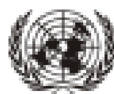
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

INTERNATIONAL INVESTMENT AGREEMENTS IN SERVICES

UNCTAD Series on International Investment Policies for Development



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NOTE

As the focal point in the United Nations system for investment and technology, and building on 30 years of experience in these areas, UNCTAD, through DITE, promotes understanding of key issues, particularly matters related to foreign direct investment and transfer of technology. DITE also assists developing countries in attracting and benefiting from FDI and in building their productive capacities and international competitiveness. The emphasis is on an integrated policy approach to investment, technological capacity building and enterprise development.

The term "country" as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

The following symbols have been used in the tables:

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

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

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

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

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

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals because of rounding.

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PREFACE

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a programme on international investment arrangements. It seeks to help developing countries to participate as effectively as possible in international investment rule-making. The programme embraces policy research and development, including the preparation of a Series of issues papers; human resources capacity-building and institution-building, including national seminars, regional symposia, and training courses; and support to intergovernmental consensus-building.

This paper is part of a new *Series on International Investment Policies for Development*. It builds on, and expands, *UNCTAD's Series on Issues in International Investment Agreements*. Like the previous one, this new series is addressed to Government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers. The Series seeks to provide a balanced analysis of issues that may arise in the context of international approaches to investment rule-making and their impact on development. Its purpose is to contribute to a better understanding of difficult technical issues and their interaction, and of innovative ideas that could contribute to an increase in the development dimension of IIAs.

The Series is produced by a team led by James Zhan. The members of the team include Victoria Aranda, Anna Joubin-Bret, Martín Molinuevo, Elisabeth Tuerk and Jörg Weber. Members of the Review Committee are Mark Koulen, Antonio Parra, Patrick Robinson, Pierre Sauvé, M. Sornarajah and Kenneth Vandevelde. The Series' principal advisor is Peter Muchlinski.

This paper contains selected parts of the *World Investment Report 2004: The Shift Towards Services* (Sales No. E.04.II.D.36) as well as additional texts, specifically drafted for this publication. It has been prepared by Elisabeth Tuerk, with the assistance of Martin Molinuevo and Pia Buller. Karl Sauvant provided overall guidance. Comments were provided by Mina Mashayekhi.

Supachai Panitchpakdi
Geneva, September 2005 Secretary General of UNCTAD

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UNCTAD's work programme on international investment agreements is implemented by a team of UNCTAD staff members and consultants headed by James Zhan. The team includes Bekele Amare, Hamed El-Kady, Anna Joubin-Bret, Federico Ortino, Anca Radu, Marie-Estelle Rey, Elisabeth Tuerk and Jörg Weber. Administrative support is provided by Séverine Excoffier-El Boutout and Josephine Lamptey. Desktop publishing was done by Teresita Sabico. Khalil Hamdani provides overall guidance.

UNCTAD has carried out a number of activities related to the work programme in cooperation with other intergovernmental organizations, including the Agence pour la Francophonie, Banco Centroamericano de Integración Económica, CARICOM Secretariat, German Foundation for Development, Inter-Arab Investment Guarantee Corporation, Inter-American Development Bank (BTD/INTAL), League of Arab States, Organization of American States, Secretaria de Integración Económica Centroamericana and the Secretaria General de la Comunidad Andina. UNCTAD has also cooperated with non-governmental organizations, including the Centre for Research on Multinational Corporations, the Consumer Unity and Trust Society (India), the Dutch Foundation for Research on Multinationals (SOMO) (the Netherlands), the Economic Research Forum (Egypt), the European Roundtable of Industrialists, the Friedrich Ebert Foundation (Germany), the German Foundation for International Development, the International Confederation of Free Trade Unions, the Labour Resource and Research Institute (LaRRI) (Namibia), Oxfam, the Third World Network and World Wildlife Fund International. Since 2002, a part of the work programme has been carried out jointly with the World Trade Organization (WTO).

Funds for the work programme have so far been received from Australia, Brazil, Canada, France, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom and the European

Commission. Argentina, Botswana, China, Colombia, Costa Rica, Croatia, Cuba, Czech Republic, Djibouti, Egypt, Gabon, Germany, Guatemala, India, Indonesia, Jamaica, Malaysia, Mauritania, Mexico, Morocco, Namibia, Pakistan, Peru, Qatar, Singapore, South Africa, Sri Lanka, Thailand, Trinidad and Tobago, Tunisia, Venezuela and Yemen have also contributed to the work programme by hosting regional symposia, national seminars or training events.

In pursuing this programme of work, UNCTAD has also closely collaborated with a number of international, regional and national organizations, particularly with the Centro de Estudios Interdisciplinarios de Derecho Industrial y Económico (the Universidad de Buenos Aires), the Indian Institute of Foreign Trade, the Legon Centre of Accra (Ghana), ProInversión (Peru), Pontificia Universidad Católica del Perú, the National University of Singapore, Senghor University (Egypt), the University of Dar Es Salaam (Tanzania), the University de Los Andes (Colombia), the University of Campinas (Brazil), the University of Lima (Peru), the Universidad del Pacífico (Peru), the University of Pretoria (South Africa), the University of Tunis (Tunisia), the University of Yaoundé (Cameroon), the Shanghai WTO Affairs Consultation Center (China) and the University of the West Indies (Jamaica and Trinidad and Tobago). All of these contributions are gratefully acknowledged.

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LIST OF ABBREVIATIONS

AIA	ASEAN Investment Area
ASEAN	Association of South East Asian Nations
BIT	Bilateral investment treaty
CARICOM	Caribbean Common Market
CEE	Central and Eastern European Countries
COMESA	Common Market for Eastern and Southern Africa
CRS	Computer reservation system
ENT	Economic Needs Test
EPA	Economic partnership agreement
EU	European Union
FDI	Foreign direct investment
FTA	Free trade agreement
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
IIA	International investment agreement
ICT	Information and communication technologies
ICSID	International Centre for Settlement of Investment Disputes
IT	Information technology
IPAs	Investment promotion agencies
LDC	Least developed country
MERCOSUR	Mercado Común del Cono Sur
M&As	Mergers and acquisitions
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PTIA	Preferential trade and investment agreement
REIO	Regional economic integration organization
RTA	Regional trade agreement
R&D	Research and development
SCM	Agreement on Subsidies and Countervailing Measures
SDT	Special and differential treatment
TNC	Transnational corporation
TRIMs	Agreement on Trade-related Investment Measures

EXECUTIVE SUMMARY

Over the past decade, the number of international investment agreements covering FDI in services has proliferated, resulting in a multilayered and multifaceted network of international rules. In many areas of services FDI, therefore, national policy-making increasingly takes place within the framework of these agreements. Agreements differ in their approach towards services FDI (investment-based, services-based, mixed) and in their substantive provisions (e.g. regulating entry as opposed to protecting investment, adopting a positive as opposed to a negative-list approach when making commitments).

Several services IIAs contain follow-up procedures and separate chapters for specific service industries. IIAs can provide a stable, predictable and transparent framework for attracting FDI in services and benefiting from it. At the same time, there is a complex process of interaction between international and national policies for services FDI. The nature of this interaction can be either autonomous-liberalization-led or IIA-driven, or anywhere in-between. Ultimately, this interaction is country- and context-specific, thereby creating additional challenges for policy-makers seeking to regulate services.

Moreover, policy-makers need to ensure that international rules are consistent with or complementary to each other in order to avoid conflicts. They also need to address issues arising at the interface of the liberalization and regulation of services. Finally, policy-makers need to strike a balance between using services IIAs for attracting FDI in services and preserving the flexibility necessary for the pursuit of national development objectives related to the services sector. It is important for IIAs to allow such flexibility. This is particularly important for developing countries, as they need to accommodate their development-oriented policy objectives and to undertake the sort of trial-and-error processes required to identify the policy options best suited to their level of development.

This paper seeks to assist developing countries to meet this challenge in the context of international investment rule-making. For this purpose it first reviews the growing importance of services FDI

and its regulation; it then provides an overview of services IIAs, and their evolution over time; next, it addresses complexities and challenges, particularly as they arise from the overlap between regional and multilateral services IIAs. The paper then addresses the dynamic and complex interaction between national and international policies and concludes by discussing the need to strike a development-oriented balance.

I. THE GROWING IMPORTANCE OF SERVICES FDI AND ITS REGULATION[1]

Services comprise a diverse set of activities[2] including basic services such as healthcare, education and water-provision, as well as infrastructure services such as telecommunications, transport, and energy services. Services are fundamental economic activities, with a key role in infrastructure building, competitiveness and trade facilitation. Services also have important implications for poverty reduction, human development and gender equality. Most services firms employ a relatively high proportion of women. This is particularly the case for government, which retains its essential function in providing many services in developing countries (UNCTAD 2005a). More broadly, services significantly affect sustainable development, including its economic, social and environmental components (Mashayekhi and Julsaint, forthcoming).

Along these lines, also foreign direct investment (FDI) in services has many important implications, including for economic development.[3] Many services are vital inputs to business activities in all sectors and an efficient service sector is therefore important to foster competitive enterprises. FDI in services can contribute through transfers of capital, technology and managerial know-how; facilitate the development of skills and the reorganization of firms in host countries; offer a means to enhance and strengthen a country's systemic and export competitiveness; and reduce supply constraints and improve export capacity of developing countries.

However, benefits may not be realized if conditions in the host economy are not right. Moreover, services FDI may entail systemic, structural or contingent risks. Systemic risks exist where the absence of effective regulation can expose a host economy to significant economic instability. In the case of financial services, the possibility of contagion effects or the volatility of foreign exchange flows are examples. Structural risks can arise from FDI in activities with large inherent monopolistic elements. The global water industry, for example, is dominated by three large corporate groups. State-owned monopolies may easily turn into private ones with developing countries failing to provide adequate regulatory frameworks or to negotiate appropriate

deals with the private sector. Finally, contingent risks can arise from FDI in socially or culturally sensitive areas, causing unintended harm. The take over of media by foreign firms is an example; the retail industry or essential services are other industries (that are) prone to such contingent risks (UNCTAD 2004 a, chapter III).

As a result of these potential risks, host-country governments need to be clear what they seek and what they can expect from foreign affiliates. This also implies that services FDI has to be managed carefully, with respect to both its attraction and its regulation.

In that context, services IIAs can offer a series of potential benefits. They can provide a stable, predictable and transparent enabling framework for attracting investment and, ultimately, benefiting from it. At the same time, the optimal realization of these potential benefits remains a challenge. This requires flexibility for the pursuit of national development strategies that include regulatory policies to maximize benefits and minimize costs associated with FDI. Such flexibility is particularly important for developing countries that frequently do not yet have optimal regulatory systems in place.

This challenge to use IIAs to attract investment while retaining national policy space to benefit from such investment is also reflected in the Sao Paulo Consensus, the main document emerging from the June 2004 UNCTAD XI Conference. More specifically, the Sao Paulo Consensus recognizes that national policy making (including in the services sector) is increasingly taking place within parameters set by international rules and, that "[i]t is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space" (UNCTAD 2004c).

In light of the above, it is important that services IIAs retain a degree of flexibility that allows countries to face the specific challenges arising at the interface of the liberalization and the regulation of services. This is even more so, as the past decades have

seen a significant growth of services FDI, both overall, as well as compared to FDI in manufacturing activities.

This paper seeks to assist developing countries to meet these challenges in the context of international investment rule-making. It does not aim to offer a comprehensive analysis of the benefits and costs of services FDI or those arising from the privatisation of public services. The paper recognizes that many recent services IIAs are concluded between developed and developing countries, and consequently, places an emphasis on the common patterns as they arise from these agreements, while offering less depth in analyzing South-South agreements. For a more comprehensive treatment of these issues, the reader is referred to a forthcoming study by UNCTAD (UNCTAD 2005b).

A. FDI has shifted towards services

During the past decades, the volume, composition and nature of FDI in services have undergone a series of changes. Not only has services FDI increased substantially, it has also changed its composition (away from trade and finance to other, new industries) and its nature (e.g. the emphasis on new entry modes).

Throughout the past three decades, the structure of FDI has shifted towards services. In the early 1970s, the services sector accounted for only one-quarter of the world FDI stock; in 1990 this share was less than one-half; and by 2002, it had risen to about 60% or an estimated $4 trillion. Over the same period, the share of the primary sector in world FDI stock declined, from 9% to 6%, and that of manufacturing fell even more, from 42% to 34%. As the transnationalization of the services sector in home and host countries lags behind that of manufacturing, there is scope for a further shift towards services FDI.

Outward FDI in services continues to be dominated by developed countries, but has become more evenly distributed among them. A few decades ago, almost the entire outward stock of services

FDI was held by firms from the United States. By 2002, Japan and the European Union (EU) had emerged as significant sources. From the 1990s onwards, developing countries' outward FDI in services began to grow visibly. Their share in the global outward FDI services stock climbed from 1% in 1990 to 10% in 2002, faster than in other sectors. Trade and trade-supporting services by manufacturing transnational corporations (TNCs) expanded particularly rapidly, while business services, hotels and restaurants, and financial services also grew.

On the inward side, the distribution of services FDI stock has been relatively more balanced, though developed countries still account for the largest share. The fastest growth has taken place in Western Europe and the United States, reflecting the fact that most services FDI is market-seeking. In 2003, developed countries accounted for an estimated 72% of the inward FDI stock in services, developing economies for 25% and Central and Eastern European Countries (CEE) for the balance. In 2002, the United States was the largest host economy in terms of the size of its inward FDI stock in services. With a few exceptions (such as China), countries that have participated in the FDI boom in services also strengthened their position among home and host countries for all FDI. There is, however, considerable variation in the share of services in the FDI of individual countries.

The composition of services FDI is also changing. Until recently, it was concentrated in trade and finance, which together still accounted for 47% of the inward stock of services FDI and 35% of flows in 2002 (compared to 65% and 59%, respectively, in 1990). However, such industries as electricity, water, telecommunications and business services (including information technology (IT)-enabled corporate services) are becoming more prominent. Between 1990 and 2002, for example, the value of the FDI stock in electric power generation and distribution rose 14-fold; in telecoms, storage and transport 16- fold; and in business services 9-fold.

The propensity of services TNCs to enter new markets through mergers and acquisitions (M&As), rather than through greenfield FDI,

is also worth noting. Most M&As that took place during the second half of the 1990s were in services, and M&As (including in the form of privatization) became a widely used mode of TNC entry. While, in the late 1980s, services accounted for some 40% of global cross-border M&As, their share rose to more than 60% by the end of the 1990s. Up to the 1980s, cross border M&As were almost exclusively the domain of United States TNCs. Since then, EU TNCs have emerged as the dominant actors: in 2001-2003, they accounted for 61% of all M&A purchases in services worldwide. Cross-border M&As have also played a prominent role in the overseas expansion of services by TNCs based in developing countries.

Overall, the propensity of TNCs to enter new markets through M&As, rather than greenfield FDI, is much greater in such service industries as banking, telecommunications and water. Privatization programmes open to FDI, which peaked in many countries during the 1990s, have added to the number of M&As.

Across a number of service industries, the growth in TNC activity and international production takes the form of non-equity arrangements – e.g. franchising, management contracts, partnerships – rather than FDI. The greater popularity of non-equity forms in services as compared with goods can be explained partly by differences in the nature of the proprietary assets of the firms involved (see UNCTAD 2004a)**.** Soft technologies and *knowledge-based*, intangible assets, rather than tangible ones, provide service firms with competitive advantages. Intangible assets, such as organizational and managerial expertise, can be separated from tangible and capital-intensive ones (such as real estate in the case of tourism facilities or water distribution networks). More importantly, because the critical knowledge transferred by TNCs and the capabilities of the local firms are frequently codifiable (e.g. in management contracts), these can be equally well-protected and enhanced by non-equity arrangements – and without putting capital at risk. For instance, quality control, performance conditions and minimum transaction costs can often be embodied in management contracts or franchising agreements. Non-equity forms are common in hotels, restaurants, car rental, retailing,

accounting, legal and other professional services. However, such activity is not captured in FDI stock and flow data, or in data on the economic activities of foreign affiliates, thereby posing challenges to the effective documentation and monitoring of FDI flows.

What explains the shift of FDI towards services? Partly it reflects the ascendancy of services in economies more generally: by 2001, this sector accounted, on average, for 72% of gross domestic product (GDP) in developed countries, 52% in developing and 57% in CEE countries. Moreover, most services are not tradable – they need to be produced when and where they are consumed. Hence the principal way to bring services to foreign markets is through FDI. In addition, countries have liberalized their services FDI regimes, which has made larger inflows possible, especially in industries previously closed to foreign entry. Of particular importance has been the privatization of State-owned utilities in Latin America and the Caribbean, and in CEE.

Firms have reacted by expanding their service production abroad. Traditionally, FDI in such services as banking, insurance and transportation had been undertaken by firms moving abroad to support or complement trade or overseas manufacturing by their manufacturing clients. This is still taking place, but the pattern has been changing: service providers more and more invest abroad on their own account, as they seek new clients and exploit their own ownership advantages. Added to that are competitive pressures. In non-tradable services, growth remains the principal location advantage for attracting FDI. In directly tradable services, the main location advantages are access to good information and communication technologies, an appropriate institutional infrastructure and the availability of productive and well-trained personnel at competitive costs.

B. Liberalization and regulation of FDI in services

In part, the boom in services FDI was due to the liberalization of services industries across the world. Much of the impetus for liberalization has come from developing and transition economies seeking to improve the efficiency of their services, to reduce the

financial burden of State-owned services by selling them to foreign investors, and to boost exports by attracting FDI related to services offshoring. As many services are essential inputs for manufacturing, and since many restrictions to trade in manufactures have been removed, the liberalization of services has also become more important. Unless countries offer internationally competitive service inputs locally, they may not be able to retain manufacturing activities that use these services. Moreover, international rules and pressures have reinforced the liberalization trend.

Mirroring the overall tendency among countries to liberalize the entry of foreign firms in the primary and manufacturing sectors, the liberalization of services has also come a long way. While FDI in services remains more restricted, both developed and developing countries have taken steps to open up their service industries. In fact, starting from a higher level of restrictiveness, developing countries may have liberalized their service industries at an even more rapid pace than developed countries over the past decade.

In general, developed countries are more open than developing countries to FDI in services (OECD 2003, p. 23, UNCTAD 2005c); however, there is great variation across industries and countries. A detailed analysis suggests a rather complex pattern. For example, even liberal and mature economies such as the United States, open to FDI in most activities, retain entry restrictions on services such as media and air transportation. Moreover, whereas low- and middle-income economies on average are more protected than high-income economies in distribution industries, Belgium, France, Italy and Switzerland were among the most restrictive in a sample of countries, while Singapore, South Africa and Uruguay were among the most liberal (Kalirajan 2000). In a study related to telecommunications, Argentina, Brazil and Chile were among the least restrictive countries, while Burkina Faso, Costa Rica, Ethiopia, Malta, the Syrian Arab Republic and Tunisia were the most restrictive (Warren 2000; McGuire 2002). Similarly, other research shows that the most open economies in maritime services included a mix of developed and developing countries, while

countries as diverse as Brazil, Chile, India and the United States had the highest barriers to foreign services providers (McGuire et al 2000).

There are several reasons why developing countries, on average, remain more restrictive to FDI in services than developed ones. It is partly due to the particular nature of services. Apart from the sensitivity of services with cultural, social, distributional or strategic significance, there are economic concerns.

- First, countries restrict FDI to avoid the risk of foreign investors killing off fledgling domestic enterprises (i.e. the infant-industry argument). For services that are crucial inputs to other industries, infant industry/national champion considerations may affect the competitiveness of other segments of the economy. If it implies keeping FDI out, the nurturing of the local providers is paid by the users of the services. Similarly, if the role of a national champion is given to a foreign investor without checks and balances, it is again the local economy that will pay the price of a virtual monopoly.
- A second reason why countries may restrict FDI is that entry by large service TNCs involves competition policy considerations, and many host countries may not feel ready to deal with the technical and legal issues involved. Industries that are characterized by a lack of competition are also likely to be subject to more regulations.
- Third, services FDI that involves the sale of public utilities to foreign firms raises complex issues related to privatization and the regulation of natural monopolies. Countries without the necessary regulatory framework may lose by rushing into liberalization, particularly when a reversal of the liberalization is hard to achieve or when liberalization has systemic implications, as in the case of the financial industry.
- Fourth, some services may not appear to offer significant technical skill creation, linkages or other benefits (reflecting partly a lack of understanding of the indirect impact of services on productivity), and governments may wonder why they should promote entry by TNCs.

- Finally, since a number of services are closed to foreign investors, are monopolies and, in any event, need to be regulated, it is frequently difficult to predict as well as to assess the effects of an opening up to FDI (e.g. on prices); and getting the right regulation in place is a challenge.

Beyond that, more and more countries are seeking actively to attract FDI in services through investor targeting. Investment promotion agencies (IPAs) are particularly interested in attracting foreign-exchange-generating services, such as computer and related services, tourism and hotels and restaurants. They are also targeting service functions of manufacturing firms, especially call centres, shared-service centres and regional headquarters functions. In this context, many export processing zones shape their promotional packages to attract services related FDI beyond commercial services and simple data entry, to include, for example, medical diagnosis, architectural, business, engineering and financial services as well. Countries are also setting up technology parks specifically geared to FDI in IT services, offering high-quality telecommunications, stable power supply, a highly educated workforce and a technology-supporting infrastructure (see UNCTAD 2004a, chapter IV).

General promotion measures, incentives and export processing zones are the most widely used tools for FDI promotion. Incentives, while used in the whole range of service industries, are most common in tourism, transport and financial services. As in manufacturing, there is the risk of a race in the use of incentives, especially to attract export-oriented FDI in services. This risk is accentuated by the footloose nature of many export-oriented service projects.

* * *

To conclude, throughout the past decades the structure of FDI has shifted towards services, and the composition of services FDI has become more diverse. Beyond FDI, non-equity forms of investment (e.g. franchising) play an important role, thus adding to the internationalization of the services sector. The shift of FDI towards

services can be explained, amongst others, by the general ascendancy of services in economies, by the fact that most services are not tradable (which makes FDI the principal way to bring services to foreign markets), and by the fact that many countries have liberalized their services FDI regimes (which has made larger inflows possible, especially in industries previously closed to foreign entry). At the same time, advances in information and communication technology (ICT) have made some services increasingly tradable across borders, opening new opportunities for offshoring of these services, with new export opportunities for developing countries.

In general, developed countries are more open than developing countries to FDI in services, but there is great variation across industries and countries. Flexibility for pursuing development objectives is amongst the reasons why developing countries, on average, remain more cautious to liberalizing services FDI fully. In view of the complex nature of services and the variation in national priorities and values, there is a need for policy space to allow governments the flexibility necessary to implement their national objectives – an issue taken up in the following sections.

Notes

[1] For a full discussion, see UNCTAD 2004a.

[2] The broad range of services activities becomes obvious when looking at the various attempts to list and classify the services economy. One of these lists is the United Nations Central Product Classification (UNCPC), which, besides "goods" also covers "services". See http://unstats.un.org/unsd/cr/ registry/regcst.asp?Cl=16. More specifically designed for international (trade) negotiations is the list contained the General Agreement on Tariffs and Trade (GATT) Secretariat document MTN.GNS/W/120 (published in World Trade Organization, WTO document S/L/92), the so-called "Services Sectoral Classification List". This list sets out 12 "sectors", including business services; communication services; construction and related engineering services; distribution services; educational services; environmental services; financial services; health related and social services; tourism and travel related services;

recreational, cultural and sporting services; transport services; and other services. For ease of reference, the list is attached as Annex 1 to this document.

[3] For a more in-depth treatment of FDI and its implications in selected services industries see UNCTAD 2004a, chapter III, discussing, amongst others, accountancy services, retail services and also public utilities (e.g. water, electricity telecom).

II. SERVICES IIAS: THEIR EVOLUTION OVER TIME

A. The growing multifaceted network of services IIAs

Over the past decade, the number of international agreements covering FDI in services has increased substantially, both in number and geographical scope. The following discussion uses a broad definition of international investment agreements (IIAs) as "agreements at the bilateral, regional and multilateral levels that address investment issues" (UNCTAD 2003*,* p. 88*)* with the qualification that the IIAs under review cover, in varying degrees, FDI in services ("service IIAs"). While some of the IIAs deal only with investment, others cover a broader range of issues, investment being one of them. Bilateral investment agreements (BITs) are an example of the former type, and most recent free trade agreements (FTAs) fall into the second category.

Countries enter into IIAs with a view to enhancing the investment climate, attracting more and better quality FDI and benefiting from capital inflows. Services IIAs reflect the negotiating parties' interests, bargaining power, technical capabilities, levels of liberalization and specific economic, social and other circumstances. The result is a multilayered and multifaceted network of international rules, with obligations differing in scope and content. Within the context of a broad liberalization trend (see above), these agreements increasingly set the parameters for national services policies – through interaction between national and international policies on services FDI. This interaction can either be led by autonomous liberalization or driven by IIAs. This complex and dynamic interaction poses challenges for development: while IIAs and autonomous liberalization create an enabling framework for FDI, the former also limit national policy space. This raises questions of how best to achieve development goals and how to strengthen the development dimension of IIAs.

At the bilateral level, the number of BITs covering FDI (including FDI in services) reached 2,332 by the end of 2003, involving 176 countries. Other agreements covering services FDI include bilateral and regional preferential trade and investment agreements (PTIAs)[1] and various types of economic partnership

agreements. Services IIAs[2] can be found in all geographical regions, and there are also some inter-regional ones (e.g. the OECD Liberalisation Codes) as well as one at the multilateral level (i.e. the 1994 General Agreement on Trade in Services (GATS) (WTO 1994a)). The reasons of why they are concluded include the desire to attract FDI to advance development, to protect FDI (i.e. to assure foreign investors that their investments and the environment in which they invest, are reasonably secure) and, increasingly, to facilitate market access and the operations of foreign affiliates.

B. Services IIAs and their impact on FDI flows

Frequently, services IIAs are concluded in the desire to attract FDI to advance development. Indeed, services IIAs can have an impact on FDI flows, most importantly by influencing one of the principal determinants of FDI – the regulatory framework. In fact, services IIAs make the regulatory framework more enabling, opening space for the decisive economic determinants to assert themselves. These agreements achieve this by:

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

To the extent that the enabling framework is enhanced (be it because of autonomous or of IIA-driven regulatory action) and the

economic determinants are attractive to investors, FDI is likely to flow to this sector. By the same token, when the economic determinants are not favourable, substantial investment flows are not likely to materialize. A good part of the growth of services FDI during the past decade or so has been in parallel with the development of an improved enabling regulatory environment (see UNCTAD 2004a). Most of the improvements have been the result of autonomous decisions, and – as mentioned above – the liberalization of services has contributed to the boom in FDI. While most of the decisions to liberalize policies for services FDI are not the result of services IIAs, they can become more credible in the eyes of investors through commitments in IIAs.

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

Thus, in the absence of comparable statistical data, and in light of the multiplicity of factors determining services FDI, it is difficult to ascertain to what extent services IIAs contribute to increased FDI flows in services.[3]

C. The evolving nature of approaches covering FDI in services

IIAs covering services FDI differ in many aspects, thereby creating a multifaceted and complex network of international rules. Besides differences in their signatories, or in the scope and content of

their obligations, services IIAs also differ in their approach towards covering services FDI.[4]

- In the *investment-based approach,* FDI is *exclusively* covered by the disciplines of the investment chapter of an agreement (e.g. the 1992 North American Free Trade Agreement (NAFTA)[5]) or – under this approach – an agreement deals exclusively with investment (e.g. BITs). In both cases, the agreement or the specific chapter covers services and non-services investments without differentiating between them.

- In the *services-based approach*, services FDI is *exclusively* covered by the disciplines of the services chapter of an agreement or by an agreement as a whole (if the latter deals exclusively with trade in services), either of which covers commercial presence as one of the four modes of trading services. Besides the GATS (box 1), the 1998 Andean Community Decision 439 and the 1995 Association of South East Asian Nations (ASEAN) Framework Agreement on Services are examples of this approach.

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

To some extent, these three approaches can be viewed as reflecting the evolution over time of IIAs in relation to services. Thus, the first and earliest approach, the investment-based approach, does not make a distinction between services and non-services investments. With BITs following this method, this first approach is quantitatively dominant, all the more so as BITs continue to be concluded in large numbers. This approach is usually characterized by the wide coverage of the definition and scope of an agreement's provisions. The

domination of this approach can be explained by the previously existing absence of any express desire by policy-makers to treat investment in services as conceptually different from investment in other sectors.

The second approach reflects the manner in which international transactions in services (including commercial presence) were addressed in the context of the GATS negotiations in the Uruguay Round (box 1).

The third approach blends the other two approaches by addressing investment, typically in a separate chapter, while simultaneously enshrining special rules for services FDI (in the context of international service transactions in general) in another chapter. These agreements also increasingly cover a host of other issues, including some that have implications for investment (e.g. competition). A growing number of recent FTAs and RTAs adopt this approach. This mixed approach raises the question of the relationship between the two chapters in an agreement – an issue discussed below.

By establishing how and where services FDI is covered in an agreement, these three approaches have important implications for the structure and organization of an agreement, as well as for the extent of investment protection and/or liberalization (and other obligations) applying to services FDI.

Agreements following the investment-based approach raise few structural difficulties, given that services and non-services investments are not differentiated for the purposes of the investment provisions of the agreements. Thus, there is no need to determine whether a specific investment is a services or a non-services investment. At the same time, these agreements grant only limited possibilities to address the specificities of services FDI (see below, United States model BIT).

Box 1. The GATS and FDI in services

The GATS is unique in that it establishes the only set of multilateral rules for services FDI in the context of international services transactions in general. All 148 members of the WTO are bound by the rules of the GATS insofar as they apply specifically to that country. The Agreement covers four modes of services supply, one of which is the supply of services through “commercial presence”, with the other modes of supply being cross-border supply, consumption abroad and the presence of natural persons.

The GATS defines “commercial presence” as “any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service” (Article XXVIII, lit. d).

This provision also sets out specific equity thresholds, establishing when juridical persons are “owned” or “controlled” by persons of a member. According to Article XXVIII, lit. n., a juridical person is "‘owned’ by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member". Similarly, it is "'controlled' by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions". Finally, the same provision states that a juridical person is "'affiliated' with another person when it controls, or is controlled by, that other person; or when it and the other person are both controlled by the same person".

While “commercial presence” is therefore akin to FDI, the investment definition in the GATS is narrower than the asset-based approach commonly found in IIAs entered into by both developed and developing countries (UNCTAD 1999).

Source: UNCTAD.

Agreements adopting a services-based approach allow addressing the specificities of services FDI. However, this approach requires a determination of whether an investment is a services or a non-services investment, which is sometimes difficult, even for statistical agencies. Such difficulties are also evident in the GATS, e.g. in the context of "services related to manufacturing consulting" or "services incidental to manufacturing".

Agreements adopting a mixed approach, too, need to determine whether an investment is a services investment or not, and what that means in each case. Under this type of agreement, it may well be that certain provisions appear in both chapters, albeit in different formulations (e.g. the approach and extent of liberalization, or the definition of investment). This could result in differently formulated provisions applying to services FDI, once covered by the investment chapter and once covered by the services chapter. In turn, this could give rise to inconsistencies – an issue discussed below.

While these three approaches may serve as a useful analytical tool to distinguish, compare and analyze services FDI, such a categorization must naturally be treated with caution. In fact, such a categorization looks only at a particular agreement – in isolation from other agreements. In reality, several agreements – together – form the legal regime for investment, both in services and non-services, between two or more countries. For example, a services-based approach in a RTA may be complemented by a BIT that also covers services FDI; taken together, they constitute a mixed approach of a different nature. To take another example, this time from the Andean Community, the 1991 Decision 291[6] deals with investment in general, thereby also covering services FDI; it is complemented by Decision 439 that takes a services-based approach (i.e. covers only services FDI). A similar situation arises in the context of ASEAN. Here, the ASEAN Framework Agreement on Services is complemented by the 1998 (as amended in 2001) Framework Agreement on the ASEAN Investment Area (AIA). While the AIA in its original form did not cover services

FDI, in its current form it covers FDI in services incidental to manufacturing, agriculture, fishery, forestry, mining and quarrying.[7] In parallel, the 1987 (as amended in 1996) ASEAN Agreement for the Promotion and Protection of Investments[8] applies to services FDI. Together, these agreements, too, constitute a mixed approach. Thus, ultimately, it is necessary to look not only at individual agreements, but also at the overall legal regime established between countries.

D. BITs and FDI in services – different approaches

BITs are typical for the investment-based approach towards covering services FDI. Consequently, they cover services FDI with the same rules as all other types of investment. Despite having much in common (UNCTAD 1998), not all BITs are identical. Some BITs, for example, contain specific obligations for certain services industries. The 2004 United States model BIT serves as an example for the case of financial services.[9]

While BITs are examples for the chronologically earliest of the three approaches, BITs continue to be negotiated, including during the past decade. Even more so, the recent years have seen new variations to BITs and the rules they establish. Again, there appear to be three main types, this time grouped according to the countries concluding the agreement: the first could be called the broad, Western Hemisphere type, promoted most actively by the United States and Canada; the second is the more narrow European type, mostly followed by European countries;[10] and the third is the South-South type (which is close to the European type). With the great number of developing countries, it is, of course, difficult to speak about a developing-country type BIT. The matter is further complicated by the fact that most developing countries have BITs with either North American or European countries.

One distinctive feature of the Western Hemisphere type is that it extends national treatment and MFN obligations to the pre-

establishment phase of investment (while accommodating country-specific exceptions to these obligations). In contrast, the other types tend to cover only the post-establishment phase. Similarly, the Western Hemisphere type tends to contain a specific article on prohibited performance requirements, while the other types may deal implicitly with such requirements, e.g. in so far as they might violate the national treatment or MFN obligations.[11] Another distinguishing feature is that the United States and Canadian model BITs include so-called a priori comment and publication procedures, whereas the few European treaties containing transparency requirements limit their applicability to the stage after the adoption of laws and regulations. Finally, the 2004 United States and Canadian[12] model BITs, both most recent examples for the Western Hemisphere type, contain provisions not to lower environmental and labour standards to attract investment.

Few specific South-South features are discernable, but there are some notable exceptions. For example, South-South BITs that aim at the protection of FDI provide for a broad definition in their coverage. At the same time, others tend to retain a certain degree of host country control over the admission of investment (e.g. the China-Sri Lanka BIT) and, at times, the treatment of investment (e.g. Singapore-Egypt BIT). Other agreements limit their coverage to a definition that excludes, among others, portfolio investments and other short-term capital flows. Similarly, South-South BITs tend to retain control over admission and establishment and not grant any pre-establishment rights to foreign investors (e.g. the Ethiopia-Yemen BIT and the Bahrain-Jordan BIT). With regard to other substantive provisions relating to the treatment and protection of foreign investors, South-South BITs vary in their approaches. In general, treatment provisions (i.e. national treatment, most-favoured-nation treatment) tend to involve a greater emphasis on exceptions (e.g. for balance-of-payments or prudential measures). In a few cases, national treatment is not granted (e.g. Malaysia-Saudi Arabia BIT and those agreements signed by China). Protection provisions generally include those related to transfer of funds, expropriation and dispute settlement, with the

notable absence of provisions for international arbitration of investor-State disputes in a number of the agreements, and an emphasis on so-called fork-in-the-road clauses, i.e. where investors must choose between the litigation of their claims in host country's domestic courts or international arbitration (e.g. in the Costa-Rica-Argentina BIT) (UNCTAD 2005 b).

Learning from investor-State litigation under NAFTA, the most recent United States and Canadian model BITs clarify the meaning of the articles on minimum standard of treatment (including fair and equitable treatment and full protection and security) and expropriation. For example, the United States model BIT emphasizes the parties' shared understanding of customary international law for minimum standard of treatment and expropriation (Annex A), and spells out in more detail the meaning of customary international law for "fair and equitable treatment", "full protection of security" and "expropriation" (Annex B). So far, this has not been done in European and developing-country BITs, perhaps in part because European and developing countries either have not yet been extensively involved in high profile investor-State litigation, or because awareness about the implications of such cases is only just beginning to emerge. It remains to be seen whether the absence of such clarifications in the European and developing-country BITs will result in a pattern of arbitration awards being more or less deferential to national regulatory autonomy, compared to future awards interpreting more recent United States and Canadian BITs.

* * *

To conclude, the multifaceted and multilayered network of services IIAs is evolving, and – in this context – increasingly addressing the specificities of the services sector. To allow developing countries to maximize benefits in terms attracting services FDI and benefiting from it, more research is needed to shed light on the relationship between services IIAs and FDI flows. Similarly, it is

important to improve the understanding of the manner how IIAs can best address the new economic realities in the services sector. The next chapter, looking at key provisions and salient features of services IIAs, constitutes a first attempt in this direction.

Notes

[1] PTIAs can take various forms, including FTAs and regional trade agreements (RTAs).

[2] Unless otherwise indicated, all agreements mentioned in this chapter can be found in UNCTAD 1996, 2000, 2001, 2002a, 2004d, 2005d, and, together with BITs, also at http://www.unctad.org/iia. Intra-European Union agreements are not considered, given the *sui generis* nature of the European integration process.

[3] For a further discussion, see UNCTAD 2003b, chapter III.

[4] For a discussion of similar issues, in the context of identifying the implications that possible negotiations on a multilateral investment framework in the WTO would have for the GATS, see Roy 2003.

[5] Note that NAFTA, while signed in 1992, entered into force in 1994.

[6] Andean Community, Decision 291, Regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties, 1991, http://www.sice.oas.org/Trade/Junac/decisiones/dec291e.asp; it does not, however, contain many of the typical investment obligations.

[7] In addition, Article 2 provides that the AIA "…shall further cover direct investments in such other sectors and services incidental to such sectors as may be agreed upon by all Member States."

[8] Agreement for the Promotion and Protection of Investments, http://www.aseansec.org/6464.htm and http://www.aseansec.org/6465.htm.

[9] See the Treaty between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment, 2004; http://www.state.gov/documents/organization/29030.doc.

[10] Since the European Commission does not have a mandate to negotiate investment issues on behalf of the members of the Union, European countries continue to conclude separate BITs, which, nevertheless, possess the same basic features.

[11] Rules on performance requirements are, however, set out in the 1994 WTO Agreement on Trade-Related Investment Measures (TRIMs).

[12] See the 2004 Canadian model BIT, Agreement between Canada and ___ for the Promotion and Protection of Investments, 2004; http://www.dfait-maeci.gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf.

III. SERVICES IIAS: THEIR KEY PROVISIONS AND SALIENT FEATURES

IIAs – services IIAs included – contain a series of key provisions. Those addressing the definition of the investment covered, the extent and nature of the liberalization and protection granted, whether (and how) they prohibit performance requirements, or what dispute settlement procedure is set up, are amongst these key provisions. The nature and exact content of these provisions can vary, amongst others, to take into account the particularities of services FDI. In addition, services IIAs may have certain salient features that are due to the services specific nature of the FDI covered by an agreement. The fact that several IIAs contain specific rules for individual services industries is a case in point.

These provisions and salient features may also vary across agreements that take different approaches towards covering services FDI (i.e. investment-based, services-based, mixed). The following chapter aims to make certain tentative observations about such key provisions and salient features of services IIAs. Thereby it aims to contribute to a better understanding of the manner in which IIAs can best address the new economic realities in the services sector.

A. The definition of investment

An agreement's definition of investment is important in so far as it sets out an IIA's subject-matter coverage. More specifically, the definition establishes the scope and breadth of investments being covered by the agreement in question. IIAs' definitions of investment can differ, being broad, asset- based, or narrow, enterprise-based; they can relate to both existing and new investment or just one of them (UNCTAD 1998, 1999).[1] The large majority of IIAs (especially BITs and FTAs) contain broad, asset-based definitions of investment (UNCTAD 1998).

Amongst services IIAs, those taking a services-based approach (i.e. the ones that cover services investment as "Mode 3/commercial presence" of services trade) are more likely to adopt narrower, enterprise-based definitions than IIAs that do not contain a services

chapter. The GATS and the Andean Community Decision 439 are examples of the former. Article 2 of Decision 439, for example, defines "commercial presence" as:

> “[a]ny kind of business or professional establishment in the territory of a Member Country for the purpose of providing a service through, for example:
> * The establishment, acquisition or maintenance of a juridical person; or
> * The creation or maintenance of a branch or a representative office.”

Some agreements using the mixed approach, adopt both a narrower, enterprise-based definition of investment in their services chapter and a broader, asset-based definition in their investment chapter. The 2002 EFTA–Singapore FTA and the Japan–Singapore Agreement, serve as examples, with their relevant provisions[2] being largely similar in language. Broadly, in their services chapters, these two agreements define "commercial presence" as “…any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person; or (ii) the creation or maintenance of a branch or a representative office; within the territory of a Party for the purpose of supplying a service”.

Adopting such a broad definition in the investment chapter, as opposed to a more narrow definition in the services chapter, may have important implications: in fact, in spite of the services chapter’s narrower definition of what an investment is, the investment may actually be covered by the broader definition of the investment chapter (e.g. when it comes to the protection of intellectual property rights often covered by the asset-based definition), unless there are specific provisions that provide for a different approach. While this may have far-reaching effects for the scope and breath of an IIA as well as for the obligations countries accept thereunder, it has, thus far, received comparatively little attention from policy-makers, particularly in developing countries.[3]

Closely linked to the definition and scope of investment covered by an IIA is the question of who should ultimately benefit from its provisions. Most of the services IIAs contain special clauses regarding the beneficiaries under the respective agreements.

These clauses are frequently entitled “Denial of Benefits”, and identify those investors and investments that are not eligible for the benefits provided by the respective agreement. In the absence of such a clause there is a possibility for round-tripping to benefit from an IIA, even if they have no substantive business operations in the other party, an issue recently addressed – in part – in the recent 2004 Tokios Tokelés v. Ukraine arbitral decision (ICSID 2003).

“Denial of Benefits” clauses are usually found either in the “Definitions” section of an agreement, or under a separate heading. While addressing the same issue, these clauses vary in their nature (discretionary or mandatory) and in the criteria they establish for an investment to enjoy the benefits of an agreement. Generally, enterprises that are not eligible for the benefits of an agreement are those that are owned or controlled by investors of a non-party. Some IIAs also allow parties to deny benefits not only to non-party enterprises in the territory of a party, but also to that party’s enterprises in the territory of the *other* party, if they do not have substantive business operations in the other party. Examples include the 2003 Chile–United States FTA[4] and the Australia–United States FTA.[5]

Frequently, denial of benefits clauses identify non-eligible investors through a so-called “substantial business operations test”. More specifically, they state that benefits can be denied to an enterprise that is owned and controlled by persons of a non-party, if the enterprise has no substantial business activities in the territory of the party under whose laws it is constituted (see, for example, Article 1113.2 of NAFTA). Some agreements set out more detailed criteria for determining whether or not an enterprise has substantive business

operations. The 2003 Mainland–Hong Kong Closer Economic Partnership Arrangement is an example.

Another interesting example is provided by the New Zealand–Singapore Agreement, which requires an enterprise to engage in substantive business operations in the territory of one or both parties (Article 25). The textual interpretation of this provision leads to the conclusion that, for example, a non-party enterprise formally established in Singapore but not engaged in substantive business operations there, would still enjoy benefits afforded by the Agreement if it engages in substantive business operations in New Zealand. It appears that this formulation leaves room for a circumvention of the denial-of-benefits clause.

The GATS, too, refers to substantive business operations, but without defining them. While one of these references is in the Article containing definitions for the purpose of the GATS (Article XXVIII, lit. m (i)), the other one refers to economic integration (Article V, para. 6). The former of the two, Article XXVIII, lit. m reads: " 'juridical person of another Member' means a juridical person which is either: (i) constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member; or (ii) in the case of the supply of a service through commercial presence, owned or controlled by: 1. natural persons of that Member; or 2. juridical persons of that other Member identified under subparagraph (i)." It is thus an example of a clause adopting a substantive business operations test.

The second of the two references to substantive business operations in the GATS is included in a provision on economic integration. It states that "[a] services supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement." In

other words, this provision entitles those service suppliers of WTO members that are established in an economic integration agreement area to the benefits of that agreement if they engage in substantive business operations in one of the parties to that agreement. Thus, it refers to the extension of benefits to third-party companies conducting "substantive business operations" in the context of a very specific set of circumstances (i.e. derogations from GATS disciplines permitted as a result of entering into economic integration agreements).[6]

Finally, benefits can also be denied for reasons other than a company not having substantive business operations in the respective countries. Such other criteria may relate to the country in which a parent firm is established, and for example, whether the host country has diplomatic relations with this other country.

B. Investment liberalization

The principal issues here are whether an agreement covers both pre- and post-entry investment, or post-entry investment only, and what are the degree and method of liberalization set out in the agreement. Whether or not an IIA grants pre-establishment rights is important, as the inclusion of pre-establishment rights considerably expands the coverage of the agreement and thereby may have important implications for a government's right to regulate. Similarly, the degree and method of liberalization may have implications for governmental regulatory prerogatives. This suggests that careful consideration is needed, before choosing to accept such potentially far-reaching obligations.

Several FTAs, particularly the more recent ones, grant the right of establishment (i.e. cover pre-entry investment). At the same time, most BITs – except for recent ones signed by some countries in the Western Hemisphere – apply to post-entry investment only (UNCTAD 1999). Where the right to establishment is granted (in some BITs and a number of FTAs), this is typically done by extending national

treatment commitments to the pre-entry stage. At the regional level, NAFTA takes this approach.

The approach is different in most services based agreements. The GATS, for example, allows members to grant pre-establishment rights in the context of the commitments they undertake. Thus, once a country has undertaken full national treatment and market access commitments, this could be viewed as similar to granting pre-establishment rights. This view is supported by the fact that the definition of commercial presence under the GATS includes the words “establishment” and “acquisition”.

In the case of mixed agreements, one can take the Japan–Singapore Agreement as an example. In fact, the Agreement's market access provision (Article 59) is phrased similar to the one in the GATS (Article XVI). The same applies to the Agreement’s national treatment provision. Depending upon the scope of a country's commitments, the Agreement's services chapter could be viewed as granting a right to establishment. In its investment chapter the relevant provision is the national treatment obligation, which states that "[e]ach Party shall … accord to investors of the other Party and to their investments in relation to the establishment, acquisition, expansion, ... or other disposition of investments, treatment no less favourable than the treatment which it accords in like circumstances to its own investments and investments…".

Overall, where countries grant pre-establishment rights, they tend to complement them with a high number of conditions or limitations. In fact, comparing reservations across a series of negative list IIAs (most of which grant the right to establishment) shows that such reservations to pre-establishment rights are particularly prevalent in the case of services, particularly when compared to manufacturing. Even more so, certain services industries exhibit a relatively high number of pre-establishment reservations. Financial services are a case in point (see also UNCTAD 2005c).[7]

Ultimately, thus, the degree of investment liberalization in most agreements depends on the level and nature of commitments their parties undertakes. This is also true for the GATS. While commitments have been undertaken during the Uruguay Round of negotiations, WTO members are currently – as part of the Doha Round – negotiating further liberalization commitments in the services area.

There are also instances of regional groupings, including those comprising developing countries, in which parties agree, in principle, to negotiate future liberalization of services to a degree that goes beyond what has been agreed in the GATS. The ASEAN Framework Agreement on Services is an example. In that context, it is important to note that regional agreements typically involve trade offs across a number of issues, thereby facilitating the achievement of broad and far reaching liberalization. In fact, compared to the multilateral commitments under the GATS, services liberalization commitments under regional trade agreements are in many cases more far reaching.

Given that the granting of pre-establishment rights may have important implications for domestic regulatory prerogatives, governments may wish to carefully chose the extent to which they grant such pre-establishment rights, in which sectors they do so, and how they circumscribe such rights through the use of reservations, conditions or limitations. In that context, careful and informed choices can, indeed, preserve policy space.[8]

C. Investment protection

Rules on investment protection are designed to guard the interests of foreign investors against host Government actions that are unduly detrimental to investors' interests. The norms in question have their roots in customary (international) law, but in recent years they have found expression in numerous treaty provisions. Such rules may address different issues, ranging from non-discrimination post-

establishment to protection against the taking of property and others. In part, these rules – and in particular the way they have been interpreted through investor-State dispute settlement – have given rise to concerns about Governments' regulatory prerogatives. (For a possible response to these challenges, see below sub-chapter E on dispute settlement.)

Most agreements taking the investment-based approach contain core protection disciplines, including national treatment, MFN and fair and equitable treatment. In some agreements, these may be linked to the observance of the international minimum standard of treatment. Equally, agreements may cover compensation for loss and expropriation, and provide for the free transfer of funds. The most recent United States and Canadian model BITs are examples of agreements containing strong rules with respect to the core investment protection disciplines.

Agreements taking the services-based approach tend to be less far-reaching as regards investment protection. For example, the GATS does not contain a full set of investment protection rules. More specifically, it does not contain rules that assure foreign investors compensation in the case of expropriation, it does not contain rules that set the minimum standard of treatment, or rules that provide for investor–State dispute settlement. At the same time, the GATS *does* contain certain disciplines *related to* investment protection. For example, it contains a general MFN obligation (subject to exemptions), a national treatment obligation (subject to limitations), rules on transfers and payments (Article XI), rules on the "reasonable, objective and impartial" administration of measures of general application in committed sectors (Article VI, para. 1), as well as rules on certain capital transactions (footnote 8 to Article XVI) (Sauvé and Wilkie 2000). As mentioned earlier, however, one single services IIA (e.g. the GATS) should not be viewed in isolation. Thus, agreements not containing strong rules on protection may be complemented by agreements focusing on protection, for example, BITs.

Finally, agreements taking a mixed approach are likely to contain all the main investor-protection standards and guarantees typically covered in investment-based IIAs. For example, the New Zealand–Singapore and the Japan–Singapore agreements contain the usual liberalization rules in the services trade chapters and the usual investment protection rules in the investment chapter, both of which apply to services FDI.

D. Performance requirements

Performance requirements matter, in so far as they are regulatory measures to assure that a country not only attracts, but also benefits from investment. Performance requirements may include, amongst others, requirements to transfer technology, to undertake research and development (R&D) in the host country, to employ local labour, to source inputs locally or to export a given level of production.

Since the middle of the 1990s, a number of services IIAs explicitly prohibit the use of certain performance requirements geared towards services. This includes requirements pertaining to exports, local content or employment, the supply of a specific region of the world market exclusively from a given territory, the location of regional headquarters and R&D. Such provisions are generally found in IIAs concluded by countries in the Western Hemisphere, starting with NAFTA. Some agreements only prohibit the use of mandatory requirements, while allowing requirements linked to the granting of incentives (box 2). For example, this approach has been followed in many of the BITs entered into by the United States and Canada. At the same time, there are also agreements that do not cover services-related performance requirements.

Box 2. The GATS and subsidies

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

The GATS thus permits subsidies as such, including subsidies contingent upon the export of services and other investment incentives. However, the MFN obligation applies to subsidies because they are covered by the definition of "measure". In scheduled industries, national treatment commitments also apply, unless they specifically exclude subsidies. In the service industries for which commitments have been made, and subject to any conditions or qualifications set out in its schedule, a WTO member must administer its subsidy schemes in a manner that accords the services and service suppliers of other members treatment no less favourable than that accorded to its own like services and service suppliers.

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

/…

Box 2 (concluded)

under the SCM Agreement. Similarly, despite the fact that the GATS and the Agreement on Agriculture address different situations, there might be subsidy regimes that can fall under both Agreements (because one and the same subsidy might affect both, trade in services and trade in agricultural products).[a] In such a case, the subsidy – or a specific aspect of a subsidy regime – that is allowed under one Agreement, could still be found to be in violation of the other.

Source: UNCTAD 2002b, p. 210.

[a] Annex 2, para. 2 of the Agreement on Agriculture refers to "… expenditures (or revenues foregone) in relation to programmes which provide services or benefits to agriculture or the rural community…". Such programmes "…shall not involve direct payments to producers or processors…". They shall include but not be restricted to: research, pest and disease control, training services, extension and advisory services, inspection services, marketing and promotion services, infrastructural services (including electricity reticulation, roads, market and port facilities, water supply facilities, dams and drainage schemes and infrastructural works associated with environmental programmes). These subsidies fall under the so-called "green box", with the additional requirement (set out in para. 1) that they have "…no, or at most minimal, trade-distorting effects…".

Table 1. Examples of services IIAs prohibiting various types of performance requirements pertaining to services, 2004[a]

Instrument	To locate head-quarters for a specific region of the world market	To export a given level or percent-age of services	Employ-ment perform-ance requirement	To supply services provided to a specific region of the world market exclusively from a given territory	To act as the exclusive supplier of services provided	R&D	To purchase or use services provided in its territory, or to purchase services from natural or legal persons in its territory	Labour certification, academic certifications or other procedures of similar effect
NAFTA, 1992		X			X		X	
GATS, 1994[b]								
Croatia–United States BIT, 1996[c]		X		X		X	X	X
Canada–Chile FTA, 1996		X			X		X	
El Salvador–Peru BIT, 1996		X		X			X	X
Canada–Romania BIT, 1996 [d]							X	
Mexico–Nicaragua FTA, 1997		X			X		X	
Jordan–United States BIT, 1997		X		X		X	X	X
Chile–Mexico FTA, 1999		X			X		X	
Jordan–United States FTA, 2000[e]								
EU–Mexico FTA, 2000								
Japan–Republic of Korea BIT, 2001	X	X	X	X		X	X	
CARICOM Agreement, 2001								
Japan–Singapore Economic Partnership Agreement, 2002	X	X		X		X	X	
EFTA–-								

Singapore FTA, 2002								
Chile–United States FTA, 2003		X						
Chile–Republic of Korea, FTA, 2003		X					X	
Chile–EU Association Agreement, 2003								
CAFTA, 2003 [f]		X		X			X	
Australia–United States FTA, 2004		X		X			X	

Source: UNCTAD.

a Apart from the four performance requirements prohibited by the TRIMs (local content requirement, trade-balancing requirements, foreign exchange restrictions related to foreign exchange flows attributable to an enterprise, and export controls), countries have included other specific prohibitions in agreements. This table is an example of some of the services IIAs that contain express provisions prohibiting certain types of performance requirements that could be considered in relation to services. Note also, that the list of performance requirements given in this table is not exhaustive. Rather, some of the listed agreements contain prohibitions additional to the ones mentioned in this table.

b Depending upon a member's commitments, the GATS market access provision (Article XVI, para. 2, lit. e) may rule out joint venture requirements or requirement for other specific types of legal entity. Similarly, even in the absence of specific disciplines, national treatment rules (again depending upon a member's commitment) and other disciplines (such as those on transparency or MFN treatment) may apply to services-related performance requirements.

c Most of the recent BITs signed by the United States contain clauses prohibiting similar measures as in the Croatia–United States BIT. Other examples are the BITs with Azerbaijan (1997), Bolivia (1998), Lithuania (1998) and Mozambique (1998).

d Most of the recent BITs signed by Canada contain clauses prohibiting similar measures as in the Canada–Romania BIT. Other examples are the BITs with Ecuador (1996), Panama (1996), Egypt (1996), Croatia (1997),

Lebanon (1997), Thailand (1997), Armenia (1997), Uruguay (1997) and Costa Rica (1998).

e Note that Jordan has scheduled a national treatment reservation under Mode 3 for architectural services, engineering services and urban planning and landscape architectural services that specifies that "[f]oreign firms are required to train and upgrade the technical and management skills of local employees".

f Central American Free Trade Agreement.

Sometimes, services IIAs allow countries to retain their ability to use otherwise prohibited performance requirements by entering into reservations. NAFTA, in particular its Articles 1106 and 1108, serves as an example for this approach. Article 1106 sets out NAFTA's rules on performance requirements with an exhaustive list of prohibited performance requirements (e.g. export requirements, local content requirements, technology transfer requirements, exclusive services supplier requirements) (para. 1); it then clarifies that certain performance requirements are not only prohibited from being mandatory, but also from being linked to the granting of an incentive (para. 2); and finally, it establishes certain exceptions (including environmental exceptions) to these prohibitions (para. 6). Article 1108, in turn, addresses reservations (for non-conforming measures) and exceptions to four of NAFTA's core investment obligations (i.e. national treatment, MFN treatment, rules relative to performance requirements and senior management and boards of directors). Amongst others, Article 1108 sets out in which Schedules/Annexes to list non-conforming measures. It also states that certain obligations (including performance requirements) shall not apply to existing non-conforming measures maintained by a local government (without the need to list them in a schedule). In this context it is important to note that Annex II NAFTA reservations are broad, including with respect to future measures.

Besides the IIAs mentioned above, the TRIMs Agreement relates to performance requirements. More specifically the TRIMs Agreement lists (and prohibits) certain trade-related performance

requirements (notably those that are inconsistent with Articles III and XI of the GATT). However, as the TRIMs Agreement applies to investment measures related to trade in goods only (Article 1 of the Agreement), it does not apply directly to services. It may, however, apply to measures regulating services FDI, for example, when performance requirements applied to services investors affect trade in goods. Requirements for a service provider to source locally the material (goods) needed for the provision of services may serve as an example (e.g. food in the tourism industry, or telecom material for telecom providers). Nevertheless it should be noted that currently the African Group is negotiating to obtain exemptions from certain of the TRIMS obligations (WTO Committee on Trade and Development 2003), and the least developed countries (LDCs) have put forward proposals to be exempted from the disciplines of the TRIMS Agreement (WTO Committee on Trade and Development 2002).

Apart from agreements that specifically prohibit performance requirements, other agreements may also be relevant for performance requirements. For example, an IIA's national treatment rules and other disciplines (such as those on transparency or MFN treatment) may apply to services-related performance requirements. Consequently, if a party wishes to continue applying performance requirements to foreign affiliates only, it would need to make a specific reservation in its national treatment commitment.

The GATS is an example for an agreement that does not explicitly prohibit performance requirements. Depending upon a member's commitments, however, the GATS' market access provision (Article XVI, para. 2 lit. e) may rule out joint-venture requirements or requirements for other specific types of legal entities. Similarly, again depending upon a member's commitments, the GATS national treatment provision (Article XVII) may rule out any performance requirement that is exclusively targeted at foreign services providers. At the same time, performance requirements can be attached as conditions to market access and national treatment commitments.

In some countries a specific requirement, arising out of the particular nature of some services, is the local presence requirement. This is a kind of duty of establishment, which requires a firm to place the business itself within a locally registered and licensed corporate entity. This can be the case, for example, with respect to financial services, where, the need for prudential supervision is difficult to achieve without the physical presence of the related assets of the businesses in the markets they serve. A further reason concerns the regulatory authorities' ability to recover assets of suppliers, should the need to do so arise. As an alternative to local establishment, a country may allow foreign suppliers of services to operate in its markets as long as they provide a suitably large deposit to cover their potential liabilities with an institution within the host country, as determined by the host country government or a regulatory authority.

Another reason for introducing local presence requirements may be to ensure more developmental benefits for the host country, for example, in terms of creating new jobs. A number of Canadian and United States FTAs, in their services chapters, prohibit signatories from requiring a service provider of the party to establish or maintain a representative office or any form of enterprise in the territory of the other party as a condition of providing services in the territory of that latter party. Article 1205 of NAFTA and Article H-05 of the 1996 Canada–Chile FTA are examples. As noted above, the Canadian and United States FTAs tend to adopt an investment-based approach and, in their services chapters, to exclude the "commercial presence" mode from their coverage. Nevertheless, even if the said prohibition were to be included in a chapter that does not cover services FDI, it would be relevant for services FDI by its very nature, as it has the potential to affect services FDI.

E. Dispute settlement procedures

Legal rights (and, conversely, obligations) are of limited significance unless they are subject to a dispute settlement system and, ultimately, enforcement. The settlement of disputes, particularly at the international level, is, in turn, an important tenant of the enforcement and implementation of services IIAs (UNCTAD 2003a).

There are differences in the types of dispute settlement systems applying to services FDI, and some dispute settlement mechanisms contain specific provisions to suit the particularities of services related disputes. For example, some agreements require specific expertise for dispute settlement (panels or other arbitral) tribunals as they deal with industry-specific issues. Financial services are a case in point. Paragraph 4 of the GATS Annex on Financial Services stipulates that "[p]anels for disputes on prudential issues and other financial mattes shall have the necessary expertise relevant to the specific financial service under dispute." Other examples with respect to financial services include the Australia–Singapore FTA (Article 6) and the EU–Mexico Agreement (Article 25).[9]

With respect to the type of dispute settlement system, a number of IIAs, in particular BITs and most recent FTAs, contain mechanisms for investor-State dispute settlement. Such a mechanism is generally not found in those IIAs – or chapters within them – that take a services-based approach. However, to the extent that services FDI is covered by the investment chapter, it may well be subject to investor-State dispute settlement if the obligations of the investment chapter are subject to such a mechanism. This may be the case for investment-based agreements as well as mixed agreements.

The 2003 Chile–United States FTA and the 2003 Singapore–United States FTA (both investment-based agreements) have investor-State dispute settlement systems that apply to services FDI (as part of the investment chapter). These two agreements are interesting in so far

as both explicitly state that specific provisions of the services chapter also apply to services FDI as it is covered by the investment chapter. Notably, this is the case with respect to e.g. market access, domestic regulation and transparency. This would raise the question, whether obligations, established in the services chapter, but also applicably to services FDI as it is covered in the investment chapter, would be subject to investor-State dispute settlement as it applies to the investment chapter. As a response to this question, the IIAs contain a footnote stating that these obligations, while applying to services FDI as it is covered by the investment chapter, are not subject to investor–State dispute settlement.[10]

In the case of the 2003 Australia–Singapore FTA[11] (a mixed agreement), investor-State dispute settlement applies to the investment chapter (covering certain aspects of services FDI), but not to the services chapter (also covering certain aspects of services FDI). Thus, to the extent that services FDI is covered as "Mode 3/commercial presence" in the chapter on trade in services, it may be subject only to the State-State dispute settlement process (or arbitration procedures), as this is the typical dispute settlement mechanism for most such chapters. In turn, to the extent that services FDI is covered in the investment chapter, it may be subject to investor-State dispute settlement.

The GATS, as part of the WTO, contains a mechanism for State–State dispute settlement only. In fact, the dispute settlement system applying to services FDI is the one set out in the Understanding on Rules and Procedures Governing the Settlement of Disputes (WTO 1994b), the same as the one applying to all other areas of WTO obligations. Similar is the situation in the 2000 Jordan–United States FTA and the ASEAN Framework Agreement on Services.

Slightly different is the situation created by the Framework Agreement on the ASEAN Investment Area (AIA). As mentioned above, the AIA does not, apart from certain industries, apply to

services FDI. Despite the fact that it takes an investment-based approach, it only provides for State–State dispute settlement procedures. Interestingly, however, Article 17 of the Agreement provides additionally that a special dispute settlement mechanism may be established for the purpose of this Agreement.

Thus, as with many other issues, where, or in which chapter, services FDI is covered can determine the type of dispute settlement mechanism applying to it. Whether or not an issue is covered by either investor–State or State–State dispute settlement is of considerable significance. Most importantly, the two systems differ with respect to the remedies they offer: investor–State dispute settlement processes usually involve the award of monetary damages. Requiring the losing (governmental) party to pay financial compensation to the winning (investor/investment) party may have significant implications, particularly for developing country governments where financial resources are scarce. State–State dispute settlement usually issues awards that oblige the loosing country to change its laws and regulations to bring them in line with the award. This in turn, may have significant implications for governments' regulatory choices.

While dispute settlement constitutes a crucial element for the effective enforcement and implementation of an IIA, it has also given rise to concerns. Such concerns were spurred by the increasing prominence of investor-State litigations, including in the services sector. For example, recent cases have involved basic utilities such as water and sewage, exposing tensions between private investors' rights and their protection on the one hand, and a population's right of access to essential services on the other hand. Also, investor-State cases have involved regulatory actions that countries have undertaken in the wake of financial crises, suggesting that IIAs can make those dynamic aspects of policy changes more difficult that allow individual countries to cope with rapidly evolving – and partly unforeseeable – economic developments.

In addition, arbitral tribunals in investor-State cases have issued interpretations of IIAs' core provisions (minimum standard of treatment and expropriation) that raise the question where the balance between regulatory action and investor protection should lie (see above, the response through issuing interpretative statements for some of the IIAs' main obligations). Also, some recent arbitral tribunals have awarded large sums, which raise concerns about their impact on developing countries. Beyond the issue of awards, the policy implications of disputes need to be looked at. Similarly, international arbitration itself can demand much by way of resources and expertise, possibly putting developing country parties as a disadvantage. Finally, there are fundamental concerns as regards due process, transparency and the proper functioning of the procedures: not only are investment disputes usually conducted behind closed doors (doors also closed to affected stakeholders), but also not all of the arbitration facilities maintain public registries of claims, thus making it virtually impossible to have precise information about the number and nature of ongoing cases (see also UNCTAD 2004b and 2005e).

On the other hand, such risks should not be overstated. This paper has already mentioned one response to concerns with investor-State dispute settlement experiences – namely, to issue interpretative statements. Likewise, one could consider inserting into future IIAs a provision protecting the right to take regulatory action. Along these lines, arbitral tribunals could be expressly required to act in a manner that recognizes the right of a government to exercise legitimate regulatory powers. A similar approach could be considered with respect to citizens' rights to access universal services. Finally, one could consider improving the due process aspects of investor-State dispute settlement cases.

F. Approaches to negotiating commitments

Services IIAs can differ in the method negotiating parties use to arrive at their individual commitments for services FDI. Under the

negative list approach, countries agree on a series of general obligations and, then, individually list all of those areas in which non-conforming measures are maintained. For example, NAFTA (in its investment chapter, which also covers services FDI) and a number of agreements involving countries of the Western Hemisphere as well as BITs take this approach. In contrast, under the positive list approach, certain obligations apply only to the industries (along with relevant limitations) listed by each country. For example, the GATS, the 1997 MERCOSUR Protocol of Montevideo and the ASEAN Framework Agreement on Services take this approach.[12]

While, in theory, both approaches can arrive at the same results, and both grant flexibility, there are important differences between them. For example, in terms of the negotiating process, the negative list approach can be administratively burdensome, particularly for developing countries with limited resources. In terms of outcomes, the negative list approach can result in a situation in which future measures may – due to lack of foresight – be inadvertently bound. This could also happen in industries in which, at a later date, governments may need to take development-oriented measures. Given that in many countries certain service industries are yet to be developed and the regulatory framework for the services sector is still evolving, this may, in certain cases, forestall policy flexibility (see also UNCTAD 2005c).[13]

Many services IIAs, whether taking a positive or negative list approach, contain mandates for further liberalization. The GATS, for example, in pursuance of its objective to liberalize services trade progressively, provides for the periodic negotiation of specific commitments through successive rounds of negotiations. Such negotiations are currently under way in the context of the Doha Round of trade negotiations. Here, liberalization is being negotiated according to the request/offer method, with countries submitting their requests (i.e. requests to make new or deeper commitments) on a bilateral basis, and offers (i.e. offers indicating where a country is prepared to enter

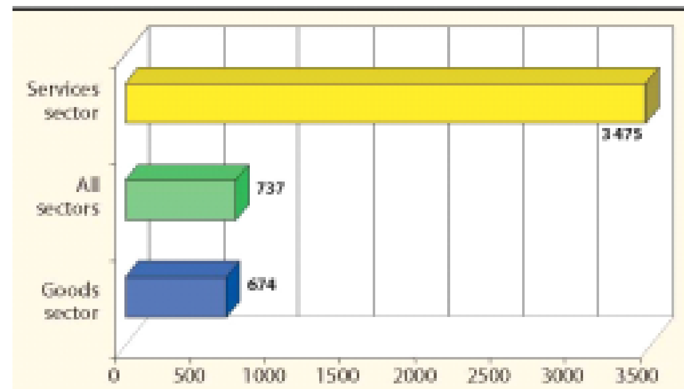
more liberal commitments into its schedule) at a multilateral basis. This process is then complemented with bilateral negotiations between the requesting and offering countries.

By their very nature, such negotiating mandates imply that reservations can be time-bound, in other words that they are potentially subject to elimination in future negotiations. Again, the GATS serves as an example: glancing over some of the initial requests in the current round of negotiations reveals that several of the conditions and limitations attached to commitments are targeted for elimination. With respect to Mode three, this applies to conditionalities such as joint-venture requirements, ceilings on foreign ownership, local job creation linked to FDI approval, implementing services provision through local providers, ceilings on remittances, or allowing the prohibition of land purchases if the intention is purely speculative. While many of these conditions are horizontal in nature, several requests for the removal of mode three conditionalities are also industry-specific, covering e.g. financial, telecommunication or tourism services. Thus, there might be concerns about the extent to which a mandate for progressive liberalization impacts on governments' regulatory prerogatives, and reduces governments' abilities to effectively use reservations as a tool to preserve national policy space.

At the same time, looking at the type and number of reservations lodged in services IIAs suggest that, thus far, countries have been able to preserve national policy space – albeit to different degrees. As reservations may be the result of an interplay between the dynamics in international negotiations and policy preferences at the national level, a closer look at IIAs reveals a series of interesting things. Based on the lists of a total of 4,886 nonconforming measures included in seven negative list IIAs, 71% were related to investment in services, 15% to horizontal restrictions that apply to all sectors and 14% concerned investment in the primary and manufacturing sectors (figure 1).[14] Within the services sector, four industries – transportation,

banking and insurance, business services and communications – accounted for 85% of all non-conforming measures (figure 2).[15]

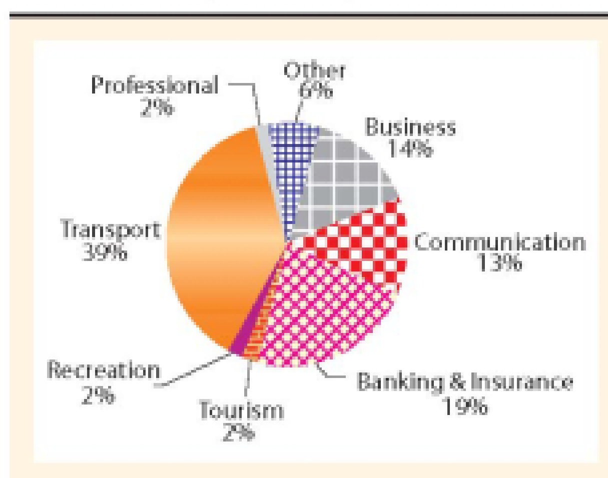
Figure 1. Reservations by sector in selected IIAs, by sector (2004)



Source: UNCTAD.

While such figures, based on the number of reservations in IIAs, may be helpful in giving an indication about the frequency of reservations in various services industries, they need to be viewed with caution. In fact, the actual number of services-related reservations does not necessarily give a precise picture of how far, in practice, national policy space has been preserved. Most importantly, reservations differ in their coverage, nature, and impact. For example, reservations range from rather broad and sweeping carve-outs for measures relating to certain policy objectives to precise limitations for specific regulatory measures. Similarly, the impact of reservations differs depending on the economic importance of the services industry they are attached to.

Figure 2. Reservations on investment in services, by industry, selected IIAs (2004)



Source: UNCTAD.

In this context, it is also interesting to note the diversity of regulatory measures that are being lodged as reservations/non-conforming measures in IIAs. They range from formal (e.g. legislations and decisions) to informal measures and from specific (applying at the level of firms or industries at large) to general (e.g. economic needs test and national interest criteria) measures. Some measures apply at the point of entry, stretching from mere notification requirements to outright prohibition of FDI; others target the operations of firms; while a third category is related to restrictions in the area of ownership and control.

G. Provisions covering specific service industries

Certain services industries may pose specific regulatory challenges, both at the national and international levels. As a response, some services IIAs contain rules for specific service industries. In the WTO, for example, separate texts have been negotiated – since the adoption of the GATS – on telecommunications, financial and accountancy services.

These texts have different characteristics and serve various policy purposes. In some instances, such rules elaborate on the obligations of the GATS according to the specificities of individual service industries; this is notably the case for the GATS Annexes on Financial Services and on Telecommunications. WTO members are bound by these two texts irrespective of whether or not they have entered into specific commitments in the telecommunications and financial services industries. In other cases, for example in telecom services, sectoral disciplines also address matters such as competition-related aspects of trade in services. Such rules can be found in the Reference Paper for Telecommunications, which features a number of pro-competitive regulatory disciplines. The Reference Paper offers WTO members the choice to opt in or to opt out of it, as well as to slightly amend its provisions, by means of adopting additional specific commitments under Article XVIII (Additional Commitments).[16]

In the case of financial services, sectoral rules address the need to undertake measures for prudential reasons. Some, such as the Understanding on Financial Services, provide a voluntary model for scheduling commitments aimed at a higher overall level of liberalization. In the accountancy sector, provisions negotiated under Article VI, para. 4 (Domestic Regulation) spell out disciplines relating to licensing, qualifications and professional standards. Such disciplines, which, under certain conditions, are scheduled to enter into force at the end of the current round of negotiations, would apply only

to those countries that undertake commitments in accountancy services.

However, since the completion of negotiations on the above-mentioned three issues (financial, telecommunications, accountancy), no new texts have been agreed upon. In fact, in light of the 2004 WTO case Mexico–Telecommunications (WTO Dispute Settlement Body 2004), some countries might become more cautious about developing industry-specific texts. In the so-called Telmex case, the Panel assessed whether Mexico's laws and regulations for the supply of public telecom services are consistent with its commitments under the GATS, including Mexico's "additional commitment" as they refer to the Reference Paper. With respect to several claims, the Panel found that Mexico had not met its obligations under the Reference Paper and under the Annex. While the Panel emphasized that its findings in no way prevent Mexico from pursing development objectives this case nonetheless points to the difficulty of formulating commitments in a manner that truly safeguards development options (UNCTAD 2005a and South Centre 2005a).

Also, despite the fact that discussions on industry-specific commitments or future rules continue, proposals on horizontal approaches cutting across industries have gained prominence. For example, this is the case in negotiations on domestic regulation (for the European Communities, see WTO Working Party on Domestic Regulation 2003). While such horizontal rules would allow for a wider and more coherent development of benchmarks, the question remains whether certain specific industries would not benefit from specific benchmarks, carefully suited and targeted to the particularities of the services industry in question.

Industry specific approaches can also be found outside the WTO. NAFTA, for example, contains a separate chapter for financial services that also covers FDI, and so do some bilateral United States FTAs. Some EU agreements incorporate provisions to allow

establishment in maritime transport.[17] Another industry becoming increasingly prominent is energy-related services.

While the above agreements develop specific rules for specific services industries, other agreements tend to exclude (in whole or in part) certain industries from their coverage. Much of air transport, which is governed by long-standing bilateral agreements pre-dating the GATS by many years, is a case in point.[18]

H. Follow-up procedures

Frequently, the conclusion of services IIAs results in the establishment of "ground rules" with several aspects left for further development. In the GATS, this is the case with respect to areas such as domestic regulation, subsidies, government procurement and safeguards, as well as the negotiation of specific commitments. The same applies to services IIAs modelled on the GATS. The ASEAN Framework Agreement on Services, the 2001 CARICOM Agreement[19] and the 1996 Euro-Mediterranean Agreement establishing an association between the European Communities and Morocco serve as examples.

The situation is similar with respect to some United States FTAs. With respect to domestic regulation, for example, the services chapter of the United States–Singapore FTA contains language analogous to the GATS, effectively setting up the same negotiating mandate as under the GATS. More specifically, Article 8.8, para. 2 reads: "With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, each Party shall endeavor to ensure, as appropriate for individual sectors, that such measures are: (a) based on objective and transparent criteria, such as competence and the ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; and (c) in the case of licensing procedures, not in themselves a

restriction on the supply of the service." This text is essentially the same as in Article VI para. 4 GATS.

Besides mandates for the development of further rules, many services IIAs contain follow-up procedures for the further liberalization of services industries. As explained above, GATS serves as an example. The first of the successive rounds of services liberalization was mandated by Article XIX of the Agreement, and was subsequently, incorporated into the negotiations launched by the 2001 WTO Doha Ministerial Meeting. The process of requests and offers of commitments is currently underway: by the end of June 2005, 68 offers (counting the European Communities (15) as one) had been received by the WTO Secretariat. A further example for a similar negotiating mandate can be found in the ASEAN Framework Agreement on Services. In fact, this agreement contains a commitment towards further liberalization, which is carried out in three-year negotiation cycles.

Another type of follow up procedures are commissions or other bodies that are charged with monitoring the implementation and functioning of the agreements. An example of such a mechanism is the "NAFTA Free Trade Commission". In July 2001, the trade ministers from the three NAFTA countries forming the above Commission issued a statement on the "interpretation" of provisions, including the minimum standard of treatment, as contained in NAFTA Chapter 11.[20]

Another type of follow up mechanisms provides a platform to review implementation of IIAs and to recommend action if needed. In the case of the GATS, for example, Article XIX para. 3 mandates an "assessment of trade in services". More specifically, the relevant provision states that: "…the Council for Trade in Services shall carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of this Agreement, including those set out in paragraph 1 of Article IV" (on increasing participation of developing countries.[21] Such an assessment could also include

questions related to the impact the GATS has had, so far, on attracting investment flows. In fact, in a 2001 communication (WTO Council for Trade in Services 2001a) a series of developing countries raised specific questions to be addressed in the assessment exercise. These included the question of whether developing countries have experienced investments in new sectors or whether investments flow only to sectors that have already been developed.

Subsequently, the GATS Negotiating Guidelines (WTO Council for Trade in Services 2001b) have further built on this assessment and, in their para. 14 state that negotiations would need to be adjusted in light of the results of the assessment (WTO Council for Trade in Services 2001b). More specifically, para. 14 states, amongst others, that the assessment "…shall be an ongoing activity of the Council and negotiations shall be adjusted in the light of the results of the assessment. In accordance with Article XXV of the GATS, technical assistance shall be provided to developing country Members, on request, in order to carry out national/regional assessments."

Along similar lines, there can be a monitoring of negotiations and the progress made therein. Again, WTO services negotiations serve as an example. In para. 15, the Negotiating Guidelines mandate the Council for Trade in Services (in Special Session), when reviewing progress in negotiations, to consider the extent to which Article IV (on increasing participation of developing countries in trade in services) is being implemented and to suggest ways and means of promoting the goals established therein.

* * *

As observed in chapter I, the services sector – as compared to the primary and secondary sectors – continues to be characterized by a range of restrictions related to FDI. Services IIAs directly touch upon such restrictions: in fact, depending on their key provisions and salient features, services IIAs affect, in different manners, the degree of

liberalization in their parties. Amongst others, services IIAs do so by specifically addressing individual services industries. Those IIAs that contain specific rules for individual services industries may serve as an example.

In and by themselves, services IIAs often reflect only the status quo of liberalization at the national level. However, such agreements can also lead to changes in national policies. This may be the case when they prohibit services-specific performance requirements or when they grant a right to establishment. In addition, services IIAs can lead to changes in national policies through the processes they establish. Follow up negotiations (both in terms of increasing liberalization and in terms of developing new rules) may serve as an example. Provisions for dispute settlement are another case in point.

Together, salient features and new aspects related to the key provisions of services IIAs make the international framework for services FDI (and for other international services transactions) increasingly complex. The resulting challenge is how to best devise services IIAs and use the related follow up processes in order to maximizing developmental benefits and minimize costs of services FDI.

Notes

[1] A related aspect relates to the pre-and post establishment phases of an investment. This aspect will be discussed further in section B of this chapter.

[2] Article 22 (d) of the EFTA– Singapore FTA and Article 58, para. 6 (d) of the Japan–Singapore Agreement.

[3] Note that the 2000 EFTA–Mexico FTA, takes a slightly different approach. Specifically, its Article 20 defines “commercial presence” as follows: “(i) as regards nationals, the right to set up and manage undertakings, which they effectively control. This shall not extend to seeking or taking employment in the labour market or confer a right of access to the labour market of another Party; (ii) as regards juridical

persons, the right to take up and pursue the economic activities covered by the Section by means of the setting up and management of subsidiaries, branches or any other form of secondary establishment" (footnotes omitted).

[4] Article 10.11, para. 2.

[5] Article 11.12, para. 2.

[6] For agreements involving only developing countries, para. 3 (b) of Article V grants some flexibility, allowing more favourable treatment to be provided to juridical persons owned and controlled by natural persons of the parties. Para. 3 (a) of this Article also provides some flexibility for economic integration agreements involving a developing country, when it comes to meeting the conditions of para. 1. There are, however, questions whether such agreements would at all need to meet the Article V, para. 1, criteria or whether additional flexibility would be granted by the enabling clause (GATT 1979).

[7] Based on reservations of nonconforming measures lodged in the negative lists of seven IIAs or drafts thereof: the Andean Pact (1991); the Canada – Chile Free Trade Agreement (1996); the G3 Free Trade Agreement between Colombia, Mexico and Venezuela (1990); NAFTA (1992); the draft Multilateral Agreement on Investment negotiated at the OECD (negotiations were abandoned in 1998); the OECD's National Treatment Instrument (2000); and the United States – Chile Free Trade Agreement (2003).

[8] It has to be noted, that many developing countries lack the data and information necessary to make such careful choices. The forthcoming study on the use of reservations in IIAs (UNCTAD 2005c) aims to assist filling this lacuna by providing an overview and analysis of the patterns and trends in the use of reservations (by both developed and developing countries) across a selection of IIAs.

[9] European Union–Mexico Decision No 2/2001 of the EU–Mexico Joint Council of 27 February 2001, Implementing Articles 6, 9, 12(2)(b) and 50 of the Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and Its Member States, of the One Part, and the United Mexican States, of the Other Part.

[10] Article 8.2, para. 2 in the case of the Singapore–United States FTA and Article 11.1, para. 3 in the case of the Chile–United States FTA.

[11] Australia–United States Free Trade Agreement, http://www.dfat.gov.au/trade/negotiations/us_fta/final-text/index.html.

[12] Note that, strictly speaking, the GATS adopts a "hybrid approach". The negative list features of the GATS can be found in members' right to enter MFN exemptions, and their right to qualify their (positive list) specific commitments with conditions and limitations.

[13] In this context, it is interesting to note that some NAFTA reservations (e.g. Annex II) carve out future measures.

[14] See above, note 7.

[15] The figures on transportation relate to modes other than aviation (i.e. concern maritime and land transportation – buses, trucks, rail services), the bulk of which (i.e. hard rights and services involved in the exercise of such rights) are specifically carved out from all of the agreements under review (as they are from the coverage of the GATS).

[16] Note that the extent to which members can make use of these flexibilities, can – in practice – be somewhat limited. Several of the countries acceding to the WTO had to accept the Reference Paper as part of their package of obligations paving the way to becoming a WTO member. Similarly, adoption of the Reference Paper is a central feature of many "requests" (as made in the context of the current negotiations to liberalize services trade), including those directed at least-developed countries.

[17] See, for example, Article 10 of the EU–Mexico Agreement. Article 10, para. 4 in Chapter II states that "[e]ach Party shall permit to service suppliers of the other Party to have a commercial presence in its territory under conditions of establishment and operation no less favourable than those accorded to its own service suppliers or those of any third country, whichever are the better, and this in conformity with the legislation and regulations applicable in each Party."

[18] In the case of the GATS, certain services related to air transport, as defined in the Annex on Air Transport Services, are excluded from the Agreement. Paragraph 2 of the Annex states that the GATS Agreement "…shall not apply to measures affecting: (a) traffic rights, however granted; or (b) services directly related to the exercise of traffic rights, except as provided in paragraph 3 of this Annex." Paragraph 3 states that "[t]he Agreement shall apply to measures affecting: (a) aircraft repair and maintenance services; (b) the selling and marketing of air transport services; (c) computer reservation system (CRS) services."

[19] Revised Treaty of Chaguaramas Establishing the Caribbean Community, including the CARICOM Single Market and Economy.

[20] More specifically, the interpretative statement clarifies in para. 1 of Section B that "[a]rticle 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party". It also states in para. 2 that "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." See NAFTA Free Trade Commission, "Notes of Interpretation of Certain Chapter 11 Provisions", 31 July 2001; http://www.dfaitmaeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp. Amongst others, such mechanisms allow for a learning process in the formulation of IIAs. It is interesting to note that subsequently, based on the experience gained with the application of the minimum standard of treatment provision, some more recent IIAs specifically contain language similar to the interpretative statement. Article 10.4 of the Chile–United States FTA is an example.

[21] In fact, the relevant provision makes the assessment a precondition for the establishment of negotiating guidelines. More specifically, it states that "[f]or each round, negotiating guidelines and procedures shall be established. For the purposes of establishing such guidelines the Council for Trade in Services shall carry out an assessment. […]."

IV. COMPLEXITIES AND CHALLENGES

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

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

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

There is another, more recent WTO case which exposes the challenges of crafting commitments that truly preserve domestic policy space. The 2005 ruling in United States – Gambling highlights these difficulties as they arise – even for countries with sophisticated regulatory frameworks and considerable experience in the negotiation of international trade agreements. In that case, the Panel and the Appellate Body both found that the United States had entered into market access commitments for gambling services, even if, as the United States argued consistently throughout the case, the United States had not intended to schedule such commitments. More

specifically, the Panel stated that, "the scope of a specific commitment cannot depend upon what a Member intended or did not intend to do a the time of the negotiation" (paras. 6.134 – 136). (WTO Dispute Settlement Body 2005a) The Panel's findings with respect to the United States' commitments were upheld by the Appellate Body (WTO Dispute Settlement Body 2005b) (albeit with slightly different reasoning) that flags the need to carefully schedule the intended commitments (UNCTAD 2005a and South Centre 2005b).

It remains to be seen whether these decisions will make WTO members more reluctant to schedule further commitments during the current round of services negotiations. In any case, these recent rulings underline the importance of scheduling carefully the commitments that are being made. But this may be a challenge, including in light of the emergence of new services – an issue of particular relevance in the context of offshoring.

The complex network of IIAs also raises questions concerning the coexistence of multilateral, regional and bilateral services IIAs, as well as the challenges resulting therefrom (UNCTAD 2003b, pp. 93-97). There is, indeed, a need to ensure that rules are consistent with each other and that they complement each other in a mutually supportive way. This is a problem not only of consistency between different international treaty obligations accepted by contracting parties, but also one of consistency in national legal and policy changes made in the process of implementing international obligations.

To avoid the adoption of inconsistent international obligations, a number of services IIAs mirror the provisions of the GATS. The ASEAN Framework Agreement on Services, the CARICOM Agreement and several European Agreements (e.g. the 1997 Euro-Mediterranean Association Agreement establishing the association between the European Union and Jordan) are cases in point. They incorporate – by reference – existing or future GATS obligations or, more broadly, affirm their complementarity with the GATS regime.

The ASEAN Framework Agreement on Services is an example for the latter: recital 7 in its Preamble reads: "REITERATING their commitments to the rules and principles of the General Agreement on Trade in Services (hereinafter referred to as 'GATS') and noting that Article V of GATS permits the liberalising of trade in services between or among the parties to an economic integration agreement". Pursuing the same goal (i.e. to avoid inconsistencies) is a specific provision in the Singapore–United States FTA. In fact, this agreement states – broadly – that one of its provisions shall be amended once multilateral negotiations dealing with the subject matter addressed by this very provision enter into effect.[1]

Nevertheless, negotiating outcomes can result in inconsistent obligations (inconsistency arising either within or between agreements), possibly leading to a conflict between such obligations. In such a case, conflicts have to be dealt with in accordance with general rules of international treaty interpretation. At least two principles should be mentioned in this regard: (1) the principle according to which, with respect to successive treaties relating to the same subject-matter, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty (lex posterior derogat legi priori, see Article 30 Vienna Convention on the Law of Treaties (United Nations 1969)); (2) the principle according to which the more specific norm prevails over the more general norm (lex specialis).

If the parties wish to ensure that certain inconsistent obligations remain in force or if they wish to determine which provisions, in the case of conflict, should prevail, they can expressly provide for this in a conflict-clause provision of the treaty. While such a provision may not be contained in the services chapter, it may be, nevertheless, relevant for rules covering services FDI. Examples for conflict clauses regulating the relationship between services IIAs can be found in the EFTA-Singapore Agreement, or in the Japan-Singapore Agreement. Article 4 of the former, for example, specifically, states that "[t]he provisions of this Agreement shall be without prejudice to

the rights and obligations of the Parties under the Marrakesh Agreement Establishing 'the World Trade Organization' and the other agreements negotiated thereunder (hereinafter referred to as "the WTO Agreement") to which they are a party and any other international agreement to which they are a party." A slightly different approach is taken by the Japan–Singapore Agreement. Its Article 6, "Relation to Other Agreements", provides in para. 1 that "[i]n the event of any inconsistency between this Agreement and any other agreement to which both Parties are parties, the Parties shall immediately consult with each other with a view to finding a mutually satisfactory solution, taking into consideration general principles of international law".

One specific example of potential inconsistencies between services IIAs and the WTO rules – as well as ways of dealing with it – relates to the MFN principle.[2] For example, when bilateral or regional agreements covering services investment contain rules granting more favourable treatment to their constituent members as opposed to their external investment partners, they might deviate from the WTO MFN principle. The GATS (like the GATT) contains a provision permitting economic integration agreements (Article V), provided they meet a series of conditions: for example, that they have substantial sectoral coverage (meaning, among other things, that no mode of supply is excluded a priori), and that they provide for the absence or elimination of substantially all discrimination through the elimination of existing discriminatory measures and/or the prohibition of new or more discriminatory measures.

According to this provision, the requirement to eliminate "substantially" all discrimination (specified in paragraph 1(b)(i) and 1(b)(ii)) depends on the substantial sectoral coverage of a services agreement; this, in turn, depends on the number of industries, the volume of trade affected and the modes of supply covered by the agreement. To a certain extent, however, the meaning of this clause is ambiguous. For example, it would appear that – according to the above language – BITs are not considered economic integration agreements,

thereby not needing to be notified. At the same time, several WTO members have notified their BITs under the Article V procedure. What seems clearer is that agreements covering all modes (in one chapter or more) need to be notified. Again, several WTO members have notified their RTAs/FTAs in the WTO.

In that context, it is interesting to note that, for developing countries, paragraphs 3 (a) and (b) of Article V provide additional flexibility. More specifically, such flexibility relates to the conditions determining the compatibility of RTAs with Article V requirements, and such flexibility shall be granted according to the level of development of the country in question. In addition, in case of a RTA involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of these countries.[3]

In addition to Article V on economic integration agreements, the GATS allows WTO members to list exemptions to the MFN obligation contained in Article II. In general, listing MFN exemptions was possible only at the conclusion of negotiations during the Uruguay Round or, for those members that joined later, at the time of accession to the WTO. To date, some MFN exemptions might still be taken with regard to certain maritime transport services, before the end of the current negotiations. In fact, as of 2001, the list of exemptions from the GATS MFN obligation contained 232 exemptions relating to other IIAs, of which 13 (or 3.1%) pertain to BITs (OECD 2001). Canada or Poland, for example, are countries that have taken MFN exemptions in the GATS regarding BITs. Besides BITs and investment guarantee agreements, MFN exemptions also cover other measures and policy goals (e.g. health or audiovisual services).

The Annex on Article II specifies, however, that exemptions should, in principle, not exceed a period of ten years, and that they should be reviewed by the Council for Trade in Services. While opinions differ on the scope of the MFN exemption review

(particularly whether its only objective is to determine whether the conditions of the exemptions still prevail or whether the review should attempt to achieve a decrease in the number of exemptions), the GATS Negotiating Guidelines provide that MFN exemptions shall be subject to negotiation.[4]

Besides the GATS, virtually all other services IIAs contain MFN obligations. MFN clauses can differ, including in their scope of coverage or in the number of beneficiaries of MFN rights. While the GATS grants MFN rights to all other WTO members, subject to MFN exemptions, under a bilateral IIA only the countries party to the agreement enjoy this right. Note, however, that there may be questions as to which investors are considered investors of a party. Ultimately, the question of MFN consistency is dependent on the type of the measure as well as on the breadth of coverage of an MFN clause against which a measure is scrutinized. For example, it may be open to discussion whether an investor from country A that has no BIT with country B should be able to benefit from protection under a BIT between country B and country C, where the investor from A establishes a legal presence through an affiliate in C that is set up specifically to benefit from that BIT, but that undertakes no business operations in C. In this case, so-called denial of benefit clauses (discussed above, section 1) may be relevant.

In addition to potential conflicts between IIAs arising from the MFN obligation, there can be other inconsistencies between IIAs. It may well be that a country that is party to an IIA adopting a positive list approach for services FDI, is also party to an IIA adopting a negative list approach for services FDI. While it can be assumed that parties intend to negotiate their international commitments for services FDI in a manner consistent with each other, inconsistencies may still arise. Some IIAs address this by including specific provisions regulating the relationship between the IIA and other international agreements. These clauses can either mention the other, specific agreement with which they aim to avoid conflict, or they can include a

broader reference to any other agreement to which the countries signatory to the IIA are parties, or a combination thereof. The EFTA-Singapore FTA may serve as an example for the latter. More specifically, its Article 4 states: "[t]he provisions of this Agreement shall be without prejudice to the rights and obligations of the Parties under the Marrakesh Agreement Establishing the World Trade Organization and the other agreements negotiated thereunder (hereinafter referred to as 'the WTO Agreement') to which they are a party and any other international agreement to which they are a party."

While such a reference to "any other international agreement" may include agreements others than those focussing on trade and/or investment, some IIAs also contain clauses regulating the relationship between themselves and other specific non-trade or non-investment related agreements. These can be, for example, environmental and conservation agreements. Article A-04 of the Canada–Chile FTA (entitled "Relation to Environmental and Conservation Agreements") is an example. More specifically, this provision states that "[i]n the event of an inconsistency between this Agreement and the specific trade obligations set out in: the Convention on International Trade in Endangered Species of Wild Fauna and Flora …, the Montreal Protocol on Substances that Deplete the Ozone Layer …, or the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal …, such obligations shall prevail to the extent of the inconsistency …".[5] In part, such conflict clauses between trade/investment and environmental agreements have given rise to much debate, specifically, in so far as they could have the effect of establishing a hierarchy between the agreements.

Apart from the issue of inconsistency *among* IIAs, inconsistencies can also arise *within* an agreement, especially in those taking a mixed approach. To guard against such potential problems, the Australia–United States FTA, for example, explicitly states (Article 11, para.2): "[I]n the event of any inconsistency between this Chapter [the investment chapter] and another Chapter, the other Chapter shall

prevail to the extent of the inconsistency". The same agreement also addresses this issue in Article 11.2, para. 3, which states that "[t]his Chapter [the services chapter] does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Thirteen (Financial Services)."

Another alternative is to identify specific provisions of the investment chapter that do not apply to FDI in services. Again, the EFTA–Singapore FTA serves as an example. Article 38, para. 2 of the agreement sets out which of the national treatment and MFN obligations (those of the services or those of the investment chapter) apply to measures affecting services (including FDI in services) as well as investors and investments in the services area.[6] While several reasons may explain the need to do so, they all relate to the objective to avoid overlap and inconsistencies between chapters in the Agreement. This is particularly important in the case of the national treatment obligation, which differs between the investment and the services chapters, for example in content ("like services" as opposed to investment in "like circumstances") and in the approach to making commitments (positive or negative lists). In fact, in light of the latter, having the investment chapter's national treatment obligation apply to services investment would nullify the positive list approach adopted in the services chapter.

In addition to inconsistencies, the multilayered nature of the network of services IIAs may also entail a specific type of externality: certain obligations provided for in bilateral or regional agreements may have effects that go beyond the parties to such agreements. For example, any benefits from an obligation (included in a BIT or a FTA) to publish laws and regulations relating to services FDI are automatically enjoyed by all other interested parties, since the States bound by the transparency requirement in the BIT or a FTA will not typically be able (or willing) to limit the beneficial effects of such an obligation to the other contracting partie(s). Similarly, an obligation setting forth certain general regulatory standards (whether procedural

or substantive in nature) may have spillover effects that go beyond the bilateral or regional agreements through which they are undertaken. For example, the requirement that domestic regulations affecting trade in services (including services FDI) be administered in a reasonable, objective and impartial manner (as included, for example, in Article 28 of the EFTA–Singapore FTA, or in GATS Article VI, para. 4) can benefit all countries, even if they are not parties to the relevant agreements. (These parties will, however, not be able to claim a violation of such obligations.) The same externality effect may arise from obligations to institute judicial, arbitral or administrative tribunals or procedures, thus providing for prompt review and appropriate remedies for administrative decisions affecting, *inter alia*, services FDI.

A variation of this externality effect arises in IIAs having obligations whose benefits are not limited to (investors of) the parties to the agreements, but rather extend to investment independently of its origin. In NAFTA-type agreements, the prohibition of certain performance requirements applies to all foreign affiliates in the territories of the parties, irrespective of the nationality of their parent firms.

* * *

The adoption of multilateral rules on services FDI has not halted regional or bilateral treaty making in this area. Rather, subsequent to the negotiation of the GATS, services provisions appear increasingly in IIAs across all regions. This multilayered and multifaceted reality raises a number of policy challenges.

While agreements may generally be consistent with or complement each other, there may also be cases of overlap, inconsistencies and gaps that, potentially, give rise to conflicts. Such situations can be addressed amongst others, through cross-references between agreements, explicit conflict clauses or interpretative means. Inconsistencies can also arise within agreements, particularly between

an IIA's services and investment chapters. While having the potential to have far-reaching implications, this issue has not yet received much attention from policy makers. Furthermore, in some cases, the complexity and, at times, ambiguity of the rules applicable to services FDI might compromise the clarity of the system, making it increasingly difficult to navigate through the resulting web of rules. This is particularly true for countries with insufficient human and institutional capacity to formulate and implement services IIAs.

There is, therefore, a need to ensure that rules are consistent with each other and clear, making their application predictable and transparent. Most importantly however, there is a need to ensure that rules for services FDI complement each other in a mutually supportive way, clearly and unambiguously directed towards the goal of enhancing development.

Notes

[1] More specifically, para. 3 of Article 8.8 of the services chapter in this agreement states that: "[i]f the results of the negotiations related to Article VI, para. 4 of GATS (or the results of any similar negotiations undertaken in other multilateral fora in which both Parties participate) enter into effect, this Article shall be amended, as appropriate, after consultations between the Parties, to bring those results into effect under this Agreement."

[2] On the broader problematique of the clause relating to regional economic integration organizations (REIO clause), see UNCTAD 2004e.

[3] The exact language of Article V, paras. 3 (a) and (b) read as follows: Article V, para. 3(a) states: "[w]here developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors." Para. 3(b) of the same provision then states: "[n]otwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more

favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement."

[4] More specifically, the GATS Negotiating Guidelines, in para. 6 state that "MFN Exemptions shall be subject to negotiation according to paragraph 6 of the Annex on Article II (MFN) Exemptions. In such negotiations, appropriate flexibility shall be accorded to individual developing-country Members."

[5] Note that the provision continues, "… provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement."

[6] More specifically, the relevant provision in Article 38, para. 2 of the investment chapter states: "Article 40 (1) [national treatment, MFN] shall not apply to measures affecting trade in services whether or not a sector concerned is scheduled in Chapter III [dealing with "services"]."

V. NATIONAL AND INTERNATIONAL POLICIES: A COMPLEX AND DYNAMIC INTERACTION

The interaction between services IIAs and national regulations for services is dynamic and complex. This is because rules for FDI in services are constantly evolving, both at the international and national levels. Unlike the liberalization of conditions for FDI in the manufacturing and primary sectors that has already progressed significantly, liberalization in the area of services has only relatively recently begun to play an important policy role. In developed countries, services regimes are undergoing significant changes. In particular, such changes result in a further opening of service industries and increased private participation in the provision of what were previously treated as public services (box 3. For a more comprehensive treatment of FDI in and privatisation of public utilities, including water, telecom or electricity, see UNCTAD 2004a**,** chapter III).

Many of the rules and regulations for services are not yet fully established, with regulators experimenting, adopting different methods, and ultimately seeking the regulatory approach that best suits the developmental needs of their countries. At the same time, new international disciplines on services are being adopted that serve as parameters for domestic regulatory action. The result of these national and international policy trends is a complex interaction, whereby some of the issues address regulation and go beyond the question of discrimination between foreign and domestic service providers.

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

limitations) that were less open than the level of services liberalization that actually existed at that time in their national policies.[1]

Other commitments reflected the status quo, such as some of those made during the extended negotiations on financial services and telecoms. But, of course, even such a cautious approach of making commitments at or below the actual level of openness locks in the existing (or part of the existing) national autonomous liberalization. The large majority of services IIAs are of this nature.

Box 3. IIAs and public services

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

/…

Box 3 (continued)

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

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

/…

Box 3 (concluded)

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

Source: UNCTAD.

[a] The GATS does not further define these terms. At the same time, the academic and policy debate has seen considerable discussion about the possible meaning of Article I, para. 3 (c) (e.g. Krajewski 2003).

[b] For a discussion of these ambiguities as they may arise in the health sector, and the challenges they bring about, see Mashayekhi, Julsaint and Tuerk, forthcoming.

[c] Liechtenstein, Norway, Sweden and Switzerland, for example, exclude the "public works function" from their sanitation services commitments. Similarly, the European Communities, in its schedule, reserves the right to make "services *considered* public utilities" subject to exclusive rights (emphasis added). Also, the European Communities' schedule states that "the supply of a service, or its subsidization, within the public sector is not in breach of this commitment". Similarly, in its 2003 initial offer, the European Communities states that "[t]his offer cannot be construed as offering in any way the privatisation of public undertakings nor as preventing the Community and its Member States from regulating public services in order to meet national policy objectives" (TN/S/O/EEC). Similarly, Brazil makes clear that its "…offer cannot be construed as offering in any way the privatisation of public undertakings nor as preventing Brazil from regulating public and private services in order to meet national policy objectives" (TN/S/O/BRA). Also, the United States states in its initial offer that,"[c]onsistent with GATS Article I.3(b) and (c), this offer applies only to services open to private sector participants, unless otherwise indicated, in the attached draft schedules, and does not include the right to acquire or invest in government monopolies supplying services included within any of the sectors or sub-sectors covered by this offer" (TN/S/O/USA).

[d] Note, however, that several other stakeholders have made requests to that effect. See, for example, various motions passed in the United Kingdom by several trade unions, members of Parliament and local authorities http://www.wdm.org.uk/presrel/current/ukgatspublic.htm.

[e] The 1996 Canada–Chile FTA matches the language of NAFTA.

[f] More specifically, Canada's Annex II reservation (for national treatment, MFN, local presence of senior management and boards of directors, that apply to both cross border services and investment) in the social services industry reads: "Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care."

A second form is an IIA-driven interaction. In such a case, it is the IIA that prompts FDI liberalization and domestic reforms in the services area. Sometimes this is the result of built-in commitments to engage in future rounds of negotiations in which one (if not the only) principal objective is market opening. The GATS provides an example: a perusal of a number of initial requests submitted by some WTO members in the current round of negotiations reveals that several of the conditions and limitations attached to members' previous commitments (either on a horizontal or on a Mode-3-specific basis) are requested to be liberalized. This is despite the fact that conditions are a tool to preserve policy space for maintaining specific domestic regulatory measures. Similar situations arise in agreements patterned on the GATS (e.g. the EFTA–Singapore FTA, Article 27, para. 5).

A related example of IIA-driven interaction are time-bound reservations or so-called pre-commitments. Regarding time-bound reservations, once they expire, domestic regulations need to be adapted. By entering into pre-commitments, countries commit themselves today to implement market access and/or national treatment commitments by a pre-determined date in the future. Both are examples of the time-bound nature of limitations inscribed in commitments.

Another example of time-bound reservations is the special case of WTO accession agreements. In fact, many of the accession protocols involve commitments to take certain liberalizing steps at a future date. The GATS commitments of China and Taiwan Province of China are examples.

IIA-driven interaction between international and national policies for services FDI can also manifest itself in other areas of policy for services FDI, for example, with regard to transparency. Recent services IIAs tend to contain obligations to publish and make available certain laws and regulations pertaining to FDI (e.g. Article III, para. 1 of the GATS[2] or Article 192 of the 2002 Chile–EU

Association Agreement), as well as obligations to notify the other party (parties) or relevant international bodies of certain new laws and regulations (e.g. Article III, para. 3 of the GATS[3] or Article L03 of the Canada–Chile FTA). IIAs can also include obligations requiring independent review of administrative decisions affecting individual investors through judicial, arbitral or administrative tribunals or procedures (e.g. Article VI, para. 2 of the GATS or Article 64, para. 2 of the Japan–Singapore Agreement). In addition, some of the more recent IIAs contain also so-called "a-priori" comment or consultation processes (e.g. Article 19.3, para. 2 of the Singapore–United States FTA).[4]

In some of these scenarios, IIAs may require policy changes at the national level, thus constituting an example of IIA-driven interaction between national and international services policies. While such interaction could result in the reduction of policy space to put in place much needed developmental policies, in some situations such interaction is sought, especially when a government wants to use its membership in an IIA, and the policy changes this requires, as a means of overcoming domestic resistance to reform, and to make it difficult for subsequent governments to reverse such commitments. This so-called "lock-in effect" has given rise to much debate: while some claim that it is anti-democratic and a threat to governments' right to regulate,[5] others perceive it as one of the central (and positive) features of international agreements. Note, however, that some IIAs, for example the GATS, contain provisions allowing for the modification of commitments (e.g. GATS Article XXI). As this provision requests the granting of compensation to affected trading partners, it remains to be seen whether it will prove a valuable and user-friendly tool, particularly for developing countries. Thus far, it is interesting to note that the European Communities resorted to Article XXI in the context of its enlargement process.

* * *

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

Notes

[1] A similar phenomenon exists in traditional trade negotiations where bound tariffs are frequently higher than actual tariffs.

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

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

[4] On transparency, see UNCTAD 2004f.

[5] More specifically for the GATS see e.g. World Development Movement (WDM)/Seattle to Brussels Network 2001.

VI. CONCLUSION: A DEVELOPMENT-ORIENTED BALANCE

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

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

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

This challenge is particularly crucial for developing countries. First, in many of these countries, the services sector is at an early stage of development and rapidly evolving. Second, certain service industries are particularly sensitive, as they are deeply embedded in a country's social, cultural and political fabric. Third, some developing countries do not yet have optimal regulatory systems in place, and policy-makers are experimenting with liberalization and regulation, with a view to building a more competitive services sector through FDI and other means. In the case of the GATS, this challenge is reflected in Article XIX, which sets out the mandate for the negotiation of specific commitments and – in that context – specifically provides that "[t]here

shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions [and] progressively extending market access in line with their development situation…". This provision also emphasises that developing countries, when making access to their markets available to foreign services suppliers, may attach to such access conditions aimed at achieving the objectives referred to in Article IV.[1] For LDCs, such flexibility is also affirmed in GATS Article IV, para. 3, which states that "[p]articular account shall be taken of the serious difficulty of the least-developed countries in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs." The point was subsequently reiterated in the LDC modalities (WTO Council for Trade in Services 2003).

In light of the above, it is important that services IIAs retain a degree of flexibility that allows countries to face the specific challenges arising at the interface of the liberalization and regulation of services. IIAs should also accommodate developing countries' efforts to achieve their development-oriented policy objectives. In this context, it is also important to leave room for the sort of trial-and-error process regulators may need in order to identify the policy options best suited to their countries' levels of development. In fact, the importance of national policy space has been affirmed in the São Paulo Consensus, as adopted at the UNCTAD XI Conference. In para. 8 the São Paulo Consensus states: "The increasing interdependence of national economies in a globalizing word and the emergence of rule-based regimes for international economic relations have meant that the space for national economic policy, i.e. the scope for domestic polices, especially in the areas of trade, investment and industrial development, is now often framed by international disciplines, commitments and global market considerations. It is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space. It is particularly important for developing countries, bearing in mind

development goals and objectives, that all countries take into account the need for appropriate balance between national policy space and international disciplines and commitments" (UNCTAD 2004c).

In that context, it has been suggested that emergency safeguard mechanisms can provide an additional policy tool.[2] They can give countries the necessary flexibility to respond to unanticipated events devastating to host economies, an issue whose relevance was highlighted by the Asian and Argentinean crises. In fact, such mechanisms can put countries in a comfort zone when locking in international commitments under IIAs.[3]

IIAs can allow governments to liberalize at a pace and sequence appropriate to their development strategies and to the rapid development of the services economy. Flexibility can be built into an IIA by various means (UNCTAD 2003b*,* chapter V). In particular, the objectives, structure, content and implementation processes of an agreement can be designed in a way that ensures a proper balance between the right to regulate in the interest of development on the one hand, and the progressive liberalization and protection of FDI in the services sector on the other (see also UNCTAD 2003b, chapter VI).

The overriding challenge for countries is to find such a development-oriented balance when formulating international policies for services FDI. In the final analysis, the merits of services IIAs from a developing-country perspective must be judged by their ability to create an enabling environment for competitive service industries that help developing countries to integrate in a beneficial manner into the international economic system, with a view towards advancing their development, which includes their ability to ensure the provision of public services and to protect their cultural diversity. GATS Article IV calls for increasing the participation of developing countries in trade in services, including through "…the liberalization of market access in sectors and modes of supply of export interest to them." The development dimension has to be an integral part of international

agreements covering services – in support of national policies to attract services FDI and to benefit more from it.

In conclusion, to benefit from an increasingly globalized and interdependent world economy, countries need to strengthen their capabilities for the supply of competitive services. If conditions are right, FDI can help to achieve this. Its most important contribution is in bringing the capital, skills and technology countries need to set up competitive service industries. This applies not only to the new IT-enabled services, but also to traditional services such as infrastructure and tourism. Moreover, as services become more tradable, FDI can help link developing countries to global value chains in services. Such chains comprise international service production networks that are increasingly important to access international markets. At the same time, caution is necessary when attracting FDI in services. For instance, some services (especially basic utilities and infrastructure) may be natural monopolies and hence susceptible to abuses of market power (whether firms are domestic or foreign). Others are public goods, and also of considerable social and cultural significance; the whole fabric of a society can be affected by the involvement of FDI in those industries. Hence, countries need to strike a balance between economic efficiency and broader developmental objectives.

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

Notes

[1] Para. 2 of Article XIX.

[2] Note that economic needs tests (ENTs) can serve a related function. For example, when attached to Mode 3 commitments, they could be viewed as a policy tool to achieve an appropriate level of supply, regardless of the origin of the service supplier (OECD 2000, p. 8). In the context of the GATS, individual countries have used economic needs tests in connection with certain service industries. There, they are found in commitments in distribution, telecoms, rental services, transport, financial services, courier, medical, dental, environmental, testing and analysis, social and education services (OECD 2000, p. 7). However, the absence of agreed criteria for an ENT also raises challenges as regards transparency and objectivity.

[3] For a discussion of safeguards, see UNCTAD 2003a, box V.3.

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