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INTERNATIONAL INVESTMENT AGREEMENTS: CONCEPTS ALLOWING FOR A CERTAIN FLEXIBILITY IN THE INTEREST OF PROMOTING GROWTH AND DEVELOPMENT

Note by the UNCTAD secretariat

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Executive summary

The countries covered by international investment agreements (IIAs) are often at widely differing levels of economic and technological development and differ from one another in many other important respects. In the case of IIAs that involve developing countries, in particular, it is generally accepted that the promotion of economic and social development is an essential goal. One of the challenges facing countries is therefore ensuring that IIAs are sufficiently flexible to serve, in addition to the specific objectives of each instrument, the development needs of developing countries. Flexibility may be reflected in IIAs in a number of ways, for instance, by stating explicit development objectives, by establishing appropriate priorities, by structuring an agreement in an appropriate manner, by shaping the substantive provisions so as to serve development aims, by allowing exceptions or by providing for differentiation in the contents or timing of the rights and obligations of the parties on the basis of their respective levels of development. The principal issue for the expert meeting is the identification of the features of IIAs that provide for flexibility in these agreements in the interest of promoting development while, at the same time, allowing them to serve other objectives. In reviewing the forms in which the concept of flexibility is found in existing IIAs, the meeting will also be able to evaluate, to some extent, the effectiveness of these forms in promoting development while encouraging investment.

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INTRODUCTION

1. In pursuance of paragraph 89 (b) of "A Partnership for Growth and Development", 1/ the Commission on Investment, Technology and Related Financial Issues, at its fourth session (14-18 September 1998), decided to convene an "expert meeting on concepts - such as exceptions and other mechanisms - allowing for a certain flexibility, including in the field of technological capacity-building, in the interest of promoting growth and development - to allow countries in different stages of development to benefit from international investment agreements" (TD/B/COM.2/15, annex I).

2. In response to this decision and in order to facilitate the discussions, the secretariat has prepared the present report which takes into account the findings of the two previous expert meetings convened by the Commission on related subjects. The purpose of the report is to describe ways in which international investment agreements (IIAs) address the issue of flexibility in the broad context of promoting development while encouraging investment.

3. The principal forum in which intergovernmental discussions on issues relating to IIAs 2/ take place in UNCTAD is the Commission on Investment, Technology and Related Financial Issues. The Commission draws on the findings of expert meetings that serve as a forum for the exchange of experiences and discussion on existing IIAs and their implications for development. Two expert meetings have been held so far: the first, held from 28 to 30 May 1997, dealt with bilateral investment treaties (BITs) (TD/B/COM.2/5) and their development dimension; the second took place from 1 to 3 April 1998, and focused on regional and multilateral investment agreements (TD/B/COM.2/11). The experts examined the nature and implications of those agreements, the range of issues addressed by them, the extent to which the development dimension was taken into account and the extent to which issues arising in the context of those agreements were relevant, from a development perspective, to a possible multilateral framework for investment.

4. The expert meeting on international investment agreements will examine the ways in which flexibility with respect to development concerns has been given effect in IIAs, so that developing countries at different stages of development and with different development strategies can benefit from them in promoting their growth and development. It is suggested that the meeting should focus on delimiting and clarifying the concept of flexibility in the context of IIAs (that is, flexibility in the service of development), of reviewing the forms it takes in existing IIAs and, to the extent possible, evaluating the effectiveness of these forms in promoting development while encouraging investment. In this context, it should be noted that an investment-friendly environment is, to a large extent, also a development-friendly environment.

5. Participants have also been invited to bring their own national experiences to bear on these questions, especially through prior written submissions.

I. FLEXIBILITY

6. The countries covered by IIAs are often at widely differing levels of economic and technological development and differ from one another in many other important respects. While it is widely recognized that IIAs need to take into account the interests and concerns of all participating parties (UNCTAD, 1996b), the asymmetries among them require special attention to ensure that the aims of such agreements are actually achieved.

7. Most IIAs - and particularly BITs - have as their main objective the intensification of economic cooperation and the creation of favourable conditions for investment, with a view towards promoting and protecting foreign direct investment (FDI), which is expected to contribute to the economic prosperity of the countries involved. In the case of agreements that involve developing countries, in particular, it is generally accepted that the promotion of economic and social development is an essential goal. One of the challenges facing countries is therefore ensuring that IIAs are sufficiently flexible to serve adequately, in addition to the specific objectives of each instrument, the development needs of developing countries. 3/ Flexibility may be reflected in IIAs in a number of ways, for instance, by stating explicit development objectives, by establishing appropriate priorities, by structuring an agreement in an appropriate manner, by shaping the substantive provisions so as to serve development aims, by allowing exceptions or by providing for differentiation in the contents or timing of the rights and obligations of the parties on the basis of their respective levels of development. These ways are explored in chapter II below. Through such flexibility - and in the broader context of development concerns - IIAs could be adapted to the particular conditions of developing countries, which would increase their positive influence on the development of these countries, while minimizing any negative effects. This is not to say, however, that every country will automatically use the flexibility built into IIAs to the fullest extent possible; the extent to which they will do so depends on the particular development strategies pursued by each country.

8. To respond to the needs and concerns of developing countries, IIAs need therefore to be designed from the start with development considerations in mind. However, the principal responsibility for the design and implementation of development objectives and policies remains with the individual countries concerned. IIAs have in the main an indirect effect and are complementary to national policies, not a substitute for them.

9. It is of course recognized that IIAs are only one factor that can influence investment flows (UNCTAD, 1998a). Other - typically more important - determinants include the size of the host country market, its rate of growth, its political conditions and macroeconomic stability, the availability and cost of resources (such as labour and skills) and, increasingly, such created assets as innovatory capabilities and technological know-how, as well as an adequate legal, administrative, physical and business infrastructure. For their part, IIAs are important as confidence-building signals to foreign investors, since, by clarifying the rights and obligations of the parties involved in international investment and by providing

mechanisms for the settlement of disputes, they help establish a favourable investment climate. They also can facilitate the integration of host economies into the international market.

10. The principal issue to be discussed at the expert meeting is therefore the identification of the features of IIAs that provide for flexibility in these agreements in the interest of promoting development while, at the same time, allowing them to serve other objectives, such as providing security and predictability to investors, avoiding unnecessary restrictions and promoting stability. To serve both types of objectives, IIAs need to define the concepts they utilize, and shape the substantive rights and obligations of the parties in such a manner as to reconcile, on the one hand, stability and predictability for the host economy and for foreign investors and, on the other, flexibility in the interest of development.

II. ISSUES

11. A major issue that arises from an examination of IIAs is that, while the parties to an agreement are formally equal (legal symmetry), they may be at different levels of economic development (economic asymmetry). 4/ A way to deal with this situation is to allow for a recognition of the real differences between the parties through, inter alia, a degree of flexibility in such agreements as they apply to developing countries participating in them.

12. The question is therefore how and by what means existing IIAs have provided the flexibility needed by developing countries to promote their growth and development. This section examines existing IIAs in this respect. More specifically, the promotion of development can be reflected in:

(a) **Objectives**: typically, the preamble of an agreement is the repository of its aims and purposes. It can spell out specific objectives that elaborate on general development themes or it can introduce development concerns for the first time in an agreement;

(b) **Substantive provisions**: development concerns can serve to determine which issues are included in an IIA and which are not, as well as the manner in which the issues included are dealt with;

(c) **Modalities of implementation and technical assistance**: these relate to the ways in which agreements operate to further development objectives. This can include technical assistance, not only as regards the implementation of agreements but also beyond. Development-oriented considerations can, furthermore, be the basis for exceptions and derogations as well as transitional periods for compliance by developing countries;

(d) **Overall structure**: here it is the very design of an agreement, not merely its substantive content, that can further development.

13. Illustrative examples from existing IIAs in respect of each of these approaches are examined below. 5/ They are intended to be indicative rather than exhaustive. They do not, however, include an evaluation of their relative importance and effectiveness - an issue the expert meeting may wish to address.

A. Objectives

14. In accordance with the Vienna Convention on the Law of Treaties (United Nations, 1987, article 31 (2)), the preamble is part of a treaty for the purposes of interpretation. It is the repository of the general aims and purposes of an agreement, and offers a summary of the grounds upon which the agreement is concluded. It is, therefore, an important aid to the interpretation of specific provisions, offering insight into the objectives and purpose of an agreement. Consequently, where the preamble of an IIA refers explicitly to development, the substantive provisions of the agreement should be interpreted so as to further development goals.

15. Numerous examples of preambular provisions that mention development goals can be found among IIAs. They occur both in agreements between developed and developing countries and, significantly, in agreements among developing countries. Such provisions can be broadly classified as follows:

(a) A generally worded recognition of the special needs of developing and/or least developed country parties requiring flexibility in the operation of obligations under the agreement, especially as regards the content of national laws and regulations (box 1), 6/ the investment regime (box 2) or without reference to national laws and regulations (box 3);

Box 1. Preamble of the General Agreement on Trade in Services

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

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

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

Box 2. Preamble of the APEC Non-Binding Investment Principles

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

Box 3. Preamble of the Treaty Establishing the Latin American Integration Association

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

(b) An expression of a more specific way to contribute to economic development through, for example, progressive liberalization or certain standards of treatment in investment matters which is seen to contribute to development (box 4).

Box 4. Preamble of the Agreement on Trade-related Investment Measures

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

Preamble of the BIT between Argentina and the Netherlands

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

16. IIAs may also include "general objectives" clauses dealing with development issues in their initial parts. These may elaborate upon themes in the preamble or they may be the first indicators of development concerns in an agreement, although this would be uncommon. Three sets of issues are important in this connection:

(a) Whether the objectives of an IIA are in fact concerned with development;

(b) Whether the objectives distinguish between different categories of signatories;

(c) Whether principles that refer to broad development issues are included, and, if so, the extent to which their formulation gives a certain degree of flexibility to the contracting parties to respond to these issues.

17. In some IIAs, there are formulations that refer to broad development issues; the question remains, however, as to what extent and under what conditions they could be applied to all commitments undertaken in an agreement. In order to measure the degree of flexibility for the parties concerned, it may be necessary to look at the issue in the context of other

provisions of the particular agreement. The Lomé Convention, for example, states numerous development objectives in the opening provisions: the promotion of economic, cultural and social development of the African, Caribbean and Pacific (ACP) States; a more just and balanced international economic order (article 1); the right of ACP States to determine their development principles and strategies in all sovereignty (article 3); respect for human rights as part of the development goal (article 5); and special treatment for the least developed ACP countries (article 8). The Agreement on Trade-related Aspects of Intellectual Property Rights (the TRIPS Agreement) states that contracting parties "may, in formulating or amending their laws and regulations, adopt measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development" (article 7); another article makes the formulation of laws in the field of socio-economic and technological development subject to consistency with the Agreement (article 8 (1)). A number of principles can also be found that refer to broad development issues, as exemplified by the Treaty Establishing the Latin American Integration Association (box 5). Read together, the provisions in this agreement appear to seek to establish a balance between the objectives of economic integration and growth coupled with the need for flexible and individual responses to the development needs of the parties to the agreement. It is noteworthy that these countries are differentiated by their level of development and that more freedom is given to the least developed countries which are signatories to the Treaty.

Box 5. Article 3 of the Treaty Establishing the Latin American Integration Association

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

B. Substantive provisions

18. The contents of IIAs are the principal means by which concepts such as flexibility are given effect, both in terms of the issues they address and the manner in which these issues are addressed.

19. When concluding an IIA, countries make choices about the type of issues they wish to include and those they wish to keep outside the scope of an agreement, to deal with them in specialized agreements (e.g. on double taxation) or as a matter of national law and policy. Even when they decide to include certain issues in an IIA, countries may wish to retain some flexibility regarding the commitments they make. They may therefore use formulations that allow them some discretion to pursue their national policies while keeping in line with the broad principles of an agreement. This is illustrated below in reference to four selected issues (for a more comprehensive listing of issues addressed in IIAs, see box 6):

(a) The types of investments, investment transactions and activities that are covered under an IIA;

(b) The admission of investment;

(c) Performance requirements;

(d) General standards of treatment of foreign investors, such as national treatment.

Box 6. Key issues addressed in recent IIAs a/

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

Transfer of technology
Transfer pricing
Transparency

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a/ The inclusion of an issue in this list does not necessarily mean that all recent IIAs address it.

20. While these issues are central to investment-host country relations, they can also have important implications for the policies and strategies of developing countries. Recent IIAs have sought to formulate these issues more or less flexibly in order to accommodate development concerns. The following are a few illustrations of the various ways in which this has been done.

1. Definition of investment

21. IIAs often define investment in a way that is both broad and open-ended (UNCTAD, 1999a). The broadest definitions embrace every kind of asset. They include in particular movable and immovable property, interests in companies (including both portfolio and direct investment), contractual rights (such as service agreements), intellectual property rights, and business concessions. The implications of a broad definition of investment in an IIA are substantial. Although developmental concerns can be addressed in part by narrowing the definition of investment, this is not the only approach in every case. In this respect it is important to remember that the ultimate effect of an investment agreement results from the interaction of the operative provisions with the provisions on definitions (UNCTAD, 1999a).

22. Some definitions of investment have excluded certain types of investments, such as portfolio investment, from the application of IIAs, thereby allowing host countries discretion to deal with those types of investment differently. In cases where the definition of investment is circumscribed to “foreign direct investment” only, this has been defined by the International Monetary Fund (IMF) as “international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy. (The resident entity is the direct investor and the enterprise is the direct investment enterprise.) The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise” (IMF, 1993, para. 359). The BIT between Denmark and Lithuania (article 1 (1)) defines investment as “every kind of asset connected with economic activities acquired for the purpose of establishing lasting economic relations between an investor and an enterprise ...”. Similarly, the BIT between Germany and Israel (article 1 (a) (i)) defines investment as "investment in an enterprise involving active participation therein ...”.

23. Another way to limit the scope of the definition of investment has been to specify that investment is covered in an agreement only if made in accordance with the laws of the host country. For example, the model BIT used by China provides that “The term investment means every kind of asset invested by investors of one Contracting Party in accordance with the laws and

regulations of the other Contracting Party in the territory of the latter ..." (article III.1). This approach is also followed by the ASEAN Agreement for the Promotion and Protection of Investments (article II.1).

24. Definitions of investment have also been limited by excluding investment established prior to a certain date, such as the date the agreement is signed or enters into force. For example, the Convention Establishing the Inter-Arab Investment Guarantee Corporation provides that investment insurance "shall not be made available except for new transactions commencing after the conclusion of insurance contracts ..." (article 15.4).

25. Some agreements cover specific sectors and this has implications of course for the definition of investment. For example, article 1 of the Energy Charter Treaty provides that "investment" refers to any investment associated with an economic activity in the energy sector and to investments or classes of investments designated by a contracting party in its area as "Charter efficiency projects" and so notifies the secretariat. Similarly, the General Agreement on Trade in Services (GATS) applies in the services sector only.

2. Admission

26. Admission clauses have important implications for development. Under customary international law, a host State has a wide margin of discretion when deciding on whether and under what conditions to permit the entry of foreign investors. Entry controls, restrictions and conditions for entry are some of the ways by which host countries give expression to their development strategies with respect to FDI. In contrast, the process of globalization is exerting increasing pressure on host countries to grant market access to foreign investors on the basis of national treatment. Over the years, several broad approaches have emerged and presently coexist in IIAs to provide a degree of flexibility in order to deal with development concerns over the question of admission.

27. Traditionally most IIAs have left the question of entry and establishment to be determined by the national laws of the signatory countries, while committing signatories to the creation of a favourable investment climate (UNCTAD, 1999b). This approach is followed in most BITs, old as well as recent, such as the BITs signed by France, Germany, the Netherlands, Sweden and the United Kingdom, as well as most BITs signed between developing countries (UNCTAD, 1998b). It is also found in many regional agreements, for example the ASEAN Agreement for the Promotion and Protection of Investments (article III.1), the MERCOSUR Protocol on the Promotion and Protection of Investments from Non-member States of MERCOSUR (article B.1), the Agreement on the Promotion, Protection and Guarantee of Investments among Member States of the Organization of the Islamic Conference (article 2), the Treaty Establishing the Common Market for Eastern and Southern Africa (article 101.1), and the World Bank Guidelines on the Treatment of Foreign Direct Investment (article II.3).

28. A second approach involves an "opt-out" procedure, which provides for certain rights of entry and establishment while stipulating ways by which the parties can retain more or less control over admission in certain activities. The BITs signed by the United States and Canada do so by extending national

treatment and most-favoured-nation (MFN) treatment to the pre-entry phase of an investment, subject to country-specific exceptions on industries and activities included in an annex (box 7). This approach is also followed in the North American Free Trade Agreement (NAFTA) (chapter XI, articles 1102-1104 and 1108) and the MERCOSUR Protocol of Colonia on Investment (Intrazone) (article 2.1). The APEC Non-Binding Investment Principles contain “best efforts” commitments to admit investment on the basis of national and MFN treatment, but with exceptions as provided for in domestic laws and policies. When the Energy Charter Treaty was concluded, it contained a similar "best efforts" commitment, coupled with a commitment to negotiate fully-binding pre-national and MFN treatment rights in a supplementary treaty.

Box 7. United States model BIT (article II), 1994 version

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

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

BIT between Canada and Trinidad and Tobago (article II (3))

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

29. A third approach involves the concept of “progressive liberalization” through an opt-in procedure, whereby each contracting party extends market access commitments only to those activities that it specifies in its schedule to an agreement. The main example is GATS, which provides for such discretion in article XVI (see section D below). This is reinforced by article XVII, whereby national treatment extends only to those sectors specified in the schedule and is subject to any exceptions taken by the contracting party in its schedule. This modality allows each country to negotiate the liberalization of individual service industries or transactions that it is ready to open up in pursuance of long-term progressive liberalization.

Moreover, article XIX (2) provides that the process of liberalization will take place with due respect for national policy objectives and the level of development of individual parties both overall and in individual sectors. Thus, flexibility is foreseen for individual developing countries.

3. Performance requirements

30. To encourage the beneficial effects of FDI, countries have often sought to impose performance requirements on foreign investors. Traditionally, IIAs did not explicitly regulate the use of performance requirements, and most existing IIAs are characterized by this approach. In these cases, host countries had discretion to use these requirements in a manner they found appropriate.

31. Recently the use of such requirements has been regulated in certain IIAs. These allow more or less flexibility for host countries to pursue their development strategies in this area by following various approaches, as illustrated by the following examples:

(a) **Prohibiting certain types of performance requirements:** the Agreement on Trade-related Investment Measures the (the TRIMs Agreement) prohibits some requirements (namely measures inconsistent with articles III and XI of the General Agreement on Tariffs and Trade (GATT)); but those mentioned in the illustrative list annexed to the Agreement do not include transfer-of-technology requirements (which are among the most significant for upgrading the technological capabilities of host developing countries) and export-performance requirements. Provisions prohibiting various types of performance requirements can also be found in BITs signed by the United States and Canada and, recently, in some BITs between some developing countries as well (for example, the BIT between El Salvador and Peru). In a number of cases (BITs signed pursuant to the 1994 United States model BIT), the prohibition does not extent to performance requirements required as a condition for the receipt of an advantage or incentive, thus allowing freedom for host countries to impose performance requirements in exchange for incentives (although they may be subject to MFN obligations). Article 1106 of NAFTA follows a mixed approach since it prohibits seven types of mandatory restrictions, four of which it also prohibits when they are voluntary conditions linked to incentives;

(b) **Discouraging the use of performance requirements:** the BITs between the United States and Zaire (now the Democratic Republic of the Congo) and between Malaysia and the United Arab Emirates require the host country to use its best efforts to avoid imposing such requirements. At the multilateral level, the World Bank Guidelines discourage performance requirements and other types of discriminatory operational conditions, and under the APEC Non-Binding Investment Principles the use of these requirements should be minimized. At the regional level, the Declaration on International Investment and Multinational Enterprises and related decisions of the Organisation for Economic Cooperation and Development (OECD) prescribe the progressive elimination of performance requirements that are inconsistent with national treatment and discourage requirements linked to incentives;

(c) **Providing for special treatment (temporal derogation) for developing countries**: the TRIMs Agreement allows a period of grace for developing countries in eliminating prohibited requirements (see also below).

4. National treatment

32. The standard of national treatment - which provides that foreign investors receive in a host country treatment no less favourable than the treatment given by that country to its national companies - is an important principle for foreign investors. However, it may be a cause for concern to some countries, since such treatment may enable foreign enterprises, especially large transnational corporations, to compete in the local economy, sometimes to the detriment of domestic enterprises. Moreover, host Governments sometimes have special policies and programmes that grant advantages to domestic enterprises in order to stimulate the development of a national industrial base. To address these concerns, host countries have often sought to qualify or limit the application of national treatment in a variety of ways, thus avoiding the potentially detrimental effects on their local enterprises.

33. Some agreements which otherwise provide standards of treatment for foreign investors do not grant national treatment. This is the case in the ASEAN Agreement for the Protection and Promotion of Investments and the majority of BITs signed by China.

34. The principle of national treatment is a relative standard. Often national treatment provisions contain an explicit reference in this respect by limiting their application to investments that are "in the same circumstances" or "in like situations", thus mitigating some of the most sweeping effects of the application of the standard. The OECD Decision on National Treatment and treaties concluded by the United States are examples of this approach (see the 1994 model BIT by the United States, quoted above).

35. Some agreements exclude from the application of the standard any benefits and advantages given to local investments. An example of this approach is the BIT between Denmark and Indonesia (article 3), which does not refer to "treatment" but rather to the "imposition of conditions".

36. A different approach is to excuse one country (or a number of countries) from the obligation to grant national treatment on account of its economic situation. This approach is found in Protocol No. 2 of the BIT between Indonesia and Switzerland, which allows derogation from national treatment of Swiss investors "in view of the present stage of development of the Indonesian economy".

37. The most common approach in recent IIAs appears to be to exclude certain industries or activities from the application of national treatment. This is the approach followed in NAFTA and United States BITs. In GATS, national treatment is to be negotiated progressively, in the same manner as market access, as included in national schedules. The OECD National Treatment instrument provides for limited exceptions subject to standstill.

38. It should be emphasized that the above discussion of some key issues on IIAs is illustrative only, both in terms of the issues covered and in terms of the approaches and examples provided. The intention is merely to show that existing IIAs provide for a variety of approaches to introduce a certain flexibility into key provisions of IIAs.

C. Implementation

39. The modalities of implementation of an IIA are quite important with respect to the development effects that such agreements are intended to serve. Implementation mechanisms may depend on the particular characteristics of an agreement, including whether they are stand-alone agreements (like BITs) or parts of a larger body of commitments. An important question here is how an implementation process can be structured so as to promote development objectives. In addition, in order to ensure that implementation is as effective as possible, it may be necessary to put in place special arrangements for technical and financial assistance.

1. Exceptions and derogations

40. One way to provide for flexibility in the implementation of an agreement in the interest of development is to allow for exceptions or derogations from the obligations of the agreement. Exceptions and derogations in IIAs may be divided into two broad categories for the purposes of this report:

(a) Exceptions and derogations that are open to all contracting parties regardless of their level of development. These can be divided into three types:

(i) *General exceptions* based on public health, order and morals, and national security. Such exceptions are present in virtually all investment agreements, but they are not necessarily related to development;

(ii) *Subject-specific exceptions*, which exempt specific issues from the application of specific provisions. For example, national treatment and MFN clauses may contain exceptions in relation to intellectual property, benefits arising from membership in a regional economic integration scheme, taxation provisions, or temporary macroeconomic safeguards;

(iii) *Country-specific exceptions* allow a contracting party to reserve, for example, the right to distinguish between domestic and foreign investors for reasons of national economic and social policy;

(b) Temporal (phasing) provisions specially aimed at permitting derogations from IIAs disciplines for a specified transitional period. Such provisions aim at allowing a period of grace for developing countries to adapt their policies and laws to the standards required of them in an agreement. They represent an acknowledgement that developing countries may not always be in a position to act in the same manner as developed countries, given their weaker economic and competitive situation (box 8).

Box 8. Article 4 of the TRIMs Agreement

"A developing country Member shall be free to deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994, the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Articles III and XI of GATT 1994."

Article 5 of the TRIMs Agreement

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

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

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

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

5. Notwithstanding the provisions of Article 2, a Member, in order not to disadvantage established enterprises which are subject to a TRIM notified under paragraph 1, may apply during the transition period the same TRIM to a new investment (i) where the products of such investment are like products to those of the established enterprises, and (ii) where necessary to avoid distorting the conditions of competition between the new investment and the established enterprises. Any TRIM so applied to a new investment shall be notified to the Council for Trade in Goods. The terms of such a TRIM shall be equivalent in their competitive effect to those applicable to the established enterprises, and it shall be terminated at the same time."

Article 65 of the TRIPS Agreement

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

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

3. Any other Member which is in the process of transformation from a centrally-planned into a market, free-enterprise economy and which is undertaking structural reform of its intellectual property system and facing special problems in the preparation and implementation of intellectual property laws and regulations, may also benefit from a period of delay as foreseen in paragraph 2.

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

5. A Member availing itself of a transitional period under paragraphs 1, 2, 3 or 4 shall ensure that any changes in its laws, regulations and practice made during that period do not result in a lesser degree of consistency with the provisions of this Agreement."

2. *Promotional measures, including technical and financial cooperation*

41. Provisions that spell out development-oriented measures and policies that parties to an agreement can take to further enhance development-friendly effects of IIAs. One approach is to promote investment and technology flows to developing countries through appropriate home country measures. The 1989 Lomé Convention, for example, contains a number of provisions concerning investment promotion and investment financing which are meant to encourage private investment flows from the European Union to ACP States; the Convention also addresses measures that home countries should take at the national level (box 9). Similarly, implementation may benefit from the completion of other tasks, such as the conclusion of agreements relating to specific projects.

Box 9. Article 259 of the Fourth ACP-EEC Convention of Lomé

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

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

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

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

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

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

(f) provide assistance to ACP States in:

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

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

42. The TRIPS Agreement, too, provides an example in this respect (UNCTAD, 1996c). It calls upon developed contracting parties to provide incentives to their enterprises and institutions for the purpose of promoting and encouraging technology transfer to the least developed countries in order to enable them to create a sound and viable technological base (article 67). In order to facilitate implementation, it goes even further in detailing technical cooperation (box 10).

Box 10. Article 67 of the TRIPS Agreement

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

43. Some BITs describe specific actions that one or the other contracting party should take to promote investment. An example of this approach is article 2 of the BIT between Malaysia and the United Arab Emirates (box 11). A different approach is that found in article 2 (3) of the BIT between the Belgium-Luxembourg Economic Union and Cameroon (box 12). This provision acknowledges the asymmetrical nature of the relationship between a capital-exporting developed country and a developing country, for it does not impose a similar obligation on Cameroon to promote investment in the Belgium-Luxembourg Economic Union.

Box 11. BIT between Malaysia and the United Arab Emirates (article 2)

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

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

BIT between the Belgium-Luxembourg Economic Union and Cameroon (article 2 (3))

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

D. Overall structure

44. The types of provisions in IIAs discussed so far are significant because they can give an agreement the flexibility necessary for enhancing its positive effects on development. Ultimately, however, the development orientation needs to be reflected in the very structure of an agreement. That structure is important because it reflects, and thereby determines, the overall design of the relationships between the parties. International agreements are generally based on reciprocity and legal symmetry, that is, the rights and obligations of the parties are generally the same, or "mirror images" of each other. Where the parties are at different levels of development, however, formal symmetry can obscure an underlying economic asymmetry. International practice in the past half-century has sought to take account of that asymmetry by developing a number of ways in which differences in the level of development among parties may be taken into account in the operation of an agreement. This can be done through particular provisions of the kinds discussed above; it can also be reflected in the very structure of an agreement.

45. The extent to which such structural flexibility is found in international agreements varies widely. As far as IIAs are concerned, BITs do not appear to make a structural distinction between the rights and obligations applicable to developed and developing contracting parties. Their actual provisions do, however, sometimes offer, as noted earlier, varying degrees of flexibility for development. Moreover, some of their provisions are meant to apply only to relationships between developed and developing countries. An instance of this is the provisions found in BITs concerning subrogation by the home country to claims for payments made on the basis of the issuance of investment guarantees, which are normally available only for investment in developing countries.

46. On the other hand, the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) is based on a distinction between developed and developing countries. More specifically, MIGA can cover investments made in the territory of developing member countries only (listed in schedule A of the Convention). 7/ The Convention is exceptional among IIAs in that such agreements do not generally distinguish, in their structure, between developed and developing countries. Another important exception in this respect is the Lomé Convention mentioned above. This Convention includes: in part one the general provisions and principles for EEC-ACP cooperation; in part two, the areas of cooperation are presented; in part three, the instruments of cooperation are listed; and part four deals with the institutions for EEC-ACP cooperation that the Convention establishes. Of particular note is title IV of part three, which distinguishes further among the developing contracting States, with provisions on the least developed, landlocked and island ACP States.

47. Another basic approach to provide for flexibility involves the use of "positive" and "negative" lists. The former list those sectors or measures in respect of which obligations are to be fulfilled; the latter list sectors or measures to which obligations do not apply. An example of a positive list can be found in GATS, where no party is compelled to permit market access or national treatment but has the right, under articles XVI and XVII, to list in its schedule those service sectors in which it is willing to make such commitments (box 12). This approach reflects the fact that the commitments are negotiated on the basis of reciprocity, which can be provided in other

service modes of supply or in access for trade in goods. By following this approach, GATS encourages the increased participation of developing countries in trade in services by facilitating their efforts to liberalize their service industries as they are able to obtain reciprocal commitments in other areas of negotiations. An example of a negative list can be found in NAFTA, where parties accept a set of principles and then negotiate sectoral exceptions. This approach may result in a long list of reservations submitted by the parties. Under this approach new activities are automatically covered by an agreement unless explicit action is taken to exclude them. It should be noted that these approaches are not mutually exclusive. An agreement could contain both approaches; GATS, for example, also has a negative listing for limitations on market access and national treatment with respect to those sectors and subsectors included in the schedule.

Box 12. Article XVI of the GATS

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

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

(a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;

(b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;

(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;

(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

(e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and

(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign share holding or the total value of individual or aggregate foreign investment."

48. It is generally recognized that the positive list approach offers the possibility for trade-offs and facilitates the achievement of reciprocal

benefits. It provides developing countries with considerable flexibility; for example, GATS does not prohibit performance requirements, and the TRIMs Agreement does not apply to services.

CONCLUSIONS

49. IIAs, whether bilateral, regional or multilateral, by their very nature impose certain disciplines and commitments which affect the ability of Governments to pursue their policies. Where both developing and developed countries are involved in an agreement, the formal symmetry of the parties is combined with an asymmetry in their underlying economic conditions. As a result, a certain degree of flexibility is required, particularly by developing countries, to take into account this economic asymmetry and permit them to benefit fully from an agreement. This report has examined the various ways in which existing IIAs provide for such flexibility, without, however, evaluating their relative importance and effectiveness.

50. The same problem is, of course, also familiar from international economic agreements in other areas. For instance, trade agreements within the World Trade Organization (WTO) provide for special and differential treatment, which can take the form of allowing developing countries not to comply with certain disciplines foreseen in an agreement for a period of time, taking into account the special needs of the developing countries concerned (see, e.g. box 13). Another interesting example is the recent United Nations Framework Convention on Climate Change and its Kyoto Protocol (box 14). The relevance of such agreements to IIAs is a subject that deserves further attention.

Box 13. Article 15 of the Agreement on Agriculture

"Special and Differential Treatment

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

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

Article 10 of the Agreement on the Application of Sanitary and Phytosanitary Measures

"Special and Differential Treatment

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

2. Where the appropriate level of sanitary or phytosanitary protection allows scope for the phased introduction of new sanitary or phytosanitary

measures, longer time-frames for compliance should be accorded on products of interest to developing country Members so as to maintain opportunities for their exports.

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

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

Box 14. "Flexibility mechanisms" for developing countries in the United Nations Framework Convention on Climate Change and its Kyoto Protocol

Objectives

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

Preamble and principles

Three key principles can be discerned:

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

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

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

Substantive provisions

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

negotiated, but are likely to contain flexible approaches.

Differentiated emission limitation and reduction commitments

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

Financial assistance and technology transfer

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

Compliance and adaptation

In furtherance of principle 2, measures have been adopted to assist developing countries adapt to climate change. The Global Environment Facility funds studies to determine vulnerability and adaptation needs, and recently has been assigned the task of helping developing countries. The Clean Development Mechanism to be established under the Kyoto Protocol, discussed below, must apply a portion of its proceeds to meet the adaptation requirements of developing countries.

The Clean Development Mechanism and sustainable development

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

Notes

1/ In paragraph 89 (b) of "A Partnership for Growth and Development" (TD/378/Rev.1), UNCTAD was called upon to identify and analyse the "implications for development of issues relevant to a possible multilateral framework on investment, beginning with an examination and review of existing agreements, taking into account the interests of developing countries and bearing in mind the work undertaken by other organizations".

2/ For a collection of IIAs, see UNCTAD (1996a), in which, unless otherwise noted, the regional and multilateral agreements and model bilateral investment treaties cited in this report are contained. Developments regarding IIAs since the publication of the *Compendium* are reviewed in the annual *World Investment Report* series (UNCTAD, 1996b, 1997, 1998a).

3/ It should be noted that developed countries also often seek flexibility in IIAs, for their own reasons.

4/ This may create a tension between the universal scope and application of such agreements, on the one hand, and the extent to which measures and policies specifically relating to the development of the developing countries are possible under their provisions on the other hand.

5/ For the purposes of this report, legally binding agreements as well as guidelines are included in the analysis. It should be noted that the legal nature of an agreement can itself be an indicator of flexibility.

6/ Unless otherwise stated, the texts of all BITs mentioned in this report can be found in International Centre for Settlement of Investment Disputes (1972-).

7/ More broadly, in agreements concerning development cooperation - intended to help developing countries in their development efforts - the distinction between developed and developing contracting parties is often an essential part of their structure, reflecting their objectives. A clear illustration is the case of the International Development Association (IDA), the World Bank affiliate which provides development credits to developing countries on particularly favourable terms. Members of the IDA are classed in two main groups, Part I countries, which are donors of aid, and Part II countries, most of which are aid recipients.

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