UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

INTERNATIONAL INVESTMENT AGREEMENTS: FLEXIBILITY FOR DEVELOPMENT

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Preface

The United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on international investment agreements, 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 that 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, Khalil Hamdani and Pedro Roffe. The principal officer responsible for its production is John Gara, who oversees the development of papers at various stages. The other members of the team include S.M. Bushehri, Anna Joubin-Bret, Patricia Mira Pontón, Aimé Murigande and Jörg Weber. The series' principal advisors are Arghyrios A. Fatouros, Sanjaya Lall and Peter Muchlinski.

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Secretary-General of UNCTAD

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Executive summary

Developing countries seek foreign direct investment (FDI) in order to promote their economic development. This is their paramount objective. To that end, they have sought to establish — through national legislation and international instruments — a legal framework aimed at reducing obstacles to FDI, while providing foreign investors with high standards of treatment and legal protection for their investments and increasingly putting in place mechanisms to assure the proper functioning of markets.

Developing countries participate in international investment agreements (IIAs) — whether at bilateral, regional, interregional or multilateral levels — because they believe that, on balance, these instruments help them to attract FDI and to benefit from it. At the same time, IIAs, like most international agreements, limit to a certain extent the policy options available to governments to pursue their development objectives through FDI. A question arises, therefore, how, nevertheless, IIAs can allow developing countries a certain policy space to promote their development. This is all the more important since the principal responsibility for the design and implementation of development objectives and policies remains in the hands of the individual countries' governments.

Thus, when concluding IIAs, developing countries face a basic challenge: how to achieve the goal of creating an appropriate stable, predictable and transparent FDI policy framework that enables firms to advance their corporate objectives, while, at the same time, retaining a margin of freedom necessary to pursue their particular national development objectives.

A concept that can help link these objectives is "flexibility" which, for present purposes, can be defined as the ability of IIAs to be adapted to the particular conditions prevailing in developing countries and to the realities of the economic asymmetries between these countries and developed countries.

Flexibility can be approached from four main angles: the objectives of IIAs, their overall structure and modes of participation, their substantive provisions and their application.

Objectives. IIAs often address development concerns by including in their text, usually in their preamble, declaratory statements referring to the promotion of development as a main objective of the agreement, or to specific ways by which the agreement is to contribute to development objectives, or a generally worded recognition of the needs of developing and/or least developed country parties requiring flexibility in the operation of the obligations under the agreement. There are many variations in such language, and it is difficult to generalize its actual role and importance. Preambles and similar declarations normally do not directly create rights and obligations for the parties to an instrument, but they are relevant to its interpretation. In fact, the texts of preambles are often the result of hard bargaining. To the extent that such language reflects the will of the participating countries, it helps to reaffirm the acceptance of development as a central purpose of IIAs. The specific language used in each case and its relationship to the rest of the instrument is, of course, important.

Overall structure and modes of participation: special and differential treatment. Promotion of development can also be manifested in the structure of IIAs. Central to this is the application of special principles and rules for developing countries which have as their common characteristic that these countries assume less onerous obligations — either permanently or temporarily — on a non-reciprocal basis. This approach is reflected in the principle of "special and differential treatment" for developing countries (or categories among them). Broadly speaking, this principle encompasses such aspects as granting lower levels of obligations for developing countries; asymmetrically phased implementation timetables; best endeavour commitments; exceptions from commitments in certain areas; flexibility in the application of, and adherence to, disciplines under prescribed circumstances; and technical assistance and training. A key issue in dealing with the principle of special and differential treatment is whether a broad spectrum of flexibility should be given to the beneficiaries,

or whether well defined criteria should be established. One way of applying the principle of special and differential treatment in the structure of an agreement is to distinguish between developed and developing countries by establishing, for instance, separate categories of countries, the members of which do not have the same rights and duties. Beyond that, international practice has evolved a number of methods to allow countries that wish to participate in an agreement to do so in ways that take into account their individual situations. Although the methods in question may be used, in principle, by any country, they can be particularly relevant as a means of addressing development concerns. The principal methods can be grouped into two main approaches. The first approach is to allow for different stages and degrees of participation in an IIA, by, for example, allowing countries to accede to an agreement at different times and in different ways; or permitting countries that are not ready to become full members of an IIA to be associated with it or to cooperate on matters of mutual interest. The second approach to structural flexibility is to allow the inclusion of various kinds of exceptions, reservations, derogations, waivers or transitional arrangements. Exceptions take a great variety of forms: they may be general (e.g. for the protection of national security), subject specific (e.g. the so-called "cultural exception"), or they may be country specific. A subset of this approach is the use of "positive" and "negative" lists. Finally, an investment framework can be built consisting of several instruments that can be negotiated over time and combine a variety of approaches.

By using these or other methods, IIAs can be constructed in a manner that ensures an overall balance of rights and obligations for all actors involved, so that all parties derive benefits from it.

Substantive provisions. The substantive content of an IIA is particularly important in reflecting development concerns and an overall balance of rights and obligations. This begins with the choices countries make about the issues they wish to include in an IIA, and those they wish to keep outside the scope of an agreement. (The range of relevant issues is reflected in the topics covered in the individual papers of the *IIA Series*.) It continues with the formulation of the substantive provisions, through ways that allow

countries to address the issues in a manner beneficial to them and, when need arises, to retain some flexibility regarding the commitments they made, keeping also in mind the various interactions between issues and provisions. The range of approaches and permutations that can be used in formulating substantive provisions in IIAs is broad. Of course, flexibility might need to be approached in different ways for each individual substantive issue, depending on its characteristics and development effects. For example, the type of approach to flexibility that can be useful in a development context regarding admission and establishment of foreign affiliates might not be relevant to post-establishment national and MFN treatment provisions, or to expropriation, labour or environmental standards. There are no general prescriptions on this matter. The choice of approach depends on the conditions prevailing in each country and the particular development strategies pursued by each government.

Application. Flexibility for development can also be exercised during the application stage of an IIA. The manner in which an IIA is interpreted, and the way in which it is to be made effective determine whether its objectives, structure and substantive provisions produce, in the end, the desired developmental effects. The degree of flexibility for the interpretation and application of an IIA depends to a large extent on the legal character of an agreement and the formulation of individual provisions. Legally-binding agreements, even if they do not provide for implementation mechanisms, impose on the States signatories a legal obligation under international law to comply with their provisions. How far such an obligation will actually limit the subsequent freedom of action of the States concerned largely depends on the language of the agreement or the type of obligations imposed. Voluntary instruments, on the other hand, are not legally enforceable but can have an influence on the development of national and international law. One way of mitigating some of the most rigorous implications of concluding a legally-binding investment agreement is to include one or several "soft" obligations among its binding provisions.

Many IIA provisions require some kind of action at the national level in order to produce their effects. Where explicit provisions requiring specific national action are absent, each State would

be free to decide the particular manner in which it may implement an agreement's provisions. Variations in normative intensity and specificity of language regarding the effects of IIAs on national systems provide possibilities for developing countries to advance their development interests. At the regional and multilateral levels, the effectiveness of an IIA is intimately related to the intergovernmental institutional machinery for following up and monitoring its application, including through built-in agendas. There are various mechanisms that can be created, ranging from simple reporting requirements (which nevertheless can be a significant inducement to act in compliance), to advisory and consultative functions (aimed at resolving questions arising out of the continuing application of an IIA), to complaint and clarification mechanisms (aimed at facilitating application of non-binding instruments under procedures of a non adjudicatory nature), to various international methods of settlement of disputes which may allow more or less freedom to the parties to accept proposed ways for the resolution of the dispute. Finally, an agreement might eventually need partial or extensive revisions. This is a fundamental facet of the entire process of the elaboration of an IIA, which is to be understood as a continuing process of interaction, review and adjustment to changing realities and to new perceptions of problems and possibilities.

In fulfilling its various functions, an international institutional machinery can play several major development roles. It is therefore of critical importance for developing countries to make the best use of the means provided by the relevant institutional arrangements for follow up, including the review of built-in agendas, to ensure that the development objectives are given full effect. An important consideration in this respect are the difficulties that many developing countries experience in participating fully and effectively in these arrangements due to lack of adequate skills and resources. To address such difficulties, IIAs can make special provision for technical and financial assistance. In addition, to ensure that the development goals of an IIA are fully realized, it may be desirable that developed countries commit themselves to undertake promotional measures to encourage FDI flows to developing countries.

In conclusion, it needs to be re-emphasized that IIAs, like all international agreements, typically contain obligations that, by their very nature, reduce to some extent the autonomy of the participating countries. At the same time, such agreements need to recognize important differences in the characteristics of the parties involved, in particular the economic asymmetries and levels of development between developing and developed countries. If IIAs do not allow developing countries to pursue their fundamental objective of advancing their development — indeed make a positive contribution to this objective — they run the risk of being of little or no interest to them. This underlines the importance of designing, from the outset, IIAs in a manner that allows their parties a certain degree of flexibility in pursuing their development objectives. To find the proper balance between obligations and flexibility — a balance that leaves sufficient space for development-oriented national policies — is indeed a difficult challenge faced by negotiators of IIAs. This is particularly important as treaty-making activity in this area at all levels has intensified in recent years.

INTRODUCTION

During the 1990s, the number of international agreements dealing with foreign investment increased dramatically at the bilateral, regional and interregional levels. As the new millennium begins, negotiating activity in this area continues to be intense. Many of these instruments and negotiations involve countries at different levels of development. Indeed, the full participation of developing countries in international investment agreements (IIAs) is important, given that these countries are increasingly becoming destinations and even, slowly, important sources of foreign direct investment (FDI). While developing countries acknowledge the value of FDI for their economic growth and development, they are equally keen that IIAs in which they participate strike a balance between the interests of foreign investors and the national development objectives of host countries. In particular, they consider that development needs and concerns should be built into IIAs, to enable developing countries to pursue their development policies according to their own needs and conditions.

The present paper deals with this question and examines ways in which IIAs can provide for flexibility with a view towards promoting development, while encouraging FDI and providing stability and predictability in investment relations. The paper first discusses briefly the meaning and purpose of flexibility in the interest of development in the context of IIAs (chapter I) and then looks at how existing IIAs have provided for flexibility from four main angles: the objectives of an agreement (chapter II), its overall structure and modes of participation (chapter III), its substantive provisions (chapter IV) and its application (chapter V). The paper reflects discussions during the three expert meetings convened by the Commission on Investment, Technology and Related Financial Issues during 1997-1999, dealing with existing IIAs and their development dimensions.[1] As recommended by the third expert meeting, it revises and expands the Note submitted by the UNCTAD secretariat to the Expert Meeting entitled "International investment agreements: concepts allowing for a certain flexibility in the interest of development" (UNCTAD, 1999a).[2]

Notes

1 The first expert meeting, held from 28 to 30 May 1997, dealt with bilateral investment treaties and their development dimensions. The second expert meeting took place from 1 to 3 April 1998 and focused on regional and multilateral investment agreements, examining in particular the nature and implications of those agreements, the range of issues addressed by them and the extent to which the development dimension was taken into account. The third expert meeting, held from 24 to 26 March 1999, dealt with the question of flexibility in IIAs and looked into the ways in which flexibility with respect to development concerns has been given effect in existing agreements.

2 The Expert Meeting recommended that "the report submitted by the UNCTAD secretariat entitled "International investment agreements: concepts allowing for a certain flexibility in the interest of promoting growth and development" be revised in light of the discussions during the Expert Meeting and submitted to the next session of the Commission" (see "Agreed Conclusions", UNCTAD, 1999b, p. 2).

PART ONE:

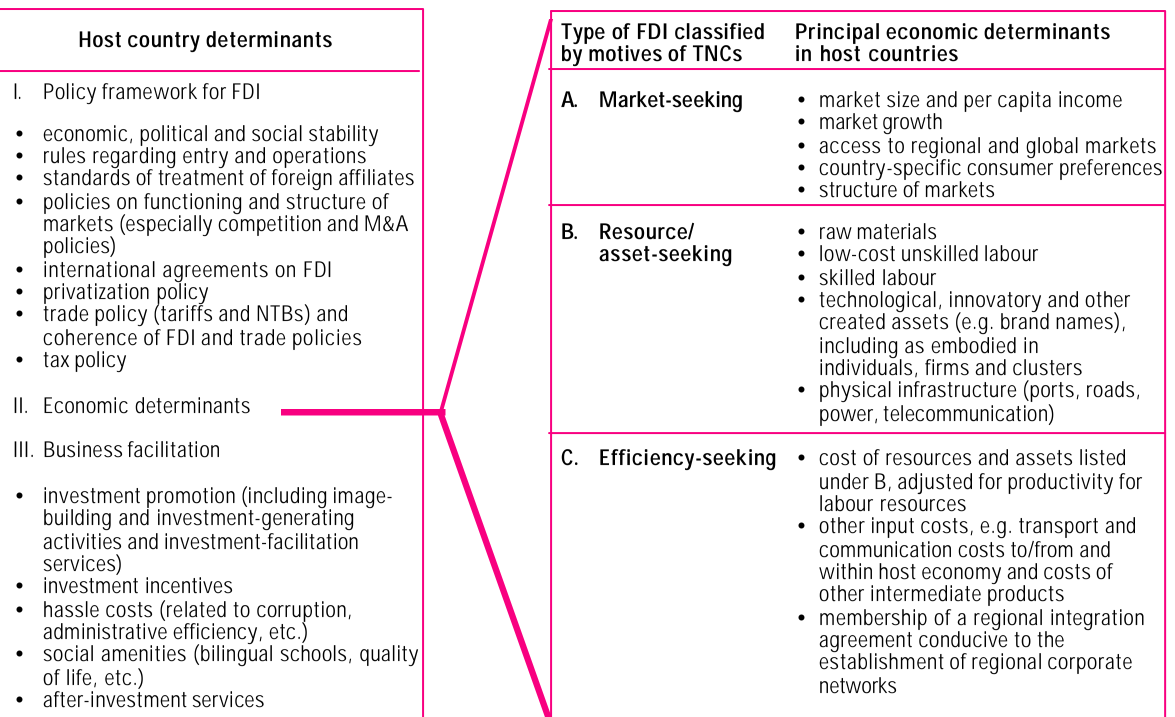
FLEXIBILITY

I. FLEXIBILITY IN THE INTEREST OF DEVELOPMENT

Development is a fundamental objective of developing countries and has generally been accepted as a goal of the international community as a whole.[1] Crucially, this involves the attainment of sufficient levels of economic growth to allow for a progressive improvement in the material standard of living of the populations of these countries. However, it also encompasses wider social objectives for which wealth creation is only a starting point. Thus, not only economic but social, political and cultural issues are involved in the process of development, a factor which development-oriented policies on FDI need to take into account (UNCTAD, 1999c).

Today, most developing countries seek to attract FDI as part of their development strategies.[2] Although economic factors are the principal determinants of FDI flows (figure I.1), an appropriate enabling policy and normative framework has a role to play (UNCTAD, 1998a, ch. IV). Virtually all countries have sought to establish such a framework through the liberalisation of relevant FDI laws and regulations. They have done so by reducing obstacles to FDI (e.g. facilitating entry and operations), strengthening the standards of treatment of foreign affiliates by host countries (e.g. by providing national treatment) and by seeking to ensure the proper functioning of the market (especially through competition policies) (figure I.2). While most liberalisation measures have been taken unilaterally by host countries, some have also been enshrined in IIAs, especially bilateral investment treaties (BITs) and regional agreements.[3] Governments conclude such agreements because they believe that, on balance, they help them to attract FDI and to benefit from it. At the same time, IIAs, by their very nature, limit to a certain extent the freedom of action of the parties involved. Governments seek, therefore, to tailor such agreements in a manner that allows them the policy space they need to advance their paramount objective of *national* development (Corrales, 1999).

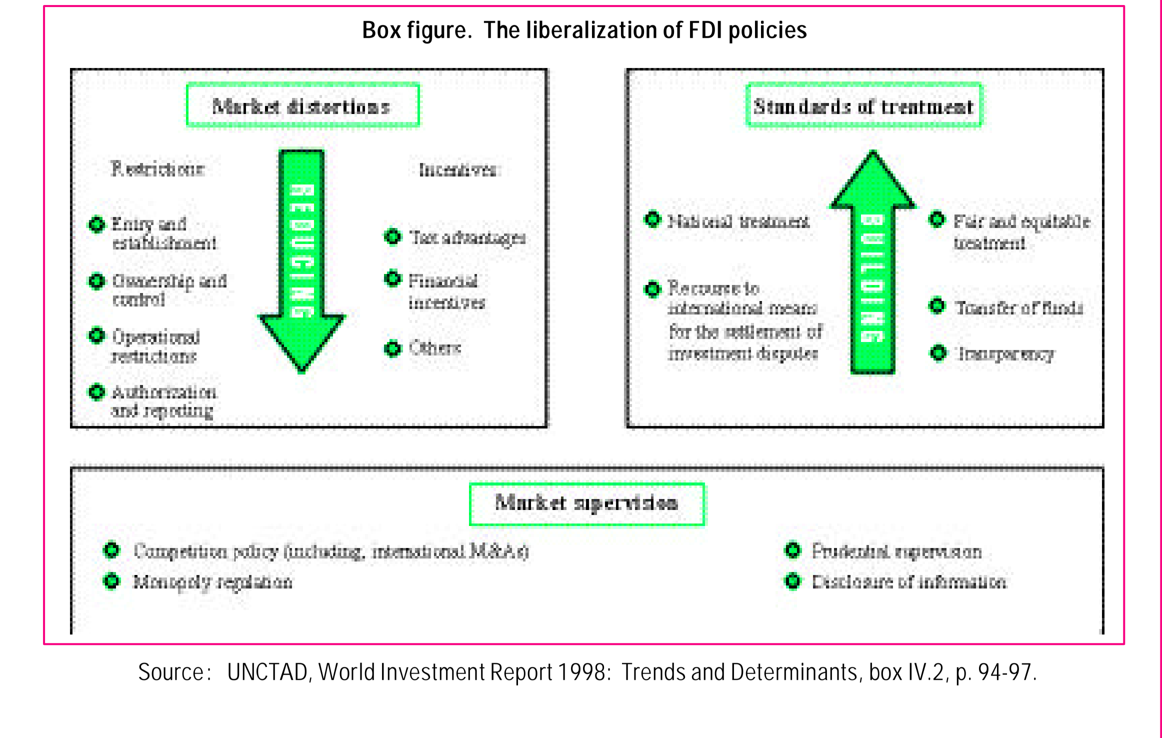
Figure I.1. Host country determinants of FDI



Source: UNCTAD, World Investment Report 1998: Trends and Determinants, table IV.1, p. 91.

Figure I.2. The process of liberalization of FDI policies

Box figure. The liberalization of FDI policies



Source: UNCTAD, World Investment Report 1998: Trends and Determinants, box IV.2, p. 94-97.

Transnational corporations (TNCs), for their part, seek to advance their paramount corporate objectives of competitiveness and profitability. They do that, by definition, in an *international* context. In a globalizing world economy, this means increasingly that TNCs need to acquire a portfolio of locational assets to obtain access to markets and resources (UNCTAD, 1995). An enabling FDI framework is therefore important for them, especially one that is stable, predictable and transparent, and one that is guaranteed to remain so through international agreement.

Seeking to advance *national* development and *international* corporate competitiveness are not mutually exclusive objectives. On the contrary: "generally speaking, an investor-friendly agreement will be development-friendly also" (Ganesan, 1998, p. 8). But the overlap is not complete. Indeed, it is the task of national policies to see to it that the benefits of FDI are maximised while its costs are minimized (UNCTAD, 1999c). Ideally, this task should be further helped by IIAs — or, at a minimum, it should not be hindered by them.[4]

This poses a challenge: namely, how to link, when concluding IIAs, the quest for an appropriate policy space that governments require to pursue their national development objectives with the quest for an appropriate stable, predictable and transparent FDI policy framework through which firms seek to advance their corporate competitiveness objectives. This challenge is all the more important as the number of IIAs at all levels is growing rapidly (UNCTAD, 1999c, ch. IV, and 2000). It is further complicated by the fact that, while countries parties to IIAs are often at widely differing levels of economic and technological development and differ from one another in many other important respects (economic asymmetry), they are usually formally equal (legal symmetry). As it is generally recognized that IIAs need to take into account the interests and concerns of all participating countries (UNCTAD, 1996b), the economic asymmetries require special attention to ensure that the application of an agreement does not increase these asymmetries, but positively contributes to the aim of development.[5]

A concept that can help link these two objectives is "flexibility". "Flexibility" is a broad concept. It denotes an instrument's ability

to serve, and to be adapted to, several differing uses and functions. The flexibility considered here relates to a particular set of objectives, those that concern the promotion of the development of developing countries parties to IIAs, without losing sight of the need for stability, predictability and transparency for investors.[6] More specifically, the function of flexibility is to adapt IIAs to the particular conditions prevailing in developing countries and to the realities of the economic asymmetries between these countries and developed countries, which act as the home to most TNCs.[7] This is particularly challenging in view of the fact that developing countries are a heterogeneous group. Their approach to utilising FDI for their development varies therefore widely. Consequently, the flexibility built into IIAs may not be equally relevant to each party; this depends on the conditions prevailing in each country and the particular development strategies pursued by each government.

In fact, whatever flexibility there is in an IIA may not be used by each country in the same manner. Nonetheless, from the point of view of developing countries, IIAs need to be designed, from the start, with development considerations in mind. At the same time, a distinction needs to be made between flexibility in the interest of development on the one hand, and arbitrariness, or excessive discretion, in dealing with foreign investors, on the other hand. In short, in order to be viable, IIAs need to strike a balance between the interests of all concerned. The question is not so much whether IIAs should provide for flexibility, but rather what degree of flexibility would be consistent with the aims and functions of such agreements. In other words, there is a need to balance flexibility and commitments, in order to arrive at a realistic level of flexibility and commitment from each contracting party according to its state of development.

A matter of functional significance, therefore, is the identification of features of IIAs that can provide for flexibility in these agreements in the interest of development while, at the same time, allowing the agreements to serve other objectives, in particular stability, predictability and transparency. Ways and means in which flexibility with respect to development concerns can be given effect in IIAs are examined in Part Two.

Notes

1 Regarding the right to development, see chapter II and box II.4 below.

2 For a discussion of the role of FDI in development, see UNCTAD, 1999c, d.

3 For a collection of these agreements, see UNCTAD, 1996a and 2000.

4 Increasingly, outward investment is becoming part of the development strategies of developing countries. Thus, it is important that discussions on investment facilitation and promotion in the interest of development do not lose sight of the potential home country status of developing countries. This is not, however, the focus of this paper. For a detailed discussion of developing country strategies on outward investment, see UNCTAD, 1995.

5 The legal symmetry/economic asymmetry situation is best illustrated by the older BITs which were usually intended to govern investment relations between a developed capital exporting country and a developing capital importing country. Although the developing country party enjoyed under the BIT reciprocal rights -- to national treatment etc. -- for the protection of its investors in the territory of the developed country partner, the reality was that, in practice, it would have little investment in that other State. Thus, the rights in a BIT which related to the capital exporting capacity of a party were, in so far as the developing treaty partner were concerned, effectively "paper rights", at any rate until the developing country's firms invested in the territory of its developed treaty partner. This is now beginning to happen as firms in a number of developing countries are becoming outward investors.

6 Developed countries also often seek flexibility in IIAs for their own reasons (e.g. to allow subnational authorities to implement their own policy measures on FDI, in accordance with their constitutional powers). Thus, while flexibility is primarily seen here in a development context, it may have other functions as well. Moreover, IIAs may need to introduce an element of flexibility simply because it is not possible for the parties to foresee all possible future developments that may affect the operation of their provisions.

7 It should be noted that all developed countries are also host countries and that (as observed earlier) an increasing number of developing countries are becoming home countries.

PART TWO:

APPROACHES TO FLEXIBILITY

The manner in which flexibility in the interest of development is approached in an IIA depends to a large extent on the characteristics of the agreement (including whether it is bilateral, regional or multilateral), its purpose, the composition of its members and the negotiating strategies pursued by the parties. These strategies are typically influenced by broader economic or political considerations prevailing at a particular time. Despite growing convergence, IIAs negotiations are seldom identical; each agreement is the outcome of a series of decisions and trade-offs that are made in particular contexts. Thus, flexibility can be considered, in principle, from many different perspectives. For analytical purposes, this part identifies four main categories of approaches, and the discussion is structured accordingly. But other classifications are also possible. In reality, moreover, there is considerable overlap between categories and approaches.

Flexibility in IIAs may be approached from four different angles:

- **Objectives.** IIAs may include preambular statements or general principles referring broadly to development as an overall objective, outlining specific development objectives or introducing the concept of flexibility.

- **Overall structure and modes of participation.** An agreement's structure can give effect to development considerations by designing the instrument accordingly and granting, where appropriate, special and differential treatment to developing countries, e.g. by spelling out different rights and obligations for developing countries, by distinguishing explicitly between categories of participants, by allowing different stages or degrees of participation for individual countries, by allowing parties to limit the substance of their obligations or to assume gradually certain obligations, or by concluding separate related instruments.

- **Substantive provisions**. Development concerns can be reflected in the substantive content of an agreement, notably in the types of issues that are included in an IIA, in how these issues are dealt with, and in the extent to which they reflect a balance of rights and obligations for all actors concerned.

- **Application**. The mechanisms by which an agreement is put into operation can also provide a basis for promoting development objectives, as these can allow varying degrees of flexibility for interpreting an IIA or adapting it to changing needs and conditions. They can also facilitate compliance and help developing countries benefit from it, especially through promotional measures and provision of technical assistance.

Examples from existing IIAs[1] and other international economic agreements in respect of each of these approaches are examined below. They are intended to be indicative rather than exhaustive. In drawing from examples of other instruments, however, attention needs to be given to the subject matter, general purpose and underlying philosophy of the agreement in determining the utility of adopting its approach.

II. OBJECTIVES

Many IIAs have incorporated the objective of development in their basic aims, purposes or principles. This has been expressed in a wide variety of ways either in preambular statements or in declaratory clauses articulating general principles. These may refer to development as an overall objective or principle of the agreement or may identify specific development dimensions and objectives, including the concept of flexibility.

According to the Vienna Convention on the Law of Treaties (United Nations, 1969, article 31 (2)), the preamble is part of a treaty for the purpose of interpretation. It is the repository of the general aims and purposes of the agreement and offers a summary of the grounds upon which it is concluded. Thus, while preambles and similar declarations normally do not directly create rights and obligations for the parties to an instrument, they are relevant for the interpretation of its provisions. In fact, the texts of preambles are often the result of hard bargaining. Therefore, to the extent that preambles reflect the will of the participating countries, they reaffirm development as a central purpose of international arrangements. Moreover, as preambles are an important aid to the interpretation of specific provisions, an express reference to development in the preamble is a factor that would contribute to their interpretation so as to further development goals.

Numerous examples of preambular statements that mention development goals and principles can be found among IIAs, both in agreements concluded between developed and developing countries and agreements among developing countries. There are many variations in the language they use, and it is hard to generalise regarding their actual role and importance. The specific language in each case and its relationship to the rest of the instrument is, of course, important. This chapter provides some examples of declaratory statements addressing development which, for presentation purposes, can be grouped in a few main categories as follows:

- A generally worded recognition of the special needs of developing and/or least developed country parties requiring flexibility in the operation of obligations under the agreement, especially as regards the content of national laws and regulations and/or the investment regime, though in some cases there is no reference to national laws and regulations (box II.1).

Box II.1. Preambles that recognize the need for flexibility for developing/least developed countries

Preamble of the General Agreement on Trade in Services

Recognizing the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right.

Preamble of the Agreement on Trade-Related Aspects of International Property Rights

Recognizing also the special needs of the least-developed country Members in respect of maximum flexibility in the domestic implementation of laws and regulations in order to enable them to create a sound and viable technological base.

Preamble of the Asia Pacific Cooperation (APEC) Non-Binding Investment Principles

Acknowledging the diversity in the level and pace of development of member economies as may be reflected in their investment regimes, and committed to ongoing efforts towards the improvement and further liberalisation of their investment regimes.

Preamble of the Treaty Establishing the Latin American Integration Association

Aware that it is necessary to ensure a special treatment for countries at a relatively less advanced stage of economic development.

/...

(Box II.1 (concluded)

Preamble of the Treaty for the Establishment of the Economic Community of Central African States

Conscious of the different levels of development in the countries of the subregions, more particularly of the situation in countries which are land-locked or semi-land-locked, islands and/or belong to the category of the least advanced countries.

Preamble of the United Nations Convention on the Law of the Sea[a]

Bearing in mind that the achievement of these goals will contribute to the realization of a just and equitable international economic order which takes into account the interests and needs of mankind as a whole and, in particular, the special interests and needs of developing countries, whether coastal or land-locked.

[a] United Nations, 1983.

- An expression of a more specific way to contribute to economic development through, for example, progressive liberalization or certain standards of treatment in investment matters which is seen to contribute to development (box II.2).

IIAs may also include general clauses containing declaratory language referring to development as part of their overriding objectives and principles. These may elaborate upon themes in the preamble or they may be the first indicators of development concerns in an agreement, although this would be uncommon. The question remains, however, to what extent and under what conditions they could be applied to all commitments undertaken in an agreement. In order to measure the degree of flexibility for the parties concerned, it may be necessary to look at these general clauses in the context of other more specific provisions of the particular agreement. The Fourth ACP-EEC Convention of Lomé, for example, states numerous development objectives in the opening provisions: the promotion of economic, cultural and social development of the African, Caribbean and Pacific (ACP) States; a more just and balanced international economic order (article 1); the right of ACP States

to determine their development principles and strategies in all sovereignty (article 3); respect for human rights as part of the development goal (article 5); and special treatment for the least developed ACP countries (article 8). The Treaty Establishing the Latin American Integration Association spells out a number of development-related principles, including the principle of flexibility (box II.3). Read together, these principles appear to seek to establish a balance between the objectives of economic integration and growth coupled with the need for flexible and individual responses to the development needs of the parties to the agreement. It is noteworthy that these countries are differentiated by their level of development and that more freedom is given to the least developed countries signatories to the Treaty. Another example of an agreement that spells out broad development principles which inform the overall approach and philosophy of the agreement include the Agreement on Andean Subregional Integration.

Box II.2. Preambles that include specific development objectives

Preamble of the Agreement on Trade-Related Investment Measures

Desiring to promote the expansion and progressive liberalisation of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country Members, while ensuring free competition.

Preamble of the BIT between Argentina and the Netherlands (1992)

Recognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment of investments is desirable.

Preamble of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices

Recognizing that restrictive business practices can adversely affect international trade, particularly that of developing countries, and the economic development of these countries.

Box II.3. Development principles in the Treaty Establishing the Latin American Integration Association

Article 3

In the implementation of the present Treaty and the evolution towards its final objective, member countries shall bear in mind the following principles: (a) Pluralism, sustained by the will of member countries to integrate themselves, over and above the diversity which might exist in political and economic matters in the region; (b) Convergence, meaning progressive multilateralization of partial scope agreements by means of periodical negotiations between member countries, with a view to establishing the Latin American common market; (c) Flexibility, characterized by the capacity to allow the conclusion of partial scope agreements, ruled in a form consistent with the progressive attainment of their convergence and the strengthening of integration ties; (d) Differential treatment, as determined in each case, both in regional and partial scope mechanisms, on the basis of three categories of countries, which will be set up taking into account their economic-structural characteristics. Such treatments shall be applied in a determined scale to intermediate developed countries, and in a more favourable manner to countries at a relatively less advanced stage of economic development; and (e) Multiple, [sic] to make possible various forms of agreements between member countries, following the objectives and duties of the integration process, using all instruments capable of activating and expanding markets at regional level.

The interpretation of an IIA as favouring development can be strengthened if mention is made of the "right to development", either in the preamble or as a general principle of the instrument. Many observers (Alston, 1979; Asante, 1979; Haquani, 1979; Umbricht, 1979; Zacklin, 1979) agree that this right is grounded in customary international law. This can be done by recalling the relevant instruments, such as, for example, the United Nations Declaration on the Right to Development annexed to the General Assembly Resolution 41/128 of 1986 (United Nations, 1986), in particular, articles 3 (3) and 4 (1) (box II.4).

Box II.4. Reference to the right to development
The United Nations Declaration on the Right to Development

Article 3

3. States have the duty to co-operate with each other in ensuring development and eliminating obstacles to development. States should realize their rights and fulfil their duties in such a manner as to promote a new international economic order based on sovereign equality, interdependence, mutual interest and co-operation among all States, as well as to encourage the observance and realization of human rights.

Article 4

1. States have the duty to take steps, individually and collectively, to formulate international development policies with a view to facilitating the full realization of the right to development.

Source: United Nations, 1986.

It can also be helpful to recall in the preamble or in a general clause of an IIA instruments that address development issues relevant for foreign investment relations. This is done, with respect to labour rights, in the International Labour Organization (ILO) Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy which, under the heading dedicated to general policies, refers to the need to respect the Universal Declaration of Human Rights (United Nations, 1948) the corresponding International Covenants adopted by the General Assembly of the United Nations and the relevant ILO Conventions. With respect to environmental protection, the preamble of the Energy Charter Treaty recalls the United Nations Framework Convention on Climate Change (United Nations, 1992a), the Convention on Long-Range Transboundary Air Pollution (United Nations, 1979) and its protocols, and other international environmental agreements with energy-related aspects.

Finally, although not specifically mentioned in article 31 (1) of the Vienna Convention, the title of an agreement is also part of its context and, therefore, a reflection of the agreement's objective and purpose. Consequently, an express reference to "development" not only in the preamble of an IIA, but also in its title could further strengthen a development-oriented interpretation.[2] An example of a United Nations instrument with an express reference in its title to development is the United Nations Declaration on Environment and Development (UNDED) (United Nations, 1992b).

Notes

1 Unless otherwise indicated, the instruments referred to are contained in UNCTAD, 1996a and 2000; or in ICSID, 1972-.

2 According to an author and IIAs' negotiator, should it ever come to the negotiation of a multilateral framework for investment, it "should become the Multilateral Agreement on Investment and Development — MAID —, an appropriate acronym, since the agreement should be servant both to investment and development" (Robinson, 1998, p. 88).

III. OVERALL STRUCTURE AND MODES OF PARTICIPATION: SPECIAL AND DIFFERENTIAL TREATMENT

The objectives of an agreement can inform its substance not only through the specific language of particular provisions but also through the overall design of the agreement, i.e. its structure. If an agreement seeks to serve development, this needs to be reflected in the agreement's very structure. This is all the more important because international agreements, as noted before, are generally based on reciprocity and legal symmetry, that is, the rights and obligations of the parties are generally the same — they are "mirror images" of each other. Where the parties are at different levels of development, however, formal symmetry can obscure an underlying economic asymmetry. International practice in the past half-century has sought to take account of that asymmetry by developing a number of ways in which differences in the level of development among parties can be taken into account. Although the approaches and methods discussed below may be used by any country or group of countries for a variety of reasons, they can be particularly relevant as a means of addressing development concerns.

A. Special and differential treatment: the principle

Central in this respect is the development of special principles and rules applicable to developing countries (or certain categories of developing countries). In other words, the condition of being a developing country can be invoked to vary the exact content of the rights and obligations of developing countries parties to an international agreement, on a non-reciprocal basis. This approach is reflected notably in the principle of "special and differential treatment" according to which one category of countries — developing countries (or categories of countries such as least developed countries or smaller developing economies) — assumes less onerous obligations (either permanently or temporarily), on a non-reciprocal basis. It was developed — originally mainly in the area of international

trade — to give legal expression to the special needs and concerns of developing countries and/or least developed countries in international economic agreements (box III.1). Broadly speaking, it involves such issues as lower levels of obligations for developing countries, asymmetrically phased implementation timetables; exceptions from commitments in certain areas; flexibility in the application of, and adherence to, disciplines under prescribed circumstances; and technical assistance and training (Bernal, 1998).

Box III.1. The principle of special and differential treatment for developing countries: background and evolution in the context of the multilateral trading system

The principle of special and differential treatment was first formulated in the context of inter-State trade relations as a result of coordinated efforts by developing countries to correct the perceived inequalities of the international trading system by introducing preferential treatment in their favour across the spectrum of international economic relations. The principle found expression in a succession of articles and instruments associated with the multilateral trading system created by GATT, notably article XVIII of GATT, "Governmental Assistance to Economic Development" (WTO, 1995) (which enabled developing countries to maintain a certain flexibility in their tariff structure in order to develop their industrial base, and to apply quantitative restrictions for balance-of-payments reasons), and Part IV of GATT, adopted in 1964 (in which, among other things, the developed countries parties declared that they "do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties" (GATT, Part IV, article XXXVI, p. 8 (WTO, 1995, p. 534)). The Generalized System of Preferences (GSP) accorded by developed countries to developing countries in international trade -- introduced at the UNCTAD II Conference in New Delhi, 1968 -- was a further manifestation of the principle. (The GSP was covered by a GATT waiver, not Part IV.) At the regional level, preferential treatment for developing countries was also embodied in the provisions of the First ACP-EEC Lomé Convention regulating non-reciprocal trade preferences granted by the European Union (European Commission, 1975).

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Box III.1 (concluded)

During the Tokyo Round, the "Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" (usually described as the "Enabling Clause") reconfirmed the principle of non-reciprocity (GATT, 1986a).[a] The Punta del Este Declaration launching the Uruguay Round of Multilateral Trade Negotiations contained four clauses (out of seven) dealing with developing countries. Three of these confirmed that developing countries would be accorded special and differential treatment, and the fourth affirmed that developing countries would participate more fully in the framework of rights and obligations as their economies developed (GATT, 1986b). The Uruguay Round agreements provided for special and differential treatment mainly in the form of time-limited derogations, greater flexibility with regard to certain obligations and "best endeavours" clauses. The time limits for such derogations would be phased out in the early 2000s. Only in the Agreement on Subsidies and Countervailing Measures is special and differential treatment linked to economic criteria.

Source: UNCTAD, 1999l.

[a] This instrument pertains primarily to the Generalized System of Preferences, non-tariff measures in the context of GATT instruments, regional and global arrangements among developing countries and special treatment for least developed countries.

The extension of the application of the principle of special and differential treatment to various aspects of international economic relations was further recognized in articles 18 and 19 of the Charter of Economic Rights and Duties of States (1974). In relation to domestic industries or firms of developing countries, the principle was included in the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices; a subsection of the Set was devoted to this principle (box III.2). In the negotiations of the Draft United Nations Code of Conduct on Transnational Corporations, an attempt by some negotiators to legitimize special and differential treatment for domestic firms was reflected in a proposed formulation, in brackets, according to which exceptions to the principle of national treatment for foreign investors could be justified on the basis of development policies of developing

countries ("development clause") (see also under section III.B.3.a). The Fourth ACP-EEC Convention of Lomé — which includes provisions on investment — differentiates in Title IV of Part III among the developing contracting States by providing for special and differential treatment for the least developed, landlocked and island ACP States (box III.2), and identifies the articles of the Convention that contain provisions pursuant to this principle.

Box III.2. Extension of special and differential treatment to firms from developing countries

The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices

Section C.7

In order to ensure the equitable application of the Set of Principles and Rules, States, particularly developed countries, should take into account in their control of restrictive business practices the development, financial and trade needs of developing countries, in particular the least developed countries, for the purposes especially of developing countries in:

(a) Promoting the establishment or development of domestic industries and the economic development of other sectors of the economy, and
(b) Encouraging their economic development through regional or global arrangements among developing countries.

Fourth ACP-EEC Convention of Lomé
Part III. The instruments of ACP-EU cooperation
Title IV
General provisions for the least-developed, landlocked and island ACP States

Article 328

Special attention shall be paid to the least-developed, landlocked and island ACP States and the specific needs and problems of each of

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Box III.2 (concluded)

these three groups of countries in order to enable them to take full advantage of the opportunities offered by the Convention, so as to step up their respective rates of development.

Article 329

The least-developed ACP countries shall be accorded special treatment in order to enable them to overcome the serious economic and social difficulties hindering their development, so as to step up their rates of development.

A recent expression of the principle of special and differential treatment is found in the General Agreement on Trade in Services (GATS). Among the main general obligations of the GATS is the principle of "increasing participation of developing countries", spelled out in article IV. Among other things, it calls on countries to give priority to the liberalisation of access in the modes of supply and service industries of export interest to developing countries (box III.3). Apart from that article, the overall structure of GATS seeks to serve the needs and capacities of developing countries. Thus market access and national treatment in GATS are negotiated concessions that allow for tradeoffs and obtaining reciprocal benefits (see below section B.4 and chapter IV.B.2). In addition, GATS article XIX.2 provides for flexibility for developing countries for opening fewer industries, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign suppliers, attaching to such access conditions (e.g. transfer of technology, training) aimed at achieving the objectives referred to in article IV (box III.3). The GATS provisions dealing with special and differential treatment for developing countries are, of course, directly relevant to FDI (under the heading "commercial presence") in the area of services as FDI is one of the four modes of supply of services identified in GATS.

Box III.3. Increasing participation of developing countries in world trade
General Agreement on Trade in Services

Article IV

1. The increasing participation of developing country Members in world trade shall be facilitated through negotiated specific commitments by different Members pursuant to Parts III and IV of this Agreement, relating to:

(a) the strengthening of their domestic services capacity and its efficiency and competitiveness, inter alia through access to technology on a commercial basis;
(b) the improvement of their access to distribution channels and information networks; and
(c) the liberalisation of market access in sectors and modes of supply of export interest to them.

2. Developed country Members, and to the extent possible other Members, shall establish contact points within two years from the date of entry into force of the WTO Agreement to facilitate the access of developing country Members' service suppliers to information, related to their respective markets, concerning:

(a) commercial and technical aspects of the supply of services;
(b) registration, recognition and obtaining of professional qualifications; and
(c) the availability of services technology.

3. Special priority shall be given to the least-developed country Members in the implementation of paragraphs 1 and 2. Particular account shall be taken of the serious difficulty of least-developed countries in accepting negotiated specific commitments in view of special economic situation and their development, trade and financial needs.

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Box III.3 (concluded)

Article XIX
Negotiations of Specific Commitments

2. The process of liberalization shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in Article IV.

A key issue in dealing with special and differential treatment is whether a broad spectrum of flexibility should be given to the beneficiaries, or whether well defined criteria should be established. A broad spectrum of flexibility grants wider discretionary authority to governments and, therefore, reduces predictability. The establishment of well defined criteria, on the other hand, is often complex and may not always cover new developments that are unforseen and may justify the application of the principle.

A special variant of the principle of special and differential treatment relates not to countries but to companies. The concept of "small and medium-sized enterprises"[1] has been broadly invoked by both developing and developed countries to allow for special and differential treatment for enterprises falling within certain parameters. Such treatment typically involves exempting the relevant firms from certain obligations (notably in the area of competition law and policy) and qualifying for special incentives. In the context of liberalization and globalization the concept of "small and medium-sized enterprises" can be further refined and focused on the ability of enterprises to compete in global markets, thus measuring "small and medium-sized enterprises" in terms of global standards.

One feature of concepts such as "least developed countries", "smaller economies" or "small and medium-sized enterprises" is that they rely on concrete economic criteria. Given that developing countries are a rather heterogeneous group with significant differences in levels of development and economic and social strategies, such concepts can provide an identifiable common characteristic.

* * *

Except for earlier attempts to extend to IIAs the principle of special and differential treatment for developing countries, and in particular for the GATS, by and large, most of the new generation of IIAs do not state the principle as such. Instead, they have used a number of component concepts as the basis for effectively granting special and differential treatment, especially by distinguishing between categories of countries, determining stages and degrees of participation, using methods by which one or more countries can select, modify or postpone certain treaty obligations, and concluding several instruments combining different approaches. While some of these concepts may well be applicable to all countries, they can also be limited, in their applicability, to developing countries (or certain categories of developing countries) only.

B. Applying the principle

1. Distinguishing between categories of countries

One way of applying the principle of special and differential treatment in order to structure an IIA is to distinguish between developing and developed countries overall. While IIAs generally do not distinguish, in their overall structure, between these categories of countries, important exceptions exist. Thus, the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) is based on an overall distinction between developed and developing countries. More specifically, MIGA covers investments made in the territory of developing member countries only (listed in schedule A of the Convention). Another important exception in this respect

are the four Lomé conventions which were signed between a group of developed countries (the members of the European Community) on the one hand, and a group of developing countries (African, Pacific and Caribbean countries) on the other hand (European Commission, 1975; 1979; 1985; 1990). This pattern is also found in other development cooperation agreements -- intended to help developing countries in their development efforts -- where the distinction between developed and developing countries is often an essential part of their structure, reflecting their objectives.[2]

A variation of this approach is to identify specific groups of developing countries. Most common is to single out least developed countries. An example is the Fourth ACP-EEC Convention of Lomé, which dedicates a title (Title IV) to general provisions for the least-developed, landlocked and island ACP States (cited in box III.2 above). Another possibility is to single out "small economies". This has been discussed in the negotiations of a Free Trade Area of the Americas where a Consultative Committee has been created to keep under review the concerns and interests of the smaller economies and bring these to the attention of the negotiating groups (OAS, 1998). The concept of "smaller economies" seeks to recognize that countries whose land area, population, GDP or other similar criteria have special concerns and interests that may call for different treatment in the application of international disciplines.

Finally, even though most BITs do not make a structural distinction between developed and developing country parties overall, they may do so indirectly when some of their provisions apply only to relationships between developed and developing countries. Such a de facto differentiation does not always or necessarily involve the favourable treatment of the developing country party to the treaty, but in some instances it may. An instance of this is the provisions found in BITs concerning subrogation by the home country to claims for payments made on the basis of the issuance of investment guarantees by that country (or by a State-sponsored agency) which are normally available only for investment in developing countries (box III.4).

Box III.4. Subrogation clause in BITs
BIT between Georgia and United Kingdom (1995)

Article 10
Subrogation

(1) If one Contracting Party or its designated Agency ("the first Contracting Party") makes a payment under an indemnity given in respect of an investment in the territory of the other Contracting Party ("the second Contracting Party"), the second Contracting Party shall recognize:

(a) the assignment to the first Contracting Party by law or by legal transaction of all the rights and claims of the party indemnified, and
(b) that the first Contracting Party is entitled to exercise such rights and enforce such claims by virtue of subrogation, to the same extent as the party indemnified.

(2) The first Contracting Party shall be entitled in all circumstances to the same treatment in respect of

(a) the rights and claims acquired by it by virtue of the assignment, and
(b) any payments received in pursuance of those rights and claims, as the party indemnified was entitled to receive by virtue of this Agreement in respect of the investment concerned and its related returns.

(3) Any payments received in non-convertible currency by the first Contracting Party in pursuance of the rights and claims acquired shall be freely available to the first Contracting Party for the purpose of meeting any expenditure incurred in the territory of the second Contracting Party.

2. Stages and degrees of participation

Some flexibility may result from provisions relating to entry into force of an international agreement. While the provisions of an agreement normally enter into force immediately after the necessary

number of parties have expressed their consent to be bound by that agreement, it may well be, however, that all prospective parties do not accede to the agreement at the same time or in the same way. This can be done through a number of techniques.

Accession. This method can be used to extend an agreement to countries that have not been associated with the original negotiation for any of a number of reasons, including because they had not reached some of the minimum requirements needed for membership. For many agreements, accession is automatic, without the need for adjustment or further approval of earlier parties.

In other cases, the original signatories would extend an offer of a negotiated accession to non-members. Typically, the offer would provide that the new members accept the obligations resulting from the original agreement, under reserve of the "adjustments" to the original treaty which can be mutually agreed upon at the time the new members enter the accession treaty. The "adjustment" technique would enable them to join the agreement under conditions that reflect their economic situation. This technique has been used in order to work out the successive enlargements of membership in especially the GATT/WTO, but also as regards the Energy Charter Treaty, the OECD and ASEAN. Thus, for example, the protocols of accession to WTO by individual countries usually contain specific schedules of concessions and commitments undertaken by the acceding country that may be implemented in stages, as specified in the schedules (box III.5).

Association. Countries that are not ready to become full members of an agreement may still be associated with it and thus obtain certain special benefits not available to third countries. An association agreement typically involves mutual rights and obligations between the members of the agreement on the one hand, and the associated country, on the other hand. The nature and level of commitments however tend to be different — usualy less strict — from those applying between the countries having full membership status. Where the associated country or countries are developing countries or countries with economies in transition, the association agreement tends to include provisions of a non-reciprocal nature that take into account their "developing" or

Box III.5. Accession
Protocols of accession to WTO

The following text was included in the Protocol of Accession of Mongolia to WTO, after paragraph 2:

> Mongolia will notify the Secretariat annually of the implementation of the phased commitments with definitive dates referred to in paragraphs 10, 13, 20, 21, 23, 24, 29, 35, 42, 44, 45, 46, 48, 51, 59 and 60 of the Working Party Report, and will identify any delays in implementation together with the reasons therefore (WTO, 1999, p. 66).

The following texts were included in the Protocols of Accession to WTO of Bulgaria, Panama, Kyrgyz Republic and Latvia:

> 4. ... [name of country] ... may maintain a measure inconsistent with paragraph 1 of Article II of GATS provided that such measure is recorded in the List of Article II Exemptions annexed to this Protocol and meets the conditions of the Annex to the GATS on Article II Exemptions (WTO, 1999, p. 66).

"transitional" status. Examples of this approach can be found in the association agreements concluded between the European Union members and individual non-member countries, such as Tunisia (box III.6), and between the members of European Free Trade Association and individual third countries.

Box III.6. Association

Euro-Mediterranean Agreement Establishing an Association between the European Communities and their Member States, of the one part, and the Republic of Tunisia, of the other part

Article 1

1. An association is hereby established between the Community and its Member States, of the one part, and Tunisia, of the other part.

/...

Box III.6 (concluded)

2. The aims of this Agreement are to:

...

--establish the conditions for the gradual liberalisation of trade in goods, services and capital,

Chapter I. Current payments and movement of capital

Article 34

1. With regard to transactions on the capital account of balance of payments, the Community and Tunisia shall ensure, from the entry into force of this Agreement, that capital relating to direct investments in Tunisia in companies formed in accordance with current laws can move freely and that the yield from such investments and any profit stemming therefrom can be liquidated and repatriated.
2. The Parties shall consult each other with a view to facilitating, and fully liberalizing when the time is right, the movement of capital between the Community and Tunisia.

Gradual integration. Some association agreements are intended to serve as an intermediate step towards full membership; in that case they tend to include a number of transitional provisions aimed at preparing the way towards accession. The association or partnership agreements between the European Community countries and a number of Central and Eastern European countries reflect this approach (box III.7).

Box III.7. Gradual integration

Europe Agreement Establishing an Association between the European Communities and their Member States, of the one part, and the Republic of Latvia, of the other part

Article 1

1. An association is hereby established between the Community and its Member States, of the one part, and Latvia, of the other part.

2. The objectives of this association are:

/...

Box III.7 (concluded)

-- To provide an appropriate framework for the gradual integration of Latvia into the European Union. Latvia shall work towards fulfilling the necessary requirements in this respect.

Chapter II. Establishment

Article 44

3. Latvia shall, during the transitional period referred to in paragraph 2(i) not adopt any measures or actions which introduce discrimination as regards the establishment and operations of Community companies and nationals in its territory in comparison to its own companies and nationals.

4. The Association Council shall during the transitional period referred to in paragraph 2(i) examine regularly the possibility of accelerating the granting of national treatment in the sectors referred to in Annex XV. Amendments may be made to this Annex by decision of the Association Council.

Following the expiration of the transitional period referred to in Article 3, the Association Council may exceptionally, upon request of Latvia, and if the necessity arises, decide to prolong the duration of exclusion of certain areas or matters listed in Annex XV for a limited period of time.

Cooperation. It is also possible for the full members of an agreement to enter into a separate agreement with third countries or with the members of another group of countries, with a view towards cooperating in a number of areas of mutual interest. Cooperation agreements tend to be framework instruments spelling out broad programmatic provisions with few, if any, specific binding substantive rules. In the case of cooperation agreements involving a group of developed countries, on the one hand, and one or many developing countries, on the other hand, these agreements tend to include provisions aimed at helping the developing country or countries in their development efforts. In some cases, cooperation agreements are a first step towards developing closer economic links. Examples of these agreements include the European Union

cooperation agreements signed with a number of non-member countries and regional groups (box III.8).

Box III.8. Cooperation
Framework Agreement for Cooperation between the European Economic Community and the Cartagena Agreement and its Member Countries, namely, the Republic of Bolivia, the Republic of Colombia, the Republic of Ecuador, the Republic of Peru and the Repubilc of Venezuela

Article 9 (1)
Investment

1. The Contracting Parties agree:

-- to promote, so far as their powers, rules and regulations and policies permit, an increase in mutually beneficial investment,
-- to improve the climate for such investment by seeking agreements on investment promotion and protection between the Community's Member States and the Andean Pact countries based on the principles of non-discrimination and reciprocity.

3. Structural flexibility for one or many participating countries: degrees and methods

International practice has evolved a number of methods to allow a degree of flexibility so that countries that wish to participate in an agreement may be able to do so in ways that take account of their individual situations. Some of these methods have been codified in the Vienna Convention on the Law of Treaties (United Nations, 1969).

a. "Ratione materiae": flexibility to limit the substance of treaty obligations

A number of well known methods exist in international treaty law and practice that allow treaties to limit the *substance* of treaty obligations with respect to one or a number of parties

(*ratione materiae*). There are, of course, limits to the capacity of the parties to exempt one or several of them from the operation of a treaty. The exemption should not be so broad as to defeat the object and purpose of the treaty (see below). Still, methods such as those outlined below can be used to choose "à la carte" on the treaty menu.

Selecting binding provisions. All provisions of international agreements are normally binding upon the parties thereto, unless the agreement provides otherwise. The European Social Charter (Council of Europe, 1965), which was drafted within the framework of the Council of Europe, sets up a mechanism that enables the parties to select the provisions of the Charter that will be binding upon them. Part I of the Charter lists the 19 "rights and principles" that the parties should try to respect. Part II sets out, paragraph by paragraph, these rights and principles. Part III allows the parties to select the provisions that will be binding for each of them, it being understood that these provisions may not be less than 10 numbered articles, or 45 numbered paragraphs. This allows a modulation of the international commitments and, therefore, allows for flexibility. It may be worthwhile examining to what extent this approach could be used in IIAs.

Protocols are agreements that, generally, include additional understandings reached before or after signature of a treaty. They have the same legal force and value as the treaty provisions themselves and may serve a variety of purposes.[3] One such purpose is to exempt one or several of the parties from the operation of certain treaty provisions, or to vary their effect on these parties. The Protocol of the BIT between Indonesia and Switzerland is one example (box III.9). Yet another example is in the Protocol annexed to the Maastricht Treaty relating to the acquisition of real estate by non-residents in Denmark, under which the parties agreed that Denmark, notwithstanding the provisions of the treaty relating to the free movement of capital, may still impose restrictions on the acquisition of secondary residences by non-residents in Denmark (European Union, 1997).

Box III.9. Protocols exempting one or several of the parties from the operation of certain treaty provisions
BIT between Indonesia and Switzerland (1974)
Protocol

At the time of signing the Agreement concerning the Encouragement and the Reciprocal Protection of Investments concluded between the Swiss Confederation and the Republic of Indonesia, the undersigned Plenipotentiaries have, in addition, agreed on the following provisions which shall be regarded as an integral part of the said Agreement:

1. Notwithstanding the provisions of article 4, paragraph 3 of the present Agreement, it is understood by both of the Contracting Parties that the application of restrictive legislations concerning the acquisition of landed property by aliens is not contrary to the provisions of the present Agreement.

2. In derogation of the national treatment provided for in article 4, paragraph 3, of the present Agreement, the government of the Republic of Indonesia in view of the present stage of development of the Indonesian national economy reserves its position with regard to national treatment of Swiss investments in the territory of the Republic of Indonesia as follows:

Certain provisions such as article 4, 6 and 14 of the Domestic Investment Law (Law No. 6 of 1968) as amended by law No. 12 of 1970 still contain additional advantages to Indonesian domestic investment as compared to foreign investments in Indonesia under the foreign investment law (law No. 1 of 1967) as amended by law No. 11 of 1970. When, pursuant to present or subsequent legislation the Indonesian Government extends additional advantages to Indonesian investors, the Indonesian Government shall, in order to ensure fair and equitable treatment, grant identical or compensating facilities to investments by companies and nationals of the Swiss Confederation in similar economic activities.

Equivalent treatment may be applied in the Swiss Confederation to investments by nationals or companies of the Republic of Indonesia.

/...

Box III.9 (concluded)

Canada - Chile Free Trade Agreement
Annex G-09.1

1. For the purpose of preserving the stability of its currency, Chile reserves the right:

(a) to maintain existing requirements that transfers from Chile of proceeds from the sale of all or any part of an investment of an investor of Canada or from the partial or complete liquidation of the investment may not take place until a period not to exceed

(i) in the case of an investment made pursuant to Law 18.657 *Foreign Capital Investment Fund Law* ("Ley 18.657, Ley Sobre Fondo de Inversiones de Capitales Extranjeros"), five years has elapsed from the date of transfer to Chile, or

(ii) subject to subparagraph (c)
(iii), in all other cases, one year has elapsed from the date of transfer to Chile; ...

Reservations.[4] According to the Vienna Convention on the Law of Treaties, reservations are unilateral statements a State makes when it signs, ratifies or accedes an agreement "whereby it purports to exclude or modify the legal effect of certain provisions of a treaty in their application to that State" (Vienna Convention, article 2 (1) (d) (United Nations, 1969)). The Convention also provides in article 19 that a State may formulate a reservation to a treaty unless it is prohibited by the treaty, or the treaty allows for certain reservations only (not including the reservation made), or, as noted, the reservation is incompatible with the objective and purpose of the treaty. At the same time, and in line with United Nations practice, the filing of reservations upon accession to existing multilateral agreements is normally subject to the scrutiny of the contracting parties to determine whether the reservation filed meets the Vienna Convention criteria (i.e. is not incompatible with the object and purpose of the treaty). This represents one major possibility of control over the contents of reservations.

Some agreements however, explicitly prohibit the making of reservations, or prohibit reservations subject to certain exceptions. An example is the United Nations Convention on the Law of the Sea (United Nations, 1983) which prohibits reservations unless they are expressly permitted by other articles of the Convention. Otherwise, certain types of reservations made by one party may not be accepted by the other parties. Article 72 of the TRIPS Agreement, for example, prohibits the making of reservations without the consent of the other parties. A similar provision is to be found in the Agreement on Technical Barriers to Trade (article 15 (WTO, 1995), the Agreement on the Implementation of Article VII of the GATT 1994 (article 21) (WTO, 1995), the Agreement on the Implementation of Article VI of the GATT 1994 (article 18 (2)) (WTO, 1995) and the Agreement on Subsidies and Countervailing Measures (article 32 (2)) (WTO, 1995). The regime for acceptance of reservations, as set out in article 20 of the Vienna Convention is fairly complex. Conversely, some multilateral agreements expressly authorise certain reservations. An example is the New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards (box III.10). Reservations tend to rest upon reciprocity -- i.e. when a country makes a reservation, other countries can invoke the same reservation against the reserving party -- although some international agreements permit the making of reservations even though they are not based on reciprocity. [5]

Box III.10. Reservations

Convention on the Recognition and Enforcement of Foreign Arbitral Awards

Mozambique
Reservation

The Republic of Mozambique reserves itself the right to enforce the provisions of the said Convention on the base of reciprocity, where the arbitral awards have been pronounced in the territory of another Contracting State.

The Philippines
Reservation made upon signature

The Philippines delegation signs *ad referendum* this Convention with the reservation that it does so on the basis of reciprocity.

/...

Box III.10 (concluded)

United Nations Convention on Contracts for the International Sale of Goods[a]

Finland
Reservation made upon signature and confirmed upon ratification

Finland will not be bound by Part II of the Convention.

Upon ratification

With reference to Article 94, in respect of Sweden in accordance with paragraph (1) and otherwise in accordance with paragraph (2) the Convention will not apply to contracts of sale where the parties have their places of business in Finland, Sweden, Denmark, Iceland or Norway.

International Convention on the Harmonization of Frontier Controls of Goods[b]

Russian Federation
Reservation
Regarding article 20, paragraphs 2 to 7:
The Union of Soviet Socialist Republics does not consider itself bound by article 20, paragraphs 2 to 7, of the International Convention on the Harmonization of Frontier Controls of Goods concerning the settlement of disputes.

[a] United Nations, 1980, p.3.
[b] United Nations, 1982, p.3.

More generally, treaty law would not prevent States from negotiating IIAs that would permit issuance of reservations with respect to a number of its provisions in the interest of development, or from limiting the filing of these reservations to one specific category of parties. To the extent that a reservation seeks to modify the legal effect of certain provisions in an IIA, it can in principle offer some flexibility. The general trend however seems to be to set stringent conditions for reservations in IIAs.

Exceptions are provisions in agreements relating to situations in which a particular principle does not apply, or applies only in part. Thus, they qualify *ab initio* the extent of the obligations undertaken by countries participating in an international agreement. They seem to be favoured over reservations as far as international economic agreements are concerned (Juillard, 1994). IIAs contain three kinds of exceptions:

- ***General exceptions*** typically relate to public health, order, morals, and national security. Such exceptions are present in a number of IIAs (box III.11), but they are not necessarily related to development. They limit the operations of an agreement because of considerations of the highest public character. The drafters of the 1992 World Bank Guidelines, for instance, sought to insert in the guideline on admission a clause to the effect that States might refuse admission to foreign investments that they thought would not be conducive to economic development (Shihata, 1993, p. 403); this clause, however, did not appear in the final version of the Guidelines. "Essential national economic interests" was one of the considerations proposed by some negotiators for a draft general exception clause on national treatment included in brackets in the Draft United Nations Code of Conduct on Transnational Corporations. It read: "consistent with [national constitutional systems and] national needs to [protect essential/national economic interests,] maintain public order and to protect national security" (UNCTAD, 1996a, p. 173).

Box III.11. General exceptions

General Agreement on Trade in Services

Article XIV

General Exceptions

Subject to the requirement 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, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any member of measures:

/...

Box III.11 (concluded)

(a) necessary to protect public morals or to maintain public order;...
(b) necessary to protect human, animal or plant life or health;
(c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:

(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
(ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
(iii) safety;

OECD Code of Liberalisation of Capital Movements

Article 3
Public Order and Security

The provisions of this Code shall not prevent a Member from taking action which it considers necessary for:

i) the maintenance of public order or the protection of public health, morals and safety;
ii) the protection of its essential security interests;
iii) the fulfilment of its obligations relating to international peace and security.

BIT between Bolivia and Peru (1993)

Article 3 (5)

Nothing in this Treaty shall prevent a Contracting Party from adopting measures, if not discriminatory, for reasons of internal and external national security, public or moral order.

- ***Subject-specific exceptions*** are those that exempt specific matters from the application of individual provisions. For example, national treatment and most-favoured-nation (MFN) treatment clauses may contain exceptions in relation to

intellectual property, benefits arising from membership in a regional economic integration scheme, and taxation provisions (box III.12).

Box III.12. Subject-specific exceptions

BIT between Chile and Malaysia (1992)

Article 3
Most favoured nation

1. Investments by nationals or companies of either Contracting State on the territory of the other Contracting State shall ... not be subject to a treatment less favourable than that accorded to investments by nationals or companies of third States.

...

3. 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; or the adoption of an agreement designed to achieve the formation or expansion of such union or area within a reasonable time; or

(b) any international convention or agreement related totally or principally to taxation, or any national legislation related totally or partially to taxation.

- ***Country-specific exceptions*** identify industries and measures that can be exempted from the operation of an IIA by allowing each individual party to list the specific industries or measures for which it claims exceptions. An example of this approach is article 7 of the Framework Agreement on the ASEAN Investment Area (box III.13) and article 1108 of NAFTA (cited in box III.18 below).

Box III.13. Country-specific exceptions
Framework Agreement on the ASEAN Investment Area
Opening up of Industries and National Treatment

Article 7

1. Subject to the provisions of this Article, each Member State shall:
   (a) open immediately all its industries for investments by ASEAN investors;
   (b) accord immediately to ASEAN investors and their investments, in respect of all industries and measures affecting investment including but not limited to the admission, establishment, acquisition, expansion, management, operation and disposition of investments, treatment no less favourable than that it accords to its own like investors and investments ("national treatment").

2. Each Member State shall submit a Temporary Exclusion List and a Sensitive List, if any, within 6 months after the date of the signing of this Agreement, of any industries or measures affecting investments (referred to in paragraph 1 above) with regard to which it is unable to open up or to accord national treatment to ASEAN investors. These lists shall form an annex to this Agreement. In the event that a Member State, for justifiable reasons, is unable to provide any list within the stipulated period, it may seek an extension from the AIA Council.

3. The Temporary Exclusion List shall be reviewed every 2 years and shall be progressively phased out by 2010 by all Member States except the Socialist Republic of Vietnam, the Lao People's Democratic Republic and the Union of Myanmar. The Socialist Republic of Vietnam shall progressively phase out the Temporary Exclusion List by 2013 and the Lao People's Democratic Republic and the Union of Myanmar shall progressively phase out their Temporary Exclusion Lists by 2015.

4. The Sensitive List shall be reviewed by 1 January 2003 and at such subsequent periodic intervals as may be decided by the AIA council.

Derogations and waivers. In addition to exceptions, which qualify an agreement from the outset, international agreements can also provide for derogations. Their role is to allow countries that find conformity with certain treaty obligations particularly

onerous, to ask the appropriate body established by the instrument to free them, temporarily or permanently, from some of their obligations. This course of action may also be taken when new situations arise, which are not fully provided for in the original agreement, but which are similar enough to exceptions or qualifications already provided for to make insistence on fulfilment of formal obligations inequitable. Examples of derogations and waivers include article 7 of the OECD Code of Liberalisation of Capital Movements (box III.14), the transitional arrangements provided for under Article 32 of the Energy Charter Treaty and, in the context of WTO, the decision to allow countries members of the Fourth ACP-EEC Convention of Lomé of 9 December 1994 to derogate from Article 1 (1) of GATT (GATT, 1994) (box III.14).[6] Derogations assume a legally-binding instrument. Clearly, non-binding instruments or instruments formulated in such manner as not to limit the options of participating countries do not need derogations.

Box III.14. Derogations

OECD Code of Liberalisation of Capital Movements

Article 7

Clauses of derogation

a. If is economic and financial situation justifies such a course, a Member need not take the whole of the measures of liberalisation provided for in Article 2(a).

b. If any measures of liberalisation taken or maintained in accordance with the provisions of Article 2(a) result in serious economic and financial disturbance in the Member State concerned, that Member may withdraw those measures.

...

WTO Decision of 9 December 1994

regarding the Fourth ACP-EEC Convention of Lomé

The Contracting parties, acting pursuant to the provisions of paragraph 5 of Article XXV of the General Agreement,

/...

Box III.14 (concluded)

Decide that:

1. Subject to the terms and conditions set out thereunder, the provisions of paragraph 1 of Article 1 of the General Agreement shall be waived, until 29 February 2,000, to the extent necessary to permit the European Communities to provide preferential treatment for products originating in ACP States as required by the relevant provisions of the Fourth Lomé Convention, without being required to extent the same preferential treatment to like products of any other contracting party.

Safeguards or "escape clauses" are provisions included in an agreement that allow parties to take action otherwise not permitted by an instrument, in order to cope with unforeseen events arising after the adoption of the instrument. As in the case of reservations, they involve, in the first place, unilateral action by the country concerned. In later phases, however, in order to enter into effect, they require prior notification and/or approval from the competent organ. Moreover, the relevant provisions normally set definite limits in terms of time and substantive measures to the action to be taken through invocation of safeguards. The most common situations contemplated in safeguard clauses in IIAs relate to balance-of-payments crises or emergency economic situations. The Framework Agreement on the ASEAN Investment Area contains such clauses (box III.15). Other examples include article 7 of the OECD Code of Liberalisation of Current Invisible Operations and article XII of GATS.

Box III.15. Safeguards

Framework Agreement on the ASEAN Investment Area

Article 14

Emergency Safeguard Measures

1. If, as a result of the implementation of the liberalisation programme under this Agreement, a Member State suffers or is threatened with any serious injury and threat, the Member State may take emergency

/...

Box III.15 (concluded)

safeguard measures to the extent and for such period as may be necessary to prevent or to remedy such injury. The measures taken shall be provisional and without discrimination.

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

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

Article 15
Measures to Safeguard the Balance of Payments

1. In the event of serious balance of payments and external financial difficulties or threat thereof, a Member State may adopt or maintain restrictions on investments on which it has undertaken specific commitments, including on payments or transfers for transactions related tosuch commitments. It is recognised that particular pressures on the balance of payments of a Member State in the process of economic development or economic transition may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.

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

3. The measures referred to in paragraph (1):

(a) shall not discriminate among Member States;
(b) shall be consistent with the Articles of Agreement of the International Monetary Fund;
(c) shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member State;

/...

Box III.15 (concluded)

(d) shall not exceed those necessary to deal with the circumstances described in paragraph 1; and
(e) shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.

4. The Member States adopting the balance of payments measures shall commence consultations with the AIA Council and other Member States within 90 days from the date of notification in order to review the balance of payment measures adopted by it.

5. The AIA Council shall determine the rules applicable to the procedures under this Article.

b. "Ratione temporis": flexibility in relation to the timing of assuming obligations under an agreement

Transitional arrangements. Temporal (phasing) provisions can be used to grant to developing countries (or certain categories of them) an extra period of time so as to enable them to get ready to assume fully and entirely their international obligations. Thus, transitional arrangements do not create rights of a permanent character. Rather, they are an acknowledgment that developing countries may not always be in a position to act in the same manner as developed countries. The TRIMs and TRIPS Agreements provide examples of such transition arrangements (box III.16). The BIT between Poland and the United States is another example. It provides for a transitional period within which Poland was to gradually assume certain obligations, such as free convertibility of its currency. Other examples of agreements outside the investment field that grant longer transitional periods for compliance to developing countries (expressly linked to an understanding that differential and more favourable treatment for developing country members was to be an integral part of the agreement) are article 15 of the WTO Agreement on Agriculture (WTO, 1995) (box III.16), the WTO Agreement on the Application of Sanitary and Phytosanitary

Measures (WTO, 1995) (box III.16) and the United Nations Framework Convention on Climate Change (United Nations, 1992a) and its Kyoto Protocol (United Nations, 1997) (see box V.10 below).

Box III.16. Phasing the implementation of specific commitments Agreement on Trade-Related Investment Measures

Article 5

Notification and Transitional Arrangements

1. Members, within 90 days of the date of entry into force of the WTO Agreement, shall notify the Council for Trade in Goods of all TRIMs they are applying that are not in conformity with the provisions of this Agreement. Such TRIMs of general or specific application shall be notified, along with their principal features. ...

2. Each Member shall eliminate all TRIMs which are notified under paragraph 1 within two years of the date of entry into force of the WTO Agreement in the case of a developed country Member, within five years in the case of a developing country Member, and within seven years in the case of a least—developed country Member.

3. On request, the Council for Trade in Goods may extend the transition period for the elimination of TRIMs notified under paragraph 1 for a developing country Member, including a least—developed country Member, which demonstrates particular difficulties in implementing the provisions of this Agreement. In considering such a request, the Council for Trade in Goods shall take into account the individual development, financial and trade needs of the Member in question.

4. During the transition period, a Member shall not modify the terms of any TRIM which it notifies under paragraph 1 from those prevailing at the date of entry into force of the WTO Agreement so as to increase the degree of inconsistency with the provisions of Article 2. TRIMs introduced less than 180 days before the date of entry into force of the WTO Agreement shall not benefit from the transitional arrangements provided in paragraph 2.

5. Notwithstanding the provisions of Article 2, a Member, in order not to disadvantage established enterprises which are subject to a TRIM

/...

Box III.16 (concluded)

notified under paragraph 1, may apply during the transition period the same TRIM to a new investment (i) where the products of such investment are like products to those of the established enterprises, and (ii) where necessary to avoid distorting the conditions of competition between the new investment and the established enterprises. Any TRIM so applied to a new investment shall be notified to the Council for Trade in Goods. The terms of such a TRIM shall be equivalent in their competitive effect to those applicable to the established enterprises, and it shall be terminated at the same time.

Agreement on Trade-Related Aspects of Intellectual Property Rights

Article 65

Transitional Arrangements

1. Subject to the provisions of paragraphs 2, 3 and 4, no Member shall be obliged to apply the provisions of this Agreement before the expiry of a general period of one year following the date of entry into force of the WTO Agreement.

2. A developing country Member is entitled to delay for a further period of four years the date of application, as defined in paragraph 1, of the provisions of this Agreement other than Articles 3, 4 and 5.

3. Any other Member which is in the process of transformation from a centrally-planned into a market, free-enterprise economy and which is undertaking structural reform of its intellectual property system and facing special problems in the preparation and implementation of intellectual property laws and regulations, may also benefit from a period of delay as foreseen in paragraph

4. To the extent that a developing country Member is obliged by this Agreement to extend product patent protection to areas of technology not so protectable in its territory on the general date of application of this Agreement for that Member, as defined in paragraph 2, it may delay the application of the provisions on product patents of Section 5 of Part II to such areas of technology for an additional period of five years.

5. A Member availing itself of a transitional period under paragraphs 1, 2, 3 or 4 shall ensure that any changes in its laws, regulations and

/...

Box III.16 (concluded)

practice made during that period do not result in a lesser degree of consistency with the provisions of this Agreement.

WTO Agreement on Agriculture
Article 15
Special and Differential Treatment

1. In keeping with the recognition that differential and more favourable treatment for developing country Members is an integral part of the negotiation, special and differential treatment in respect of commitments shall be provided as set out in the relevant provisions of this Agreement and embodied in the Schedules of concessions and commitments.

2.Developing country Members shall have the flexibility to implement reduction commitments over a period of up to 10 years. Least-developed country Members shall not be required to undertake reduction commitments.

WTO Agreement on the Application of Sanitary and Phytosanitary Measures
Article 10
Special and Differential Treatment

1.In the preparation and application of sanitary or phytosanitary measures, Members shall take account of the special needs of developing country Members, and in particular of the least-developed country Members.

2.Where the appropriate level of sanitary or phytosanitary protection allows scope for the phased introduction of new sanitary or phytosanitary measures, longer time-frames for compliance should be accorded on products of interest to developing country Members so as to maintain opportunities for their exports.

3.With a view to ensuring that developing country Members are able to comply with the provisions of this Agreement, the Committee is enabled to grant to such countries, upon request, specified, time-limited exceptions in whole or in part from obligations under this Agreement, taking into account their financial, trade and development needs.

4.Members should encourage and facilitate the active participation of developing country Members in the relevant international organizations.

4. The use of "positive" and "negative" lists

Another basic approach to provide for structural flexibility, and one that is not confined to developing countries alone, involves the use of "positive" and "negative" lists. The former kind of lists enumerate those industries or measures in respect of which obligations are to be undertaken; the latter kind of lists enumerate those industries or measures to which obligations do not apply. Thus, in the negative list approach there is a general obligation from which a country can "opt-out". In the positive list approach, there is no general obligation, but a country may assume it, i.e. "opt-in". In other words, in the first case, a country is bound by an obligation unless it acts; in the second case, a country is not bound unless it acts. (See also under "Admission", chapter IV.B, for a further elaboration of the application of positive and negative lists in the context of clauses on admission and establishment of FDI.)

An example of a *positive list* can be found in GATS, where no party is compelled to permit market access or national treatment; rather it has the right, under articles XVI and XVII, to list in its schedule those service industries in which it is willing to make such commitments (box III.17). This approach reflects the fact that the commitments are negotiated on the basis of reciprocity, which can be provided in other service modes of supply or in access for trade in goods. By following this approach, GATS encourages the increased participation of developing countries in trade in services by facilitating their efforts to liberalize their service industries as they are able to obtain reciprocal commitments in other areas of negotiations.

In addition, as noted above in this chapter (section III. A), GATS article XIX.2 grants additional flexibility for developing countries in the context of setting out their positive lists, for opening only a few industries, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign suppliers, attaching to such access conditions (e.g. transfer of technology, training) aimed at achieving the objectives referred to in Article IV.

An example of a *negative list* can be found in NAFTA, where parties accept a set of principles and then negotiate sectoral exceptions (box III.18). This approach may result in a long list of reservations submitted by the parties. Negative lists can be adopted on a "stand still" basis -- i.e. non-conforming measures or exceptions are allowed to be maintained, as are any amendments thereto (provided these do not increase the restrictive nature of the measures) -- or they can be subject to "roll back" provisions, calling for progressive liberalization. Examples of the first approach are found in some BITs. Typical examples of the latter approach are the OECD Liberalisation Codes and the Framework Agreement on the ASEAN Investment Area.

It should be noted that these two approaches are not mutually exclusive. An agreement could contain both approaches. GATS, for example, also has a negative listing for limitations on market access and national treatment with respect to those sectors and subsectors included in the schedule (box III.17).[7] One could also imagine other combinations. For example, the negative list approach could apply to one part of a given principle (e.g. national treatment in the post establishment phase) while the positive list approach applies to another part of the same principle (e.g. national treatment in the pre-establish phase). Or developing countries are allowed to use the positive list approach while developed countries are required to use the negative list approach.

Box III.17. Use of positive lists

General Agreement on Trade in Services

Article XX

Schedules of Specific Commitments

1. Each Member shall set out in a schedule the specific commitments it undertakes under Part III of this Agreement. With respect to sectors where such commitments are undertaken, each Schedule shall specify:

(a) terms, limitations and conditions on market access;
(b) conditions and qualifications on national treatment;
(c) undertakings relating to additional commitments;
(d) where appropriate the time-frame for implementation of such commitments; and

/...

Box III.17 (concluded)

(e) the date of entry into force of such commitments.

....

3. Schedules of specific commitments shall be annexed to this Agreement and shall form
an integral part thereof.

Specific Commitments

Article XVI

Market Access

1. With respect to market access through the modes of supply identified in Article 1, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule. ...

2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:

(a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
(b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; ...
(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
(e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign share holding or the total value of individual or aggregate foreign investment.

Box III.18. Use of negative lists
North America Free Trade Agreement
Article 1108
Reservations and Exceptions

1. Articles 1102, 1103, 1106 and 1107 do not apply to:

   (a) any existing non-conforming measure that is maintained by
      (i) a Party at the federal level, as set out in its Schedule to Annex I or III,
      (ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or
      (iii) a local government;
   (b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or
   (c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.

2. Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing non-conforming measure maintained by a state or province, not including a local government.

3. Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.

4. No Party may, under any measure adopted after the date of entry into force of this Agreement and covered by its Schedule to Annex II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective.

...

6. Article 1103 does not apply to treatment accorded by a Party pursuant to agreements, or with respect to sectors, set out in its Schedule to Annex IV.

Whatever approach is used, the overriding concern for a country is to identify those industries and/or activities that ought to be included/excluded in light of its particular situation and its comparative advantage. Thus, an understanding of the particular situations and comparative advantages of domestic industries is a crucial element in how a developing country will approach the listing of negative exceptions or positive commitments.

What may be potentially problematic in this context is the "information asymmetry" that a developing country might experience in that it may not have the informational resources, or access to such resources held by others, to be able to make a full and informed judgement as to the nature, scale and scope of its comparative advantages. Furthermore, the selection of exclusions from a positive list might be influenced by local interests seeking to shield themselves from international competition. Similarly, foreign investors might seek the liberalization of sectors at the cost of local competitors. Thus, the process of selecting negative or positive lists is one that assumes adequate information and a balance of special interests and lobbies, so that a proper and objective choice can be made by a given developing country. Where this is not the case, inappropriate exclusions from, or inclusions in, the liberalization process may occur.

5. Concluding several separate instruments

The discussion of possible structural approaches so far has assumed an IIA as a single instrument. It is possible however to construct an overall investment framework consisting of several instruments combining various approaches. One possibility is to conclude two or more instruments with differing binding force. This is the method used in, for example, the 1976 OECD Declaration on International Investment and Multinational Enterprises. The Declaration (which itself is not legally-binding) encompasses decisions on National Treatment, Incentives and Disincentives and Conflicting Requirements that impose certain obligations on OECD member Governments, and Guidelines for Multinational Enterprises that are recommendations by the OECD member countries as regards the behaviour of TNCs.

The logic for combining legally-binding and voluntary instruments may respond to the technical characteristics of an agreement, such as the different types of addressees involved (i.e. governments and foreign investors), but can also be a way of allowing certain groups of countries more flexible commitments on account of their development needs. It is also conceivable that the legal form of these instruments may evolve over time. Thus, a non-binding instrument may evolve into a more binding one. The proposed OECD Multilateral Agreement on Investment (MAI), for example, was intended to strengthen the binding character of some existing OECD investment instruments, such as the national treatment instrument. Conversely, an agreement imposing strict obligations may be chosen as a point of departure which may be supplemented by more flexible additions or specifications later. This is the case of, for example, the North American Agreement on Environmental Cooperation (Canada, Mexico and the United States, 1993a) and the North American Agreement on Labor Cooperation (Canada, Mexico and the United States, 1993b) which were adopted as side agreements to NAFTA. While NAFTA imposes high standards for the liberalization and treatment of investment, the two side agreements require the parties to cooperate on environment and labour matters, but recognize the right of each country to establish their own levels of domestic environmental protection and their own domestic labour standards. Similarly, in the MAI negotiations there appeared to have been a general understanding among negotiators that the OECD Guidelines for Multinational Enterprises would be annexed to the binding MAI text, but without losing their voluntary character.

The scope of the contents of an IIA may also be a consideration. For example, a comprehensive investment instrument may deal with broad principles at the outset, and move progressively towards developing detailed provisions in additional instruments later. This approach has been followed in, for example, GATS where the agreement contemplates the conclusion of individual supplementary agreements dealing with specific services industries that follow the main principles stipulated in the framework agreement. Alternatively, it may cover only certain areas and move progressively into other supplementary agreements to cover presumably more controversial areas. A case in point is the above mentioned NAFTA

side agreements on Environmental Cooperation and on Labor Cooperation. The characteristics of the parties may be another. Regional integration groups sometimes sign separate agreements aimed at governing investment relations with each other and with third parties, respectively, with, typically, the provisions affecting investment relations with third countries not being as advanced as those applying among the members of the group. This is the approach followed in, for example, the MERCOSUR Protocol on Protection and Promotion of Investments within the Countries members of MERCOSUR (Intrazone) and the Protocol on Protection and Promotion of Investments from States not Parties of MERCOSUR. These two agreements deal with the same issues and resemble one another in most respects, except for a few issues such as admission of investment where the latter is more restrictive in terms of the host countries' flexibility to allow or deny FDI entry. This method can be used to conclude separate side agreements with countries or groups of countries at different levels of development, each providing for different degrees of commitment and flexibility.

A variation of this approach is to postpone the negotiation of additional elements of an agreement or the strengthening of the existing agreement or certain provisions in it. This can be done to facilitate the conclusion of an IIA when it becomes obvious that the majority of the parties are not ready to agree to certain provisions, or can only accept "soft" obligations, at least for the time being. A case in point is the Energy Charter Treaty as regards the extension of investment protection standards to the pre-establishment phase (box III.19). Consideration to adding possible new elements to an IIA is usually given as part of its review process, after some years of experience with its application (see below under chapter V.A). In some cases, however, the possibility of adding new elements is already contemplated in the original agreement, so that the matter is included for consideration in a "built-in" agenda. Thus, some agreements include from the outset a provision giving some indication of the type of issues a complementary agreement might address. Such a provision would commit the parties at least to look at the matter over time. Article 9 of the TRIMs agreement offers an example of the "built-in agenda" approach (box III.19).

Box III.19. Postponing negotiation of additional elements of an agreement

Energy Charter Treaty

Article 10

Promotion, protection and treatment of investments

(4) A supplementary treaty shall, subject to conditions to be laid down therein, oblige each party thereto to accord to Investors of other parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3). That treaty shall be open for signature by the states and Regional Economic Integration Organizations which have signed or acceded to this Treaty. Negotiations towards the supplementary treaty shall commence no later than 1 January 1995, with a view to concluding it by 1 January 1998.

Agreement on Trade-Related Investment Measures

Article 9

Not later than five years after the date of entry into force of the WTO Agreement, the Council for Trade in Goods shall review the operation of the Agreement and, as appropriate, propose to the Ministerial Conference amendments to its text. In the course of this review, the Council for Trade in Goods shall consider whether the Agreement should be complemented with provisions on investment policy and competition policy.

* * *

The preceding discussion suggests that there are many elements involved in the construction of an IIA. These elements can be combined in a multitude of ways, and different variations can be added. Whatever the combination of elements, IIAs need to be constructed in a manner that ensures an overall balance of rights and obligations for all actors involved, so that all parties can derive benefits from it. In the context of IIAs, this issue may also include consideration of the question of the responsibilities of TNCs in their host countries with respect to development.

Of course, to achieve an overall balance of rights and obligations in an IIA, such balance needs also to find expression in the substantive content of the agreement and the formulation of its substantive provisions, keeping in mind the interactions among them. How this can be achieved is the topic of the next chapter.

Notes

1 The notion is commonplace in the legislation of most developed countries.

2 A clear illustration is the case of the International Development Association (IDA), the World Bank affiliate which provides development credits to developing countries on favourable terms. Members of the IDA are classed in two main groups: Part I countries, which are donors of aid, and Part II countries, most of which are aid recipients.

3 Strictly speaking, a protocol need not be additional to an agreement; an agreement by itself may be called a "protocol".

4 The meaning of terms such as exceptions, derogations, reservations, waivers, etc. is not fixed, and may vary from agreement to agreement.

5 This would be the case of a number of treaties relating to human rights, including the European Convention of Human Rights (Council of Europe, 1950). The rationale here is that treaties on human rights do not reflect mutual concessions: they just express fundamental rights, the respect of which does not depend upon reciprocity. But these are not the only treaties which are not premised upon reciprocity.

6 This waiver gave rise to a trade dispute between the European Union and some Caribbean States on one hand, and the United States and some Latin American States on the other, concerning bananas (WTO, 1997). The case shows clearly the need for drafting waivers, derogations, etc. (many of which are intended to be of benefit for the developing countries) with the outmost care and attention to details

7 The GATS also has a negative-list approach with regard to MFN (article 2).

IV. SUBSTANTIVE PROVISIONS

The contents of IIAs are the concrete means by which concepts such as flexibility are given effect. When concluding an IIA, countries make choices about the issues they wish to include and those they wish to keep outside the scope of an agreement, to deal with them in specialized agreements (e.g. on double taxation), as a matter of national law and policy, or not at all. Even when they decide to include certain issues in an IIA, countries may wish to retain some flexibility regarding the commitments they make. They may therefore use formulations that allow them some discretion to pursue their national policies while keeping in line with the broad principles of an agreement. Development concerns can also determine the extent to which the contents of an IIA reflect a balance of rights and obligations for all actors concerned.

IIAs -- especially multilateral and regional instruments -- often differ when it comes to the kind of substantive provisions they contain and the manner in which these are addressed. An important matter for countries to decide is thus what issues to include in a particular agreement they choose to negotiate and how to define rights and responsibilities as to the issues they decide to include. This chapter does not address the first question -- what issues to include; the list of issues appearing in IIAs is indeed quite long. Rather, it illustrates, for a selected number of issues and in no particular order, how these issues have been dealt with in existing IIAs. In doing so, the chapter draws on the papers published so far in *UNCTAD's Series on Issues in International Investment Agreements.*

There is little point in attempting to list all the various permutations that have been, or can be, used in formulating substantive provisions in IIAs, as the outcome depends on a process of negotiation in the light of specific circumstances. The range of permutations can be gleaned from the various alternative formulations reviewed below. In fact, the approaches indicated below are merely analytical constructs whose principal purpose is to indicate broad -- including hypothetical -- approaches to a given subject.

A. Scope and definition of investment[1]

The purpose of definitions in legal instruments is to determine the object to which an instrument's rules apply and the scope of these rules' applicability. Hence, they form part of the normative content of the instrument. The scope of application of an IIA depends on the definition of certain terms, principally "investment". This definition determines which investments are covered by its provisions or are excluded from the coverage of the agreement. The main approaches to the definition of investment are outlined below.

1. A broad definition

The most common trend in recent IIAs is to have a broad, inclusive definition of "investment" which may or may not be subject to limitations (box IV.1). A broad definition has implications for the development policy of the States parties to an agreement. The developmental concern can be stated quite simply: treaty coverage of all assets included within the definition may not be consistent with a State's development policy at every period in the life of an agreement.

A broad definition of "investment" may also be open-ended. This is the approach followed in BITs, as illustrated in, for example, the BIT between Ecuador and the United Kingdom (box IV.2). Reasons for this approach are that first, as a technical matter, it may be difficult to draft a more precise definition that would cover all the assets that parties wish to be covered by an agreement. Second, because the concept of investment has evolved over time and because many investment agreements are intended to last for many years, those who draft them appear to seek, as a matter of policy, to utilize language that can extend an agreement to new forms of investment as they emerge, without renegotiation of the agreement. Both of these considerations are particularly important in agreements that are intended to facilitate international investment flows.

A broad open-ended definition, at the same time, may be undesirable for countries that are concerned about certain effects of foreign investment. The danger of an open-ended definition is that it may commit a host country to permitting, promoting or protecting forms of investment that it had not contemplated at the time it entered into an agreement and might not have agreed to include within the scope of the agreement had the issue arisen explicitly. There are several ways to limit the scope of the definition, as discussed below.

Box IV.1. A broad and open-ended definition of investment
BIT between Ecuador and the United Kingdom (1994)

Article 1 (a)
Definition of investment

For the purposes of this Agreement:

(a) investment means every kind of asset and in particular, though not exclusively, includes:
   - (i) movable and immovable property and any other property rights such as mortgages, liens or pledges;
   - (ii) shares, stock and debentures of companies or interests in the property of such companies;
   - (iii) claims to money or to any performance under contract having a financial value;
   - (iv) intellectual property rights and goodwill;
   - (v) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.

2. A narrower definition

A number of agreements have narrowed the definition of investment, although there are advantages and disadvantages to any particular way of narrowing the definition. Taking each type of narrower definition in turn, the following development implications may be envisaged:

- A number of IIAs exclude portfolio investment from the definition of investment because it may be regarded as less desirable than FDI, given that it generally does not bring with it technology transfer, training or other benefits associated with FDI. Further, portfolio investment can be easily withdrawn, thus creating the potential for capital volatility in the event of economic turbulence. Examples of this approach include the Framework Agreement on the ASEAN Investment Area, the Free Trade Agreement between Canada and the United States, the BIT between Denmark and Lithuania, the BIT between Germany and Israel and the WTO General Agreement on Trade in Services in relation to the definition of "commercial presence" (box IV.3). The OECD Code of Liberalisation of Capital Movements differentiates between portfolio transactions and direct investment and includes each of these types of transactions in separate subheadings of the liberalization lists. NAFTA includes portfolio investment in its definition of investment but excludes certain types of debt securities and loans and also seeks to exclude ordinary commercial contracts (box IV.2).

Box IV.2. Excluding portfolio (or some types of portfolio) investment

Framework Agreement on the ASEAN Investment Area

Article 2

Coverage

This Agreement shall cover all direct investments other than -

a. portfolio investments; and

b. matters relating to investments covered by other ASEAN Agreements, such as the ASEAN Framework Agreement on Services.

Free Trade Agreement between Canada and the United States

Chapter Sixteen

Investment

Article 1611: Definitions

For purposes of this Chapter, not including Annex 1607.3: investment means:

/...

Box IV.2 (continued)

a) the establishment of a new business enterprise, or
b) the acquisition of a business enterprise;
c) as carried on, the new business enterprise so established or the business enterprise so acquired, and controlled by the investor who has made the investment; and
d) the share or other investment interest in such business enterprise owned by the investor provided that such business enterprise continues to be controlled by such investor.

BIT between Denmark and Lithuania (1992)

Article 1

The term "investment" shall mean

(1). Every kind of asset connected with economic activities acquired for the purpose of establishing lasting economic relations between an investor and an enterprise ...

BIT between Germany and Israel (1976)

Article 1 (a) (i)

For the purpose of this Treaty,

(a) The term "investment" shall mean, as the context may require, either

(i) investment in an enterprise involving active participation therein and the acquisition of assets ancillary thereto;

OECD Code of Liberalisation of Capital Movements

Annex A

List A

I. Direct investment

Investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof:

A. In the country concerned by non-residents by means of:

1. Creation or extension of a wholly-owned enterprise, subsidiary or branch, acquisition or full ownership of an existing enterprise;
2. Participation in a new or existing enterprise;
3. A loan of five years or longer.

/...

Box IV.2 (continued)

B. Abroad by residents by means of:

1. Creation or extension of a wholly-owned enterprise, subsidiary or branch, acquisition of full ownership of an existing enterprise;
2. Participation in a new or existing enterprise;
3. A loan of five years or longer.

WTO General Agreement on Trade in Services

Article XXVIII

Definitions

For the purpose of this Agreement:

(d) a "commercial presence" means any type of business or professional establishment, including through

(i) the constitution, acquisition, or maintenance of a juridical person, or

(ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.

North American Free Trade Agreement (NAFTA)

Chapter Eleven

Investment

Section C - Definitions

Article 1139: Definitions

For the purpose of this Chapter:

Investment means:

(a) an enterprise;

(b) an equity security of an enterprise;

(c) a debt security of an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the debt security is as least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;

(d) a loan to an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;

/...

- Some IIAs exclude assets of less than a certain value, perhaps because these investments are considered too small to justify the costs of treaty coverage or perhaps because of a desire to reserve to domestic investors those parts of the economy in which small investments are likely to be made. Examples of this approach are the Framework Agreement on the ASEAN Investment Area and article 15 of the Community Investment Code of the Economic Community of the Great Lakes Countries (box IV.3). However, the exclusion of small investments could

Box IV.2 (continued)

(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

(f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph c) or (d);

(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or

(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,

(i) claims to money that arise solely from

(i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or

(ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or

(j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h);

...

discourage small and medium-sized investors that some developing countries may seek to attract, at least during certain stages of the development process. In such cases a size limitation may not be useful.

Box IV.3. Narrowing the definition according to the size of the investment

Framework Agreement on the ASEAN Investment Area

Article 1

Definition

For the purpose of this Agreement:

" ASEAN investor" means -

i. a national of a Member State; or

ii. any juridical person of a Member State,

making an investment in another Member State, the effective ASEAN equity of which taken cumulative with all other ASEAN equities fulfills at least the minimum percentage required to meet the national equity requirements of domestic laws and published national policies, if any, of the host country in respect of that investment.

Community Investment Code of the Economic Community of the Great Lakes Countries (CEPGL)

Section I: Conditions for authorization

Article 15

Any joint enterprise or Community enterprise conducting or wishing to conduct operations in the territory of a CEPGL member State either in order to rationalize its production methods or for purpose of modernization or extension may qualify for a decision authorising inclusion under a preferential regime if it meets the criteria provided for in article 2.

The minimum volume of investments is set at one million United States dollars or the equivalent.

Box IV.4. Limitations on time of establishment
BIT between Germany and Sri Lanka (1963)

Article 9

The present Treaty shall apply to all investments made on or after November 8, 1963, by nationals or companies of either Contracting Party in the territory of the other Contracting Party consistent with the latter's legislation.

- Other IIAs exclude investments established prior to entry into force of the agreement, or another instrument (i.e. a law of the host country) in order to avoid bestowing a windfall on the investor. An example of this approach is article 9 of the BIT between Germany and Sri Lanka (box IV.4). Such an exclusion could be interpreted as calling into question the parties' commitment to investment promotion or protection and in exceptional cases could provide a permanent competitive advantage to investors who invest after the conclusion of the agreement.

- Investment agreements may limit the parts of the economy to which the agreement applies. This is the approach to definition taken by the Energy Charter Treaty (box IV.5) and GATS. It can be envisaged that other sector-specific agreements could adopt a similar approach to definitional issues.

Box IV.5. Limiting the definition of investment
to certain parts of the economy
Energy Charter Treaty

Article 1

DEFINITIONS

As used in this Treaty:

(6) (in fine) An "Investment" refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as "Charter efficiency projects" and so notified to the Secretariat.

3. A broad definition subject to the right to screen and conditional entry

Another alternative is to adopt a broad definition of "investment", but reserve the right to screen or place conditions on the establishment of individual investments. In this way, the host country does not exclude any category of investment a priori, but can exclude any specific investment. This approach has been adopted in a number of BITs and in the ASEAN Agreement for the Promotion and Protection of Investments which was superseded in 1998 by the Framework Agreement on the ASEAN Investment Area (box IV.6). It ensures that only those investments that have been approved by the host country are entitled to protection under the agreement. Moreover, such screening usually includes a review of the development implications of the investment. Consequently, approval of the investment signifies, in principle, conformity to the host country's development goals.

Box IV.6. Broad definition of investment subject to the right to screen entry
China model BIT

Article 1

For the purposes of this Agreement,

1. The term "investment" means every kind of asset invested by investors of one Contracting Party in accordance with the laws and regulations of the other Contracting Party in the territory of the latter,

...

ASEAN Agreement for the Promotion and Protection of Investments

Article 1

Definition

For the purpose of this Agreement:

3. The term "investment" shall mean every kind of asset and in particular shall include, through not exclusively:

   (a) movable and immovable property and any other property rights such as mortgages, liens and pledges;

/...

4. A broad definition with limiting substantive provisions

A further alternative is to adopt a broad definition of investment, but limit the scope of the substantive provisions. For example, if the concern about portfolio investment is that it may be withdrawn quickly, an investment agreement might define "investment" to include portfolio investment, but the currency-transfers provision would apply only if an investment has been established for some minimum period of time, such as one year. This approach has been followed in the BIT between Chile and the Czech Republic (box IV.7). Such a limitation is directed at the volatility of the investment, which may be one particular concern regarding portfolio investment. By addressing concerns generally in the operative provisions, this approach eliminates some of the burden on the investment screening agency to take account of every concern on a case-by-case basis. It also avoids the problem of an "all-or-nothing" approach. Thus, some investments may be admitted, but with only limited rights under an agreement.

Box IV.6 (concluded)

(b) shares, stocks and debentures of companies or interests in the property of such companies;
(c) claims to money or to any performance under contract having a financial value;
(d) intellectual property rights and goodwill;
(e) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract, or exploit natural resources.

Article II

1. This Agreement shall apply only to investments brought into, derived from or directly connected with investments brought into the territory of any Contracting Party by nationals or companies of any other Contracting Party and which are specifically approved in writing and registered by the host country and upon such conditions as it deems fit for the purposes of this Agreement.

This approach places a heavy burden on the negotiators of an agreement to consider the potential ramifications of each type of investment and to incorporate language in the agreement during negotiations to protect the host country's ability to execute its development policy.

5. A mixed approach

It is also possible for the parties to adopt a mixture of, for example, broad and narrow definitions or asset-based and transaction-based definitions in relation to the different purposes of an investment agreement. Thus, while some countries may wish to define "investment" to include not every kind of asset, but only the specific categories included in a list, those same countries may wish to define "investment" more broadly in an agreement that regulates foreign investment, such as an agreement on transfer pricing. Generally speaking, the liberalization of investment flows is one of the aspects of investment agreements that has most concerned many developing countries. One possibility in this respect is to use a broad asset-based definition for the purpose of protecting investments, and a narrower asset-based or transaction-based definition for cross-border investment liberalization agreements.

* * *

Box IV.7. Broad definition of investment with limiting substantive provisions

BIT between Chile and the Czech Republic (1995)

Article 1

Definitions

(2) The term "investment" shall comprise every kind of asset invested ...

Article 5

(4) Capital can only be transferred one year after it has entered the territory of the Contracting Party unless its legislation provides for a more favourable treatment

The development implications of a broad definition of "investment" in an investment agreement are substantial. Although developmental concerns can be addressed in part by narrowing the definition of "investment", that is not necessarily the only approach in every case. Depending upon the nature of the operative provisions of an agreement and the purpose(s) of the parties in concluding the agreement, these developmental concerns in particular cases may be addressed alternatively through reservations of the right to exclude investments or by limiting the applicability of specific operative provisions. It is important to remember in this context that the ultimate effect of an investment agreement results from the interaction of the definition provisions with the operative provisions. There should be sufficient flexibility in the definition to ensure the achievement of developmental objectives.

B. Admission and establishment[2]

The effects of FDI on a host country's economy, in particular its growth and development prospects, are of special interest to developing countries (UNCTAD, 1999c and 1999d). Concerns in this respect have sometimes led to controls over admission and establishment. Various considerations have figured in host government limitations on admission and establishment: infant industry considerations, defence capabilities, employment effects, technology transfer, and environmental and cultural effects. Host government policies in this respect emerge from the specific mix of political and economic circumstances characterizing particular countries. They tend to reflect the policy approaches, or a combination of them, outlined below.

1. State discretion/investment control

This approach is often preferred by countries that are uncertain about the benefits that may flow from a liberalized policy on entry and establishment. It is followed in the majority of BITs and in a number of other IIAs (box IV.8). Arguments in favour of such

an approach include the possibility that foreign investors engage in business activities that are not desirable (such as uncompetitive mergers and acquisitions or restrictive practices), requiring a degree of pre-entry control to assess the overall costs and benefits to the host economy of a proposed investment and to impose specific limitations on such practices. The retention of screening procedures may not deter inward FDI, though it may create an unfavourable image for the host country. At the same time, the use of screening may offer a "once-and-for-all" determination of the right to enter the host State and the added attraction of possible protection against competitive investment by rival firms.

Box IV.8. Admission clauses with complete State discretion/ investment control

BIT between Estonia and Switzerland (1992)

Article 2 (1)

Each Contracting Party shall in its territory promote as far as possible the investments by investors of the other Contracting Party and admit such investments in accordance with its laws and regulations.

MERCOSUR Protocol on the Promotion and Protection of Investments from non-member States of MERCOSUR

Articulo 2

B. Promoción de inversiones

1. Cada Estado Parte promoverá en su territorio las inversiones de inversores de Terceros Estados, y admitirá dichas inversiones conforme a sus leyes y reglamentaciones.

Agreement on the Promotion, Protection and Guarantee of Investment among Member States of the Organization of the Islamic Conference

Article 2

The contracting parties shall permit the transfer of capitals among them and its utilization therein in the fields permitted for investment in accordance with their laws.

Preferences for screening and restrictions over entry differ according to the industry or activity involved. Thus host countries may prefer to protect infant industries and domestic producers deemed not strong enough to compete with foreign firms. Such restrictions may only be removed where effective competition with foreign investors becomes possible — or, indeed, necessary — to ensure the development of the indigenous industry, as was the case, for example, in the liberalization of foreign entry conditions to the Brazilian informatics industry. Land and natural resources may also be subject to screening controls and ownership restrictions to protect what is considered to be part of the natural wealth and resources of the host country. Ownership and establishment restrictions may be more prevalent in certain services industries (e.g. financial services) than in manufacturing, owing to the pivotal role these industries play in the national economy and thus the consequent need for effective prudential supervision. Liberalization in this area has thus proceeded at a slower pace. They are prime candidates for an "opt in" approach as described above. It is also conceivable that restrictions over foreign ownership of infrastructure in a host country are motivated by a desire to regulate a natural monopoly in the public interest. Another justification for controls over foreign entry and establishment is the protection of small and medium-sized enterprises. Finally, controls over foreign access to cultural industries may be justified to protect the cultural heritage of the host country. However, technological change — including the rise of satellite and digital broadcasting and the widespread use of the Internet — has thrown into doubt the ability of States to apply effective national controls in this area.

2. Selective liberalization

A less restrictive approach is to allow for selective liberalization of entry and establishment in specific activities or industries. This approach is exemplified in GATS, articles XVI.1, XIX.1 (box IV.9), XX, XVI.2 (box III.17) and XIX.2 (box III.3). It offers the advantage of making liberalization commitments more sensitive to the real locational advantages of a host country, permitting the country more control over the process of negotiating liberalization measures, given the "stepped" approach to this goal that such a policy entails through the establishment of a positive list of industries in which

FDI is allowed. This approach may be useful for developing countries that have concerns about full liberalization, but would not be opposed to such a policy in activities where they are able to compete on more or less equal terms with foreign investors. It also offers a way of allowing a host country to enhance its future development and competitiveness through the introduction of investment that can stimulate the production of more complex goods and services. To the extent that this approach, too, involves an element of loss of sovereignty, it is a gradual and controlled loss, offset by the prospects of future economic development.

The circumstances in which a host country may be willing to liberalize a specific activity will echo the explanations given above as to why a specific host country may wish to restrict entry and establishment. Thus, different industries or activities may be more or less amenable to liberalization; and liberalization in

Box IV.9. Selective liberalization

WTO General Agreement on Trade in Services (GATS)

Article XVI
Market Access

1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule. ...

Progressive liberalization

Article XIX

1. In pursuance of the objectives of this Agreement, Members shall enter into successive rounds of negotiations ... with a view to achieving a progressive higher level of liberalization. Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.

manufacturing and services may be easier than in natural resources, though even in manufacturing and service industries, national interest may dictate a selective approach.

3. Regional programmes

This approach is a variant of the economic integration model favoured by regional integration groups, applied to a specific policy that seeks to set up a supranational form of business organization aimed at encouraging intraregional economic activity. As such, it offers a vehicle for regional economic development. It has been pursued by a number of regional groups such as for example the Common Market for Eastern and Southern Africa (COMESA) (box IV.10). Other agreements that have followed a similar path are the Revised Treaty of the Economic Community of West African States (ECOWAS) and the Revised Basic Agreement on ASEAN Industrial Joint Ventures. However, the practical results of such a policy may prove to be mixed. It assumes that regional capital exists and sufficient technical and managerial skills exist in the region to be able to perform economic functions without investment from outside the region. This policy may ignore the fact that technology and capital are unevenly spread both within and across regions. On the other hand, such a policy may be useful as a means of breaking down structural barriers to intraregional integration where sufficient resources exist within the region to make such enterprises viable.

Box IV.10. Encouraging the establishment of regional multinational enterprises
Treaty Establishing the Common Market for Eastern and Southern Africa

Article 101
Multinational Industrial Enterprises

(1) The Member States shall promote and encourage the establishment of multinational industrial enterprises in accordance with the laws in force in the Member States in which such enterprises shall be established, having due regard to the economic conditions and priorities of the particular Member States concerned.

4. Mutual national treatment

This approach involves a greater commitment to full liberalization than do those discussed above, though it requires a joint commitment to this process by the States participating in a regional economic integration organization. Consequently, liberalization may proceed between States that see a common interest in regional integration, but which are not necessarily committed to full multilateral liberalization. A major issue in this case is whether the effect of such a commitment is to enhance intraregional investment (and trade) without creating a diversion away from trade with non-members. Importantly, regional integration can offer a larger geographical area within which globally competitive industries can be established. The most significant and influential example of this approach are the Treaty Establishing the European Community (box IV.11).

Box IV.11. Mutual national treatment on entry and establishment

Treaty Establishing the European Community
Right of establishment

Article 43

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings ..., under the conditions laid down for its own nationals by the law of the country where such establishment is effected ....

5. National treatment and MFN with negative list of exceptions

This is the approach preferred by firms and countries that are supportive of liberalization, as it offers the best access to markets, resources and opportunities. It allows investment decisions to be determined on the basis of commercial considerations, by reducing entry controls that create barriers to the integration of production across borders, a strategy increasingly pursued by TNCs (UNCTAD, 1993). Examples of this approach include the BITs signed by the United States and Canada, NAFTA, the MERCOSUR Protocol on Investments from other MERCOSUR Member Countries, the Framework Agreement on the ASEAN Investment Area and the Asia-Pacific Economic Cooperation Non-Binding Investment Principles (box IV.12).

Box IV.12. National treatment and MFN with negative list of exceptions

BIT between Canada and Trinidad and Tobago (1995)

Article II

Each Contracting Party shall permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors of the other Contracting Party on a basis no less favourable than that which, in like circumstances, it permits such acquisition or establishment by: (a) its own investors or prospective investors; or (b) investors or prospective investors of any third state.

North American Free Trade Agreement (NAFTA)

Chapter Eleven

Investment

Section A - Investment

Article 1102: National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own

/...

Box IV.12 (continued)

investors 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 that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

4. For greater certainty, no Party may:
   (a) impose on an investor of another Party a requirement that a minimum level of equity in an enterprise in the territory of the Party be held by its nationals, other than nominal qualifying shares for directors or incorporators of corporations; or
   (b) require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the Party.

Article 1103: Most-Favored-Nation Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that its 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 that its 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.

/...

Box IV.12 (continued)

Article 1104: Standard of Treatment

Each Party shall accord to investors of another Party and to investments of investors of another Party the better of the treatment required by Articles 1102 and 1103.

Article 1108: Reservations and Exceptions

1. Articles 1102, 1103, 1106 and 1107 do not apply to:
   (a) any existing non-conforming measure that is maintained by
      (i) a Party at the federal level, as set out in its Schedule to Annex I or III,
      (ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or
      (iii) a local government;
   (b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or
   (c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.

2. Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing non-conforming measure maintained by a state or province, not including a local government.

3. Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party adopts or
maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.

4. No Party may, under any measure adopted after the date of entry into force of this Agreement and covered by its Schedule to Annex II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective.

/...

Box IV.12 (continued)

5. 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.

6. Article 1103 does not apply to treatment accorded by a Party pursuant to agreements, or with respect to sectors, set out in its Schedule to Annex IV.

7. Articles 1102, 1103 and 1107 do not apply to:
   (a) procurement by a Party or a state enterprise; or
   (b) subsidies or grants provided by a Party or a state enterprise, including government-supported loans, guarantees and insurance.

MERCOSUR Protocol of Colonia on Investment (Intrazone)

Artículo 2

Promoción y Admisión

Cada Parte Contratante promeverá las inversiones de inversores de las otras Partes Contractantes y las admitirá en su territorio de manera no menos favorable que a las inversiones de sus proprios inversores o que a las inversiones realizadas por inversores de terceros Estados, sin perjuicio del derecho de cada Parte a mantener transitoriamente exceptiones limitadas que correspondan a alguno de los sectores que figuran en el Anexo del presente Protocolo.

Framework Agreement on the ASEAN Investment Area

Article 7

Opening up of Industries and National Treatment

1. Subject to the provisions of this Article, each Member State shall:
   (a) open immediately to ASEAN investors and their investments by ASEAN investors;
   (b) accord immediately to ASEAN investors and their investments in respect of all industries and measures affecting investment including but not limited to the admission, establishment, acquisition, expansion, management, operation and disposition

/...

Box IV.12 (concluded)

of investments, treatment no less favourable than that it accords to its own like investors and investments ("national treatment").

2. Each Member State Shall submit a Temporary Exclusion List and a Sensitive List, if any, within 6 months after the date of the signing of this Agreement, of any industries or measures affecting investments (referred to in paragraph 1 above) with regard to which it is unable to open up or to accord national treatment to ASEAN investors. These lists shall form an annex to this Agreement. In the event that a Member State, for justifiable reasons, is unable to provide any list within the stipulated period, it may seek an extension from the AIA Council.

3. The Temporary Exclusion List shall be reviewed every 2 years and shall be progressively phased out by 2010 by all Member States except the Socialist Republic of Vietnam, the Lao People's Democratic Republic and the Union of Myanmar. The Socialist Republic of Vietnam shall progressively phase out their Temporary Exclusion list by 2013 and the Lao People's Democratic Republic and the Union of Myanmar shall progressively phase out their temporary exclusion Lists by 2015.

4. The Sensitive List shall be reviewed by 1 January 2003 and at such subsequent periodic intervals as may be decided by the AIA council.

However, the extension of the national treatment/MFN model to the pre-entry stage is not without its problems. This was illustrated in the negotiations leading up to the Energy Charter Treaty. The principal advocates of such an approach sought to incorporate national treatment into the pre-establishment phase so that the Treaty would reflect a standard of protection similar to that of article II of the United States model BIT. All delegations prepared negative lists for the purpose of negotiations on the pre-establishment stage, but countries in transition requested a grace period in which to finalize national legislation. As a result, a compromise position was reached whereby the contracting parties would "endeavour" to accord national treatment at the pre-investment phase and would

negotiate a supplementary treaty on the issue (Energy Charter Treaty, article 10 (2)-(4)). While agreement has been reached on this supplementary treaty along the national treatment/MFN model with negative lists of existing legislation and the process of privatization, the Charter Conference has not yet adopted the text.

The fact that the national treatment/MFN model allows for negative lists of excepted industries or activities is significant, since it makes clear that this approach recognizes that certain strategic industries may be beyond the reach of liberalization measures. However, it must be noted that such lists are difficult to negotiate and compile and may result in a lengthy and complex final text, as NAFTA exemplifies. In countries in which competition is a desired policy goal, such reservations may be of special importance in relation to infant industries that may not be able to withstand the vagaries of open international competition, or as a means of protecting natural resources against foreign ownership. On the other hand, care needs to be taken that such measures are not used to protect inefficient domestic monopolies against competition that may encourage a more efficient use of resources and improvements in consumer welfare.

6. A mixed approach

This approach combines elements of more than one of the five basic approaches. The economic effects of a mixed approach would be to offer specialized alternatives that may be more compatible with the mix of locational advantages enjoyed by particular host countries. The following combinations are examples:

The *State discretion/investment control* approach can be coupled with selective *liberalization* and/or *regional programmes* to produce a policy of investment screening with sectoral liberalization and/or regional industrial development programmes. The *State discretion/investment control* approach can also be coupled with *mutual national treatment* so long as the former is restricted to investments originating in States that are not members of the relevant regional economic integration organization. However *State discretion/ investment control* is incompatible with *mutual national treatment*

as regards investments originating in other member States of a regional economic integration grouping. This mixed approach would suit a host State that is opposed to full multilateral liberalization on national treatment/MFN principles but which sees benefits in gradual regional integration. Such combinations are exemplified by the Arab regional agreements, and the earlier ASEAN agreements mentioned above.

Mutual national treatment may be coupled with *selective liberalization* and/or *regional programmes* to produce a policy of mutual national treatment coupled with sectoral "opt-in" policies for gradual liberalization vis-à-vis non-members of a regional economic integration grouping and/or regional industrial development programmes. This mixed approach is useful to a host country that wishes to achieve full regional liberalization with its neighbours as a long-term goal but which may want to control that process through gradual sectoral liberalization and which may perceive a need to enhance regional industrial integration through specific projects. The history of European Community market integration is an example of this approach.

National treatment and MFN with negative list of exceptions can be combined with *selective liberalization* to produce a policy of general national treatment and MFN, coupled with a negative list subject to "opt-in" sectoral liberalization at a future date. This approach would suit a host country that wants liberalization on the basis of national treatment/MFN principles, but prefers gradual liberalization in specific activities. NAFTA is a good example of this approach.[3]

National treatment and MFN with negative list of exceptions and *State discretion/investment control* appear, at first sight, to be incompatible. However, the MERCOSUR agreements attempt a reconciliation by using the latter approach in relation to non-MERCOSUR investors, and the former for MERCOSUR-based investors. *Mutual national treatment* is difficult to combine with *national treatment and MFN with negative list of exceptions* except to the extent that special clauses are used. It is arguable that the Framework Agreement on the ASEAN Investment Area of 1998

attempts a combination of these two approaches by extending national treatment and MFN to ASEAN investors first and then extending national treatment to non-ASEAN investors by 2020. However, MFN is only extended to ASEAN-based investors. Thus a transitional phase approach is used from one option to another.

An important final consideration relates to the types of exceptions and reservations on admission and establishment provisions that may be appropriate for countries in order to pursue their development objectives. Reservations and exceptions to rights of entry and establishment provisions in investment agreements indeed offer a compromise option for host States that wish to make those rights compatible with their development priorities, so as to avoid having imposed on them blanket commitments to the granting of such rights. The consequences for national laws of having an agreement that protects rights of entry and establishment depend to a large extent on the nature of the derogations and reservations available under that regime. In particular, it has been noted that national security and public health/public policy concerns, including of countries that pursue national and MFN treatment, are frequently the subject of such measures. Furthermore, in relation to certain specific economic and social issues, States are likely to reserve some degree of flexibility, including the discretion to approve or disapprove privatization proposals; control of access on the grounds of prudential supervision in the financial services sector; controls over entry and establishment for environmental protection purposes; and restrictions on strategic industries or activities based on economic development considerations.

C. National treatment[4]

National treatment may be interpreted as formal equality of treatment between foreign and domestic enterprises. However, where countries at different levels of development are parties to an IIA, such formal equality may disregard important differences in the actual situation and capabilities of the enterprises on each side. In such a context, application of the national treatment standard

may require more than formal equality, so that the development needs of a developing country party to an IIA are taken into account in the definition and application of the standard. These considerations have played a more or less important role in the various approaches that have been followed in IIAs, discussed below.

1. No national treatment provision

Some IIAs have not included the standard of national treatment among their provisions. The reason is to avoid granting equality of treatment between national and foreign investors. This approach has been followed by host countries that have strong reservations about limiting their freedom to offer preferential treatment to domestic firms for certain purposes or by home countries that feel that the treatment of national enterprises is not very favourable. It is the most restrictive in terms of investors' rights and the most respectful in terms of host country discretion. Agreements enshrining this approach include the ASEAN Agreement for the Protection and Promotion of Investments (box IV.13) and some early BITs signed by China, Norway and Sweden, but they are not frequent.

Box IV.13. IIAs that do not grant national treatment

ASEAN Agreement for the Protection and Promotion of Investments

ARTICLE IV
Treatment

4). Any two or more of the Contracting Parties may negotiate to accord national treatment within the framework of this Agreement. Nothing herein shall entitle any other party to claim national treatment under the most-favoured-nation principle.

2. National treatment provision

There are a number of ways in which a national treatment clause can be granted. In each case some general exceptions may apply, in line with the common practice in many IIAs. The basic policy variations are outlined below.

a. *Post-establishment national treatment*

- ***Limited post-establishment national treatment, strong host country control.*** This approach preserves the strongest host country discretion while offering national treatment to foreign investments and/or investors at the post-entry stage. It has been used by host countries that wish to offer a degree of national treatment without limiting their regulatory powers too greatly. Its principal features include some or all of the following:

    - Application to post-establishment treatment only, thereby preserving the right to treat domestic and foreign investors differently at the point of entry, e.g. through screening laws and operational conditions on admission.

    - A development exception in the form of a development clause in the context of the declared development objectives of a host country. A development clause can be justified on the basis for example of the need to grant special and differential treatment to a developing country's domestic firms on account of their weaker competitive position vis-à-vis their foreign counterparts (see above chapter III). However, as a development clause is potentially quite wide in its scope of application, the wide discretion it reserves for a developing host country could be seen as creating uncertainty as to when and where national treatment actually applies and therefore would not be regarded favourably by foreign investors. Clear lists of excepted or included industries or activities may offer greater certainty.

- Short of a general exception for development, provisions are made for a national treatment exception in respect of special incentives granted by a host country only to its nationals and companies, especially for the purpose of stimulating local enterprise development.

- Exception of specific industries, activities and/or policy measures from the standard of national treatment.

- The substantive test of national treatment is limited to:
  - -- the "same" circumstances, thereby avoiding wider comparisons based on "like" circumstances;
  - -- the "same" treatment, thereby avoiding the possibility of treatment more favourable to the foreign investor that can arise from the formulation "no less favourable".

- An exception for political subdivisions and/or local government measures, as appropriate, reflecting the internal political organization of the host country.

- Limitation to *de jure* national treatment only, thereby allowing for *de facto* differentiation in the treatment of foreign investors.[5]

- A stand-alone national treatment clause without reference to other standards such as MFN or fair and equitable treatment.

The principal development implication of this approach is its flexibility in terms of preserving host country discretion. Examples of instruments that have some or all of these features include the BIT between Denmark and Indonesia (article 3) — which does not refer to "treatment" but to the "imposition of conditions" thereby excluding from the application of the standard any benefits or advantages given to investments — (box IV.14), the Agreement on Investment and Free Movement of Arab Capital Among Arab Countries (article 4), the draft United Nations Code of Conduct

on Transnational Corporations (1983 version), and the BIT between Indonesia and Switzerland (Protocol on article 3, paragraph 3) (cited in box III.8 above).

- ***Full post-establishment national treatment***. This approach offers a higher standard of national treatment for the foreign investor and limits the discretion of the host country to treat national and foreign investors differently. Its principal features include some or all of the following:

    - Application to post-establishment treatment only.

    - A minimal number of exceptions based on specific industries or activities seen as vital to national economic policy, and/or that need protection to survive on the basis of infant industry concerns.

    - The substantive test of national treatment is extended to:
        - "like" circumstances, allowing for the application of national treatment to similar, though not necessarily identical, situations;
        - "no less favourable treatment", thereby allowing for better treatment of foreign investors;
        - nothing is said as to whether or not national treatment applies to specified activities or factual situations or circumstances.

Box IV.14. Limited post-establishment national treatment

BIT between Denmark and Indonesia (1968)

Article 3

Neither Contracting Party shall in its territory impose on the activities of enterprises in which such approved investments are made by nationals or corporations of the other Contracting Party conditions which are less favourable than those imposed in its territory on activities in connection with any similar enterprises owned by nationals or corporations of the other Contracting Party or nationals or corporations of third countries.

- No exception for political subdivisions and/or local government measures.
- Application of national treatment *de jure* and *de facto*, thereby ensuring both formal and informal protection for foreign investors.
- A national treatment clause that coexists with, or incorporates within its text, the better of several standards of treatment such as MFN or fair and equitable treatment.

The development implications of this approach are that a host country extends the application of post-entry national treatment disciplines to as wide a range of situations as possible. Examples of instruments that include some or all of the features outlined above include most recent BITs signed by the United Kingdom, France, Switzerland and Germany, the MERCOSUR Protocol on Third Countries Investors and the original text of the OECD National Treatment Instrument (box IV.15).

Box IV.15. Full post-establishment national treatment

OECD Declaration on International Investment and Multinational Enterprises

The governments of OECD member countries:

DECLARE:

...

National Treatment

II. 1. That Member countries should, consistent with their needs to maintain public order, to protect their essential security interests and to fulfil commitments relating to international peace and security, accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another Member country (hereinafter referred to as "Foreign-Controlled Enterprises") treatment under their laws, regulations and administrative practices, consistent with international law no less favourable than that accorded in like situations to domestic enterprises (hereinafter referred to as "National Treatment");

...

The following approaches add national treatment at the *pre-establishment* phase to national treatment at the *post-establishment* stage as described above.

b. Pre-establishment national treatment

- ***Limited pre-establishment national treatment***. In this approach, national treatment extends to pre-establishment as well as post-establishment treatment, thereby limiting a host country's discretion as regards the entry of foreign investors. But the host country still retains some degree of control over the extent and pace of the liberalization of limitations and conditions of entry. This approach would be suitable for a host country that wishes to liberalize investment entry in its economy at a gradual pace. Its principal features may include one of the following two main variations:

    - Use of an "opt-in", "bottom up" or "positive list" approach *à la* GATS, article XVII (box IV.16). No industry and/or activity is made subject to national treatment at the pre-establishment phase until and unless it is specifically agreed upon by the host country.

    - A "best endeavours" option such as that used in the APEC Non-Binding Investment Principles (box IV.16), so that developing countries are not legally bound to grant national treatment at the pre-establishment phase. In a variation of this approach, a best endeavours provision is coupled with a commitment to grant (or negotiate) legally binding national treatment at the pre-establishment phase at a later stage (as done in the Energy Charter Treaty (see above, box III.19 and below box V.1). This has the advantage of allowing a transitional period for developing countries before they become subject to national treatment disciplines. Its disadvantage is that it involves uncertainty before entry for foreign investors in the short to medium term, which could act as a disincentive; it may also encourage some investors to refrain from investing in order to await the new instrument.

- ***Full pre-establishment national treatment***. Under this approach, a host country's commitment to grant national treatment on entry extends in principle to all foreign investors unless such investment is to take place in activities or industries specifically excluded by the host country in a treaty. This approach narrows considerably the discretion of a host country, since it can only use its prerogative to exclude specific activities from the operation of the standard at the time an agreement is completed.

Box IV.16. Limited pre-establishment national treatment

General Agreement on Trade in Services

Article XVII

National Treatment

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and services suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers. ...

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and services suppliers.

3. Formally identical or formally different treatment shall be 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.

APEC Non-Binding Investment Principles

National Treatment

With exceptions as provided for in domestic laws, regulations and policies, member economies will accord to foreign investors in relation to the establishment, expansion, operation and protection of their investments, treatment no less favourable than that accorded in like situations, to domestic investors.

Such a policy choice limits to a considerable extent a host country's traditional right to control the entry of aliens into its territory. It may be of value where a host country government considers that a number of industries or activities can benefit from increased openness and from a more competitive market environment. At the same time, a host country may protect certain industries or activities by way of a "negative list", although this involves a difficult assessment as to which industries or activities need such special treatment. Failure to include an industry or activity may result in it being subjected to potentially damaging competition from foreign investors, especially where an IIA contains a standstill commitment on further restrictive policies. This would prevent a host country from including industries or activities in a "negative list" in the future.

As with the post-establishment approaches noted above, pre-establishment national treatment may be broader or narrower, depending on the wording of the principle and the use of various qualifications indicated earlier. Examples of this approach include the BITs signed by the United States (following the United States model, box IV.17) and Canada, as well as the MERCOSUR Protocol on Intra-MERCOSUR investments and NAFTA (see above box IV.12).

Box IV.17. Full pre-establishment national treatment

The United States model BIT (1994 version)

Article II

1. With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favorable than that it accords, in like situations, to investments in its territory of its own nationals or companies (hereinafter "national treatment") or to investments in its territory of nationals or companies of a third country (hereinafter "national and most favored nation treatment"), which ever is most favourable (hereinafter "national andmost favoured nation treatment"). Each Party shall ensure that its State enterprises, in the provision of their goods and services, accord national and most favored nation treatment to covered investments.

/...

3. A mixed approach

Various combinations of the elements of post- and pre-establishment national treatment are available to produce a compromise between the various possibilities outlined above. For example, different permutations of the substantive test of differential treatment could be devised, resulting in wider or narrower application of national treatment. Other matters open to variation from the above options include the distinction between *de jure* and *de facto* differential treatment; the degree of interaction between national treatment and MFN and fair and equitable treatment; and the extent to which subnational entities are subjected to national treatment disciplines.

D. MFN treatment[6]

The MFN standard means that a host country must extend to investors from one foreign country the same or no less favourable treatment than it accords to investors from any other foreign country. IIAs have dealt with MFN treatment in a variety of ways, reflecting varying investment strategies that are briefly outlined below.

1. Extending MFN to pre-entry treatment or limiting it to post-entry treatment

The first set of issues concerns whether to limit MFN to post-entry treatment only or to extend the standard to both pre-entry and post-entry treatment. It suffices to note here that the issue depends much, to begin with, on whether a country differentiates

Box IV.17 (concluded)

2. (a) A Party may adopt or maintain exceptions to the obligations of paragraph 1 in the sectors or with respect to the matters specified in the Annex to this Treaty. In adopting such an exception, a Party may not require the divestment, in whole or in part, of covered investments existing at the time the exception becomes effective.

between pre-entry and post-entry treatment in general. Examples of IIAs that grant pre-entry and post-entry MFN include NAFTA Article 1103, and the APEC Non-Binding Investment Principles. Examples of IIAs that grant MFN only after entry and establishment include most BITs and the Energy Charter Treaty, article 10 (7).

2. Treating investors from different countries in different ways

Countries that apply liberal policies vis-à-vis foreign investors assume that foreign investment is a means for increasing domestic competitiveness. The MFN standard is typically an inherent part of their development policies, since an open-door policy means that no restrictions on, or discrimination between, foreign investors are in effect. In fact, countries are often less willing to grant national treatment than MFN for developmental reasons. In other words, they often reserve the right to discriminate in favour of domestic investors without reserving the right to discriminate in favour of only certain foreign investors. Thus, while a number of IIAs do not guarantee national treatment to investments, virtually every IIA requires that investment covered by the agreement should receive MFN treatment.

On the other hand, it may be argued that an exception to MFN based on the nationality of foreign investors is 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 are selected as strategic partners. The countries concerned 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 can be identified (and that granting the same conditions to investors from other countries could undermine this strategic partnership). The host country thus aligns 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 is 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.[7]

3. The use of exceptions

As has been suggested above, it would seem that in most cases host countries can pursue their development strategies without having to discriminate among investors from different foreign countries. In other words, the standard of MFN treatment does not seem to involve, in principle, significant potential negative implications for development. However, as these countries become more integrated into the global economy, they may need, in some cases, 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 broadly accepted (box IV.18). For example, when a country develops a network of bilateral double taxation agreements, it may find it appropriate not to grant MFN treatment to third countries in this respect. Mutual recognition arrangements are another area that could be undermined by a unilateral extension of the benefits of an arrangement to third countries. Finally, countries may increasingly seek recourse to MFN exceptions through regional economic integration organization (REIO) clauses.[8]

Beyond these specific exceptions, many IIAs contain general exceptions based on public policy and national security; they are not targeted at MFN *per se*, but they can indirectly limit its application. The protocol to Germany's model BIT contains a typical reservation (box IV.19). Other examples of general exceptions applying to MFN treatment can be found in GATS (article XIV and bis), the OECD Code of Liberalisation of Capital Movements (articles 2 and 3), the Energy Charter Treaty (article 24 (c), 24 (2) (b) (1) and 24 (3), and NAFTA, article 2102.

Box IV.18. MFN treatment exceptions in respect of specific matters agreed beforehand by all contracting parties

BIT between Chile and Malaysia (1992)

Article 3

Most favoured nation

1. Investments by nationals or companies of either Contracting State on the territory of the other Contracting State shall ... not be subjected to a treatment less favourable than that accorded to investments by nationals or companies of third States.

...

3. 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 similar international convention or other forms of regional cooperation, present or future, of which any of the Contracting Parties might become a party; or the adoption of an agreement designed to achieve the formation or expansion of such union or areas within a reasonable time; or

(b) any international convention or agreement related totally or principally to taxation, or any national legislation relate totally or partially to taxation.

BIT between Armenia and the United States (1992)

Article II (1)

Each Party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investment or associated activities of its own nationals and companies, or of nationals or companies of any third country, whichever is the most favorable, subject to the right of each Party to make or maintain exceptions falling within one of the sectors or matters listed in the Annex to this Treaty. Each Party agrees to

/...

Box IV.18 (concluded)

notify the other Party before or on the date of entry into force of this Treaty of all such laws and regulations of which it is aware concerning the sectors or matters listed in the Annex. Moreover, each Party agrees to notify the other of any future exception with respect to the sectors or matters listed in the Annex, and to limit such exceptions to a minimum. Any future exception by either Party shall not apply to investment existing in that sector or matter at the time the exception becomes effective. The treatment accorded pursuant to any exceptions shall unless specified otherwise in the Annex, be no less favorable than that accorded in like situations to investments and associated activities of nationals or companies of any third country.

Box IV.19. General exceptions to MFN treatment based on public policy or national security

BIT model by Germany

Article 3

(1) Neither Contracting Party shall subject investments in its territory owned or controlled by nationals or companies of the other Contracting Party to treatment less favourable than that it accords to investments of ... any third State.

...

Protocol

(3) Ad Article 3

(a) .... Measures that have to be taken for reasons of public security and order, public health or morality shall not be deemed "treatment less favourable" within the meaning of Article 3.

* * *

MFN treatment is at the heart of multilateralism and is a core principle in IIAs. At the same time, IIAs allow for 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. 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.

E. Fair and equitable treatment[9]

The fair and equitable standard plays a significant role in IIAs. In addition to filling gaps and providing a context for the interpretation of specific provisions, it seeks to provide a means for resolving problems not only by reference to strict legal rules but on the basis of equity, taking into account the surrounding circumstances of each individual case. The main basic approaches to this standard are outlined below.

1. No reference to fair and equitable treatment

States may opt not to incorporate the fair and equitable standard in their investment relations. Where this is done, the standard is not likely to be implied in the relevant investment instrument, so that, in effect, the foreign investor will not have the benefits contemplated by this standard. Its absence from a treaty may prompt investor concerns about the nature of protection to be offered by a host State. Fair and equitable treatment is not mentioned in the BITs between Egypt and Japan and between Italy and Romania and, more generally, in early BITs signed by Pakistan, Rwanda, Saudi Arabia and Singapore. Nor is the clause mentioned in the models recommended by the Asian African Legal Consultative Committee (AALCC). At the multilateral level, no reference is made to the standard in, for example, GATS and TRIPS. However, most treaties that omit reference to fair and equitable treatment provide alternative standards of treatment, usually the national treatment and MFN treatment standards. Where this is done, such standards provide some degree of contingent protection to foreign investors; principles of customary international law will also apply.

2. The hortatory approach

Under this approach States may include a clause exhorting the observance of fair and equitable treatment for foreign investors and their investments. It is doubtful that this approach gives rise to any special economic implications. This is so because, by definition, the hortatory approach does not create a binding obligation on host States to grant investors fair and equitable treatment. Rather, it indicates that fairness and equity are desirable in investment relations, but, without more, it leaves host States with a substantial degree of flexibility as to how they will treat foreign investors. In some circumstances, however, the hortatory approach reflects the starting point in a negotiating process in which fair and equitable treatment may be included in binding form in a subsequent investment agreement. This is exemplified by the Havana Charter (box IV.20), which indicated that it would be desirable for States to enter into treaties making provision for the fair and equitable standard.

Box IV.20. The hortatory approach to fair and equitable treatment

Havana Charter for an International Trade Organization

Chapter III

Economic development and reconstruction

Article 11

Means of Promoting Economic Development and Reconstruction

2. The Organization may, in such collaboration with other inter-governmental organizations as may be appropriate:

(a) make recommendations for and promote bilateral or multilateral agreements on measures designed:

(i) to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another.

3. Reference to "fair and equitable" treatment, "just and equitable" treatment or "equitable" treatment

The terms "fair and equitable" treatment, "just and equitable" treatment and "equitable" treatment appear to be equivalent and, though different in formulation, prompt the same degree of protection for investors. In each case, they mean that the host State is required, as a matter of law, to accord fair treatment to the foreign investor. This approach creates a legal environment in which aliens may undertake capital investments with some degree of confidence that they will not be subject to arbitrary or capricious treatment. The investor may also derive confidence from the simple fact that the host country has found no reason to resist offering fair and equitable treatment in practice. The BIT between the Netherlands and the Philippines offers a fairly common example of the fair and equitable standard (box IV.21).

Box IV.21. Reference to fair and equitable treatment

BIT between the Netherlands and the Philippines (1985)

Article 3

2. Investments of nationals of either Contracting Party shall, in their entry, operation, management, maintenance, use, enjoyment or disposal, be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party.

4. Reference to "fair and equitable treatment" and related standards

Where the fair and equitable standard is combined with other standards such as the MFN and national treatment standards, it probably is seen as strongest by investors, compared with situations in which only one type of these standards is granted. This is in fact the most common approach followed in IIAs, including NAFTA, the MERCOSUR Protocols and the majority of BITs, as exemplified in the model BITs prepared by Chile (box IV.22). There is reason to believe that investors will have more confidence in the host country than in situations in which only one type of these standards is granted.

Box IV.22. Reference to fair and equitable treatment and related standards

Model BIT prepared by the Government of the Republic of Chile

Article 4

Treatment of investments

(1) Each Contracting Party shall extend fair and equitable treatment to investments made by investors of the other Contracting Party on its territory and shall ensure that the exercise of the right thus recognized shall not be hindered in practice.

(2) A Contracting Party shall accord investments of the investors of one Contracting Party in its territory a treatment which is no less favourable than that accorded to investments made by its own investors or by investors of any third country, whichever is the most favourable.

5. Reference to "fair and equitable treatment" in combination with the international minimum standard

There have been different views on the relationship between fair and equitable treatment and the international minimum standard. While both standards seem to overlap significantly, fair and equitable treatment is not automatically assumed to incorporate the international minimum standard. Some countries have specifically reinforced the fair and equitable standard with formulations such as "full protection and security" which may imply the international minimum standard. Examples of this approach include the BIT between Mexico and Switzerland (box IV.23).

Box IV.23. Reference to fair and equitable treatment in combination with the international minimum standard

BIT between Mexico and Switzerland (1995)

Article 4

Protection and Treatment

(1) Investments by investors of each Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Party in accordance with international law. Neither Party shall in any way impair by discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of investors of the other Party.

* * *

In deciding the type of substantive provisions an IIA should contain to serve development objectives fully, the parties need to take into account the various and sometimes complex interactions between individual provisions. These interactions can be instrumental for achieving a balance of rights and obligations, not only within individual provisions, but also between *all* provisions of an agreement, or between separate agreements, and for *all* parties concerned.

Notes

1 For an in-depth discussion of the topic of scope and definitions in IIAs, see UNCTAD, 1999j. The paper -- like the papers mentioned below in relation to the issues covered here -- deals with (a) explanation of the issue; (b) stocktaking and analysis of how the issue has been dealt with in existing IIAs; (c) interrelations with other issues and concepts; and (d) economic and development implications and policy options.

2 For an in-depth discussion of the topic of admission of investments in IIAs, see UNCTAD, 1999e.

3 Indeed, a multilateral regional integration programme is a contradiction in terms. However, multilateral industrial development programmes are not inconceivable and could take the form of a public international corporation or an intergovernmental agency of which the Multilateral Investment Guarantee Agency (MIGA) may be an example, see Muchlinski, 1999.

4 For an in-depth discussion of the topic of national treatment in IIAs, see UNCTAD, 1999i.

5 *De jure* treatment refers to treatment of foreign investors provided for in national laws and regulations. *De facto* treatment includes any measure or action that in fact works against national treatment, as in the case for example of licensing requirements for the conduct of a business activity which depend on the possession of qualifications by skilled personnel that can only be obtained in the host country.

6 For an in-depth discussion of MFN treatment in IIAs, see UNCTAD 1999h.

7 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.

8 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 UNCTAD, 1999h). The regional economic integration organization 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.

9 For an in-depth discussion of the topic of fair and equitable treatment in IIAs, see UNCTAD, 1999f.

V. APPLICATION

The parties to an IIA may be required to take a number of concrete actions to give effect to the agreement and comply with specific provisions. These tend to be taken over time through a variety of mechanisms and interactions at the national and international levels. They can have a significant influence on the development effects of an agreement. The types of mechanisms used may depend on the characteristics of the agreement, including whether it is a stand-alone agreement (like a BIT) or a part of a larger body of commitments. Application is, of course, crucial in the context of development as the effectiveness of international economic rules "depends on satisfying the interests of all parties involved, either because compliance is beneficial, or because non-compliance is damaging. .... An effective instrument is one that has a significant impact, in the direction desired, on the behaviour of those with whom it is concerned. Consequently, it is the ultimate outcome that will determine whether ...[an international investment instrument] is or is not effective" (UNCTC, 1978, p. 3).

The developmental outcome of an IIA is intimately related in particular to the arrangements the parties make for a follow-up and monitoring of its application after the agreement has entered into force. It is through such arrangements — which, in turn, often depend on the legal character of the instrument — that it can ultimately be tested whether an IIA is performing its development functions well. In order to facilitate application and reap the benefits of such agreements it may also be necessary to put in place special promotional and technical assistance measures.

A. Legal character, mechanisms and effects[1]

The manner in which an IIA is interpreted, and the way in which it is to be made effective, ultimately determine whether its objectives, structure and substantive provisions produce the desired developmental effects. The degree of flexibility allowed for the interpretation and application of an IIA depends to a large extent on the legal character of the agreement, the formulation of individual provisions and the institutional machinery involved

in its application. IIAs are intrinsically intended to have certain effects, both at the national and international levels, even when they do not provide for follow-up mechanisms specific to them. This section discusses first variations in the binding character of IIAs, and then looks at the levels at which the application of an agreement can take place, and the institutional arrangements that may be involved.

1. Normative intensity of instruments and provisions

IIAs may be adopted as legally binding agreements (i.e. treaties and conventions) or as voluntary or non-legally-enforceable instruments. The latter can, in turn, take different forms, such as resolutions, declarations, recommendations and guidelines.

Legally-binding agreements impose on the States signatories a legal obligation under international law to comply with their provisions. How far such an obligation will actually limit the subsequent freedom of action of the States concerned will largely depend on the language of the agreement and the type of obligations imposed. Legally-binding or mandatory instruments usually contain obligations that are enforceable in national and international courts of law, and they may involve penalties or sanctions. Most bilateral and regional instruments dealing with investment, and an increasing number of multilateral instruments, have been adopted as legally-binding instruments.

Voluntary instruments, on the other hand, are not legally enforceable. For that reason, their provisions need not be couched in precise legal formulations. Still, they can have an influence on the development of national and international investment rules.[2] A considerable number of such investment instruments exist, adopted mainly during the 1970s and 1980s in international fora such as the OECD and the United Nations and its agencies. Examples are the Set of Multilaterally Agreed Equitable Rules and Principles for the Control of Restrictive Business Practices, the United Nations Guidelines for Consumer Protection and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. More recent examples of comprehensive non-binding investment

instruments are the APEC Non-Binding Investment Principles and the World Bank Guidelines on the Treatment of Foreign Direct Investment.

Intermediate degrees of binding force. Within the set limits outlined above, it is possible to perceive varying degrees of binding force among investment instruments, depending, for example, on the form the instrument takes and the level at which it is adopted. Thus, in a number of international organizations, a *decision* of the intergovernmental policy making body is considered a formal act which is normally binding on the governments of the countries members. Such is the case of, for example, the OECD Third Revised Decision on National Treatment adopted by the OECD Council.[3] A solemn *declaration*, not in the form of a binding treaty adopted by sovereign States, or a formal *resolution* of an organ of an international organization, may spell out principles that the parties declare to be appropriate or desirable. Obviously, States are free to comply with these recommendations. Beyond that, however, States may feel compelled not to act inconsistently with instruments that they have formally accepted. The circumstances of adoption of an instrument also influence the degree of effective respect it will receive. In the case of United Nations General Assembly resolutions, for example, such elements as a unanimous vote in favour, supporting statements of States during the pertinent debates, and the actual language of the resolutions, can be important in determining their real impact (UNCTC, 1978). Thus, the General Assembly resolution 1803 (XVII) on "Permanent sovereignty over natural resources" adopted by unanimous vote in 1962 enjoyed a wide measure of support from both developed and developing countries. Whereas ten years later, when the General Assembly adopted the Charter of Economic Rights and Duties of States (Resolution 3281 (XXIX), a number of developed countries abstained. In short, international instruments, whether mandatory or voluntary, need to rely on good faith, peer pressure and the political will of the signatories to be effective.

Variations in binding force within individual instruments are often expressed with terms such as "shall" or "should". Thus, when the term "shall" is used in a non-binding instrument the implication would be that the signatories expect a stronger level

of commitment to comply than when the recommendation is expressed with the word "should".

Including soft obligations among binding provisions. One way of mitigating some of the most rigorous implications of concluding a legally-binding investment agreement is to include one or several "soft" obligations among binding provisions, for the benefit of all or some parties. For example, IIAs may include a binding obligation to "endeavour" to act in a certain manner, or to "seek as far as possible" to avoid certain measures, or to "give sympathetic consideration" to the needs or aspirations of other parties or "to consult with the other parties". In the Energy Charter Treaty the difference in language between paragraphs 1 and 2 of article 10 is used to impose a softer obligation with respect to national and MFN treatment for foreign investment at the pre-establishment phase (box V.1). By avoiding rigorously binding obligations, this method eases the way for countries that may wish to sign an IIA but would find it difficult to commit themselves fully to certain specific disciplines.

Box V.1. Including soft obligations among binding provisions

Energy Charter Treaty

Article 10

Promotion, protection and treatment of investments

(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to Make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

/...

Box V.1 (concluded)

(2) Each Contracting Party shall endeavour to accord to Investors of the other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).

(3) For the purposes of this Article, "Treatment" means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.

BIT between the United States and Zaire (now Democratic Republic of the Congo) (1984)

Article II

7. Within the context of its national economic policies and goals, each Party shall endeavor to avoid imposing on the investments of nationals or companies of the other party conditions which require the export of goods produced or the purchase of goods or services locally. This provision shall not preclude the right of either Contracting Party to impose restrictions on the importation of goods and services into their respective territories.

BIT between Malaysia and the United Arab Emirates (1991)

Article 2

9. Contracting States shall seek as far as practicable to avoid performance requirements as a condition of establishment, expansion or maintenance of investment, which require or enforce commitments to export goods produced or services or services must be purchased locally must be purchased locally or which impose any other similar requirements.

Finally, as legal obligations and recommendations can be expressed in a wide variety of ways, a key element for the interpretation and application of provisions is the degree of specificity of their language. The more specific the language, the more restricted the choices open to the parties. The more general the language, the larger the margin of freedom allowed. A provision may directly impose an obligation or make a recommendation concerning a

particular action (e.g. to open up a particular industry or to refrain from imposing a performance requirement). Alternatively, it may be directed at a desirable outcome or result, thereby indirectly permitting or encouraging any action that brings about that result. This is the case, for example, where broad standards of treatment are mentioned using such formulations as "appropriate", "reasonable" or "fair".

2. Levels of application

a. National level

Many IIA provisions require some kind of action at the national level in order to be made effective. This is so independently of whether or not an IIA provides for application or follow-up mechanisms specific to it. Thus, the types of actions discussed under this subheading may well be taken in the absence of any international institutional machinery, as in the case of BITs. The very fact of the adoption of an IIA, whether as an international agreement or as a formally non-binding instrument, is bound to have an impact on the national policies of the adopting States. The impact, of course, would be stronger and more immediate in the case of the former. In that case, giving effect to an IIA often implies that its provisions are given formal recognition in the national system. The various legal techniques that are stipulated by individual constitutional systems for incorporating an international agreement into the national system are recalled here, as these will provide the legal parameters through which this objective can be obtained.

A major direct effect of an IIA, whether legally-binding or voluntary, would be that the States that have adopted it would not be able to challenge successfully an action by other States taken in accordance with provisions of the agreement on the grounds that it is inherently unlawful or improper. Obviously, problems might arise as to whether particular measures were or were not in accord with the agreement's principles. But the principles themselves would not be a viable subject of contention among the parties.

Where the relevant provisions call for the enactment of national legislation, whether expressly or by implication, the binding or non-binding character of the instrument makes, at first blush, a considerable difference. In the former case, specific legislative or administrative action would be required. Failure to take such action would be *prima facie* in breach of an international obligation. In some cases, further specification into detailed provisions would be needed, unless the agreement provides detailed treatment of the particular topic. The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, article 1, is an example of a provision that requires the adoption of more specific national legislation to give it effect (box V.2).

The degree of specificity of the provisions calling for enactment of national legislation is of particular importance in this context. If they are phrased in broad terms, a greater margin of freedom of action is left to the States concerned. Thus, article 6 (2) of the Energy Charter Treaty dealing with competition leaves ample margin to the country to determine what type of laws might be adopted (box V.2).

Even in the case of a non-binding investment instrument, it seems reasonable to assume that the States adopting it would seek to give some effect to its principles in the national legal system. The International Code of Marketing of Breast-milk Substitutes, for example, though not legally binding, calls for the adoption of appropriate national legislation and other suitable measures (box V.2). In such cases, the principal ground for subsequent compliance is likely to be the continuing perception of common interest. Unless circumstances change radically, the common ground for compliance with an agreement is likely to continue to be valid for the parties involved.

Non-binding instruments can also have an educational effect at the national level, as they provide guidance on the expectations of the international community with respect to the behaviour of foreign investors and governments, which may be replicated in national practice.

Box V.2. Provisions calling for enactment of national legislation

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions

Article 1

The Offence of Bribery of Foreign Public Officials

1. Each Party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.

The Energy Charter Treaty

Article 6

Competition

(2) Each Contracting Party shall ensure that within its jurisdiction it has and enforces such laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct in an Economic Activity in the Energy Sector.

International Code of Marketing of Breast-milk Substitutes

Article 11

11.1. Governments should take action to give effect to the principles and aim of this Code, as appropriate to their social and legislative framework, including the adoption of national legislation, regulations or other suitable measures ...

Where explicit provisions requiring national action are absent from an IIA, each State is free to decide on the particular manner in which it implements the provisions of an IIA. This approach is exemplified by BITs. In fact, as a result of that — in addition to the lack of independent monitoring — little is known about how BIT provisions have been applied in practice, except in a few cases of serious disagreements where the treaty obligations

have been enforced through proceedings in national courts and/or international tribunals (which provide binding interpretations of the provisions under review) (UNCTAD, 1998b). The resulting legal and administrative activity of States however can be diverse, and possibly even contradictory, even though the likely outcome may be a move in the general direction of the instrument.

* * *

Seen from a development perspective, the main implication of the foregoing discussion is that, in the process of advancing their development interests, developing countries can take advantage of the possibilities offered by variations in normative intensity and specificity of language of IIAs regarding their effects on the parties' national systems. They can, for example, insist on hard-binding and explicit commitments to be enacted in national laws when it comes to matters of interest to them — for example, with respect to commitments by developed countries to undertake promotional measures to encourage FDI flows to developing countries — while selecting softer, more general and flexible approaches with respect to issues for which application at the national level is likely to raise policy difficulties. The application of provisions granting developing countries more favourable thresholds for complying with their obligations under IIAs is of particular relevance in this context.[4]

b. International level

(i) Intergovernmental cooperative action

Intergovernmental cooperation here relates to the types of measures taken by individual States, either unilaterally or on the basis of inter-State arrangements, in the absence of international institutional machinery for monitoring and follow up. These are measures and actions with a clear international dimension, but on the basis of the traditional international legal pattern of decentralized decision-making and action.

One reason for this type of action is that, as foreign investors operate in several or many host countries at the same time, no single country is in a position, by its own independent action, to acquire the information on the world-wide operations of TNCs which it may need for evaluating their operations within its territory, or to exercise jurisdiction over the TNC as a whole. Moreover, jurisdictional conflicts may arise when individual States seek to exercise jurisdiction over TNC activities partly involving their territory but also involving the territories of other States. Consequently, intergovernmental cooperation is often an essential tool to facilitate compliance with the provisions of IIAs. In particular, it can enhance the ability of developing countries to deal effectively with the full dimensions of TNC operations in the application of their development strategies through FDI, minimising possible negative effects of such operations and maximising their beneficial effects, while avoiding potential conflicts that can be disruptive of productive operations.

The principal types of measures that may be envisaged include the following:

- Exchange of information between governments concerning investors' operations and related governmental activity. This is the kind of cooperation sought in most bilateral cooperation agreements on competition (UNCTAD, 1997).

- Arrangements between the parties for reciprocal recognition and enforcement of final decisions and other such measures by national courts and administrative authorities. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitration Awards provides such arrangements. IIAs — especially BITs — sometimes refer to the Convention's arrangements in connection with the settlement of investment disputes (UNCTAD, 1998b).

- Arrangements between governments for cooperation and reciprocal assistance with respect to measures of national authorities that do not amount to final decisions, particularly preliminary measures or orders concerning matters of evidence in connection with national proceedings for the application

of an IIA. Some cooperation agreements (e.g. the Agreement between Australia and the United States on Mutual Antitrust Enforcement Assistance) provides for notification of competition investigations.

- Arrangements between governments for consultations whenever problems arise out of the implementation of an agreement. Increasingly, BITs provide for consultations among the parties as a means of resolving difficulties arising out of the application of the agreement, thus preventing formal disputes. In this respect, a measure of the success of a BIT lies as much in its ability to prevent a dispute as its ability to provide a basis for resolving it. In the kind of investment climate that a BIT is intended to promote, investors and their host country would normally seek to operate on the basis of cooperation rather than confrontation (UNCTAD, 1998b). That might be a reason why this approach is followed in BITs where broader political and economic considerations appear to play a significant role in the parties' relations.

- Direct cooperation between national authorities at the working level. An example of this approach is found in double taxation treaties (UNCTAD, 1998a).

In addition to providing essential tools for facilitating the application of development-related provisions in IIAs that impinge upon the transnational nature of FDI operations, the forms of intergovernmental cooperation being described can provide flexible approaches to deal with issues arising out of the application and interpretation of IIAs in as much as they contribute to facilitating dialogue between the parties and resolving potential difficulties.

(ii) Intergovernmental institutional machinery

An international institutional machinery for monitoring and follow up on the application of an IIA can play several major developmental roles. Thus, for example, it can:

- provide the tools for studying the provisions of an IIA from the perspective of their implications for the flexibility they give to pursue policies and strategies for economic development;
- provide the basis for governments to assess in a timely manner the implications of an agreement, or specific provisions thereof, for the development of developing countries in the light of concrete situations;
- facilitate compliance by clarifying the interpretation of provisions that are found to be unclear, and providing advice and technical assistance as to the most beneficial and least costly ways of achieving compliance in the light of specific development objectives;
- provide the mechanisms by which countries can seek relief from certain obligations under certain circumstances;
- enable developing countries to make periodic determinations on the state of implementation of provisions that are of particular interest to them, such as those relating to commitments to grant them special concessions;
- facilitate a continuing dialogue among the parties to find flexible solutions to problems; and
- move the process forward, including the implementation of in-built agendas for further negotiations and/or amendments to the agreement.

It is therefore of critical importance for developing countries to make the best of the international institutional machinery provided in an IIA to ensure that development objectives are given full effect (Youssef, 1999).

Many IIAs have set out institutional arrangements for their application, monitoring and/or follow-up in general, or have spelled out concrete procedures for dealing with specific matters. This is the case in the majority of regional and multilateral investment agreements, whether legally binding or not. The specific functions of an international machinery can vary considerably. An IIA may make provision for any or all of the functions discussed below.

Administrative, technical and monitoring functions. The actual scope of such functions ranges widely from coordination,

documentation and depository functions to tasks involving extensive initiative and study, capable of having an impact on policies. The types of functions described here are typically entrusted to the secretariat of the international organizations that are charged with the administration of an IIA, such as, for example, WTO, UNCTAD, OECD, or the Energy Charter Secretariat. Secretariats often play a significant role as guardians of the institutional memory of the negotiation and application of IIAs, in coordinating the work of governments and providing technical, procedural and substantive backup to negotiations and follow up processes. These functions undertaken by an international secretariat can be especially useful for countries with limited resources and capabilities.

Reporting requirements. A simple monitoring procedure involves mainly reporting by contracting parties upon their practice in the observance of the provisions of the agreement. In some cases, reporting is meant to ensure transparency of existing national policy and practice. In other cases, the parties are requested to report on specific measures and/or changes introduced in national policies pursuant to the commitments made in an agreement. Where an investment instrument requires regular or ad hoc reporting on the part of the States parties on various aspects of the application of an instrument, this obligation can be seen as a significant inducement for States to act in compliance. Reporting requirements may be imposed not only by formally binding instruments, but also by instruments that otherwise lack a binding character. Reporting requirements relating to existing national practice are provided for in, for example, the TRIMs Agreement. Reporting requirements regarding changes in national policy and practice are found in article III.3 of the GATS, which requires each member to inform the Council for Trade in Services promptly, and at least annually, of the introduction of any new, or any changes to existing, laws regulations or administrative guidelines that significantly affect trade in services covered by the members' specific commitments under the Agreement.

Reporting requirements can be instrumental in facilitating a systematic flow of information on the manner in which certain commitments made by one group of countries to grant preferential treatment (e.g. non-reciprocal concessions to developing countries)

are given effect, so as to allow developing countries continuously to monitor the situation (Youssef, 1999).

Consultative functions. Consultations on the application and interpretation of an instrument can provide useful and flexible means for dealing with problems and situations that have not yet crystallized into disputes. Consultations of this kind typically stress non-adversary procedures of inquiry and discussion. They may deal with general or specific issues submitted to the relevant body by any concerned party or — through appropriate screening procedures — by a non-State entity, such as a trade union or a TNC. Consultations are a central task of most monitoring and follow up mechanisms established by investment instruments, such as GATS, TRIMs and TRIPS in the WTO, the Liberalisation Codes, the National Treatment Instrument and the Guidelines for Multinational Enterprises in the OECD, the Tripartite Declaration on Multinational Enterprises and Social Policy in the ILO and the Framework Agreement on the ASEAN Investment Area.

An important development function of the consultation machinery can be to ensure coherence between the development objectives of an IIA and the actual implementation of its provisions.[5] Development objectives are by definition flexible and sometimes require adjustments to link the conceptual and practical levels effectively. In particular, the difficulties facing developing countries in complying with their obligations within transitional periods in various agreements can be examined in a flexible and practical manner, in order to evaluate the adequacy of these thresholds and whether they should be refined more or even reconsidered in the light of experience in implementing relevant agreements. Another function can be to interpret development-related provisions that are vague or ineffective or are expressed in "best endeavour" terms and perhaps give them a more precise and action oriented interpretation. This can be achieved through the establishment of guidelines, or the adoption of appropriate decisions by the relevant bodies. Measurable criteria for the evaluation of the implementation of development-related commitments can also be devised. In some cases, the implementation of certain provisions can be facilitated by developing model laws or clauses that countries

may take into consideration when developing appropriate national legislation.

Complaint and clarification mechanisms. Some investment instruments of a voluntary nature include a rather unique mechanism for dealing with questions relating to the meaning of their provisions arising from an "actual situation". In the OECD, the mechanism in question is known as "clarifications". It was first developed as part of the follow-up arrangements for the application of the OECD Guidelines for Multinational Enterprises. The clarifications are intended to facilitate the application of the Guidelines by allowing governments of member countries, and the trade unions and business advisory committees (TUAC and BIAC) to submit specific questions arising in a concrete case. The clarifications are prepared by the Committee on International Investment and Multinational Enterprises — which is the body with authority to monitor the application of the Guidelines — under procedures of a non-adjudicatory nature. However, since the clarifications arise from "actual situations", they inevitably involve ascertainment of certain facts, though not resolution of matters of fact and law, the factual situation being treated as hypothetical. Although these interpretations are not legally binding, they have helped to adapt the Guidelines to changing situations.

The ILO Tripartite Declaration has adopted a similar procedure for examination of disputes concerning the application of the Tripartite Declaration. This procedure cannot be invoked for matters covered by the ILO Conventions or recommendations.

Most of the clarifications so far have related to employment issues at the instance of trade unions. However, they can be used for other purposes as well, including, notably, for defining and clarifying the social responsibilities of TNCs. Moreover, while the clarification mechanisms have been used in the context of voluntary instruments, they can also be utilized in the context of legally binding instruments as a means of avoiding more formal, rigid -- and costly -- procedures.

Settlement of disputes. Another category of functions are those related to the settlement of disputes arising out of the application and interpretation of an investment instrument. In this respect, a distinction needs to be made between disputes between States and disputes between States and foreign investors or other non-State entities. The question of settlement of disputes is not discussed in this paper.[6] Only a few aspects of interest for the overall discussion on flexibility are briefly mentioned in the following paragraphs.

International methods of dispute settlement that involve a binding decision by a third party must be distinguished from those where the parties to a dispute retain the right to decide whether to accept proposed ways for the resolution of a dispute (i.e. procedures known as mediation, conciliation etc.). As to the latter, there is a certain overlap with the functions described in the context of some of the approaches discussed above, since non-adversarial procedures directed at an ultimate agreement between the parties are involved. It needs to be emphasized here that, in the case of inter-State disputes, for a matter to become a "dispute" in the legal sense of the term, either party concerned, or both, must decide to treat it as such. This is particularly true with respect to procedures involving decision by a third party. Conciliation and mediation are part of the follow up systems created by many IIAs, for example, BITs, GATS and NAFTA.

An IIA may include provisions on methods of dispute settlement involving a binding decision by a third party -- an arbitrator or arbitration tribunal. The relevant provision may establish a fully voluntary system of dispute settlement: whenever a dispute arises, the parties may agree to have recourse to arbitration or judicial procedures. In other words, the parties to a dispute would retain the right to decide whether to proceed to arbitration or judicial settlement. This is the system followed by BITs and most regional agreements, such as NAFTA. Alternatively, an IIA might provide for a compulsory system of dispute settlement by arbitration or judicial proceedings. This would require a binding provision in the agreement to the effect that, when a dispute arises concerning the application and interpretation of the instrument, it must be submitted to the applicable procedures of arbitration or judicial

settlement. Article 8 of the TRIMs agreement, for example, stipulates that the dispute settlement system of the GATT, as elaborated and applied by the WTO Dispute Settlement Understanding, "shall apply to consultations and the settlement of disputes under this Agreement". Chapter IX of MIGA is another example of a compulsory system for the settlement of disputes between the Agency and its members.

Sanctions. An investment instrument, whether legally-binding or not, may include provisions for sanctions against parties that have been found to have seriously infringed the rules established by the instrument. However, if sanctions are provided for, several preconditions for their proper administration need to be met. For instance, the procedures to be established would need to protect the rights of all parties concerned, allow a right to a hearing and establish a reasonably impartial body to decide upon the facts and law. A reasonable gradation of sanctions may be appropriate to correspond to violations of differing weight.

Sanctions decided at the international level may be applied at the international or at the national level. Internationally-administered sanctions tend to include measures involving publicity, "blacklisting", or calls for denial of contracts or suspension of membership. An example of the last type of sanction is article 52 of MIGA, in relation to a failure to fulfil the membership obligations under the Convention. Sanctions administered by national authorities tend to be more diverse and often more effective. This type of sanction is provided by the OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions which stipulates in article 3 that "the bribery of a foreign public official shall be punishable by effective, proportionate and dissuasive criminal penalties".

Policy making and revision of an instrument. Policy decisions and actions that may need to be taken through the follow up process range from resolving individual problems arising out of monitoring the application of an agreement, to imposing sanctions, to giving effect to built-in agendas (including follow up negotiations), to undertaking partial or extensive revisions of the instrument. Clearly, such functions can be discharged only by a political body composed

of government representatives of the States parties to the agreement, or by subsidiary bodies with specific functions mandated and appointed by them. In other words, through this decision-making process the parties retain control over important systemic matters arising out of an agreement, including whether or not to depart from the original implementation plans.

Among the most important policy functions to be discharged by the relevant intergovernmental body are those related to the application of built-in agendas for further negotiations, and those concerning limited or substantial revisions of an instrument. Such functions, in turn, require full evaluation of the operation of the IIA provisions and of the implementation process, including, for example, the transition periods granted to developing countries for meeting certain obligations. In some cases, the agreements themselves foresee the possibility that the transition periods could be extended (e.g. in the case of the TRIMs Agreement and the Subsidies Code of WTO). The need for previous evaluation may be recognized in an agreement. This is the case in GATS which contains provisions that link progressive liberalization in the context of each round of negotiations to an assessment of trade in services in overall terms and on a sectoral basis with reference to the Agreement's objectives, including those set out in paragraph 1 of article IV. This means that future liberalization is related directly to the achievement of concrete benefits in terms of capacity building and export opportunities for developing countries (Shahin, 1999). In other agreements, experience with the operation and application of certain provisions may be such as to indicate that there could be considerable room for improvement. Thus the documentation of developing countries' experiences with the operation of provisions in IIAs can provide elements for specific proposals for improvements. These can be linked to concrete measures to be adopted by developed countries to give effect to their commitments towards developing countries (Youssef, 1999).

Finally, given the complexity of some of the issues involved in the elaboration of an IIA, the functioning of an instrument may need to be continually re-evaluated, with a view towards its revision. This is a fundamental matter in the process of preparation of an

IIA which is to be understood neither as a preliminary document, nor as a final definitive formulation of rules and procedures. Instead, it may rather be seen as part of a continuing process of interaction, review and adjustment to changing realities and to new perceptions of problems and possibilities. Like any legal instrument, an IIA may be seen not as a body of rules but as a process of ongoing decision making.

To sum up, as IIAs, by their very nature, are intended to produce their effects over a (typically) long period of time, their implementation mechanisms need to be devised in such a way as to ensure that their effective aspects are enhanced and their ineffective ones can be changed through adequate revision procedures.

Combinations. Most IIAs that include an international institutional machinery for follow up combine some or all of the mechanisms discussed above. Thus, while a number of investment-related instruments provide for a simple reporting mechanism as a means of monitoring their application (e.g. some United Nations General Assembly resolutions containing recommendations or declarations), others combine simple reporting procedures with consultations and other informal means of conflict resolution based on peer pressure (e.g. the OECD Declaration on International Investment and Multinational Enterprises and the Liberalisation Codes), while still others include, in addition, an institutional system for the settlement of disputes (e.g. the WTO agreements). Emphasis on formality is not necessarily a guarantee for better results in terms of achieving the objectives of an IIA. As noted before, the effectiveness of any institutional mechanism depends ultimately on the political will of the parties to make it functional.

* * *

In considering appropriate mechanisms for the application of an IIA it needs to be borne in mind that a fundamental aim of IIAs is to promote growth and development. These are, by definition, flexible objectives. Therefore, care needs to be taken that the modalities of application are not so rigid as to prevent the very

purpose of the agreement to be realized. In particular, legally-binding agreements require mechanisms that permit timely adaptation to the needs of developing countries. However, in this respect, many developing countries experience difficulties in trying to apply an international agreement due to lack of adequate skills and resources. This problem is addressed in the next section.

B. Promotional measures and technical assistance

Developing countries often face certain handicaps in meeting obligations under IIAs and deriving benefits from them. Financial, administrative and human resource constraints often prevent them from putting in place appropriate mechanisms and institutions to give full effect to the possibilities contained in such agreements and to participate fully in the machinery designed to monitor and follow-up on their implementation. To facilitate the realisation of development objectives and address the economic asymmetries between the parties, IIAs can include provisions spelling out measures that can be taken to enhance the developmental effects of such agreements. These measures are typically addressed to developed countries that are home countries, and they can be complemented with provisions for technical assistance through relevant international organizations. As home country measures are addressed in a separate paper of the IIAs Series, these are dealt with here only in summary fashion.

* * *

The traditional approach to promoting investment and technology flows to developing countries involves a range of ***unilateral home country measures***. Apart from liberalising the regulatory framework for outward FDI — the basis for FDI flows to developing countries — promotional home country measures can encourage investment by helping to overcome market failures and risks that sometimes inhibit outward FDI to developing countries, such as incomplete or inaccurate information about investment potential and investment risks. These measures can be grouped into several broad categories (UNCTAD, 1995):

- Information and technical assistance. Government agencies or government-owned special banks in virtually all developed countries offer information and technical assistance programmes, including some support for feasibility studies and sometimes start-up support for smaller or less experienced investors. Some home country agencies make available to developing countries information database on home country enterprises interested in investing abroad. Information is disseminated through publications, seminars, teleconferences, trade fairs, investment missions and hosting foreign delegations for prospective investment sits. Matchmaking activities represent more direct interventions that seek to link a particular investor with an identified opportunity.

- Direct financial support and fiscal incentives. Financial support is provided by about half of the OECD countries through some type of development finance institution. Fiscal incentives generally do not differentiate in their application between FDI in developing or developed countries. However certain incentives may be offered in conjunction with regionally oriented development assistance programmes (see below).

- Investment insurance. National investment insurance exists in most developed countries to provide coverage for expropriation, war and repatriation risks. Some programmes are designed to cover FDI only in developing countries.

Unilateral home country measures to promote FDI to developing countries are generally part of national development assistance programmes which, at the same time, may be designed to promote the competitiveness of the home country's TNCs. Examples of home country agencies that undertake these measures include the United States' Overseas Private Investment Corporation (OPIC), Japan's JETRO, Finland's Finnfund, Denmark's IFU and Canada's Export Development Corporation.

Bilateral investment treaties can be a vehicle to encourage home country promotional measures. The BIT model A prepared by the Asian African Legal Consultative Committee provides an

example of mandatory language for concrete measures: Article 2 (I) commits home country partners to "take steps to promote investments in the territory of the other Contracting Party and encourage its nationals, companies and State entities to make such investments through offer of appropriate incentives, wherever possible, which may include such modalities as tax concessions and investment guarantees". However, in the few cases in which the promotional provisions of BITs are directed explicitly at the home country partner, they use hortatory language. Article 2 (3) of the BIT between the Belgium-Luxembourg Economic Union and Cameroon (box V.3) is an example of a BIT that addresses specifically the home country in this respect. This clause, however, is unusual in BIT practice in that it acknowledges the asymmetrical nature of the relationship between a capital—exporting developed country and a developing country, for it does not impose a similar obligation on Cameroon to promote investment in the Belgium—Luxembourg Economic Union. Because few concrete actions in this regard are specified, any substantive follow-up to relevant provisions depends on the voluntary adoption of home country measures. There are, however, some BITs that specify concrete actions that one or the other contracting party should take to promote investment. This is done, for example, in the BIT between Malaysia and the United Arab Emirates (box V.4) which, among other things, stipulates consultations about investment opportunities.

Box V.3. Home country promotional measures in BITs

BIT between the Belgium-Luxembourg Economic Union and Cameroon (1980)

Article 2

3. Aware of the importance of investments in the promotion of its policy of cooperation for development, the Belgium-Luxembourg Economic Union shall strive to adopt measures capable of spurring its commercial operations to join in the development effort of the United Republic of Cameroon in accordance with its priorities.

In the context of the mutuality of benefits promised by BITs, there is still room for the BIT partners to explore more specific home country promotional measures. For example, embodied in a "technical cooperation clause"such measures could include the dissemination of information to the partners' investment communities on business opportunities, sponsoring investment missions by the representatives of their companies and provision of advisory assistance on ways to encourage the transfer of technology. These and similar commitments from home countries can positively contribute to enhancing the development dimension of BITs.

Box V.4. Mutual investment promotion measures in BITs

BIT between Malaysia and the United Arab Emirates (1991)

Article 2

(6) The Contracting Parties shall periodically consult between themselves concerning investment opportunities within the territory of each other in various sectors of the economy to determine where investments from one Contracting State into the other may be most beneficial in the interest of both Contracting States.

(7) To attain the objectives of the Agreement, the Contracting States shall encourage and facilitate the formation and establishment of the appropriate joint legal entities between the investors of the Contracting States to establish, develop and execute investment projects in different economic sectors in accordance with the laws and regulations of the host State.

Regional and interregional trade and investment arrangements with a development orientation often encompass commitments involving the adoption of home country promotional measures. For example, the Lomé Conventions reflected many of the development-oriented programmes adopted by countries of the European Community. The Fourth ACP-EEC Lomé Convention contains a number of provisions concerning investment promotion and investment financing that are meant to encourage private investment flows from the European Community to ACP States; the Convention also specifies measures that home countries should take at the national level in this respect (box V.5).

Box V.5. Home country promotional measures in interregional agreements

Fourth ACP-EEC Convention of Lomé

Article 259

In order to encourage private investment flows and the development of enterprises, the ACP States and the Community, in cooperation with other interested bodies, shall within the framework of the Convention:

(a) support efforts aimed at promoting European private investment in the ACP States by organizing discussions between any interested ACP State and potential investors on the legal and financial framework that ACP States might offer to investors;

(b) encourage the flow of information on investment opportunities by organizing investment promotion meetings, providing periodic information on existing financial or other specialized institutions, their facilities and conditions and encouraging the establishment of focal points for such meetings;

(c) encourage the dissemination of information on the nature and availability of investment guarantees and insurance mechanisms to facilitate investment in ACP States;

(d) provide assistance to small and medium-sized enterprises in ACP States in designing and obtaining equity and loan financing on optimal terms and conditions;

(e) explore ways and means of overcoming or reducing the host-country risk for individual investment projects which could contribute to economic progress;

(f) provide assistance to ACP States in:

(I) creating or strengthening the ACP States' capacity to improve the quality of feasibility studies and the preparation of projects in order that appropriate economic and financial conclusions might be drawn;

(ii) producing integrated project management mechanisms covering the entire project development cycle within the framework of the development programme of the State.

Other association and cooperation agreements between the European Community and its country members, on the one hand, and third countries or groups of countries, on the other hand, tend to include some mutual promotional measures to encourage investment flows (box V.6 and III.8).

Box V.6. Mutual investment promotion measures in association and cooperation agreements

Partnership and Cooperation Agreement Between the European Communities and Their Member States and Ukraine

Article 54

Investment promotion and protection

1. Bearing in mind the respective powers and competences of the Community and the Member States, cooperation shall aim to establish a favourable climate for investment, both domestic and foreign, especially through better conditions for investment protection, the transfer of capital and the exchange of information on investment opportunities.

2. The aims of this cooperation shall be in particular:

-- the conclusion, where appropriate, between the Member States and Ukraine, of agreements for the promotion and protection of investment;
-- the conclusion, where appropriate, between the Member States and Ukraine, of agreements to avoid double taxation;
-- the creation of favourable conditions for attracting investments into the Ukrainian economy;
-- to establish stable and adequate business laws and conditions; and
-- to exchange information on investment opportunities in the form of, inter alia, trade fairs, exhibitions, trade weeks and other events.

There are also action plans and programmes that, although non-legally-binding, are indicative of what can be done. The United States' Caribbean Basin Initiative represents a regional approach similar to that of the Lomé Conventions to an area of special

development concern and includes United States policies that provide tax and trade incentives to encourage FDI in Caribbean Basin countries. The European Union measures to boost FDI in Asia set out in its policy document "Towards a new Asia strategy" are another example in this respect (box V.7).

Box V.7. Non-binding action plans

Measures adopted in the context of the Asia-Invest Programme[a]

The European Union's overall approach to Asia was set out in the document "Towards a new Asia strategy" adopted in 1994. The elaboration of this policy was the first step towards developing a consistent and comprehensive strategy regarding the region.

Among its main initiatives is the Asia-Invest Programme which establishes a number of new instruments to assist investment including the following:

- The Business Priming Fund. The principal types of activities supported are:
  - market-place monitoring;
  - language and business culture familiarization;
  - technical assistance.
- The Asia Enterprise and Asia Partenariat
- The Asia Investment Facility. Activities include:
  - research by country and by industrial sector;
  - initial guidance for European Union companies seeking to invest in Asia;
  - dissemination in Asia of information on investment opportunities in the European Union.
- The Asia-Invest Network. Activities include:
  - the Asia-Invest antennae;
  - the annual Asia-Invest conference;
  - the Asia-Invest Membership Scheme;
  - The Asia-Invest Inforoute.

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Regional agreements also can provide for mutual promotional measures within the countries members of the regional group. The Framework Agreement on the ASEAN Investment Area, for example, provides (article 6) that, for the implementation of their obligations under the Agreement, the member countries shall jointly undertake to develop and implement, among others, Promotion and Awareness Programme which sets out detailed promotional measures to encourage investment flows within the Area (box V.8).

Box V.7 (concluded)

- Asia-Invest Support Activities. Activities include:
  - -- Asia Branch Network meetings;
  - -- BC-Net/EIC/BRE support for Asia;
  - -- Seminars, training and information materials;
  - -- newsletters.
- European Community Investment Partners. It supports five facilities:
  - -- Facility 1: identification of potential partners;
  - -- Facility 2: feasibility-study loans;
  - -- Facility 3: capital investment in companies or share-secured loans;
  - -- Facility 4: management assistance and training loans;
  - -- Facility 5: grants for privatization.
- European Investment Bank financing. One or more of the following criteria are used for project approval:
  - -- joint ventures between Asia and European Union firms;
  - -- projects with a high technology transfer from the European Union;
  - -- projects fostering closer relations between Asia and Europe;
  - -- projects involving environmental improvements;
  - -- investments fostering regional integration.

[a] UNCTAD, 1998c and d.

Box V.8. Mutual investment promotion measures in regional agreements

Framework Agreement on the ASEAN Investment Area
Schedule II
Promotion and Awareness Programme

In respect of the Promotion and Awareness Programme, Member States shall --

1. Organise joint investment promotion activities e.g., seminars, workshops, inbound familiarisation tours for investors from capital exporting countries, joint promotion of specific projects with active business sector participation;

2. Conduct regular consultation among investment agencies of ASEAN on investment promotion matters;

3. Organise investment-related training programmes for officials of investment agencies of ASEAN;

4. Exchange lists of promoted sectors/industries where Member States could encourage investments from other Member States and initiate promotional activities; and

5. Examine possible ways by which the investment agencies of Member States can support the promotion efforts of other Member States.

Multilateral instruments present another opportunity to negotiate commitments for home country measures beneficial to development objectives. To begin with, MIGA has been established precisely to provide insurance to firms investing in developing countries. The TRIPS Agreement provides an example in the more specific area of transfer of technology. It calls upon developed contracting parties to provide incentives to their enterprises and institutions for the purpose of promoting and encouraging technology transfer to the least developed countries in order to enable them

to create a sound and viable technological base (box V.9). In order to facilitate the implementation of the Agreement, it goes further in detailing technical cooperation (UNCTAD, 1996c). The Energy Charter Treaty also contains provisions encouraging the promotion of transfer of technology on non-commercial terms to assist in the effective implementation of the objectives of the agreement (box V.9). Home country measures are furthermore included among the provisions of article IV of GATS (box III.3). In particular, developed countries are required to establish contact points to facilitate the access of developing countries services suppliers to key information related to their respective markets. In addition, technical cooperation is to be made available under article XXV (box V.9).

Box V.9. Home country promotional measures in multilateral agreements

Agreement on Trade-Related Aspects of Intellectual Property

Article 66

Least-Developed Country members

2. Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base.

Article 67

Technical Cooperation

In order to facilitate the implementation of this Agreement, developed country Members shall provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and least developed country Members. Such cooperation shall include assistance in the preparation of laws and regulations on the protection and enforcement of intellectual property rights as well as on the prevention of their abuse, and shall include support regarding the establishment or reinforcement of domestic offices and agencies relevant to these matters, including the training of personnel.

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Box V.9 (concluded)

Energy Charter Treaty

Article 8

Transfer of Technology

(1) The Contracting Parties agree to promote access to and transfer of energy technology on a commercial and non-discriminatory basis to assist effective trade in Energy Materials and Products and Investment and to implement the objectives of the Charter subject to their laws and regulations, and to the protection of Intellectual Property rights.

(2) Accordingly, to the extent necessary to give effect to paragraph (1) the Contracting Parties shall eliminate existing and create no new obstacles to the transfer of technology in the field of Energy Materials and Products and related equipment and services, subject to non-proliferation and other international obligations.

General Agreement on Trade in Services

Article XXV

Technical Cooperation

1. Service suppliers of Members which are in need of such assistance shall have access to the services of contact points referred to in paragraph 2 of Article IV.

Finally, the recent United Nations Framework Convention on Climate Change and its Kyoto Protocol offers an example in the area of environment of a multilateral instrument that provides for flexibility for developing countries, not only in its objectives and preambular provisions, its structure and its substantive provisions, but, most notably, in its application. To assist developing countries in meeting their commitments and achieve sustainable development, the Convention provides for financial assistance and technology transfer, and establishes a Clean Development Mechanism that seeks to benefit both developed and developing countries (box V.10).

Box V.10. "Flexibility mechanisms" for developing countries in the United Nations Framework Convention on Climate Change and its Kyoto Protocol[a]

Objectives

Article 2 of the United Nations Framework Convention on Climate Change states that the objective of the agreement is "to achieve ... stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system" and "to enable economic development to proceed in a sustainable manner".

Preamble and principles

Three key principles can be discerned:

(1) Common but differentiated responsibilities: parties to the Framework Convention have a common responsibility to protect the climate for present and future generations. Different countries, at different levels of economic development, are expected to fulfil their common responsibilities in different ways. Developing countries' emissions are expected to grow, albeit less rapidly than they would without the Framework Convention;

(2) Developing countries, particularly low-lying island and coastal States, States with semi-arid areas, areas subject to floods, drought or desertification, or fragile mountain ecosystems are especially vulnerable to the adverse effects of climate change and deserve special consideration;

(3) The parties should promote sustainable development, and measures to avert climate change should be appropriate for the specific conditions of each party and should be integrated into national development programmes.

Substantive provisions

The principles identified in the preamble and principles section of the Framework Convention are given full expression in its substantive provisions and those of its Kyoto Protocol. Some of these provisions

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Box V.10 (continued)

remain to be fully negotiated, but are likely to contain flexible approaches.

Differentiated emission limitation and reduction commitments

The Framework Convention contains two categories of emission limitation or reduction commitments, the general commitments contained in article 4.1 whereby all parties must adopt measures to mitigate climate change and the specific commitments contained in article 4.2 (a) and (b), whereby the developed countries must aim to return their emissions to 1990 levels by 2000. The Kyoto Protocol goes further. It obligates Annex I Parties (developed countries) only to reduce their emissions by a specified amount during the period 2008-2012. Unlike the commitments in article 4.2 (a) and (b) these obligations are considered legally binding on Annex I Parties. Developing countries may choose, but are not required, to adopt similar commitments. Argentina and Kazakhstan indicated at the recent Conference of the Parties held in Buenos Aires in November 1998 that they will undertake voluntary commitments.

Financial assistance and technology transfer

A financial mechanism has been established to provide financial assistance to developing countries in meeting their obligations under the Framework Convention and Kyoto Protocol. The operating entity of the financial mechanism is the Global Environment Facility, which, under article 4.3 of the Convention, will pay the agreed full costs of developing country reporting requirements. It also pays the agreed full incremental cost of measures in developing countries to reduce emissions and or in other ways further the objectives of the Convention. The parties are still discussing the modalities for implementing the provisions of the Convention relating to the development and transfer of technologies.

Compliance and adaptation

In furtherance of principle 2, measures have been adopted to assist developing countries adapt to climate change. The Global Environment Facility funds studies to determine vulnerability and adaptation needs,

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Box V.10 (concluded)

and recently has been assigned the task of helping developing countries. The Clean Development Mechanism to be established under the Kyoto Protocol, discussed below, must apply a portion of its proceeds to meet the adaptation requirements of developing countries.

The Clean Development Mechanism and sustainable development

The Kyoto Protocol establishes a Clean Development Mechanism (CDM) to assist developed countries in meeting their emissions reduction commitments and developing countries in achieving sustainable development. Through the CDM, developed countries — or private companies in them — pay for projects in developing countries that will reduce emissions. The developed country investor gets some or all of the credit for the reductions, which it can apply against its own emissions or sell to another party. The project must enhance sustainable development in the host developing country. The parties are still discussing the CDM and the modalities for its operation.

[a] United Nations, 1992a; and 1997.

* * *

Regional and, especially, multilateral instruments appear to provide the best opportunities for securing developed home country commitments to promote FDI flows to developing countries. Explicit and concrete undertakings are of course preferable to broad and hortatory goals. Consideration can also be given to initiatives that encourage FDI flows among developing countries which, simultaneously, would strengthen the international competitive capabilities of developing country TNCs. Home country promotional measures can also be complemented with technical assistance provided by relevant international organizations to enhance the capacity of developing countries to deal effectively with foreign investors. Such capacity, in terms of skill, information, negotiation and implementation abilities, is needed to ensure that the increased flexibility provided for in IIAs to implement their development policies and strategies is used to "deliver" all the benefits FDI can offer.

Notes

1 This section draws extensively on UNCTC, 1978.

2 For a more detailed discussion on the role of voluntary instruments dealing with foreign investment, see, Blanpain (1979); Horn (1980); Rubin and Hufbauer (1984); Kline (1985); Sauvant and Aranda (1993); Fatouros (1993).

3 The different degrees of binding force among OECD investment instruments can be illustrated by comparing the National Treatment instrument and the Guidelines for Multinational Enterprises.

4 See, for example, Youssef (1999) for a discussion on the issue of the adequacy of the transitional periods in the TRIMs and TRIPS agreements; and Shahin (1999) for a discussion on the weakness in the implementation of provisions in GATS granting developing countries special and differential treatment.

5 See Youssef (1999) for suggestions on how the implementation of many provisions granting special and differential treatment could be made more effective and meaningful to address development concerns. Some of these are outlined in this paragraph.

6 The issue of settlement of investment disputes is discussed in two papers of the IIA Series.

SUMMARY AND CONCLUSIONS

Developing countries seek FDI in order to promote their economic development. This is their paramount objective. To that end, they have sought to establish — through national legislation and international instruments — a legal framework aimed at reducing obstacles to FDI, while providing foreign investors with high standards of treatment and legal protection for their investments and increasingly putting in place mechanisms to assure the proper functioning of markets.

Developing countries participate in IIAs — whether at bilateral, regional, interregional or multilateral levels — because they believe that, on balance, these instruments help them to attract FDI and to benefit from it. At the same time, IIAs, like most international agreements, limit to a certain extent the policy options available to governments to pursue their development objectives through FDI. A question arises, therefore, how, nevertheless, IIAs can allow developing countries a certain policy space to promote their development. This is all the more important since the principal responsibility for the design and implementation of development objectives and policies remains in the hands of the individual countries' governments.

Thus, when concluding IIAs, developing countries face a basic challenge: how to achieve the goal of creating an appropriate stable, predictable and transparent FDI policy framework that enables firms to advance their corporate objectives, while, at the same time, retaining a margin of freedom necessary to pursue their particular national development objectives. A concept that can help link these objectives is "flexibility" which, for present purposes, can be defined as the ability of IIAs to be adapted to the particular conditions prevailing in developing countries and to the realities of the economic asymmetries between these countries and developed countries.

Flexibility can be approached from four main angles: the objectives of IIAs, their overall structure and modes of participation, their substantive provisions and their application.

Objectives. IIAs often address development concerns by including in their text, usually in their preamble, declaratory statements referring to the promotion of development as a main objective of the agreement, or to specific ways by which the agreement is to contribute to development objectives, or a generally worded recognition of the needs of developing and/or least developed country parties requiring flexibility in the operation of the obligations under the agreement. There are many variations in such language, and it is difficult to generalize its actual role and importance. Preambles and similar declarations normally do not directly create rights and obligations for the parties to an instrument, but they are relevant to its interpretation. In fact, the texts of preambles are often the result of hard bargaining. To the extent that such language reflects the will of the participating countries, it helps to reaffirm the acceptance of development as a central purpose of IIAs. The specific language used in each case and its relationship to the rest of the instrument is, of course, important.

Overall structure and modes of participation: special and differential treatment. Promotion of development can also be manifested in the structure of IIAs. Central to this is the application of special principles and rules for developing countries which have as their common characteristic that these countries assume less onerous obligations -- either permanently or temporarily -- on a non-reciprocal basis. This approach is reflected in the principle of "special and differential treatment" for developing countries (or categories among them). Broadly speaking, this principle encompasses such aspects as granting lower levels of obligations for developing countries; asymmetrically phased implementation timetables; best endeavour commitments; exceptions from commitments in certain areas; flexibility in the application of, and adherence to, disciplines under prescribed circumstances; and technical assistance and training. A key issue in dealing with the principle of special and differential treatment is whether a broad spectrum of flexibility should be given to the beneficiaries, or whether well defined criteria should be established. One way of applying the principle of special and differential treatment in the structure of an agreement is to distinguish between developed and developing countries by establishing, for instance, separate

categories of countries, the members of which do not have the same rights and duties. Beyond that, international practice has evolved a number of methods to allow countries that wish to participate in an agreement to do so in ways that take into account their individual situations. Although the methods in question may be used, in principle, by any country, they can be particularly relevant as a means of addressing development concerns. The principal methods can be grouped into two main approaches. The first approach is to allow for different stages and degrees of participation in an IIA, by, for example, allowing countries to accede to an agreement at different times and in different ways; or permitting countries that are not ready to become full members of an IIA to be associated with it or to cooperate on matters of mutual interest. The second approach to structural flexibility is to allow the inclusion of various kinds of exceptions, reservations, derogations, waivers or transitional arrangements. Exceptions take a great variety of forms: they may be general (e.g. for the protection of national security), subject specific (e.g. the so-called "cultural exception"), or they may be country specific. A subset of this approach is the use of "positive" and "negative" lists. Finally, an investment framework can be built consisting of several instruments that can be negotiated over time and combine a variety of approaches.

By using these or other methods, IIAs can be constructed in a manner that ensures an overall balance of rights and obligations for all actors involved, so that all parties derive benefits from it.

Substantive provisions. The substantive content of an IIA is particularly important in reflecting development concerns and an overall balance of rights and obligations. This begins with the choices countries make about the issues they wish to include in an IIA, and those they wish to keep outside the scope of an agreement. (The range of relevant issues is reflected in the topics covered in the individual papers of the *IIA Series*.) It continues with the formulation of the substantive provisions, through ways that allow countries to address the issues in a manner beneficial to them and, when need arises, to retain some flexibility regarding the commitments they made, keeping also in mind the various interactions between issues and provisions. The range of approaches and

permutations that can be used in formulating substantive provisions in IIAs is broad. Of course, flexibility might need to be approached in different ways for each individual substantive issue, depending on its characteristics and development effects. For example, the type of approach to flexibility that can be useful in a development context regarding admission and establishment of foreign affiliates might not be relevant to post-establishment national and MFN treatment provisions, or to expropriation, labour or environmental standards. There are no general prescriptions on this matter. The choice of approach depends on the conditions prevailing in each country and the particular development strategies pursued by each government.

Application. Flexibility for development can also be exercised during the application stage of an IIA. The manner in which an IIA is interpreted, and the way in which it is to be made effective determine whether its objectives, structure and substantive provisions produce, in the end, the desired developmental effects. The degree of flexibility for the interpretation and application of an IIA depends to a large extent on the legal character of an agreement and the formulation of individual provisions. Legally-biding agreements, even if they do not provide for implementation mechanisms, impose on the States signatories a legal obligation under international law to comply with their provisions. How far such an obligation will actually limit the subsequent freedom of action of the States concerned largely depends on the language of the agreement or the type of obligations imposed. Voluntary instruments, on the other hand, are not legally enforceable but can have an influence on the development of national and international law. One way of mitigating some of the most rigorous implications of concluding a legally-binding investment agreement is to include one or several "soft" obligations among binding provisions.

Many IIA provisions require some kind of action at the national level in order to produce their effects. Where explicit provisions requiring specific national action are absent, each State would be free to decide the particular manner in which it may implement an agreement's provisions. Variations in normative intensity and specificity of language regarding the effects of IIAs on national systems provide possibilities for developing countries to advance

their development interests. At the regional and multilateral levels, the effectiveness of an IIA is intimately related to the intergovernmental institutional machinery for follow up and monitoring its application, including through built-in agendas. There are various mechanisms that can be created, ranging from simple reporting requirements (which nevertheless can be a significant inducement to act in compliance), to advisory and consultative functions (aimed at resolving questions arising out of the continuing application of an IIA), to complaint and clarification mechanisms (aimed at facilitating application of non-binding instruments under procedures of a non adjudicatory nature), to various international methods of settlement of disputes which may allow more or less freedom to the parties to accept proposed ways for the resolution of the dispute. Finally, an agreement might eventually need partial or extensive revisions. This is a fundamental facet of the entire process of the elaboration of an IIA, which is to be understood as a continuing process of interaction, review and adjustment to changing realities and to new perceptions of problems and possibilities.

In fulfilling its various functions, an international institutional machinery can play several major development roles. It is therefore of critical importance for developing countries to make the best use of the means provided by the relevant institutional arrangements for follow up, including the review of built-in agendas, to ensure that the development objectives are given full effect. An important consideration in this respect are the difficulties that many developing countries experience in participating fully and effectively in these arrangements due to lack of adequate skills and resources. To address such difficulties, IIAs can make special arrangements for technical and financial assistance. In addition, to ensure that the development goals of an IIA are fully realized, it may be desirable that developed countries commit themselves to undertake promotional measures to encourage FDI flows to developing countries.

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In conclusion, it needs to be re-emphasized that IIAs, like all international agreements, typically contain obligations that, by their very nature, reduce to some extent the autonomy of the

participating countries. At the same time, such agreements need to recognize important differences in the characteristics of the parties involved, in particular the economic asymmetries and levels of development between developing and developed countries. If IIAs do not allow developing countries to pursue their fundamental objective of advancing their development — indeed make a positive contribution to this objective — they run the risk of being of little or no interest to them. This underlines the importance of designing, from the outset, IIAs in a manner that allows their parties a certain degree of flexibility in pursuing their development objectives. To find the proper balance between obligations and flexibility — a balance that leaves sufficient space for development-oriented national policies — is indeed a difficult challenge faced by negotiators of IIAs. This is particularly important as treaty-making activity in this area at all levels has intensified in recent years.

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