the MAI included exceptions or carve-outs for other related areas, including some for related agreements. As important as taxation for international investment is financial regulation. The GATS in principle prohibits member states from imposing restrictions on international current account payments (art. XI), although it does permit them to make regulations including such restrictions in order to safeguard their balance of payments, subject to strictly defined conditions (art. XII). These include an obligation to act in compliance with the Articles of Agreement of the International Monetary Fund (IMF). The draft MAI included similar provisions. Also, the GATS Annex on Financial Services permits members to take measures `for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system'. This is subject to the proviso that `they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.' This proviso is not as rigorous as the chapeau of GATS article XIV, and as with the chapeau, if domestic measures comply with internationally-agreed standards (such as the banking capital requirements laid down by the Basle Committee on Banking Supervision) they are more likely to satisfy the proviso.

A third area of general regulation affecting international investments is monopolies and restrictive business practices. In principle, measures to ensure competitive markets should be highly compatible with agreements for investment liberalization. However, states have jealously guarded their prerogative to decide what constitutes fairness in competition, and how far it should be enforced. Both positive-list and negative-list procedures enable states to retain either public or private monopolies in sectors where they consider this important. However, GATS art. VIII requires contracting parties to ensure that monopolist service suppliers do not abuse their position, and the MAI envisaged a similar anti-abuse requirement. The difficulty is the lack of reference to any internationally-agreed standard defining what constitutes abuse of dominant position. In relation to other kinds of restrictive business practices, GATS IX recognises that they may affect the supply of services, but merely requires states to give `full and sympathetic consideration' to any request for consultations, and to cooperate by supplying relevant `publicly available non-confidential information', and other information available to it `subject to its domestic law and to the conclusion of satisfactory agreement concerning the safeguarding of its confidentiality'. These provisions do not refer to existing international agreements relating to competition law and regulation, although in some respects they echo some of these arrangements.

In addition, investment agreements may carve out specific sectors which are regulated by other regimes. For example, the GATS Annex on Air Transport Services specifies that the GATS `shall not reduce or affect a Member's obligations under bilateral or multilateral agreements that are in effect on the date of entry into force of the WTO Agreement.' However, this is to be kept under review by the GATS Council. Furthermore, the WTO's dispute-settlement procedure applies only where `obligations or specific commitments have been assumed by the concerned Members and where dispute settlement procedures in bilateral and other multilateral agreements or arrangements have been exhausted'.

4. Incorporation of International Standards: Positive Linkages

The reference in investment protection agreements to related agreements by means of an exclusion or carve-out creates what may be called a `negative linkage' between these two types of agreement. This is particularly necessitated because of the potential for the general non-discrimination and property protection provisions to invalidate measures taken by states even if they are in compliance with or required by other treaties. There may also be `positive linkages' with related agreements, especially those establishing internationally-agreed regulatory standards.

A method which has become well-established in the WTO agreements is to encourage or require national state regulations to comply with internationally-agreed standards. Such provisions are now a central part of the regime for regulating trade in goods, through the agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT) (Picciotto 1993). These require states to base their domestic regulations on relevant international standards where they exist,[9] and provide a `safe harbour' if they do so, by deeming such regulations to comply with the non-discrimination obligations. In relation to services, the GATS provisions on Domestic Regulations include a similar but rather weaker provision. GATS art. VI.5.b provides that `account shall be taken of international standards of relevant international organizations applied by that Member' in deciding whether licensing and qualification requirements and technical standards adopted by a member state constitute a nullification or impairment of commitments undertaken by that state.[10]

The stronger provisions of the SPS and TBT in effect incorporate into the WTO standards agreed by other international organizations, provided that those organizations are open to membership by all WTO members.[11] This is so even if all WTO members have not joined those organizations, or have not participated in the development of such standards. Furthermore, even if those organizations do not regard their standards as binding, the effect of the SPS and TBT agreements is to create an obligation on WTO member states at least to use such standards as a basis for their national regulations.

The WTO's Agreement on Trade Related Intellectual Property Rights (TRIPS) also takes this approach. The TRIPS contains two kinds of obligations requiring national intellectual property laws to comply with international standards. First, it requires WTO members to apply the main provisions of several multilateral intellectual property (IP) treaties, in particular the Berne Copyright Convention and the Paris Industrial Property convention. This applies regardless of whether the WTO member has ratified those agreements. In addition, of course, the TRIPS agreement itself contains a large number of minimum requirements for

9. TBT Article 2(4), and SPS article 3(1).

10. Similarly, the Disciplines on Domestic Regulation in the Accountancy Sector adopted by the GATS Council (14 December 1998), although they are in fairly general terms, state (para. 26) that `account shall be taken of internationally recognized standards of relevant international organizations' in deciding the validity of national measures. For a comparison of the GATS with the SPS and TBT, see Trachtman 2002.

11. The SPS agreement specifies the three main organizations setting standards within its purview, in particular for food safety the Codex Alimentarius Commission; others may be recognized by the SPS Committee. Under the TBT, standards may be set by any body or system whose membership is open to the relevant bodies of all Member states of the WTO.

IP protection, in relation both to substantive IP laws but also, very importantly, their enforcement procedures.

In the negotiations for the OECD's MAI, a milder form of incorporation by reference was proposed, for the OECD Guidelines for Multinational Enterprises. The Guidelines were to be `associated' with the MAI by their inclusion as an Annex, while the Agreement itself would have included provisions to `encourage' member states to participate in the procedures for applying them. However, it was to be made clear that this Annexation would have no bearing on the application or interpretation of the MAI itself, nor would it alter the non-binding status of the Guidelines.

B. AN EXAMPLE OF INVESTMENT-RELATED AGREEMENTS: TAXATION

1. Nature and History of the Issue

The main taxes which affect international investments are direct taxes on income or profits International agreements to coordinate taxation of income or profits date back to the beginning of the 20th century. Direct taxation of income began to replace duties and tariffs as the main source of state revenues in developed countries, as the funding needs of governments grew for both welfare and warfare. By the end of the 19th century this had already led to complaints of unfair taxation from firms engaged in international trade and investment. Capital-exporting countries, such as the UK, asserted the right to tax their nationals or residents on income from all sources worldwide, including income from foreign investments.[12] In practice, if investors placed their funds in a company formed and controlled abroad, the business profits of that company would be taxable only in the host country, but the payments it made to the investors (dividends, interest and fees) could be taxable both in the host country (the source) and in the home country of the investor or parent company (the country of residence).[13] Some countries were willing to exempt foreign-source

12. Indeed, the UK went further, since British courts took the view that a company incorporated abroad could be resident in the UK if the real control, in the sense of the investment decisions, was exercised from the UK (De Beers v Howe 1906). Conversely, a UK company could be resident abroad if controlled from abroad, e.g. if the Board consisted of foreign residents and met abroad (Egyptian Delta Land and Investment Co. Ltd v. Todd, 1929). In contrast, the US applied its income taxes to citizens, which in the case of corporations meant those formed in the US, so excluded foreign subsidiaries. France, however, taxed commercial and business profits of any establishment situated within the country, regardless of whether it was operated by a locally incorporated entity, or was simply a branch of a foreign corporation.

13. See generally Picciotto 1992, ch.1.

income, but major capital-exporting states (notably the UK) considered that this would create too strong an incentive for investment abroad in countries where lower taxes prevailed. Thus, the US unilaterally introduced a credit for foreign taxes paid on income from investment. Nevertheless, internationally-operating business continued to complain of `international double taxation'.

The issue was extensively debated, mainly through the League of Nations, which convened an international conference in 1928, to consider drafts which had been prepared for four international conventions. These covered (i) Direct Taxes, (ii) Succession Duties, (iii) Administrative Assistance in Taxation, and (iv) Assistance in the Collection of Taxes. However, due to significant national differences in tax systems, as well as variations in the balance of capital flows between countries, it proved impossible to agree a multilateral convention. Instead, it was agreed to treat the drafts as Model conventions, to be used as a basis for the negotiation of bilateral treaties, although only a few such treaties were agreed in the inter-war period. The work of the League culminated in the issuing of a Model Bilateral Convention for the Prevention of Double Taxation of Income,[14] which also incorporated a text adopted in 1935 on the Allocation of Business Income, to deal with the problem of transfer pricing. A separate Model dealt with Administrative Assistance in Assessment and Collection of Taxes, and another with Succession taxes.

Attempts were made by the United Nations to continue the work of the League, through a Financial and Fiscal Commission set up by the Economic and Social Council, but it failed to make headway due to both East-West and North-South conflicts, and ceased to meet in 1954. Later, in 1967, the Secretary-General set up an Ad Hoc Group of Tax Experts, which has continued to meet intermittently. However, international tax coordination has mainly been dominated by the work of the Committee on Fiscal Affairs of the OECD (OECD-CFA), originating in 1956. In 1963 the OECD issued its draft Convention on Income and Capital, together with Commentaries. It was adopted on the basis of a Council recommendation that its members should negotiate and

14. There were two versions of this, the first following western hemisphere Regional Tax Conferences in Mexico City (since the League of Nations was headquartered during the 2nd World War in Princeton University), was referred to as the Mexico Model; a London Model was issued in 1946 when the Fiscal Committee of the League reconvened in Europe. The London version somewhat favoured residence taxation, notably requiring exemption from source taxes of interest, and of dividends paid to a parent company.

apply bilateral treaties in conformity with the model, bearing in mind reservations, and with the interpretations in the commentaries, subject to national observations in them.[15] The Model has indeed provided the basis for the negotiation of an extensive network of bilateral tax treaties, not only among OECD members themselves, but also (especially since the 1980s) between OECD countries and both developing and newly emerging states. The OECD version has in practice been the template for other model conventions, including that adopted by the UN Group of Experts (1980), and regional versions, notably the ASEAN model.

2. The Bilateral Treaty Network

Tax treaties attempt to prevent both juridical and as far as possible economic double taxation in relation to international investment,[16] by agreeing an allocation of tax jurisdiction between the home and host states. Generally, the primary right to tax income is given to the country of residence of the recipient, except for income from immoveable property which is taxable in the state where the property is located. However, the source state is permitted to tax business profits earned there if they are attributable to a `permanent establishment'.[17] Where the business is carried out through a foreign subsidiary company, its business profits are in any case taxable in the host state under the residence principle. The main issue for negotiation between the states concerned is the extent to which payments of dividends, interest, fees and royalties may be subject to source taxation via `withholding' taxes. Between developed countries, which may have an approximate balance of reciprocal investment flows, the host country may agree to apply zero or very low (e.g. 5%) withholding taxes on payments made to affiliated entities (direct investors, e.g. from a subsidiary to a parent company), and to reduce them (usually to between 5% or 15%) if paid to unrelated par-

15. A new version was issued in 1977, and since 1995 it has been issued in loose-leaf form and is under continual review.

16. Juridical double taxation is taxation of the income of the same legal person twice, e.g. if a host state taxes the business profits of a local branch of a foreign company, and they are included in the company's overall profits which are taxable in its country of residence. Economic double taxation is where the same income stream is subject to the same or comparable taxes although in the hands of different legal persons, e.g. income tax is levied on the business profits of a subsidiary in the host country, and then the dividends received from it by the parent company are taxed as part of its overall income.

17. This includes a branch or office; article 5 of the Model treaty defines this term; the definition is slightly broader in models and treaties favoured by capital-importing developing countries, e.g. to include oil rigs and construction sites in place for six months rather than 12. Treaties also generally give a right to tax entertainers and athletes on income derived from such activities to the state where they take place, up to a defined maximum.

ties (portfolio investors).[18] The flip side of the restriction of taxation at source is that the country of residence must either exempt income validly liable to source taxation, or give a credit for such taxes paid. It was historically more difficult to reach agreement between capital-exporting and capital-importing countries, either because the latter preferred a greater priority for source taxation, or because the former were reluctant to grant a credit for taxes `spared' under tax holiday schemes designed to attract investments.

Thus, tax treaties make no attempt to harmonise tax systems, nor even to specify important aspects such as the definition of the tax base, in deference to state sovereignty, which is especially jealously guarded in fiscal matters. However, this has created significant difficulties, especially in relation to the taxation of internationally-integrated business activities carried out by corporate groups or transnational corporations (TNCs). This problem was identified very early, and by the 1920s host states had adopted measures to enable them to tax the `true' profits of a foreign-owned establishment or subsidiary, although such unilateral measures could and did cause conflicts with both the firm and its home state. This resulted in the 1935 draft on Allocation of Business Income, which was integrated into the basic model treaty.

These provisions establish the so-called Arm's Length or separate enterprise principle, for both permanent establishments and associated enterprises, to deal with the pricing of intra-firm `transfers'.[19] Thus, article 7 of the Model defines the business profits attributable to a PE (and thus taxable at source) as those `which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions'. It also requires an allowance as deductions for expenses incurred for the purposes of the PE, including a `reasonable allocation' of fixed or overhead expenses of the enterprise as a whole, such as those for gener-

18. In relation to dividends the allocation works best if states accept the `classical' view that taxes on corporate profits are separate from those on the investor's income from dividends. However, this may be considered to entail economic double taxation, which has increasingly led states to adopt some form of `integration' of business profits taxes with the income tax levied on dividends. The allocation may still be unproblematic if the host operates a fully-integrated system which merely reduces the tax on the company by the amount of the credit of the tax payable by its shareholders. Difficulty is caused by partially-integrated systems, especially if it involves a high rate of tax on the corporate profits with an imputation credit for shareholders; however, in such cases a host country may concede an imputation tax credit also to non-resident shareholders (see e.g. USA-France treaty of 1967).

19. The commonly used term `transfer pricing' is an ambiguous one, since it implies the manipulation of such prices in order to minimise overall liability to tax, by allocating a greater proportion of the tax base to low-tax jurisdictions.

al administration, research and development, and debt service. Article 9, on Associated Enterprises, starts from the assumption that separately incorporated companies are taxed independently even if they are affiliated within a corporate group. Hence, it provides that if `conditions are made or imposed [between such affiliates] which differ from those which would be made between independent enterprises, then any profits which, but for those conditions would have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly'.

As can be seen, these provisions also make no attempt to define or allocate the tax base of related business activities. Not surprisingly, this has created problems, especially where these activities are of an integrated character, involving economies of scale or scope, and synergy profits. The rapid growth of internationally-integrated TNCs from the 1950s led national tax authorities, especially the US IRS, to activate the provisions in their national laws allowing adjustments of related enterprise accounts in conformity with the `separate enterprise' Arm's Length principle. Complaints by US TNCs about what they regarded as the arbitrary nature of such adjustments led to the drafting of Regulations, completed in 1968. These required the IRS to focus on adjustments of prices on intra-firm transactions, if possible on the basis of the Comparable Uncontrolled Price (CUP): the amount that was charged or would have been charged in comparable transactions between unrelated parties.

Since the 1960s there has been increasing concern about the opportunities for international tax evasion and avoidance created by the rudimentary nature of the system for international tax coordination. Tax specialists have become increasingly adept at devising structures utilizing intermediary companies or other entities incorporated in convenient jurisdictions, or tax havens, to exploit the many loopholes in the international tax regime. In broad terms, a TNC can take advantage of deferral of taxes in its `home' state on retained earnings, while also reducing its liability to tax on business profits at source by charging various costs to holding companies (Picciotto 1992, 135-141; European Commission 1992, ch. 6). Further, an internationally integrated firm may achieve significant reductions in tax liability by even quite small adjustments in transfer prices, which are hard to counteract using the crude Arm's Length principle.

3. Attempts to Combat Harmful Tax Practices

Having laid the groundwork for the tax treaty system, the OECD-CFA spent much of the 1980s trying to deal with the increasingly vexed problem of transfer pricing, attempting to reconcile the economic artificiality of the arm's length principle with the globally integrated nature of much TNC activity. Since the late 1990s it has become the focus of unusual controversy, resulting from the launch of its initiative on `harmful tax competition' (OECD 1998). This has especially targeted tax havens as well as working on `preferential tax regimes' in OECD countries. This initiative has been carried out through a subsidiary body of the OECD-CFA, the Forum on Harmful Tax Practices. The OECD's Forum, faced with incipient organised opposition from groups such as CARICOM (for the Caribbean havens) and the Commonwealth and Pacific Island Forum (Peter-Szerenyi 2003), agreed to set up a Global Forum on Taxation (although only involving jurisdictions the OECD defined as `cooperative'). This has led to a degree of politicisation of international tax, focusing especially on international evasion and avoidance (Oxfam 2000; Friedrich-Ebert-Stiftung 2003).

Applying the criteria outlined in the 1998 Report, the OECD's Forum in June 2000 identified 35 jurisdictions as tax havens, and adopted a carrot-and-stick approach to persuade them to cooperate in ending such practices. Cooperation has essentially entailed accepting obligations to provide information on request for the purposes of assessment and enforcement of taxes. To this end, the OECD-CFA issued a Memorandum of Understanding which establishes a template for the undertakings regarding access to and provision of information. The inducement for this cooperation was the threat that OECD members would adopt coordinated `defensive measures' in relation to uncooperative jurisdictions. These would include measures such as disallowing deductions, exemptions, credits or other allowances related to transactions with such havens, denying tax credits or participation exemptions for distributions sourced from them, and applying enhanced audit requirements and comprehensive reporting to entities resident there (OECD 2000, para. 25). This was relatively successful, and of the original 35 jurisdictions, only 7 were included in the List of Uncooperative Tax Havens issued in June 2002.[20] In the meantime the Forum has also been examining the 47 OECD tax regimes identified as being potentially harmful. This was especially important since the jurisdictions targeted as havens, many of which were developing countries, could justly complain of unfair discrimination against them compared to OECD members which offered many of the same advantages, notably Switzerland and Luxembourg. Indeed, many of the commitments made by cooperating jurisdictions were conditional on the same commitments being obtained from Switzerland. It was therefore a very significant event when, following the OECD-CFA's meeting in early July 2003, press reports suggested that Switzerland would be added to the OECD's blacklist.[21]

4. Prospects for Closer Coordination

As this account has shown, the international arrangements for coordination of direct taxation have a long history, and have greatly helped to facilitate international investment, by substantially eliminating international double taxation, at least between countries which have been able to negotiate bilateral treaties. However, they have been less successful in combating fiscal avoidance and evasion, due especially to the limited provisions for cooperation in tax assessment, and even less in enforcement. Furthermore, the reliance on treaties negotiate bilaterally (even if based on standardised model terms) has resulted in a very patchy and complex network, which is constantly being renegotiated and renewed. The very many discrepancies as well as gaps in this network create problems for revenue authorities, work for specialist tax advisers, and opportunities for the less scrupulous or more competition-driven businesses who are tempted to push the limits of tax planning.

This indicates that a more robust framework for coordination of direct taxation is needed to establish a tax-neutral environment for international investment. This would entail (i) a more comprehensive coverage of participating states; (ii) an international definition of the tax base of international business, (iii) a more standardised system for allo-

20. Andorra, Liechtenstein, Liberia, Monaco, the Marshall Islands, Nauru, and Vanuatu. Vanuatu was removed from the list in May 2003, having made the required commitment.
21. `OECD Targets Switzerland in New Tax Haven Blacklist', Tax Notes International 31: 91 (July 14, 2003).

cation of the tax base of international business, and perhaps above all, (iv) a comprehensive multilateral agreement for cooperation in assessment and enforcement of taxes.[22]

Such a degree of international cooperation would certainly be an ambitious undertaking. However, the alternatives could be very damaging. It has become clear that the network of tax treaties fall significantly short of establishing a tax-neutral framework for the international allocation of investment. In many respects, international investors would have legitimate complaints of discriminatory treatment, in the absence of effective exclusion or carve-out provisions in such agreements (discussed in Section A above). This would include, for example, national measures to combat `thin capitalization' by disallowing a deduction for interest paid to an affiliate and its treatment as a disguised dividend, and the absence of provisions for carry-over of losses between affiliates of a TNC. A similar intersection of taxation with trade regulation (Slemrod and Avi-Yonah 2002) was highlighted by the EU's complaint to the WTO against the USA's Foreign Sales Corporation regime, which was upheld by the WTO Panel (entitling the EU to apply a record tariff penalty against US imports, which so far it has suspended).

On the other hand, inadequate coordination of the taxation of international investment also leaves many loopholes for tax avoidance and evasion. These are damaging to national government revenues, especially of developing countries, which lack the resources to combat them effectively. At the same time, they create severe competitive inequalities between those firms and investors able or willing to indulge in aggressive tax planning and others who are more conservative or cautious, as well as purely national firms and investors who have no such opportunities.

In view of all this, it is not surprising that there have been calls for the establishment of an International Tax Organization, notably by the High Level Panel chaired by former Mexican President Ernesto Zedillo, in its report to the UN Conference in Monterrey on Finance for Development held in 2002.[23]

22. The 1988 Convention on Mutual Administrative Assistance in Tax Matters agreed in the Council of Europe and the OECD provides an existing framework for cooperation which goes beyond the minimal provisions of bilateral tax treaties. It has now been supplemented by the OECD Model Agreement on Exchange of Information in Tax Matters, adopted as part of the drive against Harmful Tax Practices, discussed above.

23. UN 2001, at p. 27-28; see also Whisenhunt 2002

C. A MORE COMPREHENSIVE FRAMEWORK FOR INVESTMENT?

It has become increasingly apparent that recent discussions regarding a potential multilateral investment agreement are too limited in scope. One of the main criticisms made of existing proposals and models for a multilateral investment framework is their imbalance. They generally emphasise rights for investors without any concomitant responsibilities, and impose restrictions or `disciplines' on host state powers; but they involve no obligations on home states to enhance corporate regulation, and provide no arrangements for cooperation between states to ensure adequate enforcement of regulation. This was pointed out in a Communication to the WTO's Trade and Investment Working Group by a group of developing countries,[24] calling for proposals to strengthen the obligations of investors and home governments. Such proposals would be in line with the Doha Declaration's mandate that

> Any framework should reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest.[25]

It would also reflect the Plan of Implementation adopted at the World Summit on Sustainable Development in Johannesburg in September 2002, calling for measures to actively promote corporate responsibility.[26]

An alternative approach could adopt the technique of a Framework Convention. This has emerged in recent years, as a means of establishing a set of objectives and principles which are binding on states, together with implementation mechanisms and processes for the formulation of more specific norms. Initiated for the purposes of developing regimes for environmental protection (such as Climate Change), the technique has been adapted by the WHO for its proposed Framework Convention on Tobacco Control (Bodansky 1999). Its advantages are that it can establish an organisational and proce-

24. "Investors and Home Government Obligations", Communication from China, Cuba, India, Kenya, Pakistan and Zimbabwe to the WTO Working Group on the Relationship between Trade and Investment, WT/WGTI/W/152, 19 November 2002.
25. Ministerial Declaration, adopted 14 November 2001 at the 4th session of the WTO Ministerial Conference, Doha (WT/MIN(01)/DEC/1) Para 22.
26. UN 2002, Annex, Point 49.

dural basis to develop new standards, as far as possible through deliberative processes involving a range of civil society as well as governmental participants, providing a stronger basis for mutual trust.

This approach would also in some respects revive suggestions made prior to the 1980s by a number of commentators. For example, Charles Kindleberger, the economist who in many ways pioneered the study of international investment, put forward proposals for a General Agreement on Multinational Enterprise (GAME), which included provisions for coordination of direct taxation (Kindleberger 1980). Similarly, George Ball, formerly a US under-Secretary of State and UN representative, and then Chairman of Lehman Brothers International, proposed the `denationalization' of TNCs. He argued that a supranational citizenship for TNCs should be provided by treaty, since in his view the pragmatic policy followed by TNCs of obeying local laws in each country where they operate would not resolve the `inherent conflict of interest between corporate managements that operate in the world economy and governments whose points of view are confined to the narrow national scene' (Ball 1967, 1975).

A Framework Convention could also adopt a more flexible approach to combinations of hard and soft law codes. For example, it can establish legal requirements on participating states to lay down specifications for corporate codes in general terms, while providing that they should be based on appropriate internationally-agreed standards which may be developed subsequently. As explained above, the WTO agreements establish a Framework Convention in this sense, since they require states to ensure that national regulations do not create unnecessary obstacles to trade by `basing' them on internationally-agreed standards where they exist.

The example of the WTO can also be adapted to deal with the criticism that international investment agreements are one-sided in granting significant rights to investors without any responsibilities. This has raised the question of how a better balance might be achieved in a multilateral framework for investment. A Framework Convention could provide an umbrella for a number of related agreements which would deal with both investor rights and responsibilities, combining liberalisation and regulation.

The technique of including related agreements within an umbrella

Framework Convention could be used, firstly, to clarify the impact of investment protection obligations both on related agreements and on national law. As with the TBT and SPS agreements under the WTO, a presumption could be created that national measures based on internationally-agreed standards (e.g. of environmental protection, or human rights) would be valid. This would help to prevent disputes or claims based on indirect discrimination or de facto expropriation.

Secondly, international agreements and standards could be associated within a multilateral investment framework either on a required or conditional basis. Some international instruments might be considered to embody such core values and standards that they should form an essential part of the package, just as the TRIPS agreement has made acceptance of basic intellectual property rights a requirement of participation in the WTO system. This might be the case, for example, for the ILO Declaration on Fundamental Principles and Rights at Work of 1998. Other issues which might be regarded as an essential part of a multilateral investment framework, and for which multilateral agreements already exist which could be used or adapted for the purpose, include combating bribery, and cooperation in tax enforcement. This model might also be an appropriate way to deal with the difficult problem of tax benefits and incentives, by associating a code on unfair tax competition, along the lines of the codes now being applied within the EU and by the OECD. Association of such agreements within a single framework would help to create public confidence that the benefits extended to investors by globalization would be complemented by a strengthened framework of international cooperation to prevent abuse of the freedoms of the global market.

Both agreements and non-binding standards could also be associated on a basis of reciprocal conditionality, which would provide flexibility. Thus, states could choose to extend investment protection benefits only to investors from states participating in specified agreements. Such conditionality could also be applied to enterprises, through an appropriate Denial of Benefits clause. This would permit a state to deny the benefits of investment protection to enterprises breaching specified or related standards. Thus, for example, a host state could rule out bids for licences or concessions, or cancel them, if the enterprise concerned were found to be in breach of relevant standards.

Thus, a firm which breached Prior Informed Consent procedures, or provisions of the WHO Infant Formula Code, could be denied the right to bid for public contracts.

Finally, relevant agreements and standards could be associated within a multilateral framework for investment on an opt-in basis. States and enterprises could be encouraged to sign up to a range of agreements and codes as appropriate to their activities and circumstances. This would help to provide a higher visibility for positive regulatory standards, as well as helping to authenticate both those standards and their monitoring and compliance mechanisms.

In my view such a more comprehensive approach would provide the best prospects for a more balanced framework which could provide fair treatment for international investments. However, such an approach would clearly go well beyond the remit of the WTO. Rather than continue to widen the ambit of the WTO, it would seem preferable to make a fresh start with this new concept, in another forum.

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Chapter 3

Chapter 3

Pre-establishment commitments in a multilateral investment agreement – the GATS approach

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PRE-ESTABLISHMENT COMMITMENTS IN A MULTILATERAL INVESMENT AGREEMENT-THE GATS APPROACH

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Abstract

Given that it covers foreign direct investment (FDI) in services, which represents about half of all FDI stocks and flows, the GATS is a natural starting point for developing a multilateral investment agreement covering foreign investment in all sectors, including manufacturing. However, application of the GATS has revealed several potential weaknesses with the GATS approach to pre-establishment commitments. It would be desirable that any shortcomings not be automatically transferred to an investment agreement. For example, national treatment – a core discipline for trade and investment liberalisation – is not a general obligation in the GATS, applying instead to only those sectors listed without any relevant limitation in each Member's schedule of commitments (the positive list approach). Further, commitments to provide most-favoured-nation (MFN) treatment can be qualified, by listing exemptions, and making use of "grandfathering" scheduling provisions, unlike the GATT on goods. The paper attempts to contribute to the debate over a possible GATS-based investment agreement by examining the strengths and weaknesses of the GATS, especially those aspects that relate to the pre-establishment phase of investment, and identifying some options for avoiding problems if the GATS approach is used. Approaches used in other international investment agreements (IIAs) and trade agreements that cover investment provide some insights into alternative design options, although they also have shortcomings. The effectiveness of any multilateral investment agreement ultimately depends on the commitment of the signatories to progressively expand schedules of commitments (where a positive list approach is used) or to limit and regularly review lists of reservations

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(where a negative list approach is used). Achieving this will be the real test of success for any multilateral investment agreement, and will be helped if a liberalizing framework is adopted. While whether to have a multilateral investment agreement is beyond the paper's scope, simply extending the GATS modalities to non-services investment may achieve little since most investment restrictions are found in services and are already covered by the GATS. If a multilateral investment agreement is to negotiated, it may achieve more to keep services investment in the GATS, and to devise a much better multilateral agreement to cover non-services investment that overcomes the GATS' shortcomings. These very different agreements could co-exist satisfactorily in the WTO. They could be desirably integrated at some stage based on the liberalizing experiences of both agreements.

1. Introduction

At the World Trade Organisation (WTO) Ministerial Conference held in Doha in November 2001 Ministers 'recognised the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment ….' (Ministerial Declaration 2001). Paragraph 22 of the Ministerial Declaration sets out a number of areas where further work on an investment framework is required before the next WTO Ministerial Conference in September 2003. The focus in this paper is on one of the issues identified in paragraph 22 – 'modalities for pre-establishment commitments based on a GATS-type positive list approach'.[1]

Pre-establishment treatment refers to the laws and regulations of a host country that govern the entry of foreign investment. They determine whether access is possible at all, and if so then on what terms and conditions foreign investment can establish locally (WTO 2002d).

Pre-establishment treatment is likely to be a contentious issue in a multilateral investment agreement. The WTO Working Group on the Relationship Between Trade and Investment reports that some Members feel that pre-establishment commitments should not be part of a multilateral approach to investment (WTO 2002a). Most existing bilateral investment treaties (BITs) do not cover the pre-establishment

1. While the GATS (Articles XVI and XVII) cover both pre- and post-establishment (on-going operations), paragraph 22 of the Doha Declaration refers only to pre-establishment.

phase of investment. Where it is covered, in some BITs and some wider investment and trade agreements, the process of reaching agreement on pre-establishment commitments has often been long and complicated. OECD members took more than 20 years to agree on commitments on the right of establishment in the Code of Liberalisation of Capital Movements and Current Invisible Operations (Weber 2002). Further, OECD countries, a small subset of WTO Members, could not reach agreement on the Multilateral Agreement on Investment (which covered pre-establishment), and in the case of the APEC Non-Binding Investment Principles, consensus was difficult and the non-binding principles rather weak.

Given the likely reluctance of some Members to make pre-establishment commitments, proponents of the GATS-based positive list approach will need to show that it can deliver more than existing international investment instruments (including the GATS itself) and that the shortcomings of the GATS will not simply be repeated. The weaknesses and likely issues involved in using the GATS approach need to be identified and addressed to ensure that the effort involved in negotiating a new investment agreement will be worthwhile. Concerns about insufficient preparatory work on key issues have been identified as a major stumbling block in the failed MAI negotiations (Hinton 2002). Similar problems should be avoided if possible with a GATS-based agreement.

If the shortcomings of the GATS are not addressed, then it is reasonable to ask whether it is worth pursuing a GATS-based multilateral investment agreement. Investment in services, already covered by the GATS, accounts for around half of all FDI stocks and flows. Further, it has been estimated that 80 to 85 per cent of restrictions affecting international investment are applied in services sectors (World Bank 2003). An agreement that extends to non-services and covers all investment in one agreement may not generate much additional benefit, unless it also addresses some of the GATS shortcomings.

The aim in this paper is to examine the strengths and weaknesses of the GATS, especially those aspects that relate to the pre-establishment phase of investment, and identify any options for avoiding problems if the GATS approach is used for a multilateral investment agreement.

Approaches used in other investment and trade agreements covering investment provide some insights into design options, although they also have shortcomings.

As background for the discussion of the GATS, the aims of investment agreements are set out in the following section. Strengths and weaknesses of the GATS and alternative models are then assessed against these aims. Issues and options are summarised in the final section.

2. Aims of a multilateral investment agreement

Open and stable international investment regimes have long been recognised as important for economic development. The 1948 Havana Charter, which aimed to establish the International Trade Organisation (which formed the basis for the GATT), included an article (article 12) on international investment (UNCTAD 1999a).

Since then a complex web of bilateral, regional and multilateral agreements have been negotiated. The first bilateral investment treaty was signed in 1959, between Germany and Pakistan (Sornirajah 2002). The number of BITs in force has grown rapidly, especially in the past two decades. In 2001, 97 countries (the largest number ever) were involved in the conclusion of 158 bilateral investment treaties (BITs), bringing the total from 1941 at the end of 2000 to 2099 at the end of 2001 (UNCTAD, web page).

Regional investment agreements were initially developed in the early 1960s, starting with the OECD's Codes of Liberalisation of Capital Movements and of Current Invisibles (UNCTAD 1999a). Major developments in multilateral and regional agreements covering investment have taken place in the past decade, most notably with the signing of the GATS in 1994. Many regional agreements covering investment have also been implemented in the 1990s. NAFTA, signed in 1992, incorporates features that have subsequently been adopted in several investment and trade agreements.

Aims, priorities, scope and structure vary widely across the different types of investment agreements. The principle aims of most BITs have been investment promotion and protection. The focus has been on the post-establishment phase of investment. Pre-establishment terms and conditions have often been explicitly left to the discretion of host governments.

While no formal objectives have yet been set for a possible WTO investment agreement, it is likely that they would be similar to the aims of the GATS. The preamble to the GATS refers to the desire to achieve progressive liberalisation and a transparent framework of principles and rules, giving due respect to national objectives and the particular needs of developing countries. The aims would therefore be broader than those of BITs.

Some regional agreements have similar aims. For example, the Framework Agreement on an ASEAN Investment Area binds members to 'progressively reduce or eliminate investment regulations and conditions' (article 3). The agreement involves three broad programs: co-operation and facilitation; promotion and awareness; and liberalisation. NAFTA also emphasises liberalisation, with 'remove barriers to trade in goods and services' the first listed objective in chapter 1.

The broader aims and coverage of multilateral agreements make them more complex to negotiate. The fact that there may be trade-offs between some of the aims further complicates the task. For example, adopting design features which give greater flexibility and discretion to signatories to pursue their own agendas and meet their own needs may be at the expense of greater transparency, predictability and liberalisation. Trade-offs such as these have been an important influence on the design of current agreements, and will continue to be crucial for any future investment agreement negotiated under the auspices of the WTO.

3. The GATS as a model for a multilateral investment agreement

The GATS consists of:

- A set of general obligations, which are either unconditional and apply to all measures affecting trade in services in virtually all sectors in all WTO member countries (for example, MFN) or conditional and apply only to sectors that are subject to specific commitments (for example, unrestricted payments and transfers);

• The schedules of specific commitments for each country, which set out how each member will apply the market access and national treatment obligations, for each of the four possible modes of supply ; and

• A list of country-specific exemptions from most-favoured-nation (MFN) treatment that should not exceed ten years in principle.

Foreign direct investment (FDI) is covered under one of the four modes of service supply defined in the GATS – establishment of a commercial presence. FDI in the services sector accounts for approximately half of world FDI stocks and flows (UNCTAD 2001), so the GATS is a natural starting point for the development of a framework covering FDI in all sectors.

The country schedules in the GATS are positive lists, meaning that only those sectors listed are subject to the market access and national treatment rules and disciplines. It is therefore mainly a sector-specific agreement. In contrast, exemptions from the general MFN obligation are by way of a negative list, so that MFN applies unless a service sub-sector or measure is specifically exempted.

Market access involves a commitment to not maintain or adopt any of the six measures specified in Article XVI. The national treatment obligation requires that countries apply no less favourable treatment to foreigners than they apply to domestic service suppliers (Article XVII). For those sectors included in its schedule, a country can indicate that it places no restrictions on market access or national treatment by listing 'none' against the relevant sector and mode. Alternatively, if a country wishes to maintain measures that violate one of the principles, they exhaustively list specific exemptions, or make no ('unbound') commitment, in the relevant column. In addition to these sector-specific commitments, many schedules have horizontal limitations that apply across all committed sectors.

The general MFN discipline (Article II) requires each member to accord to any other member treatment no less favourable than it accords like services and service suppliers of any other country. One-off exceptions nominated as at 1 January 1995 when GATS became operative, or the date of accession for countries that have joined since, are in principle meant to be temporary, for not more than 10 years, subject to review after not more than 5 years.

Members are required to enter into subsequent negotiations with a view to achieving progressively higher levels of liberalisation (Article XIX). While these constituted part of the WTO's 'built in' agenda and started on schedule in 2000, progress was slow, and the negotiations were integrated into the current Doha Round. The potential effectiveness of 'built in' negotiation agendas in particular areas outside full negotiation rounds are therefore largely untried, but are unlikely to provide sufficiently broad coverage to enable successful negotiated trade-offs.

While the GATS is predominantly a positive list model, it is a hybrid, and combines a positive list approach to market access and national treatment obligations (with negative list exceptions permitted within the list) with a negative list approach to MFN commitments, where temporary departures can be listed. The GATS approach has been labelled a 'selective liberalisation' model whereby countries can 'opt in' (UNCTAD 1999b). It is also referred to as the 'bottom up' approach.

The two other most widely used approaches in international investment agreements and free trade agreements covering investment are:

- The investment control model; and
- The MFN and national treatment model.

The investment control model is the most widely used (in terms of numbers of agreements). It is used in most BITs, except those involving the US and Canada, and the Japan-Korea BIT (Table 1). The investment control approach is also used in the World Bank Guidelines on the Treatment of Foreign Direct Investment (UNCTAD 1999b). The investment control type models do not require commitments to national treatment or MFN treatment at the pre-establishment stage. The host government retains full control over entry and establishment.

Table 1: Pre-establishment commitments – alternative approaches

Agreement	Pre-establishment commitments/treatment
GATS, ASEAN Framework Agreement on Services (covers investment)	Positive list for market access and national treatment, with the possibility of attaching limitations to market access and national treatment commitments. One-off possibility of listing exemptions from MFN
NAFTA, APEC Non-Binding Investment Principles, bilateral investment treaties (BITs) involving US and Canada, Japan-Korea BIT, MERCOSUR Protocol on Investment	Negative list for national treatment and MFN
Framework Agreement on the ASEAN Investment Area	National treatment subject to a negative list – for ASEAN investors currently then for non-ASEAN by 2020. MFN for ASEAN investors only.
Most BITs, World Bank Guidelines on the Treatment of Foreign Direct Investment	No requirement for pre-establishment national treatment or MFN treatment

The national treatment and MFN model offers rights of entry and establishment based on the better of national treatment and MFN, subject only to a reserved negative list of sectors to which the rights do not apply. This is also referred to as the 'top down' approach, or the approach where sectors and measures are 'negotiated out', rather than 'negotiated in' as they are with a positive list approach. Examples of agreements using the negative list approach include NAFTA, the US and Canada model BITs, the Japan-Korea BIT and the APEC Non-Binding Investment Principles. The abandoned negotiations on the OECD Multilateral Agreement on Investment also adopted the pre-establishment MFN and national treatment approach.

Some agreements are variants of the above models, offering restricted national treatment and MFN treatment. For example, the Framework Agreement on the ASEAN Investment Area (AIA) extends national treatment to ASEAN investors immediately and to non-ASEAN investors by 2020, subject to negative lists of exemptions. MFN treatment is extended to ASEAN investors only.

4. Strengths and weaknesses of the GATS approach to pre-establishment commitments

Contrasting views of WTO members on the strengths and weaknesses of the GATS illustrate that what may be seen as a strength by some may be seen as a weakness to others or against other criteria. For example, a positive list, 'bottom up' approach to undertaking country-specific commitments is considered by some to be the best way to integrate policy flexibility for development into the basic structure of an investment framework. However, others have argued that a negative list, 'top down' approach is preferable since it would result in a more transparent and comprehensive framework of investment rules (WTO 2002a).

National treatment

The national treatment obligation in the GATS requires Members to accord foreign services and service suppliers treatment no less favourable than that provided their own like services and suppliers. Treatment is considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member (GATS Article XVII).

National treatment and MFN treatment together ensure non-discrimination against foreigners – a cornerstone of trade and investment liberalisation (see Box 1). National treatment is concerned with non-discrimination between imports and domestic services, while MFN achieves non-discrimination between different trading partners. Where an investment agreement allows the non-discrimination obligation to be weakened, say via exceptions or reservations, there will be costs as the types of advantages set out in Box 1 will not be fully realised. These costs should be balanced against any expected benefits of allowing exemptions, such as giving signatories greater flexibility or discretion over their commitments.

Unlike in the GATT, where national treatment covers only internal (non-frontier) measures affecting imports, the GATS applies it to both frontier and non-frontier measures. The broader scope of the GATS is largely due to the nature of services trade. Foreign services are often directly supplied to a domestic market via the supplier establishing a commercial presence in the country, so the services do not actually cross the border. Where the service supply does involve cross border trade (that is, the supplier and consumer are in different countries), it is often difficult or impossible to physically identify and regulate the trade at the border.

Box 1: The importance of non-discrimination

Non-discrimination, between different trading partners and between foreign and domestic supplies, is widely regarded as the cornerstone of trade and investment liberalisation. There are several reasons why non-discrimination is an important element of trade and investment agreements.

In a market economy, leaving commercial transactions to be concluded on the basis of price competition, without reference to their origin or destination, is generally believed to lead to a better allocation of resources for all parties concerned. It allows a country to benefit from the comparative advantage of each of its trading partners, and it allows them to benefit from the comparative advantage that they each enjoy. There is no systematic economic gain from favouring transactions with one particular trading partner over another simply on the grounds of nationality.

As trade or investment restrictions are liberalized, the benefits are extended automatically to every participant in the agreement. The principle of non-discrimination opens up new market access opportunities to all of a country's commercial partners and spreads the benefits of liberalization.

Legal security and confidence in sharing in the benefits of a unified, rules-based commercial treaty are increased, particularly for participants with less individual commercial or political influence than others.

Transaction and administration costs are reduced (at customs, for example), and there is an economy of rule-making, when the same policy measures are applicable to all commercial transactions instead of being differentiated by origin or destination.

For the private sector, the guarantee of non-discrimination translates into greater transparency, stability and predictability of government policies, and therefore into lower risk for their commercial activities.

Applying the rule of non-discrimination through international treaty law is often perceived by foreigners as offering a better guarantee than applying it solely through national legislation, which can be changed unilaterally.

Source: Based on WTO 2002c

The broader scope of national treatment in the GATS came at a cost – its application is more limited. Rather than being a general obligation, as in the GATT, it is a specific obligation, applying only to scheduled services, and even then subject to any limitations listed. Making national treatment a specific obligation gives Members the flexibility to maintain measures that protect local suppliers. In the GATT this can be done via tariffs, because they are not subject to national treatment. Thus, tariffs are allowed as a legitimate trade barrier to be negotiated downwards progressively. However in the GATS, which covers border and internal measures, full unconditional national treatment would amount to free trade and no opportunity to protect local suppliers. For investment, this would mean that host countries could not, for example, exempt certain sectors from foreign investment or impose conditions on foreign investment that do not apply to local investors.

National treatment and market access

A further way in which national treatment in the GATS differs from the GATT is that in the GATS it is accompanied by the market access obligation; the term market access does not exist in the GATT. The dilemma facing GATS negotiators was that achieving national treatment, even where broadly defined to cover all measures that discriminate against imports, would still not ensure liberalisation of service markets. In some service sectors, entry is closed to all private investors, local or foreign. More than national treatment was therefore required to open services markets, so the market access obligation was added.

The GATS approach to encouraging market access liberalization of services is to specify types of restrictions that are not permitted, then allow Members to schedule their commitments, using the positive list approach. For scheduled service sectors, six categories of market access restrictions, generally quantitative measures, including caps on foreign equity, are prohibited, unless such measures are scheduled or left 'unbound'.

A strength of the positive-list approach is that it gives signatories discretion over what to include and when. Politically sensitive areas can be kept outside the scope of the agreement. It has been argued that this type of flexibility has been especially important given that the GATS was entering new and unchartered areas where there was a risk of making unforseen mistakes (WTO 2002a). Developing countries in particular needed the scope to make gradual commitments. The alternative of trying to list all exemptions, as in the negative list approach, is considered by some to be more difficult, given the technical difficulties of covering all aspects of a new area. The need for Members to screen all services-related regulations at all federal levels across all sectors and all modes of supply for potential inconsistencies with core GATS obligations also makes it difficult to implement a negative list approach, even for developed, let alone developing, countries. Furthermore, if new services emerge, say as the result of technological developments, they are not automatically covered under the positive list approach, whereas they would be with a negative list. It could be argued however that failure to automatically include new types of services is a weakness of the positive list approach, especially if transparency and liberalisation are considered priorities.

The experience with the GATS illustrates the potential weaknesses of the positive list approach in terms of achieving the objectives of liberalisation and transparency. While in principle commitments could be far reaching and comprehensive, subject to few exceptions, in practice commitments in many sectors have been limited and national treatment and market access commitments heavily qualified.

Around one-third of members have scheduled less than 20 sectors and sub-sectors (out of a possible 140) (WTO 2001).

Only 15 per cent of GATS market access commitments for mode 3, commercial presence, are unqualified (Table 2). Only thirty per cent of national treatment commitments are unqualified. Members from developing and transitional economies have shown a greater propensity to make full commitments.

Restrictions on new entry and foreign equity participation are the most common type of qualification for the commercial presence mode. These restrictions – at the pre-establishment phase – are particularly common in financial, communications and business services (Mattoo 2002).

A further GATS weakness in terms of transparency and liberalisation is that the conditions or limitations on market access and national treatment are often listed as ceilings on or minimum standards of treatment and thus do not necessarily represent actual practice (Stephenson and Pietro 2002). This can result in less transparency for potential investors and a less stable and predictable investment setting. Although Members are in principle required to provide annually to the WTO details of changes to measures significantly affecting trade in scheduled services, this requirement is poorly executed, so the schedules are often the only source of information on restrictions (Bosworth 2002). One possible way of bringing bindings closer to the policy status quo may be to link the opportunity to take safeguard actions (discussed below) to commitment levels that reflect the status quo (Low and Mattoo 2000).

Table 2: GATS commercial presence commitments

	Total number of commitments	Full market access	Full national treatment
All members	1891	15%	30%
Developed	763	11%	19%
Developing and transition	1128	18%	37%

Source: Based on WTO 1999

Analysis of other GATS-style agreements also points to weaknesses in terms of achieving transparency and liberalisation progress.

The ASEAN Framework Agreement on Services (AFAS) provides a useful case study of a framework based on the GATS model. ASEAN members have used the request and offer format for AFAS negotiations, similar to the approach used in GATS. However, this modality has not been very effective in opening up markets, largely due to the reluctance of members to engage in liberalisation (Stephenson and Nikomborirak 2002). Weaknesses in the negotiating framework have also been identified as a reason for lack of progress. For example, the vague and undefined nature of the progressive liberalisation obligation in the AFAS and the GATS (no specific dates or target levels of achievement have been set) has meant that market access and national treatment commitments are often unfocussed and marginal and undertaken in inconsequential service sub-sectors (Stephenson and Nikomborirak 2002).

A further issue with the GATS is the overlap between market access and national treatment, which results in confusion about the scope of national treatment commitments. The difficulty in identifying the scope of national treatment commitments is most acute for the commercial presence mode (Low and Mattoo 2000). The extent of national treatment commitments is unclear for measures that are also inconsistent with market access, namely discriminatory (quantitative) market access measures. This means that the national treatment obligation of a Member making an 'unbound' market access commitment and also inscribing for the same service and mode of supply no national treatment limitations (none) may be only to not operate discriminatory measures that do not fall under the six types ofmeasures listed under market access. Members may therefore be technically able to maintain discriminatory market access measures even though they scheduled no national treatment limitations (Bosworth 2002).

The application of the national treatment obligation to sub-national governments is a further potential weakness of the GATS, which needs to be addressed if the framework is to be used for an investment agreement. The obligations covering sub-national government measures are much weaker than those maintained by national governments. Members are required only to take such reasonable measures as may be available to ensure that sub-central governments meet their obligations. This seems to be a weaker application of the national treatment obligation than in the GATT, even though such violations would appear in principle to be subject to the same enforcement procedures as those committed by national governments (Bosworth 2002). Investment incentives (discussed further below) are one area where sub-national governments are particularly active, and strong non-discrimination disciplines are therefore important.

Ranking different types of market access and national treatment restrictions

The absence of a preference for relatively efficient policy instruments in the national treatment and market access obligations is a weakness of the GATS that is likely to be particularly important for an investment agreement. The GATT rules broadly reflect the ranking of instruments suggested by economic theory – quotas are prohibited, tariffs are allowed but progressively negotiated down and bound, and production subsidies are permitted but subject to countervailing action under certain circumstances (Mattoo 2001). In contrast, the GATS rules do not create a similar hierarchy. The market access obligation simply lists six types of restrictions that are prohibited in scheduled sectors unless otherwise specified. The national treatment obligation prohibits any form of discrimination against foreign services or service suppliers in scheduled sectors.

Strengthening the national treatment and market access disciplines to recognise that some measures involve higher economic costs should be a priority for a multilateral investment agreement. The emphasis in GATS market access negotiations has been on changing ownership, through easing foreign equity limits, rather than encouraging competition through greater market access. Increased foreign ownership may deliver benefits even when it is not accompanied by an increase in competition. For example, foreign entry may introduce new technology or know-how, and it may help to recapitalise troubled financial institutions (Low and Mattoo 2000). However, if foreign investors enter a market where competition is limited then the net effect may be a welfare loss for the host country. The hosts will continue to bear the economic costs of limited competition and in addition foreigners may capture rents that would otherwise accrue to domestic producers.

A stronger focus on removing relatively costly restrictions on competition, such as limits on the number of suppliers, rather than changing ownership should be a priority if the investment agreement is to generate significant net benefits. In the GATS, restrictions on the number of suppliers are treated the same as limits on ownership by foreigners, which are included as prohibited market access restrictions. Securing stronger commitments to open markets to competition, as opposed to changing ownership, is likely to be difficult as it impinges on domestic competition policy.

A further aspect of the policy ranking could be a preference for fiscal measures over quotas and other discriminatory measures. For example, limits on the number of foreign suppliers could be replaced by higher taxes on foreigners compared with locals. Such measures are likely to be politically unpalatable, but making the discrimination transparent may put pressure on governments to avoid it.

Alternatives to the GATS approach to national treatment and market access

Most international investment agreements and trade agreements with investment chapters take approaches to pre-establishment national treatment that differ from the GATS approach. The GATS allows Members to protect domestic suppliers and maintain entry restrictions in certain sensitive sectors by adopting a positive list approach to national treatment and market access commitments.

One alternative approach is to leave pre-establishment national treatment outside the scope of the agreement – as in most BITs (see Table 1). While this investment control model gives host governments full discretion to adopt measures that favour local investors or restrict access, for foreign or local investors, to certain sectors, it achieves little in terms of liberalisation, transparency and predictability. Therefore, while there are many weaknesses with the GATS approach to pre-establishment national treatment and market access, it is still likely to achieve more than approaches which do not cover pre-establishment at all.

The other main alternative to the GATS approach is to make national treatment a general obligation but permit exemptions via a negative list. National treatment applies unless a specific exemption is listed.

The negative list approach is likely to result in greater transparency than the positive list approach, as it makes explicit which sectors are not covered – that is, only those that are listed. In contrast, under the positive list it is necessary to deduce which sectors are not covered by the national treatment commitment – that is, all those not listed. The negative list approach may also promote stronger liberalisation, as long lists of exemptions may embarrass governments, although it could be argued that short lists of commitments (as in the positive lists) are equally embarrassing (Low and Mattoo 2000).

The question of whether the negative list approach delivers stronger and more comprehensive commitments to national treatment than a positive list approach hinges on how extensively the exemptions are used. If exemptions are widely used, then the negative list approach may deliver limited progress, just as for the positive list approach if relatively few sectors are listed.

National treatment reservations listed in the Annexes to NAFTA illustrate that substantial sectors can be exempt, just as they can be in a positive list model. The United States, Canada and Mexico have each listed national treatment reservations for existing measures and liberalisation commitments (Table 3). The United States has listed exceptions in 7 sectors or sub-sectors, plus one exception that applies across all sectors. Canada has listed 9 exceptions in 7 sectors or sub-sectors, plus 6 reservations that apply across all sectors. Mexico has scheduled 21 reservations in 9 sectors, plus 5 reservations that affect all sectors.

As well as the reservations for existing measures, each country makes several reservations for future measures (Annex II), to allow flexibility to introduce new non-conforming measures in the future.

In addition, Mexico reserves the right to perform exclusively and to refuse to permit the establishment of investments in 11 activities, including major industries such as electricity, petroleum and basic chemicals, railroads, satellite communications (NAFTA Annex III).

Table 3: NAFTA national treatment reservations for existing measures - investment (number of reservations in brackets)

United States	Canada	Mexico
Energy – atomic (1)	Agriculture (1)	Agriculture, livestock and forestry (1)
Communications - telecommunications (enhanced and value-added) (1)	Business services (2)	Communications – entertainment services (5) - telecommunications (2)
Manufacturing – agricultural chemicals (1)	Energy – oil and gas (3)	Construction (2)
Mining (1)	Energy – uranium (1)	Educational services – private schools (1)
Public administration (1)	Fisheries – fish harvesting and processing (1)	Energy – petroleum products (2)
		Fishing (1)
Transportation – land (1)	Transportation – air (1)	Manufacturing (6)
Transportation services – customs brokers (1)		Mining – extraction and exploitation (1)
		Printing – newspaper publishing (1)
All sectors (1)	All sectors (6)	All sectors (5)

Source: NAFTA Annex 1, Schedules for the United States, Canada and Mexico.

An important strength of the negative list approach is that progressive liberalisation can be achieved by placing restrictions on the exemptions that are listed. For example, time limits can be placed on exemptions and signatories required to justify any continuing exemptions (see Box 2). In contrast, under the positive list approach, progressive liberalisation must be achieved through gradually expanding lists of unbound commitments. This can be encouraged, as it is in Article XIX of the GATS, which sets out procedures for negotiating progressively higher liberalisation in specific commitments. However, direct controls on exemptions are much easier to enforce than are obligations on negotiating and commitment strategies.

Box 2: Exemptions and progressive liberalisation – ASEAN example

Under the Framework Agreement on an ASEAN Investment Area (AIA), the ASEAN countries committed themselves to 'progressively reduce or eliminate investment regulations and conditions, which may impede investment flows and the operation of investment projects in ASEAN' and not to create any new restrictions. Restrictions that remain under the temporary exclusion list (TEL) and sensitive list (SL) are also subject to the stand still and roll back principles. With the commitment to the stand still and roll back principles, ASEAN countries bind themselves not to create new restrictions and to progressively eliminate existing regulations that impede investment flows or restrict foreign investment.

ASEAN countries have to submit their TEL and SL to the AIA Council within 6 months after the date of signing the agreement and the TEL shall be reviewed every 2 years and progressively phased out by the year 2003. The AIA Council may decide to carry out a further review of the SL so that all negative lists might be lifted.

Source: Based on Thanadsillapakul 2003

Most-favoured-nation treatment

The most-favoured-nation (MFN) obligation in the GATS requires each Member to immediately and unconditionally accord all other Members treatment no less favourable than it accords like services or service suppliers of any other country. As in the GATT, the MFN obligation is general and unconditional. It applies to all sectors, regardless of whether they are included in country schedules. The obligation applies to 'any measure covered by the agreement', so it therefore covers all aspects of investment, pre-and post-establishment.

While it is a general obligation, MFN in the GATS, unlike the GATT, has been weakened by permitting exemptions. Exemptions must meet the conditions in the Annex on Article II Exemptions. Only measures listed at the time the GATS came into force (or the time of accession for new Members) can be exempt from the MFN obligations. No new exemptions may be listed.

Around two-thirds of all WTO members have listed MFN exemptions. They are mainly concentrated in 4 sectors – transport, communication, financial and business services (Table 4).

Table 4: GATS MFN exemptions – selected sectors

Sector	Number of exemptions
Transport services	147
Communication services	98
Financial services	51
Business services	22
Non-sector specific	73

Source: WTO 2001

In more than 80 per cent of the exemptions, no time limit has been applied to the listed measures and the duration is often listed as 'indefinite', despite the fact that in principle they are restricted to less than 10 years.

Perhaps even more important than the MFN exemptions that have been listed are those that did not need to be. For example, the Annex on Air Transport specifically excludes the complex network of bilateral agreements on air traffic rights from the GATS rules (Mattoo 2001). The MFN obligation has also been suspended for those Members that have not yet taken commitments on maritime transport, where bilateral cargo-sharing arrangements cover most liner shipping flows. Bilateral arrangements in air transport and maritime transport would, if covered by GATS, violate both the MFN and national treatment obligations.

The GATS (Article V) also allows Members to depart from the MFN rules where they wish to enter regional economic integration agreements extending preferential access to each other. Article V requires that the non-MFN agreements be notified to the WTO and places conditions on them in an attempt to ensure that they are consistent with the multilateral trading system. However, many of the criteria for assessing the multilateral consistency of such agreements are not defined (Bosworth 2002). Furthermore, many regional service agreements affecting services have not been notified to the WTO (Stephenson 1999).

A further problem with MFN exemptions in the GATS is that some Members have listed comprehensive trade agreements or wide-ranging services exemptions under such agreements as Article II exemptions (Stephenson 1999). Wishing to avoid examination under the Article V provisions may have been the motivation for this. However, the listing would appear to be a misuse of Article II provisions, which were intended to cover only limited sectoral MFN exemptions and not more comprehensive exemptions forming part of wider economic integration agreements (Bosworth 2002).

Each of the above issues in the application of MFN treatment in the GATS – sectoral exemptions, specific exemptions such as in the Air Transport Annex, and exemptions for regional integration agreements – are relevant to investment and will need to be addressed if the GATS framework is to be used for a multilateral investment agreement.

A further potentially important issue for an investment agreement is the use of grandfathering provisions and their implications for MFN treatment. In the financial services negotiations in the GATS several Members adopted their own scheduling innovation of grandfathering existing measures that subjected new foreign suppliers to move restrictive discriminatory measures than incumbents. These measures mainly provided for lower foreign equity limits or limitations of the types of legal forms used by new entrants (Bosworth 2002). The measures protected existing foreign suppliers or reflected more restrictive legislative changes made since the incumbents entered the market.

Providing less favourable treatment to new, compared to existing, firms may be inconsistent with the MFN principle, even if the current restrictive measures are applied to all Members (Mattoo 1999). This could be the case when, for example, country A admits a new supplier from country B under more restrictive access conditions than it applies to an incumbent supplier from country C. Only by applying MFN strictly are the interests of new entrants and incumbents protected from discrimination. Applying a time limit on MFN, to allow grandfathering, allows governments to strengthen the position of incumbents (including foreign-owned) by offering inferior conditions for new entrants.

A possible concern about the strict application of MFN, with no allowance for grandfathering, is that it could, in the case of tighter foreign equity limits being introduced, require forced divestment by incumbent foreign firms. However, the potential political cost of such an outcome should help to deter governments from introducing more restrictive measures such as tighter foreign equity limits. But the potentially stifling impact on competition of grandfathering provisions that disadvantage future foreign suppliers relative to the foreign incumbent also raises major efficiency concerns.

Alternatives to the GATS approach to MFN

The MFN standard has been a feature of international investment agreements since the late 1950s, when it was included in the first BITs. It is therefore older than the national treatment obligation, which was incorporated into BITs only at a later stage (UNCTAD 1999c). However, as noted earlier, in most BITs it does not apply to the pre-establishment phase of investment.

Most international investment agreements permit MFN exceptions. There are three broad categories of exemptions: general (for example, national security, health); reciprocal subject specific (for example, taxation, regional economic agreements); and, country-specific (as listed in specific schedules). As in the case of national treatment, exceptions are allowed because of the broad scope of MFN obligations, covering internal as well as border measures. Different approaches are taken to the conditions on the exceptions – duration, justification, and review processes. As with national treatment, agreements also differ in whether pre-establishment is covered.

The major difference between the GATS and NAFTA approaches to MFN treatment is that NAFTA allows non-conforming measures to be added to the list of exemptions after the initial signing of the agreement. The scope to include new measures in the future is designed to take account of issues or problems that could not be foreseen at the time of signing the agreement.

As in the GATS, the opportunity to schedule MFN exemptions is widely used in NAFTA. For international agreements in force or signed after the date of entry into force of this Agreement, the United States, Canada and Mexico all take an exception to Article 1103 (MFN) for treatment accorded under those agreements involving:

- aviation;
- fisheries;
- maritime matters, including salvage; or
- telecommunications transport networks and telecommunications transport services (this exception does not apply to measures covered by Chapter Thirteen (Telecommunications) or the production, sale or licensing of radio or television programming). (NAFTA, Annex IV, Schedules of the United States, Canada, and Mexico).

In addition, all three countries take an exception to Article 1103 for treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the date of entry into force of this Agreement.

The existence of MFN exemptions in most existing international investment agreements suggests that they will also be required by signatories to a multilateral investment agreement. However, there may be scope to strengthen the MFN discipline via tighter controls on the use of exemptions. The case for allowing for new exemptions to be added, as in NAFTA, should also be considered. Ideally a weakening of the MFN obligation in this way should be traded-off with tighter controls on exemptions – that is, allow new exemptions to be added, but only if shorter time limits and more rigorous review processes are accepted.

Investment incentives

Investment incentives are a widely used element of investment regimes. Incentives often relate to entry and establishment, rather than ownership and ongoing operations. Direct financial incentives, often offered by sub-national governments, are common, as are subsidised infrastructure and preferential government contracts.

The possible economic justification for investment incentives is that FDI may generate positive spillovers for the domestic economy, say through transfer of technology or training of labour. However, the limited empirical evidence on the existence of such effects is mixed

(Hoekman and Saggi 2002). Further, even if they do exist it is unlikely that governments would have the necessary information to judge which projects would generate positive externalities and what subsidy may be justified.

As with other aspects of pre-establishment treatment, most governments have been reluctant to extend policy disciplines to investment incentives. The core GATS disciplines of national treatment, market access and most-favoured-nation treatment do not limit investment incentives. Provided they are offered to all potential investors on a non-discriminatory basis, most if not all incentives will not violate national treatment or MFN treatment. Additional disciplines are therefore needed to control investment incentives.

The failure to adequately address incentives is a weakness of the GATS. It has been argued that a key determinant of the pay-off from a multilateral investment agreement will be its treatment of investment incentives (Hoekman and Saggi 2002, World Bank 2003). It is possible for competition for FDI via incentives to improve the global allocation of FDI, by signalling where it is most valuable. In practice, however, locational competition is generally not driven by informational asymmetries that prevent FDI flowing to where social returns are highest. Instead, incentives are often driven by the desire of industrial countries to retain or attract FDI that may be more efficiently employed in developing countries (Hoekman and Saggi 2002). Developing countries stand to gain from disciplines on industrial country policies that have the effect of keeping firms from relocating to developing countries.

There seems to be no easy solution to the issue of how to deal with incentives in an investment agreement. Most regional agreements that cover investment do little toward effectively constraining the ability of governments to provide investment incentives. Even the relatively far reaching disciplines of the European Union are insufficient to constrain investment incentives, as illustrated by disputes regarding the use of incentives by local governments (Hoekman and Saggi 2002).

Safeguards

A further issue for the GATS and a multilateral investment agreement is whether and how to include emergency safeguard provisions. A safeguard is a mechanism for temporarily increasing protection to relieve difficulties or pressures that arise as a result of commitments or obligations made in a trade or investment agreement. The existence of safeguard measures in trade agreements has been viewed as a mechanism to help persuade domestic constituencies to accept greater liberalisation (Sauve 2002). Safeguards are relevant to pre-establishment as they may affect the willingness of signatories to make pre-establishment commitments in an investment agreement. Safeguard provisions in the GATS are weak (Article X requires multilateral negotiations), and the scope for going beyond these in an investment agreement needs to be addressed.

Most of the focus of WTO Working Group discussions of emergency safeguards in an investment agreement has been on balance of payments emergencies or crises (WTO 2002a). An important factor influencing the need for and role of a balance-of-payments safeguard provision in an investment agreement is the type of foreign investment covered by the agreement. Most IIAs take as their starting-point a comprehensive, asset-based definition of investment. Balance-of-payments safeguard provisions in such agreements allow a host country to react where a need arises to control inflows and outflows of investment, particularly short-term, speculative capital flows, and to control outflows of transfers and payments associated with established investment. Many Members feel that any prospective WTO investment framework should exclude from its coverage those categories of foreign investment – notably short-term, speculative capital flows – that could be most problematic from a balance-of-payments point of view, thus reducing the need for safeguards (WTO 2002a).

Safeguards could also apply to issues such as the equivalent of an import surge in the investment area and concerns about the crowding out of domestic investors. While approaches used in existing WTO agreements (such as the WTO Agreement on Safeguards) could provide some guidance for an investment agreement, there are conceptual difficulties in applying trade type measures to investment issues (Sauve 2002).

For example, the WTO Agreement on Safeguards imposes a two-part test before safeguards can be applied: imports must have increased in absolute terms or relative to domestic production, and; imports must cause serious injury to a domestic industry producing like or directly competitive goods. For the case of establishment of commercial presence in the GATS, 'imports' involve two stages – establishment in the host country, then sales or domestic operations of the foreign firm in the host country. How should imports be measured for the purposes of triggering a safeguard mechanism? Should a foreign ownership threshold be the relevant trigger, or sales by foreign-owned firms? If the latter, can the test be applied based on available data? Further, what aspects of imports should be limited when the safeguard is activated – only entry of new foreign firms, or also the activities of established foreign firms in the host country?

One option for dealing with the safeguards issue may be to experiment with a safeguard-like instrument in a sector where concerns about the potentially disruptive effects of liberalisation may be especially strong. The financial services sector has been suggested as suitable (Sauve 2002). ASEAN countries in particular have argued that safeguards are justified for financial services. The sector specific safeguard approach has been used in NAFTA, where Mexico is allowed to impose market share caps if the specified thresholds agreed to are reached before 2004. The caps may be applied once, and for no more than three years, and they must not be applied beyond 2007.

The GATS strategy of leaving difficult issues, such as safeguards, to be resolved after negotiating the agreement, has not worked well. Whether or not to have emergency safeguard measures, for example, was to have been resolved by 1998, well in advance of any subsequent negotiations on services so that the rules on which such negotiations would be based were known. This would have been desirable and removed uncertainty. Instead, extended deadlines have been repeatedly missed, and negotiations on whether to have safeguards were integrated into the current services negotiations, an unsatisfactory outcome. After all, the main rationale for having safeguards is to facilitate negotiation of more liberalizing sectoral commitments by members in the knowledge that safeguards are available if needed at some stage in the future. Safeguards cannot play this potentially significant role if their very existence is being simultaneously negotiated. Thus, it would be far better if safeguards and other difficult issues were determined up front as an integral part of negotiating any multilateral investment agreement, and not left until afterwards.[2]

Request and offer format

If the positive list approach is to be used for a multilateral investment agreement, as suggested by paragraph 22 of the Doha Declaration, then the format for developing country schedules of commitments will need to be decided. The approach used in the GATS has some advantages, but it also has some shortcomings.

The content of a country schedule in the GATS is largely determined in request-offer negotiations with interested trading partners. Member countries submit liberalization requests for certain sectors or certain activities to each other, and examine these requests and make offers. An advantage of using this modality for an investment agreement is that Members are familiar with it and have developed the resources for implementing it (WTO 2002b).

However, it has been argued that alternative negotiating modes may encourage wider and deeper commitments. For example, some Members have used a formula approach to make financial services commitments based on the Understanding on Commitments in Financial Services. This type of approach may be effective where a sub-set of Members are willing to develop deeper disciplines and are willing to extend the benefits on a MFN basis to other Members. It has been described as a 'follow-the leader' model (Low and Mattoo 2000).

Another approach was used in basic telecommunications, where the reference paper contains a set of regulatory commitments entered into the additional commitments column (Article XVIII) of the country schedules of those Members which accepted the reference paper.

A third possible approach is to develop a model schedule of commit-

2. Any decision to allow emergency safeguards in services or investment should ideally have much stronger controls than currently exist in the GATT on goods to prevent their mis-use, such as genuine sunset and public interest clauses.

ments. Support for this approach is based on the premise that a set of standard commitments could secure a higher level of commitment overall than if Members devised liberalisation offers independently (Low and Mattoo 2000). Model schedules were developed in the GATS maritime and basic telecommunications negotiations.

The relevance of each of these options to a multilateral investment agreement and the scope for improvement over the simple request and offer format should be further investigated.

Incentives for autonomous liberalisation

Recognition for autonomous liberalisation is an ongoing issue for the GATS and will also be an important issue for a multilateral investment agreement. As with trade reform, most of the benefits from foreign direct investment liberalisation come from unilateral reform of domestic policies (World Bank 2003). A weakness of the GATS is that it does not provide adequate recognition or encouragement for Members to liberalise unilaterally (Stephenson and Nikomborrirak 2002).

The lack of progress in attempts to establish modalities for autonomous liberalisation for the GATS (see Choi 2002) and the unsatisfactory outcomes to date suggests that it will also be a difficult issue for an international investment agreement.

5. Summary and conclusions

The GATS provides a useful starting point for developing a multilateral agreement covering investment in all sectors. However, if the aims of progressively liberalising investment and creating a stable, transparent and predictable set of rules are to be met, several important shortcomings in the GATS approach, especially aspects of it that relate to pre-establishment, need to be addressed. For most of the shortcomings or problems there are no simple solutions – as suggested by the fact that the problems remain more than 8 years after the GATS took effect.

Several aspects of the national treatment and market access obligations in the GATS can be considered weaknesses or problems, which could undermine the effectiveness of a multilateral investment agreement:

- National treatment is not a general obligation – limited specific commitments, often accompanied by exemptions or qualifications, undermine its application;
- The overlap between market access and national treatment creates confusion over the scope of national treatment obligations;
- Conditions or limitations on market access and national treatment are often listed as ceilings on or minimum standards of treatment and thus do not necessarily represent actual practice, thereby reducing transparency and predictability;
- Disciplines on sub-national governments are relatively weak; and,
- There is no ranking of policy instruments, and no presumption in favour of relatively efficient instruments, as there is in the GATT.

Making national treatment a general obligation subject to a negative list of exceptions or reservations is potentially a way of strengthening the discipline on national treatment. However, in practice the negative list approach may be significantly undermined by extensive use of reservations, just as the positive list approach may be undermined by limited and heavily qualified commitments.

If the GATS positive list approach is to be adopted, as suggested by paragraph 22 of the Ministerial Declaration, then a priority should be strengthening the disciplines on progressive liberalisation, to encourage progressive expansion of specific commitments and gradual phasing out of exemptions, conditions and qualifications on national treatment and market access.

A stronger focus on removing relatively costly restrictions on competition, such as limits on the number of suppliers, rather than changing ownership should also be a priority if the investment agreement is to generate significant net benefits. However, issues such as limits on the number of suppliers, including bans on private ownership (foreign or local) in some industries, are likely to be contentious as they impinge on national competition policies.

Problems with the application of the MFN obligation in the GATS are also relevant to pre-establishment commitments in an investment agreement. The main problems are:

- Exemptions are widely used, and time limits are not strictly applied;
- Exemptions for regional agreements may be misused;
- Broad sectoral exemptions, such as for maritime and air transport, seriously weaken the MFN discipline; and,
- Grandfathering provisions may violate MFN obligations and allow incumbents to be protected while new entrants are discriminated against.

Tighter disciplines on the use of MFN exemptions should be a priority in the design of a multilateral investment agreement.

The treatment of investment incentives is a further key issue which will determine whether a GATS-based investment agreement generates significant benefits. The fact that sub-national governments often apply incentives makes it more difficult to discipline them, as does the fact that the national treatment and MFN obligations do not effectively control incentives.

While experience with the GATS shows how the architecture of an agreement can shape its effectiveness, the attitude or commitment of signatories is equally, if not more, important for the success of an agreement in meeting its objectives. Excessive use of exemptions (where the negative list approach is used) or limited willingness to schedule unqualified commitments (where a positive list approach is used) can undermine the effectiveness of an agreement. While there are many possible reasons why signatories may be reluctant to make commitments in some areas (especially in the pre-establishment phase), the costs of exemptions, such as the costs of discrimination against certain sources of investment, should be balanced against the perceived benefits. Flexibility and discretion are worthwhile objectives, but at some stage they may come at the expense of the benefits of liberalisation, transparency and predictability.

While the Doha mandate recognises "the case for a multilateral investment agreement to secure transparent, stable and predictable conditions for long-term cross-border investment", whether there will be such an agreement is still to be negotiated. However, the mandate does seem to create a presumption that if there is to be an agreement, it will cover pre-establishment arrangements and be styled on a GATS-type positive approach.

The fundamental question of whether there should be a multilateral investment agreement is beyond the scope of this paper. However choosing the most appropriate format of any such investment agreement will depend very much on the rationale for having it in the first place. Presumably, the main objective would be to liberalize global foreign direct investment. However, widespread unilateral investment liberalization all around the world has been tremendously successful. The current negotiations come against the backdrop of one of the most impressive waves of foreign direct investment in history, with flows to developing countries increasing sixfold during the 1990s (Newfarmer 2003). While this is no argument against an investment agreement, it does mean that any such agreement needs to be well structured to have any practical significance or relevance to continued unilateral liberalization. If not, any such agreement may have little impact on investment liberalization, and create a major burden for the WTO system, already in danger of being overloaded and loosing sight of its main, and still very incomplete, objective of liberalized global trade. Although the economic benefits of FDI liberalization irrespective of other country's investment policies have generally been accepted by most countries, this is unfortunately certainly not the case in trade, where much more multilateral effort is therefore required.[3]

The urgency for a multilateral investment agreement has also been reduced since the negotiation of the GATS, which covers commercial presence in services. The main FDI restrictions affect services, especially in finance, telecommunications, power, transport, ports, wholesale and retail trade, real estate and business and legal services, which are already covered by GATS. Having FDI in services subject to multilateral disciplines and not in goods is a weakness, and one overall investment agreement would be preferable. However, for such an

3. For example, UNCTAD data has shown that of the 1,393 regulatory changes in national FDI regimes between 1991 and 2001, the vast majority were introduced autonomously rather than in the context of international negotiations, and that roughly 95% created a more favourable FDI environment (Newfarmer 2003). If only this was also the case in trade.

agreement to have any substantial liberalizing advantages over what currently exists for services under the GATS, it would need to be a substantial improvement.

It is unclear how negotiating a GATS-styled general multilateral investment agreement would make such sufficient gains to justify its existence. While there are several channels through which a multilateral investment agreement could potentially generate benefits – for example, by controlling the use investment incentives – the extent to which the GATS framework can deliver such benefits is unclear (World Bank 2003). Moreover, how would a GATS-based investment agreement co-exist with the GATS? Having both would seem wasted effort. However, transferring commercial presence from GATS to the new agreement would have major implications for the GATS; is unlikely to generate any more liberalizing commitments than already possible in the GATS; and would have to resolve the problem that the new investment agreement would presumably cover pre-establishment measures while the GATS in principle covered both pre- and post-establishment restrictions. If both co-existed, then any such difference would mean that the new investment agreement would have less coverage than the GATS.

It would seem therefore that the main argument for having a WTO investment agreement hinges on the extension of multilateral investment disciplines to non-services. This could be a big step forward, even though as already noted non-services is the "tip of the iceberg" as far as FDI restrictions are concerned. But quite apart from this, would extending a GATS-styled modalities on pre-establishment measures to non-services be very liberalizing? This would seem very uncertain. For one, major FDI restrictions affecting non-services are likely to be related to questions of ownership of agricultural land and natural resources, largely untouchable areas one would think in any investment agreement. Secondly, the jury is still undecided as to whether the GATS-styled framework sufficiently facilitates liberalization, and so adopting this model as the basis of an investment agreement may well be premature. Perhaps better to wait until its success in services is more clearly demonstrated.[4]

4. The lack of general commitments on national treatment (and market access) in the GATS and too few such sectoral obligations was undoubtedly a major factor contributing to it being to date primarily a standstill agreement that has produced little services liberalization (Bosworth 2002). Little more than standstill commitments within sectors already open was achieved even by those countries making significant obligations (Snape 1998).

So where does this leave the debate? An alternative approach to that currently being considered would be to work within the GATS to try and negotiate more liberalizing commitments on commercial presence, especially in the more sensitive service sectors where coverage of commitments is poor, and to negotiate a more liberalizing investment agreement for non-services based on another model. Such a model could, for the reasons advanced in this paper, be centred on one based on a short negative list of exemptions (e.g. foreign land ownership) with national treatment made a general commitment. Post-establishment measures and investor protection may also be included. Such an agreement would seem to be more complete and useful. The feasibility of achieving this would be greatly enhanced by having services excluded and still covered by the GATS. These two agreements could co-exist sensibly in the WTO, and could be integrated into a single agreement at some future stage, drawing on the liberalization experiences of both agreements.

Unless a substantial multilateral investment agreement is at least achieved for non-services, the practical value of any such agreement would be seriously diminished. This would be an unfortunate outcome for the WTO, and could itself accelerate the increasing tendency for members to use potentially serious trade/investment diverting preferential trading arrangements to advance trade and investment liberalization.

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Chapter 4

Chapter 4

Globalizing Investment Dispute Settlement

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GLOBALIZING INVESTMENT DISPUTE SETTLEMENT

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Emerging approaches in a global context

Whoever drafted the text of the first bilateral investment treaty could not have imagined how popular his or her work would become. It has been copied by the thousands and found its way into not less than 2000 treaties today in force, in addition to it being reflected in various multilateral treaties dealing also wholly or in part with investments.[1] It has been interpreted and reinterpreted by numerous international tribunals and some domestic courts.

Along this process, which is not long in time, a number of issues have been clarified, either in terms of the development of new approaches or understandings or of the placing of limits to some inevitable exaggerations that happen occasionally. The aggregate of developments have meant that the settlement of disputes relating to foreign investments has become truly global in the past decade, both in the meaning of substantive law and also in respect of important jurisdictional questions. It is also opening the way for new developments concerning other important international activities, such as trade. It might well happen that in the long term this unfolding arrangements will also apply to a variety of aspects that today appear exclusively related to domestic law and jurisdictions.

This contribution purports to examine the main issues characterizing this evolution, with particular reference to those decisions of ICSID tribunals that have to a significant extent influenced a change in perspective, not only in respect of the extent of bilateral investments treaties and related instruments but also of the very meaning of international law in some respects. In spite of critical perceptions, that are

1. Elöise Obadia: "ICSID, Investment Treaties and Arbitration: Current and Emerging Issues", in Gabrielle Kaufmann-Kohler and Blaise Stucki: Investment Treaties and Arbitration, 2002, 67-75.

not entirely wrong in some matters,[2] the end result of such a process has helped thus far to reach a balance between the right of host States to undertake regulatory functions in the public interest and the right of foreign investors to carry on their business without arbitrary or unlawful interference.

The expression of consent and the avoidance of abuse

On a number of occasions the State Party to the ICSID Convention that is brought to court by an investor raises the question that it has not expressly consented to the submission of that particular dispute to arbitration. In that point of view, commitment to arbitration under a bilateral investment treaty requires a specific "compromis" in which both parties will agree to that submission and its modalities. True enough this was the traditional modality of inter-State arbitration in the early part of the twentieth century. States agreed to the arbitration of disputes under a treaty, but this was regarded only as a "pactum de contrahendo" the implementation of which required an additional and specific "compromis".

This is, however, the question that has fundamentally changed in the context of the settlement of investment disputes. Interestingly enough this is not the result of the ICSID Convention that only requires the parties to consent in writing to the submission of the dispute to the Centre.[3] It is rather the result of the network of bilateral investment treaties that have provided for the overall expression of consent by States parties in respect of disputes that might arise with foreign investors. This same result can be obtained by a general offer of submission to ICSID arbitration in domestic law.

As these investors are not a party to the treaty but are the beneficiaries of rights bestowed directly upon them under international law, or under domestic law, their own expression of consent might come later in time or under separate instruments. This happens typically when consent by the investor is given in a direct agreement with the State concerned or simply by resorting to such a choice in writing, or even by instituting proceedings in the Centre.

2. See generally M. Sornarajah: The Settlement of Foreign Investment Disputes, 2000.
3. ICSID Convention, Article 25.

ICSID tribunals have had no difficulty in finding that the offer by the State to submit to arbitration, followed by acceptance, is a definite binding legal obligation without further steps needed to establish jurisdiction.[4] This incidentally is not just the result of the operation of the bilateral investment treaty in respect of ICSID but also in so far other choices are available to the investor, particularly arbitration under UNCITRAL rules.

But also ICSID tribunals have controlled exaggeration in this matter not accepting modalities that are far remote from a proper consent. In Cable TV v. St. Kitts and Nevis, for example, the tribunal ruled that references to an ICSID clause in domestic proceedings did not amount to consent to arbitration.[5] On the other hand, however, tribunals have also been strict in not allowing a State that has expressed its consent to elude its obligations in respect of the foreign investor. So happened in CSOB v. Slovakia, where the Tribunal found that an ICSID clause included in a BIT not yet in force had been embodied by the parties in a direct agreement and upheld jurisdiction on this basis.[6]

In this same case, although the pertinent treaty provided that upon the agreement of both parties the dispute would be submitted to the Centre, it was held that this did not mean, as alleged, that submission had to be made jointly as this would imply the need for an additional agreement to put into practice the consent expressed by the State in the treaty.[7] The "pactum de contrahendo" approach was thus expressly ruled out.

"Arbitration without privity" is here to stay, as evidenced not only by a variety of bilateral investment treaties but also by multilateral arrangements.[8] The NAFTA, in the context of the operation of the ICSID Additional Facility, like the Energy Charter Treaty, contain forms of unconditional consent to ICSID or UNCITRAL arbitration.

4. Francisco Orrego Vicuña and Christopher Pinto: "Peaceful Settlement of Disputes, Prospects for the 21st Century", Report Prepared for the Centennial of the First International Peace Conference, in Frits Kalshoven: The Centennial of the First International Peace Conference, Reports and Conclusions, 2000, 261-418, at 286.
5 .Cable TV v. St. Kitts and Nevis, ICSID Award of January 13, 1997.
6. CSOB v. Slovakia, ICSID Decision on Jurisdiction of May 24, 1999.
7. Ibid.
8. J. Paulsson: "Arbitration without Privity", ICSID Review, Foreign Investment Law Journal, Vol. 10, 1995, 232.

A rather disquieting view has been recently held by a Respondent State in the context of the registration in ICSID of an investor's request for arbitration under a bilateral investment treaty. Because there had been diplomatic demarches by the State of the investor's nationality in support of the investor's right to take the dispute to arbitration, the Respondent State made the argument that there was a State to State dispute that had to be settled first through the operation of the ad-hoc arbitration that investment treaties normally provide for disputes between States parties. It should be noted that diplomatic exchanges directed to facilitate the settlement of the dispute are not considered a form of diplomatic protection under Article 27(2) of the Convention.

That argument, if accepted, would have meant that recourse to ICSID arbitration by a private investor and the Centre's jurisdiction would be paralysed until a different arbitration finalizes. As diplomatic exchanges not amounting to diplomatic protection regularly take place when there is an investment dispute, it would be easy for any Respondent State to elude its obligations toward the investor by claiming the existence of an inter-State dispute. This situation would entangle ICSID's jurisdiction for long periods of time to the disadvantage of the investor. Moreover, it is quite evident that the kind of disputes between States parties to which the inter-State procedures could apply are very different from those affecting the investor's rights under a bilateral treaty, a situation somewhat paralleled by Article 64 of the Convention and its negotiation history.

Developing practice on global bases

One most noticeable aspect of the globalization of foreign investment dispute settlement is that it is not exclusively related to a relationship between developed and developing countries as was to an extent originally conceived. It is much broader than that. In fact, developing countries have followed among themselves the same approach of bilateral investment treaties and signed such instruments by the hundreds, with no or little modification. And the same is true of multilateral investment treaties made among developing countries, such as the MERCOSUR Protocols[9] or Free Trade Agreements.[10]

9. MERCOSUR, 1994 Colonia and Buenos Aires Investment Protocols.
10. See, for example, the 1994 Free Trade Agreement between Colombia, Mexico and Venezuela.

There are two other aspects important to note in this process of globalization. The first is that under the ICSID Convention not only an investor can bring a State to court but also a host State can initiate proceedings against an investor provided a written consent has been given, as happens often under direct investment agreements. States has seldom used this alternative and it seems that awareness about its existence is not widespread.[11] There is also of course the possibility of counterclaims in a proceeding initiated by an investor.

The second aspect is still more significant. For many years developed countries appeared to believe that bilateral investment treaties were a one way street allowing for claims against developing host States. Much to the surprise of a few OECD countries, investors from developing countries have recently initiated proceedings against them, thus evidencing that bilateral treaties mean a two-way street. At least one of these claims has been successful.[12]

The role of the most-favored nation clause

The expansion of the system, however, does not end there. Ever since the very outset of the protection of foreign traders by means of treaties of commerce and navigation, the most-favored-nation clause had a crucial role to play in terms of the material conditions in which trade was developed. This very trend continued unabated under the modern system of protecting the rights of foreign investors. The possibility of applying the clause to procedural matters had arisen but never decided, the most notable example being the Ambatielos case.[13] This was to change too under the new system.

Just recently an Argentine investor proceeding against Spain applied directly to the Centre not taking first his claim to Spanish courts for an eighteen-month period as provided for in the Argentine-Spain investment treaty. The justification for this omission was that under the Chile-Spain investment treaty direct recourse to the Centre was allowed, what was argued meant a more favourable treatment to Chilean

11. Gabon v. Societé Serete S. A., ICSID Case No. ARB/76/1, and discussion in Ibrahim F. I. Shihata and Antonio R. Parra: "The Experience of the International Centre for Settlement of Investment Disputes", ICSID Review-Foreign Investment Law Journal, Vol. 14, 1999, 299-361, at 316.
12. Maffezini v. Spain, ICSID Award of November 13, 2000.
13. Ambiatelos Case, United Nations, Reports of International Arbitral Awards, 1963, p. 107. The case was discussed both by the International Court of Justice and a Commission of Arbitration.

investors in Spain and hence should be extended under the clause to the Argentine investor.

The ICSID Tribunal, after carefully examining the treaty practice of both Argentina and Spain, concluded that the eighteen-month period did not amount to a requirement of exhaustion of local remedies, which can be made under the ICSID Convention. On that basis, it decided that the clause was applicable to this procedural question and hence affirmed jurisdiction.[14] The Ambatielos discussion was thus brought to an end.

The effect of this decision is that, given similar circumstances, the clause will interconnect the vast network of bilateral investment treaties, not just on the substantive, historical treatment of investors, but also on the procedural aspects required for the operation of such treaties. This extent of the clause has already been invoked in other requests for arbitration made before ICSID. It should be noted, however, that the Tribunal was also careful in explaining that such a clause cannot be used in highly institutionalized dispute settlement arrangements where procedural aspects have been built as an essential requirement of jurisdiction and admissibility.

Time matters

Time of course plays a most important role in affirming or dismissing jurisdiction in a given case. In Tradex v. Albania, for example, the Tribunal rejected jurisdiction on the basis of an investment treaty that had not yet entered into force.[15] In Holiday Inns v. Morocco, however, the Tribunal faced a more complex situation. At the time of the investment agreement containing the consent to arbitration the pertinent States had not yet ratified the ICSID Convention, but these requirements were satisfied before proceedings were actually instituted. The Tribunal concluded that it was the date when conditions were satisfied that should be deemed to constitute the date of consent and, accordingly, affirmed jurisdiction as the request for arbitration was made after this date.[16]

14. Supra note 12.
15. Tradex v. Albania, ICSID Decision on Jurisdiction of December 24, 1996.
16. Holiday Inns v. Morocco, Unpublished, Reported in Lalive: "The First 'World Bank' Arbitration", British Year Book of International Law, Vol. 51, 1980, at 123.

Also time is of the essence of most bilateral investment treaties in that disputes that can be submitted to arbitration are normally only those that arise after the treaty has entered into force. The investment in most cases might have been made earlier. Given the fact that discussions and disagreements between investors and host States might extend for a long period of time, tribunals occasionally have to decide on the time the dispute arose and whether it is under its jurisdiction. The test was explained in Maffezini where it was held that disagreements and difference of views might extend for a period of time, even before the entry into force of the treaty, but what matters is the moment in which there is a claim with a legal meaning in respect of rights and obligations of the parties concerning the investment.[17]

Available and unused safeguards

There are a number of safeguards available to the parties of bilateral investment treaties that are not always resorted to and the very existence of which many times appear not to be particularly noted, until it is too late. States, for example, can exclude from investment treaties given classes of disputes. Most treaties, however, include broad expressions of consent. On occasions more limited expressions of consent are made in national legislation or in investment agreements, but then these may not be quite relevant if the dispute arises under the terms of a broadly defined treaty.

A second safeguard concerns the exhaustion of local remedies, a rather basic feature of traditional international claims that found its way into Article 26 of the ICSID Convention. As noted in the Annulment Decision in Amco v. Indonesia, this safeguard must be resorted to in an express manner and certainly before consent is perfected.[18] Also, as noted in Maffezini, other procedural provisions, such as a submission to local courts for a certain period of time, are not the equivalent of a requirement to exhaust local remedies.

One additional aspect concerning the expression of consent and safeguards needs to be examined in the light of this evolution. All bilateral investment treaties provide for a period in which amicable settle-

17. Supra note 12.
18. Amco v. Indonesia, ICSID Annulment Committee, ICSID Reports, Vol. 1, at 526.

ment must be attempted, most often a six-month period. It also happens that occasionally the investor will not follow this requirement or do so rather casually, and it happens more frequently that the government will ignore all the communications from the investor to this effect. The view has recently arisen that such is just a procedural step and not a jurisdictional requirement, and that what matters is to afford the government an opportunity to engage in such settlement which if not taken might open the way to arbitration even before the period in question has lapsed.[19]

Two aspects appear relevant to find an answer to this question. The first is that, as noted in Tradex v. Albania, when the investor repeatedly requests the government to enter into discussions and this is ignored over a period of time, then on completion of the six-month period the request for arbitration may be introduced and such efforts will be considered enough to satisfy the amicable settlement requirement.
The second aspect is whether ICSID's Secretary-General could register a request that has not complied with the six-month amicable settlement requirement. The answer to this is that probably it cannot. Then the conclusion is that the issue is not merely procedural but concerns a crucial question of jurisdiction. Just as the investor cannot pretend registration and ultimately jurisdiction if amicable settlement has not been attempted, so too the State cannot object to registration and ultimately to jurisdiction if it has not reacted to the pertinent invitations to this effect during the established period of time.

Who is who

Some of the most difficult issues that ICSID tribunals have had to deal with in examining jurisdiction of the Centre and their own competence concern the question of who may be a party to proceedings before the Centre. This is in part connected with the interpretation of Article 25 of the Convention, but it is also connected with the extent of investment agreements and investment treaties.

A first issue that has given place to growing confusion relates to the status of a constituent division or agency of a State as parties to an

19. Lauder v. Czech Republic, Final UNCITRAL Award of September 2001, pars. 181-191; Ethyl Corporation v. Canada, Award on Jurisdiction of June 24, 1998, pars. 74-88.

ICSID proceeding. Under the Convention, the participation of such division or agency requires the approval of the State or else that the State notifies that no such approval is necessary. Seldom has this been done. But when proceedings are instituted against the State because of acts or omissions of such divisions or agencies then often the argument is made that no approval has been given to the effect of their participation.

However, one thing is the participation of a division or agency in its own right and quite another is the responsibility of the State for the conduct of its organs, whether they are a part of the central government or entirely decentralized, including provinces, municipalities and other entities that exercise public functions. The designation envisaged in the Convention relates to the first aspect only, that is when an investment agreement has been entered into with a given subdivision or agency and then such entity is authorized by the State to participate in an ICSID proceeding in order to make effective the consent of the entity and the investor to submit their disputes to arbitration. It was thus held in Cable Television v. St. Kitts and Nevis that an investment agreement made with a constituent subdivision of that State that included an ICSID clause could not determine the jurisdiction of the Centre as that entity had not been designated by the State in accordance with Article 25.[20]

But if the dispute arises under a bilateral or multilateral investment treaty to which the State is a party and concerns an investment agreed to with a given subdivision or agency, even if such entity has not been designated to participate in ICSID proceedings the State is still accountable for responsibility under international law. Article 4 of the Draft Articles on State Responsibility adopted by the International Law Commission, which on this point unequivocally reflects customary international law, is very precise in establishing the responsibility of the State for acts or omissions of its organs.[21]

This question has been recently discussed and decided in the case of Compagnie Générale des Eaux (or Vivendi) v. Argentina, where the existence of a concession contract with an Argentine province and

20. Supra note 5.
21. James Crawford: The International Law Commission's Articles on State Responsibility, 2002, Comments on Article 4, at 94-99.

the fact that that province had not been designated to participate in ICSID proceedings, did not prevent the Centre's jurisdiction under a bilateral investment treaty between Argentina and France whose provisions governed the rights and obligations of the Republic of Argentina and foreign investors in its territory.[22]

The participation of natural persons as claimants in ICSID cases has not given place to particular difficulties as on this point the applicable rules of international law are generally well established, including the test of effectiveness in case of disputed facts as decided by the International Court of Justice in the Nottebohm case.[23]

The changing corporate structure

Very different, however, is the situation concerning juridical persons. The very complexity of corporate structures and investment consortia offers fertile ground for divergent views about who can or cannot claim before ICSID or other arbitration mechanisms.

The private or public nature of the functions of a corporate entity has recently given place to important clarifications. The Convention envisaged allowing for claims by private entities against a State, but not by public entities against another State, although this alternative was not entirely ruled out in the negotiations. In CSOB v. Slovakia the claimant was a State agency of the Czech Republic that initiated proceedings against Slovakia what prompted an objection to jurisdiction on this basis. Interestingly enough, the Tribunal found that jurisdiction could be upheld as that particular entity, although owned by the State, was engaged in banking activities that had been privatized and were essentially commercial by nature.[24] The test thus became not government control but the essence of the activities performed. The same test was later applied in Maffezini to establish whether some activities of an agency of the Spanish State were of a public or private nature and hence engaged or not the responsibility of the State.
Agreement of the parties on the question of corporate nationality will of course be most influential on a finding of jurisdiction by a tribunal.

22. Compañía de Aguas del Aconquija et al. v. Argentina, ICSID Award of November 21, 2000, and Vivendi ICSID Annulment Decision, July 3, 2002.
23. Nottebohm Case (Second Phase), ICJ Reports, 1955.
24. Supra note 6.

So happened, for example, in MINE v. Guinea where an agreement of the parties establishing that a corporation had Swiss nationality prevailed over the fact that technically the nationality was different.[25] Issues relating to the real interest behind the investment and control of a corporation are relevant to this effect.

The ICSID Convention facilitates this more flexible approach. In particular, Article 25(2)(b) refers to the situation of a corporate entity that has the nationality of the Defendant State, but because of foreign control the parties have agreed it should be treated as a national of the other relevant State party, and thus can claim against the Defendant State. It is not unusual that bilateral investment treaties and investment agreements will contain clauses to this effect.

ICSID tribunals have occasionally found that certain arbitration clauses and other provisions might result in an implied agreement to treat a locally incorporated company as a foreign investor, as evidenced in Amco v. Indonesia[26] and Klöckner v. Cameroon.[27] It should be noted that this same result can be achieved by means of the definition of investment, which if broad enough, as is usually the case, might not need an agreement on nationality or control.

Overtaking the Barcelona Traction

In an earlier APEC workshop the decision of the International Court of Justice in the Barcelona Traction case[28] was referred to as an expression of customary international law in respect of corporate nationality and diplomatic protection,[29] a decision that ruled out the protection of shareholders by their State of nationality when the corporate entity was incorporated in a different country, except in very limited circumstances. This understanding, however, was not always shared and appears to be dramatically changing in recent years.

25. MINE v. Guinea, ICSID Award of January 6, 1988.
26. Amco v. Indonesia, ICSID Decision on Jurisdiction of September 25, 1983.
27. Klöckner v. Cameroon, ICSID Award of October 21, 1983.
28. Barcelona Traction, Light and Power Co. Ltd. (Belgium v. Spain), Judgment of February 5, 1970, ICJ Reports 1970, 3.
29. M. Sornarajah: "The Scope and Definition of Foreign Investment", APEC Workshop on Bilateral and Regional Investment Rules/Agreements, 17-18 May 2002, 86-100, at 88.

In point of fact, the very International Court of Justice in the Elettronica Sicula decision accepted, some years later, the protection of shareholders of a corporation by the State of their nationality in spite of the fact that the affected corporation had a corporate personality under the defendant State's legislation.[30] Moreover, the very concept of diplomatic protection underlining these decisions has been dwindling in current international law, as the State of nationality is no longer considered to be protecting its own interest in the claim but that of the individual affected.[31] To an extent, diplomatic protection is intervening as a residual mechanism called to intervene in the absence of other arrangements recognizing the direct right of action by individuals.

Recent State practice also appears to support the meaning of this changing scenario. Besides accepting the protection of shareholders and other forms of participation in corporations and partnerships, the concept of limiting it to majority or controlling participations has given place to an ever-decreasing threshold in this respect. Minority and non-controlling participations have thus been included in the protection granted or have been admitted to claim in their own right. Contemporary practice relating to lump-sum agreements,[32] the decisions of the Iran-United States Tribunal[33] and the rules and decisions of the United Nations Compensation Commission,[34] among other examples, evidence increasing flexibility in the handling of international claims.

These trends have gathered momentum in ICSID decisions. This is evidenced first by the discussion of who actually controls a corporation. In SOABI v. Senegal, an ICSID tribunal went quite far in searching for the controlling entity of a locally incorporated company.[35] The immediate controller was a Panamanian company, but Panama was not a party to the Convention; beyond that company, Belgian nationals

30. Case Concerning the Elettronica Sicula S. p. A. (ELSI) (United States of America v. Italy), Judgment of July 20, 1989, ICJ Reports 1989, 15.
31. International Law Commission: Preliminary Report on Diplomatic Protection, by Mohammed Bennouna, Special Rapporteur, A/CN.4/484, 4 February 1998, at 5.
32. David J. Bederman: "Interim Report on Lump Sum Agreements and Diplomatic Protection", International Law Association, Committee on Diplomatic Protection of Persons and Property, Report of the Seventieth Conference, New Delhi, 2002, 230, at 253-256.
33. For the jurisprudence of the United States-Iran Claims Tribunal see generally George H. Aldrich: The Jurisprudence of the Iran-United States Claims Tribunal, 1996; Charles N. Brower and Jason D. Brueschke: The Iran-United States Claims Tribunal, 1998.
34. United Nations Compensation Commission, Decision of the Governing Council on Business Losses of Individuals, S/AC.26/1191/4, 23 October 1991, par. F, and Decision 123 (2001).
35. SOABI v. Senegal, ICSID Decision on Jurisdiction, August 1, 1984.

were in control and Belgium was a State party. The tribunal ultimately accepted this last control. In Amco v. Indonesia,[36] however, the tribunal refused to go beyond the control exercised by the immediate parent company of a locally incorporated company.

Expanding the coverage of shareholders

A second related issue that arises in this context is whether a foreign investor is allowed to claim for damages affecting a corporate entity only when such investor has a controlling interest or can do so even if it is a minority shareholder. In Vaccum Salt Products Ltd. v. Ghana an ICSID Tribunal held that foreign control was an objective test and found out that this test was not met by an investor holding a 20% of a Ghanaian corporation.[37] However, in various cases other elements have been considered as evidence of control, such as voting power and managerial control.[38] This can be an important question when investment consortia participate in locally incorporated companies because of legal requirements of the host State.

A number of ICSID and other cases have discussed this question, in particular AAPL v. Sri Lanka,[39] AMT v. Zaire,[40] Antoine Goetz et consorts v. Republique du Burundi,[41] Maffezini v. Spain,[42] Lanco v. Argentina,[43] Genin v. Estonia,[44] the Aguas Award[45] and Vivendi Annulment[46] and CME v. Czech Republic.[47] These cases have dealt with different situations, involving both majority shareholders and on occasion minority shareholders. On occasions too the investor has been directly affected while in other situations the affected entity has been the corporation as such. But it appears again that the substantive interest associated to the investment is becoming the object of protection.

In Goetz the tribunal found in favor of the real interest underlining the investment in the following terms:

36. Supra note 26.
37. Vaccum Salt Products Ltd. v. Ghana, ICSID Award of February 16, 1994.
38. See for example LETCO v. Liberia, ICSID Decision on Jurisdiction of October 24, 1984.
39. AAPL v. Sri Lanka, ICSID Award of June 27, 1990.
40. AMT v. Zaire, ICSID Award of February 21, 1997.
41. Antoine Goetz et consorts v. Republique du Burundi, Sentence du CIARDI du 10 Fevrier 1999.
42. Supra note 12.
43. Lanco v. Argentina, Preliminary Decision of the ICSID Tribunal of December 8, 1998.
44. Genin et al .v. Estonia, ICSID Award of June 25, 2001.
45. Supra note 22.
46. Supra note 22.
47. CME. v. Czech Republic, Partial Award of September 13, 2001.

"...le Tribunal observe que la jurisprudence antérieure du CIARDI ne limite pas la qualité pour agir aux seules personnes morales directement visées par les mesures litigieuses mais l'étend aux actionnaires de ces personnes, qui sont les véritables investisseurs."[48]

Similarly, the Committee on Annulment in the Compañía de Aguas del Aconquija or Vivendi, held in this connection:

"Moreover it cannot be argued that CGE did not have an "investment" in CAA from the date of the conclusion of the Concession Contract, or that it was not an "investor" in respect of its own shareholding, whether or not it had overall control of CAA. Whatever the extent of its investment may have been, it was entitled to invoke the BIT in respect of conduct alleged to constitute a breach of Articles 3 or 5".[49]

In Lanco it was specifically held that an 18.3% investment in a domestic corporation qualified for protection in the circumstances of the case.

Treaties and Contracts

Because of the various forms that an investment venture can today adopt, there has also been a growing distinction between contracts made with the host State and the rights of the investors under the applicable bilateral investment treaty. Many times these are parallel arrangements that occasionally entail different dispute settlement mechanisms. This situation has become characteristic of concession contracts or license agreements made by a foreign investor with the host government while at the same time the investment qualifies for protection under a bilateral investment treaty.

The starting point to make this distinction is found in Article 26 of the Convention. This provision has clearly established that consent to ICSID jurisdiction is to the exclusion of any other remedy. The Tribunal in Lanco, for example, found that when the parties give their consent to ICSID arbitration, they lose their right to seek to settle the dispute in any

48. Supra note 41, par. 89.
49. Supra note 22, par. 50.

other forum, domestic or international.[50] In that same case it was held that the provisions of an investment treaty could not be diminished by the submission of a dispute to a domestic court to which a concession agreement remitted.[51] The ICSID tribunal in Compañía de Aguas del Aconquija was of the view that jurisdiction could be affirmed as the claims were not based on a concession contract referring disputes to domestic courts but in the alleged violation of the investor's rights under the Argentina-France bilateral investment treaty.[52]

An ICSID Annulment Committee in Wena also clarified the connection between contracts and the investment treaty.

"The Committee cannot ignore of course that there is a connection between the leases and the IPPA since the former were designed to operate under the protection of the IPPA as the materialization of the investment. But this is simply a condition precedent to the operation of the IPPA. It does not involve an amalgamation of different legal instruments and dispute settlement arrangements.(...) [T]he acts or failures to act of the State cannot be considered a question connected to the performance of the parties under the leases. The private and public functions of these various instruments are thus kept separate and distinct".[53]

Defining investment

Many aspects discussed above are closely related to the definition of investment. It is well known that the Convention did not define "investment" as there was no agreement on this point.[54] Many examples of investment were given along the negotiation of the Convention. The precise definition of investment was therefore left to the consent of the parties on jurisdiction, normally embodied in the bilateral investment treaties. This is not to say that these treaties are entirely free to define jurisdiction as the parties may please. The definition has to be com-

50.. Supra note 43, par. 36.
51. Supra note 43 par. 40.
52. Supra note 22, pars. 53-54.
53. Wena v. Egypt, Decision on Annulment of the ICSID Committee of February 5, 2002, par. 35. The IPPA is the relevant Bilateral Investment Treaty between Egypt and the United Kingdom.
54. See Fedax v. Venezuela, Decision of the ICSID Tribunal on Objections to Jurisdiction, July 11, 1997, pars. 21-26, with citations to the relevant cases and literature.

patible with the meaning of the Convention and not go beyond what can be reasonably regarded as investment.

In most cases the dispute will relate to an investment on which there can be no doubt. In a few instances doubt has arisen and the Secretary-General has refused registration because the case is manifestly outside the jurisdiction of the Centre. So too an ICSID tribunal can refuse to accept jurisdiction on this ground. As ICSID jurisprudence develops, a number of cases have clarified whether a particular activity is or not an investment under the relevant treaty. Taxation inconsistent with mining contracts,[55] the development of a timber concession,[56] construction contracts[57] and other activities have been identified as a pertinent investment under the relevant treaties. On the other hand, for example, in Mihaly v. Sri Lanka negotiations on a construction project that had not materialized in a contract were held not to constitute an investment.[58]

Two new situations have recently emerged. The first is highly relevant for APEC and WTO work on investment as it concerns investment for trade development. In two NAFTA cases the question has been decided. In Pope & Talbot, Inc. v. Canada, Canada argued that the dispute did not concern investment but trade and hence the tribunal lacked jurisdiction; the tribunal, however, found that the two questions were not "wholly divorced from each other".[59] The tribunal in S. D. Myres, Inc. v. Canada faced similar arguments and decided that the questioned measures concerning goods "can relate to those who are involved in the trade of those goods and who have made investments concerning them".[60] The connection between trade and investment is thus becoming a strong one.

55. LETCO v. Liberia, ICSID Award of March 31, 1986.
56. SOABI v. Senegal, ICSID Award of February 25, 1988.
57. Salini v. Morocco, ICSID Decision on Jurisdiction of July 23, 2001.
58. Mihaly International Corporation v. Sri Lanka, ICSID Award of March 15, 2002.
59. Pope & Talbot Inc. v. Canada, Award on Motion to Dismiss, January 26, 2000.
60. S. D. Myres, Inc. v. Canada, Partial Award of November 12, 2000.

Financial markets not ignored

The second new development relates to financial instruments. Although not typically an investment of the traditional kind, financial instruments have become a crucial source for government financing and heavy investments are made in them worldwide. In Fedax v. Venezuela the tribunal had to deal with promissory notes issued by the government that had circulated internationally and Fedax, a foreign financial institution, had invested in them. The tribunal decided that the promissory notes were a means by which loans and credit benefiting the State had been made available and their purchase qualified as an investment under the investment treaty.[61] Also in CSOB v. Slovakia, the tribunal held that loans in the circumstance of a large banking operation qualified as an investment.[62] In both cases it was held that the resources made available to the State did not need to be physically transferred across borders to qualify as an investment.

Financial developments cannot of course extend indefinitely as a covered dispute and the circumstances will provide clear limits to this end. In a recent and unreported case, a Belgian investor who had bought a participation in an international asset fund claimed against Malaysia on the ground that general economic measures adopted by this country had diminished the value of his portfolio. Although this claim was dismissed on jurisdictional grounds, there was little hope for it to succeed on the merits.

Arising directly

The Convention also requires the dispute to be a legal dispute and to arise directly from the investment. In Amco v. Indonesia, a dispute concerning general tax obligations under domestic law invoked in a counter-claim was held not to qualify as an investment as it did not arise directly from the investment made.[63] Occasionally, however, there is some confusion between a dispute arising directly from an investment and the question of the investment being a direct and not an indirect one. The point was also discussed in Fedax v. Venezuela, where the tribunal held:

61. Supra note 54.
62. Supra note 6.
63. Amco v. Indonesia, Resubmitted Case, Decision on Jurisdiction of May 10, 1988.

"However, the text of Article 25 (1) establishes that the "jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment". It is apparent that the term "directly" relates in this Article to the "dispute" and not the "investment". It follows that jurisdiction can exist even in respect of investments that are not direct, so long as the dispute arises directly from such transaction. This interpretation is also consistent with the broad reach that the term "investment" must be given in light of the negotiating history of the Convention".[64]

As noted above, the definition of investment agreed to in treaties is usually very broad and encompasses movable and immovable property, shares and other forms of participation in a company, claims to money and other contracts of financial value, intellectual property, business concessions and other matters. This broad definition is at the very heart of the interpretation of treaties made by ICSID and other tribunals. Although under Article 24(4) of the Convention a Contracting State can notify the Centre of classes of disputes it would or would not consider submitting to the jurisdiction, this is seldom done and in any event such a notification does not constitute consent under the Convention nor does it change any consent given in other instruments.

It might be important for governments and investors to be as precise as possible on the investments they intend to protect as this may avoid many disputes and misunderstandings and might also avoid ancillary claims and counterclaims that further complicate disputes submitted to arbitration.

A uniform approach to substantive treatment

The definition of investment is not merely a jurisdictional question. It also touches heavily upon the merits of a claim as the action or omission of State organs and agencies will be measured against the type of investment concerned. The substantive treatment embodied in bilateral and other investment treaties is virtually the same. Fair and equitable treatment, national treatment, non-discrimination, most-favored-nation treatment, fund transfers and requirements and guar-

64. Supra note 54.

antees concerning expropriation are almost identical throughout the spectrum.[65]

It is interesting to note that the discussion on the merits in most cases relates to the balancing of the rights of the State with those of the investor. The protection of property and acquired rights is no longer a fundamental issue in international law. For a long time the right to protection could not be easily reconciled with the supremacy of national sovereignty. Only after difficult confrontations an understanding was reached about the limits of the respective contentions, and conditions were set to diplomatic protection and the right to expropriate, including the right to compensation. International adjudication was instrumental in reaching such understandings.

The success of this approach, together with inescapable economic realities, has been so evident that outright direct expropriation is today rather exceptional and has a number of well set requirements to be accepted as valid under international law. If one examines the list of ICSID and other relevant cases of the past few years will realize that this type of expropriation is quite exceptional.[66]

Some degree of accommodation has also been taking place in respect of indirect or regulatory expropriation, but this is thus far insufficient, scant and on occasions contradictory. The State holds its right to adopt measures in pursuance of public policies. Investors hold their right to be compensated if such measures amount to a taking. Neither of these views can be questioned in and of themselves. The problem lies in how and where the respective limits and conditions should be established, that is in identifying the point of common interest and reconciliation.

Yet, when we might have thought that the legal framework was rightly evolving in the direction of attaining such a balance, principally under the case law of ICSID, all of a sudden the confrontation flares up again. Is there a NAFTA/BIT treatment or just a minimum customary law

65. See generally the discussion and contributions made to the APEC workshop cit., supra note 29.

66. Direct Expropriation was involved for example in the case Compañía de Desarrollo de Santa Elena S. A. v. Republic of Costa Rica, ICSID Award of February 17, 2000. In other prominent cases only regulatory measures alleged to have amounted to expropriation were involved, as was the case for example in Metalclad v. Mexico, 40 International Legal Materials 55 (2001) and Waste Management Inc v. Mexico, 40 International Legal Materials 56 (2001).

standard? Are such standards those of the twenty-first century or still those of the nineteenth century?[67]

International legal thinking has had great difficulty in focusing on the right approach to the issue of regulatory authority, particularly if it entails indirect expropriations, as opposed to formal expropriation. This again is evidenced by examining the list of ICSID and NAFTA cases where the vast majority concerns such questions as the right of the State to adopt certain types of regulations, the distribution of powers within the State and its various provincial or local governments, the effects of those measures and their connection with the treatment embodied in treaties.

Two issues on which this discussion is based must be disposed of at the outset. There can be no doubt about the first such issue, namely the right of the State to adopt regulatory measures in implementation of legislation and other expressions of sovereignty. The second issue is that regulatory authority cannot be validly exercised if it violates the framework of legal rights and obligations in which it operates. This will be subject to scrutiny by constitutional bodies, judicial entities or international mechanisms.

Limits of regulatory powers

The problem lies in establishing the limit of such powers or functions under international law. First, it appears that it is a well-established principle that States may not act in a manner contrary to treaties and contracts, at least those contracts that are under some form of protection of international law itself. Second, as noted, it is quite evident that under the principle of attribution States are responsible under international law for acts not only of central government authorities but also of any other public agency exercising regulatory functions of some sort.[69]

67. Asan Sedigh: "What Level of Host State Interference Amounts to a Taking under Contemporary International Law?", The Journal of World Investment, Vol. 2, 2001, 631. See also the discussion concerning NAFTA in Andrea Menaker: "Standards of Treatment: National Treatment, Most Favored Nation Treatment and Minimum Standards of Treatment", APEC workshop cit., supra note 29, 102-112, and in connection with environmental regulations Thomas Wälde and Abba Kolo: "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law", International and Comparative Law Quarterly, Vol. 50, 2001, 811-848.

68. Rosalyn Higgins: "The Taking of Property by the State: Recent Developments in International Law", Recueil des Cours, Academy of International Law, Vol. 176, 1982-III, 263.

69. Crawford, supra note 21.

In the light of recent ICSID and NAFTA case law,[70] as well as under many other international precedents,[71] it has also become evident that most of the problems with regulatory authority entailing some form of expropriation occur not with central government authorities that are conscious of international obligations but with lesser governmental units, local states, municipalities and the like. This has gone so far that in a recent treaty it was necessary to expressly provide for the obligation to adopt measures to ensure the compliance with the treaty provisions by national, provincial and regional authorities and a mechanism of supervision was established to this effect.[72]

Domestic and international judicial control over administrative decisions of States and its various agencies has helped to pave the way for finding the right balance in this respect. More recently, again in the light of both domestic and international experiences, the doctrine of legitimate expectation appears to be gaining momentum as a standard that has to be respected in terms of citizens' rights, or for that matter investors' rights.

In search of legitimate expectation

In Preston, a leading English case, the House of Lords ruled that unfairness amounting to an abuse of power could arise from conduct equivalent to breach of contract or representation.[73] Still more directly in the recent case R. v. North and East Devon Health Authority, ex p. Coughlan[74] the Court of Appeal in England sought to redress the inequality of power between the citizen and the State.[75] In this case it was held that:

> "Where the Court considers that a lawful promise or practice has induced a legitimate expectation of a benefit which is substantive, not simply procedural, authority now establishes that here too the court will in a proper case decide whether to frustrate the expectation is son unfair that to take a new and different course will amount to an abuse of power. Here, once

70. Supra note 22.
71. Sedigh, supra note 67, 666-671.
72. Protocol to the Argentina-Chile Treaty on Mining Integration and Cooperation, 20 August 1999, Article 5.
73. Preston v IRC (1985) 2 All ER 327, (1985) AC 835.
74. R v North and East Devon Health Authority, ex Parte Coughlan (2000) 3 All ER 850.
75. Mark Elliott: "Case and Comment, House of Lords Decisions", Cambridge Law Journal, Vol. 59, 2000, 421.

> the legitimacy of the expectation is established, the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy."[76]

The Court, having examined prior cases, then added:

> "The court's task in all these cases is not to impede executive activity but to reconcile its continuing need to initiate or respond to change with the legitimate interests or expectations of citizens or strangers who have relied, and have been justified in relying, on a current policy or extant promise".[77]

The situation is not altogether different under international law. Governments and international organizations may undertake changes of policy in their continuing need to search for the best choices in the discharge of their functions. However, to the extent that policies earlier in force might have created legitimate expectations both of a procedural and substantive nature for citizens, investors, traders or other persons, these may not be abandoned if the result would be so unfair as to amount to an abuse of power. This also assumes the international protection of the rights concerned. Herein lie the limit of discretion and the role of judicial review as a means of redress.

Because this approach is rooted in fairness it would not be unthinkable that from citizens' rights and foreign investors' rights it might gradually expand into other areas of concern for the international community, most notably trade, the international civil service and other matters. Global society is approaching, quite rightly, global protection.

76. Supra note 74, par. 57.
77. Supra note 74, par. 65.

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