UNCTAD/ITE/IIT/10(Vol. III)

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

MOST-FAVOURED-NATION TREATMENT

UNCTAD Series
on issues in international investment agreements

UNITED NATIONS
New York and Geneva, 1999

NOTE

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The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable;

A slash (/) between dates representing years, e.g. 1994/95, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g. 1994-1995, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

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UNCTAD/ITE/IIT/10 (vol. III)

UNITED NATIONS PUBLICATION
Sales No. E.99.II.D.11
ISBN 92-1-112450-6

IIA Issues Paper Series

The main purpose of the UNCTAD Series on issues in international investment agreements is to address key concepts and issues relevant to international investment agreements and to present them in a manner that is easily accessible to end-users. The series covers the following topics:

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Preface

The United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on a possible multilateral framework on investment, with a view towards assisting developing countries to participate as effectively as possible in international investment rule-making at the bilateral, regional, plurilateral and multilateral levels. The programme embraces capacity-building seminars, regional symposia, training courses, dialogues between negotiators and groups of civil society and the preparation of a series of issues papers.

This paper is part of this series. It is addressed to government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers. The series seeks to provide balanced analyses of issues that may arise in discussions about international investment agreements. Each study may be read by itself, independently of the others. Since, however, the issues treated closely interact with one another, the studies pay particular attention to such interactions.

The series is produced by a team led by Karl P. Sauvant and Pedro Roffe, and including Victoria Aranda, Anna Joubin-Bret, John Gara, Assad Omer, Jörg Weber and Ruvan de Alwis, under the overall direction of Lynn K. Mytelka; its principal advisors are Arghyrios A. Fatouros, Sanjaya Lall and Peter T. Muchlinski. The present paper is based on a manuscript prepared by Joachim Karl. The final version reflects comments received from Mark Koulen and Hamid Mamdouh. The paper was desktop published by Teresita Sabico.

Funds for UNCTAD's work programme on a possible multilateral framework on investment have so far been received from Australia, Brazil, Canada, the Netherlands, Norway, Switzerland, the United Kingdom and the European Commission. Countries such as India, Morocco and Peru have also contributed to the work programme by hosting regional symposia. All of these contributions are gratefully acknowledged.

Rubens Ricupero
Secretary-General of UNCTAD

Geneva, December 1998

Table of contents

Page

Table

Executive summary

The most-favoured-nation treatment (MFN) standard is a core element of international investment agreements. It means that a host country treats investors from one foreign country no less favourably than investors from any other foreign country. The MFN standard gives investors a guarantee against certain forms of discrimination by host countries, and it is crucial for the establishment of equality of competitive opportunities between investors from different foreign countries.

The MFN standard may also have implications for host countries´ room for manoeuvre in respect of future investment agreements, because it can create a so-called "free rider" situation in that the MFN standard commits a host country to extend unilaterally to its treaty partners any additional rights that it grants to third countries in future agreements. Furthermore, as the globalization of investment activities makes corporate nationality more difficult to use as a ground for distinguishing between companies, it may become equally more difficult to identify the nation that actually benefits from MFN.

While the MFN standard has for decades been a common feature of bilateral investment treaties (BITs), efforts have been undertaken in recent years to translate this standard in a multilateral framework.[1] Moreover, some recent agreements extend the MFN standard to both the pre- and post-establishment phases. On the other hand, there are several exceptions to the MFN standard which could be general exceptions (e.g. for national security reasons), exceptions based on reciprocity considerations (for example in the area of taxation and intellectual property) and individual country-specific exceptions. The annex provides a diagram of MFN clauses with illustrations of the extension of the MFN standard, its beneficiaries, scope and exceptions.

The MFN standard interacts with various other investment issues and concepts addressed in this series of papers, in particular the so-called international minimum standard and the standard of national treatment (NT). While MFN is generally more than the minimum standard required under customary international law, it does not go so far as to put the foreign investor on an equal footing with domestic investors in the host country.

Although international investment agreements allow for exceptions from MFN, it seems that contracting parties have hitherto not used this freedom to discriminate among foreign investors from different countries beyond those policy areas where differential treatment is explicitly recognized (for instance, taxation, intellectual property or mutual recognition). However, the possibility of using exceptions to MFN introduces an element of flexibility in taking account of development objectives where this may be appropriate.

Note

1 Unless otherwise noted, all instruments cited herein may be found in UNCTAD, (1996a).

INTRODUCTION

One of the core provisions of international investment agreements concerns MFN. Indeed, that standard is at the heart of multilateralism. The MFN standard means that a host country must extend to investors from one foreign country treatment no less favourable than it accords to investors from any other foreign country in like cases. In other words, the MFN standard seeks to prevent discrimination against investors from foreign countries on grounds of their nationality. At the same time, the MFN standard sets certain limits upon host countries with regard to their present and future investment policies by prohibiting them from favouring investors of one particular foreign nation over those of another foreign country.

MFN applies both in the trade and the investment fields. However, contrary to trade, where the MFN standard only applies to measures at the border, there are many more possibilities to discriminate against foreign investment. This paper, while taking stock of existing agreements, examines the fields in which there have been departures from MFN. Countries have followed very similar approaches with regard to these exceptions, although there are also a few substantial differences. It then examines potential interactive effects of the MFN standard with other investment-related issues. These include, *inter alia*, host country operational measures, the principle of national treatment and trade policy measures. In each case, the question is how the MFN standard in investment matters affects these other concepts or policy areas. Finally, the paper assesses the economic and development implications of the MFN standard. It concludes that the MFN principle is itself flexible in the sense that it allows in-built exceptions that could accommodate development concerns of host countries.

Section I

EXPLANATION OF THE ISSUE

A. Definition and scope

The MFN standard means that a host country must extend to investors from one foreign country the same treatment it accords to investors from any other foreign country in like cases. It potentially applies to all kinds of investment activities, such as the operation, maintenance, use, sale or liquidation of an investment. With regard to the admission and establishment of an investment, international MFN commitments are less frequent, although there is a certain movement towards an extension of the rule in this direction (see section II below). This comprehensive coverage ensures that investors are protected even if the investment-related activities change or expand during the lifetime of their investments. Moreover, the standard can be invoked with regard to any investment-related legislation.

In principle, one can distinguish several types of MFN clauses. They can be either unilateral or reciprocal, conditional or unconditional, limited (by territory, time, or substantive scope) or unlimited. The MFN standard (with exceptions) usually applies in the areas of trade, investment, foreign exchange, intellectual property, diplomatic immunities, and the recognition of foreign judicial awards.

As far as investment matters are concerned, MFN clauses show the same basic structure. They are usually reciprocal (which means that all contracting parties are bound by it), unconditional and apply to all investment-related matters. However, this does not mean that these clauses use identical language. Most agreements refer to “treatment no less favourable” when defining the MFN standard (for instance, the General Agreement on Trade in Services

(GATS), article II, and the Energy Charter Treaty, article 10, paragraph 7). The North American Free Trade Agreement (NAFTA), while using the same terminology, includes the qualification that such treatment applies only "in like circumstances" (article 1103).

Many investment agreements entitle both foreign investors and their investments to MFN. This is so, for example, in the case of NAFTA (article 1103), and the BITs concluded by Germany, Switzerland and the United Kingdom (UNCTAD, 1998b). By contrast, the Energy Charter Treaty (article 10, paragraph 7) and the BITs of the United States only grant MFN to the *investment*. Still another approach has been followed in the French model treaty, which gives MFN to the investors with regard to their investments.

There is no evidence that, by using different wording, the parties to these various agreements intended to give the MFN clauses a different scope. Whatever the specific terminology used, it does not change the basic thrust of MFN, namely its non-discriminating character among foreign investors investing in a particular host country.

There are also variations concerning the investment activities covered by the MFN standard. In general, the coverage is broad (UNCTAD, 1999a). NAFTA uses the terms "establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments" (article 1103). The Energy Charter Treaty covers all investment-related activities, "including management, maintenance, use, enjoyment, or disposal" (article 10, paragraph 7). The French model treaty refers to "activities in connection with an investment". The GATS applies MFN in respect of "any measure covered by this Agreement" (article II). Once again, irrespective of the concrete wording, the aim is to cover all possible investment operations.

However, not all treatment given by a host country to foreign investors falls under the scope of the MFN provision. In order to be covered by the MFN clause, the treatment has to be the *general* treatment *usually* provided to investors from a given foreign country. Therefore, if a host country granted special privileges or incentives to an individual investor in an investment contract between it and the host country (so-called "one-off" deals), there would be no obligation under the MFN clause to treat other foreign investors equally. The reason is that a host country cannot be *obliged* to enter into an individual investment contract. Freedom of contract prevails over the MFN standard. Only if this individual behaviour became general practice in the host country -- for example, if an incentive is granted under a general subsidy programme -- would the MFN provision apply. It may be difficult to decide at what point an individual practice, which has been repeated in several cases, becomes general treatment. The relevance of MFN in this particular instance is that all foreign investors should be treated equally for purposes of being potential candidates for the special privilege or incentive which in practice could only be granted to one individual investor.

Furthermore, the MFN standard does not mean that foreign investors have to be treated *equally* irrespective of their concrete activity in a given host country. Different treatment is justified vis-à-vis investors from different foreign countries if they are in different objective situations. The model BIT of the United States, as well as NAFTA, contain an explicit provision in this respect, according to which MFN applies only to investors and investments that are "in like situations" (United States model BIT) or "in like circumstances" (NAFTA)[1]. Thus, the MFN standard does not necessarily impede host countries from according different treatment in different sectors of economic activity, or to differentiate between enterprises of different size. It would therefore not violate the MFN standard *per se* for a host country to grant subsidies only to investments in, say, high-technology industries, while excluding foreign investment in other areas. Likewise, the MFN clause would not give a big foreign investor the right to claim government assistance under a programme that was designed only for small and medium-sized enterprises. However, such different treatment could still amount to *de facto* discrimination. This would be the case if the only purpose of the differentiation were to exclude investors of a particular nationality from the benefits of the programme.

The MFN standard is not without exceptions. While the degree and extent of these exceptions vary considerably in individual treaties, they can be traced back to some general considerations: exceptions are needed because the scope of the MFN standard is very broad. It potentially covers all industries and all possible investment activities. It therefore applies to such different issues as social and labour matters, taxation and environmental protection. In fact, many of these policy areas are governed by a reciprocity rule. Examples are bilateral tax treaties, agreements on the protection of intellectual property rights, or arrangements in the field of labour mobility and the harmonization and recognition of professional services. Reciprocity is also the rule for agriculture and for maritime, air and road transportation -- all industries in which foreign investment may occur. As a result, in all these areas, an unqualified commitment to MFN usually does not exist, as discussed further in section II below.

While the MFN standard applies in both the trade and investment fields, its sphere of operation differs in each area. In trade, the standard only applies to measures at the border, in particular to tariffs. In relation to investment, the MFN standard has usually applied to the treatment of investors *after* entry, though, as noted above, some agreements also extend its operation to the pre-entry stage. Despite their distinct spheres of operation, given the close interrelationship between trade and investment in the operations of transnational corporations (TNCs), the combined effect of trade-related and investment-related MFN is to offer freedom for TNCs to choose the precise mode of operation in a host country on an equal basis with their competitors. Thus, in relation to investment already made in a host country, discriminatory treatment may be prejudicial to existing investors, given the “sunk costs” already incurred in setting up an investment, and the more beneficial situation that other competing foreign investors enjoy on the same market. At the point of entry, both trade and investment-related MFN seek to avoid preferential access to the host State which could prove damaging to the excluded companies through the denial of commercial opportunities in the host State, which may not always be easily mitigated by trading and/or investing elsewhere.

B. MFN treatment and equality of competitive opportunities

Foreign investors seek sufficient assurance that there will not be adverse discrimination which puts them at a competitive disadvantage. Such discrimination includes situations in which competitors from other foreign countries receive more favourable treatment. The MFN standard thus helps to establish equality of competitive opportunities between investors from different foreign countries. It prevents competition between investors from being distorted by discrimination based on nationality considerations. The more foreign investors from various home countries play an important role in a host country, the more important the MFN standard becomes.

While a non-discrimination clause may already exist in the domestic legal system of a host country (for example as a principle of its constitution), this would often not be perceived as sufficient to give foreign investors the same degree of assurance as an obligation under international law. In the view of foreign investors, domestic law, including a domestic MFN provision, could be amended at any time by unilateral national action. Through an international commitment, investors could be confident that the host country cannot easily try to disguise discrimination among foreigners.

C. The "free rider" issue

Despite its importance for appropriate investment protection, MFN may at the same time limit countries' room for manoeuvre in respect of investment agreements they want to conclude in the future. This is so because the MFN standard obliges a contracting party to extend to its treaty partners any benefits that it grants to any other country in any future agreement dealing with investment. This can cause a so-called "free rider" situation: assume, for instance, that in an agreement between countries X and Z, X grants Z certain rights which it has not granted to country Y in an earlier agreement with an MFN clause; country Y can now claim the additional rights granted to Z. The original contractual balance between X and Y is thus upset, since the MFN clause has added additional obligations to country X, without imposing any other obligations on country Y.

To remedy this potential imbalance, certain countries initially construed the MFN clause as implying an obligation on the part of the country benefiting from its operation to renegotiate the initial agreement so as to redress the contractual balance between the two original parties. This was known as the "conditional" MFN clause, that is to say, the MFN treatment was granted on condition of strict and specific reciprocity. Other countries objected to this interpretation, arguing that it deprived the MFN clause of its automatic effect and thereby made it essentially inoperative. By the 1920s, the unconditional interpretation was generally accepted. To buttress the interpretation and counter the free rider argument, the reciprocity involved is now construed in a broader, more abstract sense: a country's promise of MFN treatment is given against a counter-promise to the same effect; it is the MFN treatment that is thus assured, while the actual specific treatment to be applied depends on the other treaty commitments of the parties. Of course, this is but an assumption, and it is inoperative if there is clear evidence that the parties intended their agreement to be governed by strict reciprocity.

The actual seriousness of the free rider problem varies from case to case. The issue may also take different forms in respect of bilateral and multilateral treaties. In the latter case, it may be less acceptable because of the potentially huge number of free riders involved. Furthermore, free riding would become less tolerable, the more the substantive obligations in the treaties concerned differ. In brief, the gravity of the free rider issue depends on the extent to which it creates asymmetrical situations.

One may ask whether the free rider issue has special relevance in the context of economic development. So far, the development strategies of many developing countries have been based on selective intervention. This means that these countries have favoured those foreign investors they considered able to make major contributions to their own economic development. A question, therefore, is whether an unconditional MFN commitment could undermine such a strategy -- an issue which is discussed further in the last section of this paper.

D. The identity issue

The emergence of integrated international production systems makes the determination of corporate nationality more difficult (UNCTAD, 1993, pp. 188-190). A foreign affiliate is only entitled to MFN if it can show that its parent company is located in a country that is entitled to such a commitment. The issue of corporate nationality is not new. However, with the emergence of new forms of integrated production, and with management and decision-making possibly spread among several parts of a corporation, it becomes increasingly difficult to identify the nationality of the parent company. The relations among different units of a TNC no longer necessarily reflect the traditional pattern of subordination. Furthermore, if the units are incorporated and administered in different countries, especially if they are owned by shareholders of different nationalities or linked to one another by contractual arrangements, it may become difficult in practice to attribute nationality to a particular affiliate. The question of "who is us?" (Reich, 1991) may also arise with regard to how far back in the corporate chain it is appropriate to reach in order to determine an affiliate's nationality.

Furthermore, even if an investing company can be clearly identified, the owners of that company do not necessarily have the nationality of the country in which the investing company is located. This may result in a situation in which an investor indirectly benefits from an MFN obligation in a treaty that does not apply to it. If, for example, Volkswagen Mexico makes an investment in Colombia, it is both the Mexican investor and (indirectly) the German parent company that benefit from MFN obligations which may exist in favour of Volkswagen Mexico. Such situations may become more frequent as an increasing number of foreign-controlled companies become investors abroad, either because they were originally established as pure holding companies or because they function as bridgehead investments in the overall investment strategy of a TNC (UNCTAD, 1993, 1998a).

Note

1 See article II, United States model BIT, and article 1103 of NAFTA.

Section II

STOCKTAKING AND ANALYSIS

A. The standard

MFN has traditionally been linked to trade agreements. The first example of an MFN clause was when King Henry V of England signed a treaty (Treaty for Mercantile Intercourse with Flanders on 17 August 1417) with Duke John of Burgundy in Amiens, according to which English vessels were granted the right to use the harbours of Flanders "in the same way as French, Dutch, Sealanders and Scots" (Kramer, 1989, p. 478). It was only in the seventeenth century that the point of reference for MFN was no longer a limited number of named countries, but any third state. An example is the treaty dated 16 August 1692 between Denmark and the Hanseatic League. The first "modern" trade treaty that included an unconditional MFN clause was the Cobden treaty dated 23 January 1860 between the United Kingdom and France. Later, in March 1929, the Council of the League of Nations adopted a model MFN clause in respect of tariffs. After the Second World War, the MFN standard was revived in the negotiation of the Havana Charter. Furthermore, the GATT 1947 contained the most classical unconditional MFN commitment in its article I (Kramer, 1989). With regard to *investment*, the development of MFN became common in the 1950s with the conclusion of international investment agreements, including BITs. The MFN standard was included in such treaties from the beginning, and the MFN standard is thus older than the parallel provision for "national treatment", which found its way into most BITs only at a later stage.

Although MFN clauses are characterized by a basic similarity in terms of structure and substantive coverage, they nevertheless differ in one important area, namely, whether they apply only at the post-entry stage or also at the pre-entry stage.

1. The post-entry model

The vast majority of BITs do not include binding provisions concerning the admission of foreign investment. This means that there is an obligation to apply MFN under these terms only *after* an investment has been made. With regard to the pre-establishment phase, contracting parties are usually encouraged to create favourable conditions for foreign investors and admit their investments in accordance with their domestic laws (UNCTAD, 1999b). Other treaties restrict the MFN clause explicitly to post-entry investment only. This is exemplified by article 10 (7) of the Energy Charter Treaty:

> "Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable."

However, the contracting parties can extend MFN to the pre-establishment stage according to a supplementary treaty (www.encharter.org).[1]

2. The pre- and post-entry model

By contrast to the first model, this model requires the application of the MFN standard in respect of both the establishment and subsequent treatment of investment. Most BITs of the United States and some recent treaties of Canada follow such an approach. Similarly, article 1103 of NAFTA contains the following clause:

> "1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

Other similar pre- and post-entry clauses can be found in the Southern Common Market (MERCOSUR) Colonia Protocol (article 2) and in the Asia-Pacific Economic Cooperation (APEC) Non-Binding Investment Principles. This shows that, in the era of globalization, non-discriminatory treatment with regard to market access is becoming an increasingly important issue.

B. Exceptions

1. General exceptions

Investment agreements contain several types of exceptions of a general nature that are not specifically limited to MFN. Some of these general exceptions are discussed below.

a. Public order/health/morals

Most BITs allow contracting parties to derogate from the non-discrimination standard, if this is necessary for the maintenance of public order, public health or public morality (UNCTAD, 1998b). Nevertheless, it is hard to identify concrete cases where, for example, the maintenance of public order would actually require discriminating among foreign investors, although the case of a foreign investor being involved in systematic abuses of human rights might elicit such a response, especially if required by the resolution of an international organization.

On the other hand, a "public order" exception may be a substitute for a "national security" exception. For instance, the Treaty Establishing the European Community (article 56) refers to "public policy, security or health." In these cases, there may be a justification for discrimination based on nationality (see below the section on "national security").

The GATS (article XIV) also contains an exception clause concerning the protection of public morality and the maintenance of public order. In addition, an exception can also be made if this is necessary to protect human, animal or plant life or health, or to secure compliance with laws or regulations that are not inconsistent with GATS provisions, including those related to safety. Contrary to most bilateral agreements, the GATS exceptions relate to the agreement as a whole. However, such measures must not be 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.

Likewise, the Organisation for Economic Co-operation and Development (OECD) Code on the Liberalisation of Capital Movements allows members to take any action they consider necessary for the maintenance of public order or the protection of public health, morality and safety (article 2).

Furthermore, the Energy Charter Treaty contains an exception clause in respect of the maintenance of public order and the protection of human, animal or plant life or health. With regard to public order, a contracting party is allowed to take any measure it considers necessary, except measures that would affect the treaty obligations concerning expropriation and losses due to war and civil disturbance (article 24, paragraph 3c). With regard to the protection of human, animal or plant life or health, a contracting party can take any measure, provided that it does not constitute a disguised restriction on economic activity in the energy sector, or arbitrary or unjustifiable discrimination between contracting parties or between investors or other interested persons of contracting parties (article 24, paragraph 2b(i)).

b. National security

Most BITs do not contain an exception for national security reasons. Nevertheless, it would seem that contracting parties could take at least any measure that the United Nations Security Council would authorize them to take. An explicit national security exception can be found in the GATS at article XIV bis(1):

"Nothing in this Agreement shall be construed: ......
(b) to prevent any Member from taking action which it considers necessary for the protection of its essential security interests:
(I) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
(ii) relating to fissionable and fusionable materials or the materials from which they are derived;
(iii) taken in time of war or other emergency in international relations; or
(c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security."

Accordingly, nothing in the GATS prevents a member from taking an action it considers necessary to protect its essential security interest or meet its obligations under the United Nations Charter for the maintenance of international peace and security. Likewise, article 3 of the OECD Code on the Liberalisation of Capital Movements allows members to take actions that they consider necessary for the protection of their essential security interests, or the fulfilment of their obligations relating to international peace and security. The Energy Charter Treaty has a similar provision (article 24, paragraph 3), but in this case, a member is not allowed to derogate from its obligations under the provisions on expropriation and protection from civil strife. NAFTA also includes a national security exception (article 2102).

These provisions give contracting parties broad discretion in deciding whether they want to invoke the exception clause or not (so-called "self-judging" clauses). In particular, it is not necessary for the party to be in an actual state of war. It would be sufficient for the party to consider its national security interests to be threatened.

2. Reciprocal subject-specific exceptions

A common element of many investment agreements is that they contain MFN exceptions based on reciprocity that are specifically focused on MFN provisions. The most frequent exceptions of this type are analysed in this section.

a. Taxation

All investment agreements dealing with taxation matters contain an MFN exception. This means that a contracting party is not obliged to extend to its treaty partners, via the MFN clause, any privilege or other advantage that it has granted to a third country and its investors under a bilateral agreement on the avoidance of double taxation. The reason is that, under the latter treaties, the contracting parties delimit their right to tax investors of the other contracting party. This means that the contracting parties partly renounce their right to tax investors located in their territories in order to avoid double taxation. This happens on a mutual basis. Each contracting party therefore waives its taxation rights only if the other contracting party undertakes the same commitment. Thus, a unilateral extension of the waiver vis-à-vis third countries via the MFN standard, including its financial implications, would not be acceptable. For example, the Chile - Malaysia BIT (article 3) provides:

> "The provision in this Treaty relating to treatment no less favourable than that accorded to investments of third States shall not be interpreted to oblige a Contracting Party to extend to investors of the other Contracting Party the benefits of any treatment, preference or privilege by virtue of:
>
> ...
> (b) any international convention or agreement related totally or principally to taxation, or any national legislation related totally or partially to taxation" (UNCTAD, 1998b, p. 58).

b. Intellectual property

Most BITs apply the MFN clause fully with regard to intellectual property. However, where these treaties contain binding obligations only for the post-establishment phase, which is the case for BITs other than the United States and the more recent Canadian models, the MFN commitment only applies once the rights have been granted. The host country can therefore condition the acquisition of an intellectual property right on the fulfillment of certain requirements, including the requirement that its own investors receive a similar level of protection in the home country of the foreign investor.

In addition, some international conventions dealing with the protection of intellectual property rights, e.g. the Berne Convention (United Nations, 1980a) and the Rome Convention (United Nations, 1964), explicitly allow contracting parties to deviate from the MFN standard with regard to the acquisition and contents of certain intellectual property rights, namely copyrights. Under these conventions, the treatment accorded by one State to nationals of another member State is a function of the treatment accorded in that other country. The WTO-TRIPS Agreement (article 4 paragraph (b)) confirms this rule:

> "With regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members. Exempted from this obligation are any advantage, favour, privilege or immunity accorded by a Member:
> ...
> (b) granted in accordance with the provisions of the Berne Convention (1971) or the Rome Convention authorizing that the treatment accorded be a function not of national treatment but of the treatment accorded in another country;" ...

A foreign investor may therefore acquire and use intellectual property rights covered by the Berne Convention and the Rome Convention in a particular host country only to the extent that investors from the latter country have the same rights in return (UNCTAD, 1996c).

Accordingly, recent regional investment agreements dealing with the pre-establishment phase include an MFN exception in this respect. Thus, NAFTA, article 1108, paragraph 5 stipulates:

> "Articles 1102 and 1103 do not apply to any measure that is an exception to, or derogation from, the obligations under Article 1703 (Intellectual Property - National Treatment) as specifically provided for in that Article."

And article 10, paragraph 10, of the Energy Charter Treaty provides:

> "Notwithstanding any other provision of this Article, the treatment described in paragraphs (3) and (7) shall not apply

> to the protection of Intellectual Property; instead, the treatment shall be as specified in the corresponding provisions of the applicable international agreements for the protection of Intellectual Property rights to which the respective Contracting Parties are parties."

However, as far as NAFTA is concerned, the MFN exception is not limited to a reciprocity requirement. It also allows for MFN exceptions in respect of intellectual property rights in general (article 1108, paragraph 5).

c. Regional economic integration

Investment agreements in which countries that are members of a regional economic integration organization (REIO) participate usually include a so-called REIO clause. Under this provision, REIO members are exempted from the obligation to grant MFN to non-members. The purpose of this provision is to allow members of a REIO to advance with their internal investment liberalization at a faster pace than that to which the non-members have agreed. For example, the Chile - Malaysia BIT (article 3) provides:

> "The provision in this Treaty relating to treatment no less favourable than that accorded to investments of third States shall not be interpreted to oblige a Contracting Party to extend to investors of the other Contracting Party the benefits of any treatment, preference or privilege by virtue of:
>
> (a) any customs union, free trade area, common market or monetary union, or any similar international convention or other forms of regional cooperation, present or future, of which any of the Contracting Parties might become a party;..." (UNCTAD, 1998b, p. 58).

Without such a clause, the MFN clause would oblige the REIO members unilaterally to grant investors from non-member countries all the privileges deriving from REIO membership.

Such an obligation could result in problematic situations for the following reasons (Karl, 1996):

- Investment liberalization in a REIO is usually based on the presence of common rules. All members undertake the same commitments. A non-member would benefit from all advantages of the internal liberalization without simultaneously being subject to the obligations deriving from the REIO membership and thus be a "free rider".

- The integration concept that applies in a REIO may differ substantially from the methods of investment liberalization generally used in international investment agreements. Under the latter agreements, investment liberalization is based on the standard of non-discrimination, that is, foreign investors must not be treated less favourably than domestic (or other foreign) investors. By contrast, investment liberalization in a REIO may also encompass the removal of all existing unjustified investment barriers, irrespective of whether they are discriminatory or not (as in the European Union). Without an MFN exception, such far-reaching rights would have to be granted by the REIO to non-members on a unilateral basis.

- In a REIO, it may not be the individual member State that decides on a liberalization measure, but the REIO as a whole. For example, in the European Union the individual member state has transferred its competence for internal investment liberalization to the Union. An implicit extension of this competence towards the external relations of the REIO via an MFN clause would not be covered by the REIO constitution.

- Third countries may be outside the institutional framework of the REIO. They may not participate in the internal decision-making process which may result in investment liberalization. They are not bound by awards of a REIO court, such as the European Court of Justice. Nor do they contribute to the budget of the REIO.

On the other hand, REIO clauses do not usually result in a complete and unconditional waiver of MFN. The GATS, for instance, prohibits a REIO member, when adopting a new liberalization measure, from increasing the overall level of investment barriers vis-à-vis non-members (article V(4)). Furthermore, once a foreign investor is established in a member country, it can usually claim the same treatment as investors from REIO member States. It is considered to be a domestic enterprise. In this case, the REIO clause does not apply with regard to treaty provisions dealing with investment protection, in particular provisions concerning expropriations and dispute settlement. The practical effects of the REIO clause are therefore, in principle, limited to market access issues. It allows REIO members to restrict foreign investors from outside the region in industries that are open for intra-regional investment.

d. Mutual recognition

Mutual recognition arrangements are a common feature facilitating the cross-border provision of services, including through a commercial presence. In these agreements, the contracting parties recognize the legal requirements of the partner country concerning the provision of a particular service as equivalent to their own domestic requirements. Foreign investors can therefore offer their services in the host country without having to obtain domestic licences or permits there, provided that they possess the equivalent licences or permits from their home countries. The industries most frequently open to mutual recognition arrangements are professional services and financial services (banking, insurance).

Similarly, some international agreements, while not creating new substantive law provisions, considerably facilitate the acquisition of intellectual property rights by providing for harmonized application procedures. Among the most relevant ones are the treaties concerning international co-operation in the field of patent matters, the Washington Treaty (dated 19 June 1970 (United Nations, 1980b)), the European Patent Convention (dated 5 October 1973) and the Strasbourg Convention concerning the international classification of patents (dated 24 March 1971 (United Nations, 1980c)). As third countries would not be bound by these rules, they cannot claim that they unilaterally benefit from the harmonization they entail.

An unlimited MFN provision may imply that a party to a mutual recognition arrangement is obliged also to recognize the regulations relating to a particular service in a third country, although a recognition agreement does not exist in this respect. The third country would have to show that its domestic regulations are identical (or at least equivalent) to those of the country with which the recognition arrangement has been concluded. But, even then, doubt would remain as to whether the MFN provision could be successfully invoked.

Mutual recognition arrangements imply -- by definition -- a reciprocal commitment. This concept would be undermined by unilaterally extending the benefits of the recognition arrangement to third countries. Moreover, a condition for a recognition arrangement is that the parties have agreed upon certain common standards that an applicant has to fulfill in their countries before, for example, a licence or permission, can be granted. As third countries would not be obliged to adhere to these standards, a basic condition for applying the recognition arrangement to them would not be met.

Despite the considerable practical importance of mutual recognition only the GATS (article VII) contains an explicit provision dealing with recognition arrangements. However, it is not, as one might suppose, a mere MFN exception. Rather, it encourages countries that have entered into such agreements to negotiate similar treaties with other States. This means, on the one hand, that the GATS does not consider the MFN standard, as such, as being applicable to recognition arrangements. Otherwise, the provision encouraging negotiations on this subject would make little sense. On the other hand, the GATS does not simply allow for an MFN exception. It goes one step further by encouraging a gradual multilateralization of mutual recognition arrangements by subsequent rounds of bilateral negotiations (GATS, article VII, paragraph 2).

e. Other bilateral issues

There are a number of other investment-related issues that are usually addressed only on a bilateral basis, and thus do not lend themselves to a multilateralization via an MFN provision. Examples are bilateral transportation agreements (involving landing rights for vessels or aircraft) and fishing arrangements. They are all based on the concept of reciprocity.

Despite their relevance for investment matters, international investment agreements have not yet explicitly dealt with these issues. The reason may be that the link with investment activities is weak. In the context of negotiations in the OECD on a Multilateral Agreement on Investment (MAI) (OECD, 1998), however, the possible need to make exceptions in this respect has been discussed.

3. Country-specific exceptions

Some treaties give contracting parties the right to make an MFN exception with regard to any measure, sector or activity, provided that the exception is listed in the country-specific schedule.

a. The GATS approach

Article II of the GATS states that, with respect to all measures covered by the Agreement, each member shall accord immediately and unconditionally to services and service suppliers of any other member treatment no less favourable than it accords to like services and service suppliers of any other country. According to paragraph 2, however, a member may maintain a measure inconsistent with paragraph 1, provided that such a measure is listed in, and meets the conditions of, the annex to the article. The annex states that the MFN exception should not apply for more than 10 years. Moreover, the exception is subject to revision in subsequent negotiating rounds. The GATS also includes a specific MFN exception for public procurement (article XIII). Furthermore, the application of MFN to the maritime transport sector has been suspended until the next round of negotiations (WTO, 1996).[2]

The GATS therefore allows member countries to make any exception to MFN that they can negotiate. They do not have to show that there is an exceptional situation that merits exceptional measures such as a threat to national security or a danger to public health. Nor is the right to make an exception limited to certain categories of agreements. The only constraint is that exceptions need to be made at the time of the entering into force of the GATS. The exceptions also continue to be subject to negotiations in subsequent rounds. Member countries therefore know at least the extent to which exceptions exist when the agreement becomes effective, and they can be sure that no additional exceptions can be made in the future.

The explanation for this approach towards an MFN exception is that the scope of the GATS is very broad. It covers, in general, any measure of a member country affecting trade in services, including a service provided through "commercial presence", that is, FDI. Thus, the scope of the MFN provision is equally broad. Member countries may therefore not always be able to apply the clause to the fullest extent possible. Moreover, the GATS' focus is not on investment protection per se in the same way as the bilateral and regional agreements analysed above.

b. The NAFTA approach

NAFTA (article 1108, paragraph 1) allows for an exception similar to that found in the GATS. Accordingly, the MFN clause does not apply to non-conforming measures maintained at the level of the federal, state or local government. In addition, it permits member countries to adopt new non-conforming measures in the future. This is permitted with regard to those sectors, subsectors or activities which a country has set out in a specific schedule. This allows the country to take any kind of discriminatory measure in the future against foreign investors in the sectors or with regard to the activities so designated (article 1108, paragraph 3). The only limit is that, under no circumstances may a contracting party require an investor from another party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective (article 1108, paragraph 4).

Furthermore, NAFTA includes MFN exceptions with regard to public procurement and subsidies provided by a contracting party or a state enterprise, including government-supported loans, guarantees and insurance (article 1108, paragraph 7). In addition, there are MFN exceptions in connection with intellectual property rights and other international agreements that contracting parties have set out in their schedule (article 1108, paragraphs 5 and 6).

The NAFTA approach is based on the consideration that there may be a need to make an MFN exception for possible measures in the future which cannot be exactly foreseen at the moment.

For instance, a contracting party may preserve its right to give certain subsidies only to domestically controlled enterprises, or to promote specific domestic economic activities.

Both the NAFTA and the GATS approach allow developing countries to make MFN exceptions for development purposes. Countries can identify those industries for which they would want to apply a policy of selective intervention and favour foreign investors of a particular nationality.

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From the foregoing, the current state of practice regarding the use of the MFN standard in investment agreements can be summarized as follows:

- Most BITs offer the unconditional post-entry MFN standard.
- Some BITs, notably those of the United States and Canada, and some regional agreements offer a pre- and post-entry MFN standard. (During the MAI negotiations, it was also envisaged to have binding rules for both for the pre- and post-establishment phases.)
- There are various *possible* exceptions to the MFN standard. These can be classified as general exceptions based on public policy or national security; reciprocal subject-matter specific exceptions; and country-specific exceptions. Furthermore, there are a number of other treaty-specific discretionary exceptions which, in general, not only cover any existing discrimination but also permit future departures from MFN. These exceptions arise in respect of public procurement, government loans, subsidies, insurance agreements and intellectual property agreements.

Notwithstanding the necessarily extensive discussion of exceptions, it must be stressed that the majority of bilateral agreements contain very few exceptions to the MFN standard, even though most (if not all) BITs contain an exception for taxation; many also have an exception for REIOs. However, conditions and exceptions become more likely where more parties are added to an agreement.

Notes

1 The supplementary treaty had not been signed as of November 1998.
2 Decision adopted by the Council for Trade in Services on 28 June 1996.

Section III

INTERACTION WITH OTHER ISSUES AND CONCEPTS

MFN interacts with nearly all investment-related issues discussed in this series. The key interactions are highlighted in table 1.

Table 1. Interaction across issues and concepts

Concepts in other papers	Most-favoured-nation treatment
Scope and definition	+
Admission and establishment	++
Incentives	++
Investment-related trade measures	+
National treatment	++
Fair and equitable treatment	++
Taxation	+
Transfer pricing	+
Competition	++
Transfer of technology	+
Employment	+
Social responsibility	+
Environment	+
Home country measures	+
Host country operational measures	++
Illicit payments	+
Taking of property	++
State contracts	+
Funds transfer	+
Transparency	+
Dispute settlement (investor-State)	+
Dispute settlement (State-State)	+
Modalities and implementation	+

Source: UNCTAD.
Key: 0 = no interaction.
\+ = moderate interaction.
++ = extensive interaction.

- **Admission and establishment**. Host countries can restrict or even prohibit FDI in certain industries. The main purpose of doing so is to promote indigenous capacities, especially a host country's technological development. Or, while being open to foreign investors, a host country can offer special incentives for investment in particular economic activities. The host country thereby seeks to attract those foreign investors and activities that are particularly conducive to the upgrading of the domestic economy and the deepening of its own technological infrastructure. In both alternatives, the question is whether these policies are influenced by MFN considerations.

  Restrictions on the entry of foreign investment usually apply to particular industries or activities, not to the nationality of a particular foreign investor. To the extent that restrictions exist, they do not differentiate between investors from different home countries. As the purpose of these restrictions is to shield domestic enterprises from foreign competition in general, the entry barriers would have to apply to all foreign investors in order to be effective. Thus, market access is denied on a non-discriminatory basis. This entails an exception to NT (UNCTAD, 1999a), not to MFN.

- **Incentives**. Notwithstanding the general importance of the NT standard, there is one policy area in which MFN applies and NT does not necessarily do so. A host country may sometimes grant special investment incentives for foreign investors only. In cases where domestic investors cannot claim the same privileges, NT becomes irrelevant. On the other hand, the MFN standard does not give foreign investors full protection against possible discrimination in this field. The MFN clause would only apply to general incentive programmes designed for a particular industry as a whole. By contrast, the MFN standard would be of no avail with regard to so-called one-off deals in which a host country grants an incentive on an individual basis (see section I above).

- **National treatment**. There is a strong link between the MFN and the NT standard (UNCTAD, 1999c). The latter means that foreign investors must not be treated less favourably than domestic investors in a host country. MFN alone does not seem to be enough to exclude possible discrimination against foreign investors. It is therefore supplemented by

NT in order to guarantee a more fully non-discriminatory legal environment. Otherwise, a host country could favour its domestic enterprises by ensuring them better treatment and a privileged place in the domestic market. In the extreme case, a host country could deny foreign investors all rights. As long as this happens on a non-discriminatory basis, it would not violate the MFN standard. It is the combination of the two standards, and the degree to which exceptions to both standards exist, that determines whether the legal situation in a host country is attractive to foreign investors or not.

It should be noted that exceptions to NT are more frequent than exceptions to MFN. This reflects the fact that countries find it more difficult to treat foreign and domestic investors equally than to provide for equal treatment among investors from different home countries. Furthermore, there may be special situations in which a privileged treatment of domestic enterprises can be justified (see below, Conclusion).

While MFN and NT are two distinct legal concepts, there may be situations in which the standards interfere with each other. If country X grants MFN to investors from country Y and NT to investors from country Z, it seems that investors from country Y could likewise claim NT via the MFN clause. However, the result would be different if country X has explicitly taken an exception to NT vis-à-vis country Y. In this case, MFN is not tantamount to NT.

Furthermore, a question may arise about which treatment prevails if a foreign investor can claim NT and MFN. Some investment agreements contain an explicit rule in this respect, entitling investors to the more favourable of the two standards of treatment. One example is the Energy Charter Treaty (article 10, paragraph 3). This becomes relevant in cases in which the two standards lead to different results. For instance, NT would mean that foreign investors could own up to 100 per cent of their affiliates in a host country, whereas they might have to respect ownership restrictions under MFN.

The above-mentioned rule raises a number of questions that -- it seems -- have not been dealt with so far in the international legal arena. First, it may be difficult to assess whether NT or MFN results in "better" treatment. For instance, with regard to dispute settlement, NT would mean that a foreign investor can sue a host government before its national courts -- like any domestic investor. MFN may allow a foreign investor to chose international arbitration. What kind of dispute settlement is more favourable? Furthermore, should one apply objective criteria for making this assessment, or is it a subjective judgment? In the latter case, should it be the opinion of the investor which matters or the host government which decides?

Moreover, one may ask whether the assessment needs to be made in respect of an individual case, or with regard to the issue in general. To revert to the above-mentioned example as regards dispute settlement, domestic law (the application of NT) may provide a foreign investor with a greater choice of judicial remedies than would be available under international arbitration. Could the investor nevertheless opt for the latter, because in the current situation the domestic courts of the host country do not function properly (for instance in a situation of political turmoil)?

Another issue is whether the "whichever-is-more-favourable" formula would allow investors to follow a "pick-and-choose" strategy. While NT might be better for them in respect of certain aspects of their investment activities, they may prefer MFN with regard to others (for instance in the exceptional case that MFN is better than NT -- so-called "reverse discrimination"). One may argue that foreign investors have to decide whether they want to be treated like a domestic enterprise (NT applies), or like a foreign company (MFN), and that, consequently, they should not be entitled to a "mixed" treatment. Still, the difficulty would remain how to assess whether -- all investment activities considered -- NT or MFN is more favourable. Moreover, the preference for one particular treatment may change over time as the legal framework for investment in a host country changes.

One might ask whether MFN alone would be sufficient in a host country where a given industry is dominated by foreign investors. In this case, NT would not be needed for governmental measures and programmes that apply to this industry only. However, NT would still be important for all laws and regulations of a general nature.

- **Fair and equitable treatment**. MFN and fair and equitable treatment (UNCTAD, 1999d) may both be inserted into the same clause covering post-entry treatment of an investment. Although MFN and fair and equitable treatment may often lead to the same legal result, the two standards are not identical.

- **Competition**. The MFN standard needs to be understood in relation to competition laws, in particular antitrust rules (UNCTAD, 1997). In the absence of effective competition policy, the first foreign investor entering a host country may be able to acquire a monopolistic position. An MFN commitment would be of no help for subsequent competitors trying to break the monopoly. Likewise, MFN in the post-establishment phase could be undermined if the foreign investor is not protected against unfair competition from other foreign companies. Only competition laws can respond to these cases in order to restore a balance of competition between foreign investors operating on the host country market.

- **Host country operational measures.** As part of their individual development strategies, host countries sometimes impose upon foreign investors certain operational conditions, such as local content requirements or transfer of technology. Most BITs do not contain explicit provisions on this subject. However, such measures would be covered by the general MFN rule, because they relate to the "operation and maintenance" of an investment. A host country would therefore not be allowed to impose different requirements on foreign investors of different nationalities. This prohibition does not exist under the TRIMs Agreement, which imposes obligations on parties only in respect of the NT standard and quantitative restrictions.

- **Taking of property**. The importance of the MFN standard is underlined by the fact that it appears in other investment treaty provisions as well, in particular in rules on expropriation and protection from strife. The latter concept relates to losses that a foreign investor may suffer in a host country due to war or other armed conflict, a state of emergency, revolution, insurrection, civil disturbance or any other similar event. Any expropriation has to be non-discriminatory -- which includes MFN. With regard to protection from strife, a host country usually commits itself not to discriminate if it decides to pay compensation for the loss suffered; once again, the MFN standard applies.

In addition, there are two areas that are not covered separately in this series, but which nevertheless deserve mentioning as they bear on the consideration of MFN in international investment agreements:

- **Trade policy**. A major portion of international trade takes place among the various entities of TNCs. Furthermore, FDI can create new trade flows, and trade measures can influence FDI flows (UNCTAD, 1999e). With the growth of investment activities and the establishment of worldwide networks of integrated production, the interdependence between trade and investment policies is stronger than before (UNCTAD, 1996b). The entities of a TNC are no longer quasi-autonomous, but tend to be closely interlinked by various production, trade and technology channels (UNCTAD, 1993).

  The question arises as to whether an obligation to grant MFN in investment matters would automatically extend to trade as well. This may be the case because, as discussed before (section I), the MFN standard has a broad scope and covers, *inter alia*, the maintenance and use of an investment. One might argue that the trade relations of a TNC are part of these activities. Thus the MFN standard in respect of investment matters could prohibit a country from discriminating against foreign investors with regard to their trade activities. The conclusion of a preferential trade agreement with a particular country would, as such, not amount to discrimination, because any investor could, in principle, benefit from it. The assessment may be different if there is substantial intra-firm trade in competing TNCs. In this case, a parent company located in country X and its foreign affiliates would be unilaterally favoured. This could amount to *de facto* discrimination. However, to the extent that this preferential treatment is covered by an MFN exception under the WTO, this exception may also cover the investment-related MFN clause.

  One might also pose the question the other way round and ask whether MFN in trade could be automatically extended to investment. This could be the case if investment could be considered as one possible means of doing trade. In general, trade and investment are regarded as two substantially different ways to supply a foreign market. However, as the example of the GATS shows, trade (in services) may include a commercial presence in the host country. If an international agreement contains such a broad definition of "trade", MFN in trade would therefore encompass investment as well.

- **International minimum standard**. Legal doctrine distinguishes the MFN standard from the so-called "international minimum standard" which is considered part of customary international law. The latter standard prohibits treatment that amounts "to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency" (United States v. Mexico, 1926, pp. 61-62). Investment protection agreements usually refer to this standard by prohibiting any arbitrary or unreasonable action. Discrimination based on the nationality of an investor does not as such violate this standard. There may be valid reasons why a country would like to give preferential treatment to investors of a particular nationality. The MFN standard can therefore substantially improve the situation for foreign investors that would otherwise prevail under customary international law. It should also be remembered that, as a treaty-based standard, MFN ensures a binding obligation to which the disputed international minimum standards often do not apply.

* * *

The interaction between the MFN standard and other issues and concepts can therefore be summarized as follows:

- There are strong links between MFN and other investment-related concepts.

- The importance of the MFN standard is underlined by the fact that it applies to a broad range of issues, including investment incentives, trade and competition policies.

- The MFN standard alone is usually not sufficient to secure non-discriminatory treatment in the host country. It works, but if accompanied by the NT standard.

CONCLUSION:

ECONOMIC AND DEVELOPMENT IMPLICATIONS AND POLICY OPTIONS

The above analysis has shown that the MFN standard, as such, is widely used and that, at the same time, exceptions and reservations to the standard exist. In determining the contents of an MFN clause, two sets of options arise:

- whether to limit MFN to post-entry treatment only or to extend the standard to both pre-entry and post-entry treatment;

- whether to make exceptions to the application of the standard in either case.

As regards the first issue, much depends, to begin with, on whether a country differentiates between pre-entry and post-entry treatment in general. The next question would be whether the prevailing circumstances or the national policies in effect involve treating investors from different countries in different ways. These matters are discussed further in the Issues Paper on Admission and Establishment (UNCTAD, 1999b).

With regard to exceptions, three broad categories can be distinguished. The first includes general exceptions based on public policy or national security; these are not targeted at MFN per se but they can indirectly limit its application. The second allows MFN exceptions only in respect of a limited range of sectors or matters agreed beforehand by all contracting parties (especially, taxation, intellectual property, REIO, mutual recognition, transportation). The third approach gives more freedom to the parties and allows them, in principle, to make exceptions of their own choosing, provided that the exception is listed in country-specific schedules (e.g. with regard to subsidies).

A. Development strategies and MFN

In the past -- and in the present to a lesser extent -- national policies of developing countries concerning FDI have varied considerably. At opposite ends of the spectrum are open-door policies with no attempt at intervention either in the flow of international investment or in the behaviour of investors, and highly restrictive policies with prohibitions on foreign investment. It is not the purpose of the present analysis to assess which policy best promotes economic development (UNCTAD, 1999f). Rather, the question is whether MFN considerations play a particular role in the case of developing countries.

The countries that apply liberal policies vis-à-vis foreign investors assume presumably that foreign investment is a means for increasing local productivity and competitiveness. The MFN standard has been an inherent part of their development policies, since after all an open-door policy means that no restrictions on, or discrimination between, foreign investors are in effect that are based on the nationality of the investor.

On the other hand, there have also been strategies of selective intervention. Countries pursuing these strategies seek to steer foreign investors into those activities they consider particularly important for their economic development (Agosin and Prieto, 1993). There is evidence that such a policy can contribute to an acceleration and deepening of the process of industrial development in particular. This approach requires the identification of activities in which a country can reasonably expect to acquire a comparative advantage and the promotion of production in such areas.[1]

It may be argued that an exception to MFN based on the nationality of foreign investors would be consistent with the strategy of a host country that has made the judgement that the best way to pursue the economic development of the country is to establish and maintain special economic relations with one or several specific other countries, which would be selected as strategic partners. The countries concerned would thus grant market access or other special privileges only to investors from these countries. Such a strategy assumes that one or several countries with strategic advantages over other potential partners could be identified (and that granting the same conditions to investors from other countries would undermine this strategic partnership). The host country would align its own pattern of comparative advantages and its stage of development to the comparative advantages of the partner.

What is not clear is why obtaining the desired investment from one set of investors would be more desirable than obtaining them from another set of investors, as long as the underlying development objectives are being served. Rather, it would appear that strategies of this type are normally based on a distinction between foreign and domestic investors and *not* on a distinction among foreign investors.[2]

B. The use of exceptions

As has been suggested above, host countries can pursue their development strategies without discrimination among investors from different foreign countries. However, as they become more integrated into the global economy, they may, in some cases, need to make use of MFN-specific exceptions, even though these may not necessarily be inspired by development considerations.

In particular, a number of reciprocal subject-specific exceptions appear to be accepted. For example, the more a country develops a network of bilateral double taxation agreements, the more it may be faced with the issue of MFN exceptions in this respect. Mutual recognition arrangements are another area that would be undermined by a unilateral extension of benefits of an arrangement to third countries. Finally, countries may increasingly seek recourse to MFN exceptions through REIO clauses.[3]

* * *

In conclusion, it needs to be reaffirmed that the MFN standard is at the heart of multilateralism and is a core principle in international investment agreement. At the same time, the standard allows flexibility for countries to pursue their policies, both in relation to the question of the treatment of foreign investment before and after entry, and through exceptions and reservations to the MFN standard. But, the fact that various ways to limit MFN have been discussed on the basis of an analysis of existing agreements is not meant to suggest that any of these ways are advocated. Rather, whether or not a country actually wants to utilize any of these exceptions needs to be evaluated by it, in the context of its specific conditions. Exceptions to MFN would only exceptionally be justified for development purposes.

Notes

1 It can be carried out either by way of controls over the entry of investors, where this can protect indigenous technological development, or by providing special incentives for foreign investment in activities in which foreign participation is seen as desirable. In the latter case, the purpose is to guide the resource allocation of foreign investors and to induce them to locate more complex functions in host countries than they would otherwise have done. Such a policy may in addition use certain performance requirements to try to advance economic development in certain respects.

2 In any case, an MFN exception on these grounds might cause "victim" countries to retaliate, in particular by denying the host country MFN as well. As an increasing number of firms from a growing number of countries become foreign investors, such retaliation could have adverse economic consequences.

3 As to the last of these cases, a question concerns the stage of integration at which an MFN exception may be justified. One approach is that an exception can be justified if integration within a region is *qualitatively* different from integration based only on the standard of non-discrimination (see section II). The REIO may therefore have to reach a stage in which member States have committed themselves to removing virtually all barriers to cross-border investment, irrespective of whether these barriers are discriminatory or not. As long as the REIO members have only accepted the standard of non-discrimination amongst themselves, an MFN exception with regard to non-members may be more difficult to justify.

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