UNCTAD/ITE/IIT/2005/8

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

PRESERVING FLEXIBILITY IN IIAs: THE USE OF RESERVATIONS

UNCTAD Series on International Investment Policies for Development

ANNEXES

UNITED NATIONS
New York and Geneva, 2006

ANNEX 1

A BRIEF DEPICTION OF THE SAMPLE IIAS UNDER REVIEW

Andean Community (Decision 510)

The Andean Community Decision 291 establishes the general regime for foreign investments in the Andean countries. It makes no reference to the positive or negative listing of commitments or reservations for non-conforming measures. Indeed, the obligations enshrined in the Decision are general and mandatory. Information on restrictions concerning the establishment and operation of foreign investment in Andean countries is to be found in other legal instruments. Andean Decision 510, entitled *"Adoption of the Inventory of Measures that Restrict Trade in Services"* provides no mandatory disciplines, but annexes countries' lists of services-related investment measures that do not comply with the disciplines on market access and national treatment found in GATS Articles XVI (Market Access) and XVII (National Treatment). While restrictive measures not listed are "automatically liberalized", listed measures are subject to a gradual liberalization process, which is scheduled to be completed in 2005. No such Decision currently exists with respect to foreign investment in goods-related industries. Some references to national preferences in primary and secondary sectors can be obtained from Andean countries' constitutions. Nonetheless, countries may apply restrictions in other sectors than those indicated in their constitutions.

NAFTA (Chapter XI)

NAFTA's Chapter XI covers investment activities, except for financial services, which is subject to specific disciplines under a separate chapter (Chapter XIV). Under Chapter XI, MFN and national treatment disciplines apply across-the-board to all covered investments in both the pre- and post-establishment phases of an investment. Subsidies and government incentives are, however, carved out from the scope of the agreement’s national treatment

and MFN obligations. Chapter XIV on financial services extends national treatment and MFN rights to investors and their investments in the sector. Under Chapter XI, performance requirements are subject to a comprehensive ban (on the basis of a detailed list of prohibited measures) that focuses on both goods- and services-related requirements (a novelty at the time and a departure from the WTO TRIMs Agreement whose disciplines only apply to investment measures affecting trade in goods). The movement of key personnel, including that related to the establishment and post-establishment operation of an investment, is governed by provisions found in another chapter of the NAFTA (Chapter XVI, entitled "Temporary Entry for Business Persons").

NAFTA was the first major regional trade agreement to follow an elaborated negative list approach to scheduling non-conforming measures (earlier on, such negative list approaches were also adopted in post-war treaties on friendship, commerce and navigation by the United States). Indeed, the Agreement is often cited as the model example of such an approach. As discussed in the study, NAFTA's negative listing technique requires contracting parties to provide a high degree of regulatory detail on the nature of non-conforming measures they wish to maintain or introduce in future. Worthy of mention is the fact that the NAFTA did not generate any lists of non-conforming measures at the sub-national level, an important shortcoming. Though the Agreement initially foresaw the preparation and publication of such lists two years after the Agreement’s entry into force, the Parties ultimately agreed to "grandfather" existing restrictions (i.e. to allow the maintenance of restrictions already in force), without listing them.

Canada-Chile Free Trade Agreement (Chapter G)

This agreement was modeled on the NAFTA, following most of its core disciplines and adopting its same broad architecture, including the elaborated scheduling technique used in

NAFTA. The FTA carves out investment in financial services from its main disciplines. However, contrary to the NAFTA, the Canada–Chile FTA does not feature any other chapter addressing financial services. Accordingly, the agreement lists no reservations in financial services, a sector in which a range of non-conforming measures tends to be maintained, as suggested by other IIAs in this sample.

G-3 (Chapter XII) and the US-Chile Free Trade Agreement (Chapter X)

Both agreements were based to a large extent on the investment chapter of the NAFTA. As a result, many of the comments applicable to the latter agreement (see above) also pertain to these treaties. However, as regards the lodging of reservations, contracting parties to both agreements agreed to reduce the number of Annexes containing lists of reservations (although the types of non-conforming measures recorded remain broadly identical). Both agreements follow an elaborated negative list approach, generating extensive detail on the nature, type and sectoral incidence of non-conforming measures.

Mercosur (Colonia Protocol)

Mercosur's Colonia Protocol on the Promotion and Reciprocal Protection of Investments within Mercosur was signed on 17 January 1994, but it has yet to be ratified by all parties. Accordingly, it has not yet entered into force. Nevertheless, it remains an important agreement for assessing sensitive sectors and measures in the field of foreign investment in a South-South context. The Protocol grants MFN treatment and national treatment to investments of investors of other contracting parties in all economic sectors, in both their pre- and post-establishment phases. Unlike with most other sample IIAs, no sectors are excluded from the scope of the Colonia Protocol, not even highly sensitive or complex ones, such as air transport or energy production. All performance requirements are banned if they relate to (and hence

distort) international trade in goods and services. The agreement features no specific provisions on other issues, such as incentives or quantitative restrictions, which are covered by the Protocol's treatment obligations to the extent that they are discriminatory in character.

As with other IIAs covered in the sample, Mercosur's Colonia Protocol allows the parties to lodge reservations under the different disciplines it establishes. These include: the right of establishment; (post-establishment) national treatment and trade-related performance requirements. Almost all reservations lodged under the Protocol relate to the right of establishment obligation. Unlike NAFTA, the G-3 or the Canada-Chile and US–Chile FTAs, reservations under the Colonia Protocol do not indicate the specific non-conforming measure that the country wishes to maintain. The parties were only required to mention the economic sector where they would apply such a restriction – without giving additional details on the policy measures concerned.

OECD National Treatment Instrument

The Third Revised Decision of the OECD Council on National Treatment (OECD National Treatment Instrument) constitutes a legally non-binding plurilateral agreement entirely devoted to the granting of national treatment to established foreign-controlled enterprises. Its only substantial provision is Article 1 (out of 7 articles), which requires the parties to notify the OECD secretariat of all current and future measures that constitute an exception to national treatment. The Instrument does not accord MFN treatment, nor does it provide disciplines on other issues such as performance requirements or quantitative restrictions. Nevertheless, several such measures are covered by the Instrument to the extent that they are discriminatory in nature. The Instrument does not include a right of establishment. This issue is covered by the legally binding OECD Code on Liberalisation of Capital

Movements. Despite the exclusion of the pre-establishment phase, numerous countries have listed discriminatory measures concerning the making of an investment in the National Treatment Instrument.

In following a negative list approach to lodging exceptions, the NT Instrument generally provides (without mandating) a high level of regulatory detail, indicating the legal source of the measure, the type of restriction, and the time period over which the measure is meant to be maintained (when applicable). However, some countries have opted to indicate that certain non-conforming measures may be applied in given sectors, without referring to the legal source of the measure nor to the time period over which it will be maintained, modified or eliminated.

Draft OECD Multilateral Agreement on Investment (never concluded)

The draft Multilateral Agreement on Investment (MAI) was negotiated at the OECD among Member countries, the EU and a number of developing country non-Member countries (typically those granted observer status at the OECD at the time). The MAI negotiations were officially called off in December 1998, three years after their launch, owing to the great complexity of the subject, a large number of intractable substantive differences among key parties to the talks and amidst a rising chorus of opposition within the ranks of civil society. At the time when the MAI was abandoned, the text of the proposed agreement was well advanced with regard to its core disciplines and provisions. The draft MAI foresaw that MFN and national treatment obligations would be extended to foreign investments and investors in all economic activities, subject to a few carve-outs (e.g. air transport; public services; intellectual property). The agreement aimed at ensuring entry rights to foreign investors, and ruled out specific performance requirements (both trade- and service-related). It also featured disciplines on the movement of key personnel but stopped

short of extending specific disciplines on the granting of investment incentives, leaving such an issue to future negotiations.

Before the negotiations were called off, the initial reservation lists of prospective contracting parties (solely at the national level in the case of federal states) had been prepared and exchanged. It is not possible to identify precisely which reservations would have remained had the negotiation been brought to a successful conclusion. Still, the draft reservation lists allow a number of inferences to be drawn on the nature and sectoral incidence of sensitive sectors and measures for the purposes of this study.

ANNEX 2

HANDLE WITH CARE: A WORD OF METHODOLOGICAL CAUTION

The empirical work conducted in this study consists of recording the number, nature and sectoral incidence of reservations contained in the reservation lists of each contracting party to the eight IIAs under review. The study's main aim is not so much to focus on the aggregate number of reservations found under each agreement – which will naturally vary according to the sectoral scope and substantive provisions found in them – but rather to present major trends and to infer and compare patterns of conduct and the policy preferences these patterns reveal. The conclusions and findings stemming from this analysis should be considered as a first tentative approximation on the issue. They should be regarded with a few additional considerations in mind:

a) Concerning the countries covered: although an effort was made to select countries that have signed several negative-list IIAs, the cross-country comparisons found in the study are based on reservations found in a limited sub-sample of agreements (usually 2 or 3). Moreover, some key global players are not represented in the study (e.g. India, China), as they have not signed a considerable number of negative list IIAs.

b) Concerning the types of measures and the coverage of the agreements: in order compare the various agreements, a decision was taken to focus solely on agreements operating on the basis of negative lists of non-conforming measures. However, even negative-list agreements may not always be completely alike in their scope and coverage. In particular, it should be borne in mind that:

- Some sectors may be carved-out of an agreement, which may result in the complete absence of reservations in the sector. This is the case, for instance, with investment in financial

services and trade and investment in audio-visual services in the Canada-Chile FTA. It is also the case with much of the air transport sector in several of the IIAs under review;

- Some reservation lists present a lesser level of detail than others, which may hinder the classification of reservations into the most adequate categories. This is notably the case with the Andean countries regarding investment restrictions in the goods sector. To the extent that they stem from constitutional treaty provisions and not from reservations lists appended to investment agreements, such non-conforming measures are described in much more general language and scope;
- Not all agreements under review allow contracting parties to lodge reservations with regard to the same disciplines. For instance, the NAFTA allows reservations to be lodged against nationality requirements applied to the composition of companies' boards of directors, whereas other agreements treat such limitations under national treatment;
- Countries may differ in their interpretations of certain key investment disciplines. For example, certain countries record requirements establishing minimum levels of local equity participation as reservations falling under performance requirements. However, one could also refer to national treatment, market access (quantitative restrictions) and, where relevant, MFN treatment principles when scheduling a reservation to protect legislation on minimum local equity participation. In order to ensure some degree of consistency, whenever performance requirement reservations related to minimum local equity participation and joint venture requirements were found, they were recorded as national treatment and/or MFN reservations. It therefore cannot be excluded that some non-conforming measures were counted more than once (e.g. as reservations on national treatment and MFN treatment). This problem was most acute in the context of the draft MAI, given that reservation lists were produced at

a time when countries were still negotiating the core provisions of the Agreement and were thus unclear on a number of important parameters of scope, definition and coverage. Moreover, MAI data in this study refers solely to reservations scheduled at the national level, as is the case under NAFTA and the Canada-Chile FTA. The absence of information on sub-national measures underestimates the overall importance of non-conforming measures, particularly in services, as these sectors are often subject to extensive regulation at the sub-national level in countries like Canada, the United States and Germany.

c) Concerning the sectoral classification of reservations: the classification that has been used for services is based on GATS schedules. It differs in one important respect, however, insofar as the study takes out "Professional Services" from "Business Services" in order to better reflect its particularities and policy sensitivities (and consequent restrictive measures found in the sector).

Other considerations to bear in mind include the following:

- Countries' definitions of particular sectors vary widely. In the draft MAI, for instance, Austria classified a reservation on "tourist guides" as arising in the "business services" sector, while many other countries classified the same type of reservation under "tourism services." In order to ensure a certain degree of consistency across countries, it was occasionally necessary to record reservations in sectors different from those specified by countries;
- A related problem arises when countries lodge reservations that cut across two or more sectors. For example, under the G-3 agreement, Mexico inscribed a reservation in the "Telecommunications and Transport" sector. In such cases, a decision was made to split such reservations into two: one in

the telecommunications sector and the other in the transport sector;

- Disparities may also arise as regards the scope of individual reservations. Under the OECD National Treatment Instrument and the draft MAI, for example, some countries have lodged one reservation covering their entire "professional services" sector. Other countries have lodged separate reservations for legal, auditing, dental, and taxation services. As a result, countries with very similar regimes in a particular sector might have a very different number of reservations in that sector. This underscores the fact that the number of reservations may not fully capture the "restrictiveness" of a particular country's regulatory regime. For this reason, it is preferable to interpret information in terms of shares (i.e. percentages) and avoid comparing the aggregate number of reservations across countries; two different sorts of instruments where utilized to document Andean country reservations in services- and goods-producing industries. While for the former recourse was made to the Andean Decision 510, countries' restrictions on goods were taken from constitutional treaty provisions. The differing nature of these instruments may influence the actual "weight" of restrictions in each sector. Measures listed under a dedicated regulatory instrument (i.e. Decision 510) typically feature a greater level of detail, and tend to be greater in number.
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