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PRESERVING FLEXIBILITY IN IIAs: THE USE OF RESERVATIONS

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CHAPTER I

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I. FLEXIBILITY IN IIAs

A. APPROACHES TO SCHEDULING NON-CONFORMING MEASURES IN IIAs

1. GATS-type approach and negative list approach

An important aspect of providing policy flexibility under IIAs relates to the choice of modality used to negotiate and schedule liberalization commitments. Two alternative approaches are found in IIAs:[1] the GATS-type approach, on the one hand, and the negative list approach, on the other.

A GATS-type approach[2] basically means the positive listing of sectors, sub-sectors and (in trade in services) individual modes of supply in which countries voluntarily undertake liberalization commitments. This is combined with the negative listing of the non-conforming measures countries wish to maintain in scheduled sectors, sub-sectors and/or modes of supply. The selective nature of liberalization under this approach entails that an agreement's core obligations apply only to the activities listed in a country's schedule and solely on the terms described therein. Importantly, the terms described in a country's commitments may differ from the regulatory *status quo* prevailing at the time that the commitments are scheduled. Another important implication and defining feature of IIAs relying on a GATS-type approach is that the agreement's obligations do not apply to sectors, sub-sectors or modes of supply that are either listed as "unbound" or that simply do not appear in the country's schedules. This has the advantage of giving host countries greater latitude in determining the overall level of obligations, and in specifying the regulatory conditions under which any commitments are made. For these reasons, the GATS-type approach is generally regarded as more development-friendly than a negative list approach.

Alternatively, countries may rely on a negative list approach. In that case, countries agree on a set of general

obligations and then list all individual measures to which such obligations either do not apply or which qualify their obligations. For example, the NAFTA parties agreed to extend national treatment to all foreign investors and their investments, yet at the same time each of the parties listed those particular measures, sectors and/or activities to which the Agreement's national treatment obligation does not apply, either in part or in full.

A negative list approach is useful for producing a detailed inventory of all non-conforming measures IIA contracting parties maintain. To measures that do not appear in reservation lists the liberalization commitments apply in full *ab initio*. This approach is most appropriate in IIAs involving countries with a high degree of liberalization. Such negative lists are useful from a perspective aimed at comprehensive (and rapid) liberalization: since negative lists provide a full road map of remaining barriers to investment they allow for a rank-ordering of remaining impediments for future liberalization negotiations. In addition, such lists may make it easier for countries to identify possible formula-based negotiating proposals for sectors characterized by similar investment impediments across countries.[3] This, in turn, may further increase the liberalizing character of future negotiations.

As noted above, the negative list approach implies in general the need for host countries to "reveal" the precise nature of investment-restrictive measures enshrined in their laws and regulations. Normally, no such pressure to expose current legislative or regulatory restrictions arises under GATS-type agreements, as host governments can schedule commitments at any desired level of openness or (most likely) restrictiveness. By providing such a snapshot of the prevailing regulatory landscape, negative lists can prove useful for the investment community. They can allow for more informed business decisions to be taken by prospective investors.

There is little doubt that the challenge of preparing a negative list can prove daunting from an administrative perspective, particularly in developing countries suffering from a lack of expertise. Nonetheless, experience suggests that the *process* of preparing a negative list, for which the provision of technical assistance and longer timeframes can and should normally be foreseen, may nonetheless enhance good governance.[4] Such a process may compel host countries to perform an audit of existing regulatory practices in the investment field and to assess the rationale, effectiveness, and continued need for maintaining discriminatory or restrictive investment measures.

The negative list approach usually implies a "standstill" commitment, i.e. the contracting parties are not allowed to introduce new non-conforming measures beyond those included in the negative list. However, some IIAs go further than generating a standstill with regard to sectors subject to the agreement's substantive obligations. Starting with the NAFTA, a number of agreements also feature a so-called “ratchet” effect. Under such agreements any regulatory changes towards further liberalization (whether autonomously, between periodic negotiating rounds or otherwise) are automatically reflected in a country's commitments under the IIA.[5] Such a mechanism may deprive host countries of flexibility that they may not wish to see locked-in (and open to challenge) under international law. For example, this may be the case for sectors in which regulatory regimes and enforcement institutions are nascent, and where the future effects of new liberalization are unclear. A ratchet clause may also deprive host countries of negotiating clout that could potentially be “spent” in the context of multi-sectoral negotiations.

In theory, both positive list and negative list approaches can yield the same outcome in terms of liberalization. This would be the case if countries had the capacity to make informed

judgments about the desirability of maintaining individual measures or, more broadly, about the extent of the commitments they are willing to make. In practice, however, the negative list approach involves a potentially higher level of bound liberalization – to the extent that it locks-in the regulatory *status quo*. This, of course, does not imply that agreements based on positive listing cannot lead to investment liberalization and to *status quo* lock-in. This can, indeed, occur: either as a result of an autonomous policy decision on the part of a host country government, or alternatively due to negotiating pressures arising from bilateral request-offer negotiations (particularly those conducted along North-South lines).

Similarly, and as already noted, even agreements based on a negative list approach may afford some freedom to introduce new non-conforming measures in sensitive sectors. Indeed, most IIAs (featuring either positive or negative lists) concluded in recent years allow countries to list sectors and activities in which future regulatory immunity is preserved. This then becomes the negative list equivalent of an unbound commitment under GATS-type agreements. Moreover, parties to an IIA may always, independently of the chosen scheduling technique, agree to keep some key industries out of the agreement's scope. Adopting carve-out clauses is a tool to this effect (see box 1).

Whatever approach to scheduling non-conforming measures is ultimately used, the overriding concern for a host country is to identify, first, those industries, activities and policy measures against which commitments should be scheduled; and, second, the conditions attached to such commitments in the light of a host country's particular regulatory and developmental circumstances and the competitive strength of its domestic industries.

Box 1. Carve-out clauses

One way to preserve flexibility in particular sectors, independently of the sort of IIA concluded (i.e. under a negative or positive list approach), is to exclude particular sectors from the coverage of an agreement. IIA contracting parties can agree to do this through so-called "carve-out" clauses. One notable example of this approach can be found in the GATS. For instance, Article 2 of the GATS Annex on Air Transport Services expressly declares that the agreement shall not apply to transport rights or services directly related to the exercise of such rights.[a] This implies an almost complete carve-out of air transport services from the scope of GATS obligations (except for a few ancillary services mentioned in Article 3). Such carve-outs have been replicated in a large number of economic integration agreements (EIAs) that feature comprehensive investment disciplines. They are also found in the majority of IIAs reviewed in this study.

Another prominent example of carve-outs relates to public services. So-called "public services carve-outs" can be found both in the GATS and in numerous EIAs. IIAs tend to describe public services as "*services supplied in the exercise of governmental authority*" and they are generally understood to encompass services that are neither offered on a commercial (for profit) basis, nor rendered in competition with other *like* services. A narrower variation of a carve-out clause can be found in the Canada-Chile FTA, which excludes in its entirety all measures relating to trade and investment in cultural industries.

Technically, such exclusions do not constitute reservations to the agreements. While their effect might be the same (i.e. excluding certain economic activities from the obligations undertaken) reservations and carve-out clauses differ in nature. Carve-out clauses form an integral part of an IIA and its substantive provisions, and therefore, require the explicit

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Box 1 (concluded)

consensus of all contracting parties during the negotiating phase of an agreement. Reservations, on the other hand, even if discussed and subject to negotiating pressures in bilateral request-offer discussions, retain a unilateral dimension. Most importantly, for their scheduling they do not require consensus of all the prospective IIA contracting parties. Finally, reservation lists are often revisited in periodic negotiating rounds with a view to achieving progressive liberalization. Carve-out clauses in turn, would require an explicit reopening of an agreement in order to be abrogated or modified.

Overall, carve-out clauses can be an appropriate means to address sectors which all prospective contracting parties of an agreement perceive as particularly sensitive or complex, and which are, accordingly, best left untouched by an agreement's substantive or procedural disciplines. Air transport or public services serve as examples. However, given the broad nature and far-reaching implications of a carve-out, such provisions may not be the best means of addressing economic activities that raise different policy sensitivities across countries or where the need to maintain non-conforming measures may be temporary in nature.

[a] Art. 2 and 3 of the Annex read as follows: "2. The Agreement, including its dispute settlement procedures, 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. 3. The 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. "

Of particular importance in this regard is the potential "information asymmetry" that developing countries might experience in confronting the above challenges. This may be problematic to the extent that such countries may not have the

information required to make informed judgements about the nature, scale and scope of the competitive strengths of their domestic industries and hence, of the sectors and policy measures requiring particular flexibility.

Furthermore, the lodging of reservations under a negative list approach, or the absence of a sector from a positive list, may reflect a desire by incumbents (both domestic and foreign) to be shielded from greater international competition. In addition, foreign investors might seek the sweeping opening of sectors at the expense of local competitors. The process of selecting negative or positive list approaches to liberalization may thus be affected by a proper determination of a country's offensive and defensive negotiating interests in the investment field. Similarly, a host country's ability to weigh the pleas for protection by special interests may also play a role.

2. Examples of the negative list approach

IIAs with a negative list approach are generally perceived as more demanding in terms of regulator transparency, the level of obligations assumed and the extent of liberalization achieved. However, such agreements do not imply the elimination of national flexibility. Nor do they rule out a host country's ability to regulate FDI in sectors subject to IIA disciplines and commitments. Depending on the agreement's scope and substantive disciplines they can, however, limit a host country's recourse to certain policy measures and decisions. Notably, this is the case for the desire to retain some space between *applied and bound regulatory policy*.[6] However, such policy limitations are not absolute in character. Indeed, top-down (i.e. negative list) agreements usually afford contracting parties the ability to preserve flexibility for certain sectors by listing existing (and in some cases future) non-conforming measures in reservation lists.[7]

Negative-list IIAs contain different approaches towards the scheduling of reservations. One of the main distinguishing features is the level of information required for the reservations lodged under them. In most cases, host countries are required to provide full details on the nature and scope of the non-conforming measures they wish to maintain or to apply in the future. Such an approach was pioneered under NAFTA. It can also be found in numerous agreements concluded subsequently in the Western Hemisphere and, most recently, in South-East Asia. Of the sample agreements covered by this study, the Canada-Chile and the United Sates-Chile FTAs, as well as the G-3 have opted for this scheduling technique. It can be termed the "elaborated approach" emphasising the degree of liberalization and extent of detail offered.

At the other extreme are IIAs that require contracting parties to merely indicate the sectors in which they intend to maintain or introduce restrictive measures, with little additional detail. The Mercosur countries under the Colonia Protocol for the Promotion and Reciprocal Protection of Investments within Mercosur are an example. Each approach will now be briefly examined.

(i) Elaborated approach

Under the NAFTA-type, "*elaborated negative list approach"*, the main features of the non-conforming measures must be specified in detail. These typically include the following elements:

- the economic sector in which the reservation is taken;
- the specific industry in which the reservation is taken;
- the activity covered by the reservation, (where applicable) according to domestic industry classification codes;

- the substantive or procedural obligation for which a reservation is taken (e.g. MFN treatment, national treatment, performance requirements, nationality requirements for boards of directors);
- the level of government applying the restrictive measure for which a reservation is taken (e.g. national; sub-national);
- a description of the specific law, regulation or other measure for which the reservation is taken;
- liberalization commitments applying at the entry into force of the agreement, and the remaining non-conforming aspects of existing (or future) measures for which the reservation is taken, if any; and
- phase-out commitments, if any.

With the purpose of promoting transparency and enhancing the predictability of host countries' investment climates, IIAs based on a negative list approach typically inscribe non-conforming measures in various annexes, each of which describes measures differing in nature and scope. For example, the annexes used by the NAFTA contracting parties comprised the following categories:

- *Annex I: Reservations for Existing Measures and Liberalization Commitments*: this Annex encompasses existing non-conforming measures that countries wished to maintain after the entry into force of the agreement. Reservations could be lodged with respect to the following substantive treaty obligations: national treatment; MFN treatment; performance requirements and nationality requirements applicable to boards of directors, as well as local presence (i.e. mandated establishment) requirements applied to cross-border services suppliers. Reservations

lodged under this Annex have to supply the level of informational detail specified above.

- *Annex II: Reservations for Future Measures:* this Annex sets out those economic sectors and activities where new restrictive measures can be implemented in the future – regardless of whether or not the non-conforming measures are currently applied. This category of measures, which can pertain to any of the substantive obligations covered by Annex I reservations, can be compared to sectors, sub-sectors and modes of supply under GATS in which WTO members have either scheduled an "unbound" commitment or that they have left outside their county schedules. The purpose of this Annex is to afford broader flexibility in certain areas for future regulations, allowing the introduction of new non-conforming measures or to tighten existing ones. Unlike the GATS, however, countries lodging such a type of reservation must provide detailed information on the nature of existing non-conforming measures for which future flexibility is being sought.
- *Annex III: Activities Reserved to the State:* this Annex, which is not found in all IIAs using a negative list, was used by Mexico under the NAFTA to reserve measures governing the regulation of activities (including of foreign investment) reserved to the State as decreed in the Mexican constitution (primarily in the oil and gas sector). The unique nature of this Annex meant that Mexico did not need to specify the exact nature of non-conforming measures maintained in sectors subject to Annex III reservations.
- *Annex IV: Exceptions from Most-Favoured-Nation Treatment:* this Annex carves out a number of sectors (as opposed to individual measures as per Annex I) from MFN treatment. It works in a manner analogous to that of exemptions lodged under Article II of the GATS. This

Annex granted the NAFTA countries greater flexibility in the lodging of reservations, allowing them to inscribe whole industries (e.g. "fisheries") without the level of specificity applied to Annex I and II measures.

- *Annex V: Quantitative Restrictions, and Annex VI Miscellaneous Commitments:* these Annexes list non-discriminatory quantitative limitations placed on the cross-border supply of services. Consequently, they relate to measures falling under the services chapter of NAFTA (Chapter 12) as opposed to NAFTA's investment chapter. Because NAFTA did not, unlike the GATS, proscribe the maintenance or enactment of such measures, the three countries agreed to list them solely for transparency purposes and with a view to facilitating discussions on their possible future elimination or liberalization. Despite the non-binding nature of the substantive provisions to which the reservations relate, NAFTA countries agreed to provide full regulatory details.
- *Annex VII: Reservations, Specific Commitments:* while similar to Annex I, this Annex focuses solely on measures in the financial services sector, including with respect to investment in the sector (pursuant to Chapter 14 of the NAFTA). As in Annexes I, II and V and VI, parties agreed to provide detailed regulatory information on the non-conforming measures maintained under this Annex.

Using such an elaborated approach to scheduling may have important implications, both for the ultimate scope of an IIA and for the administrative efforts that such a negotiation process may entail. This is so, in part, because this negotiating modality implies that, unless a reservation is taken, all future measures are automatically subject to the agreement’s liberalization obligations – without qualification and in sectors/activities that do not yet exist, or where regulatory frameworks are not (or not fully) in

place at the time when the IIA enters into force.[8] In contrast, under agreements based on a GATS-type approach, flexibility is more readily available. This is so both in terms of the ability of host countries under positive list IIAs to choose not to lock-in the *status quo* if they so desire, as well as with regard to the discretion they retain for future regulatory conduct in the covered sectors.

At the same time, negative listing can bring gains in transparency, as well as the expected benefits of good governance and an enhanced investment climate that may accrue in the wake of the preparation of negative lists. It should be noted, however, that the supposed gains in transparency and in policy consolidation that can arise from an elaborated approach to negative listing can be seriously undermined if Parties to an IIA allow sweeping general reservations to be lodged. For instance, in its FTA with Chile, the United States has lodged an Annex I reservation that exempts "all existing non-conforming measures of all states of the United States, the District of Columbia, and Puerto Rico". This carves-out from the agreement's scope all non-conforming measures maintained at the sub-national level without providing any information on the nature, type and sectoral incidence of the restrictive measures concerned.

As indicated above, the conclusion of an IIA with an elaborated negative list approach requires dedicated efforts at identifying and assessing all potential non-conforming measures. This, in turn, demands a sound system of inter-agency coordination within governments and equally effective consultative mechanisms with civil society and private sector organizations. To make the best use of a negative list, host countries must indeed have full knowledge of the rationale for, effectiveness of, and possible continued policy need for particular types of non-conforming investment measures (including, where relevant, at the sub-national level). Failure to lodge a specific reservation will result in the

subsequent need to rescind its possible non-conforming nature, or run the risk of seeing its maintenance challenged under an IIA's dispute settlement procedures.

While deficiencies and weaknesses in internal and external coordination and constraint mechanisms are by no means unique to developing countries, the associated administrative burden tends to weigh more heavily on resource-constrained administrations. The same applies to the consequences of making a mistake in completing such lists. For this reason, administrative capacity needs to be carefully assessed before entering into IIAs involving the generation of elaborated negative lists of non-conforming measures. This could give rise to technical assistance requests as a *quid pro quo* for agreeing to such a negotiating modality.

(ii) Alternatives to the elaborated approach

There are, however, alternatives to the elaborated approach. They can be found in the technique favoured by Canada and the United States in their bilateral investment treaties (BITs), as well as by the Mercosur countries under the Colonia Protocol for the Promotion and Reciprocal Protection of Investments within Mercosur. Under these IIAs reservation lists require contracting parties to indicate what sort of non-conforming measures they wish to maintain in a given sector without the above-described level of regulatory detail. This reduces the administrative burden on national authorities when lodging reservations. Under such IIAs, host country governments are neither required to indicate the specific law, regulation or provision for which the measure is taken, nor are they obliged to mention whether such a measure exists at present or whether it might be implemented in the future.

The three types of IIAs essentially all endeavour to provide some degree of transparency on host countries' investment regimes

by indicating the nature of the non-conforming measures and the sectors where they apply. By looking at the reservation lists produced under these types of IIAs, it is possible, for instance, to determine whether road transport services are subject to national treatment restrictions, whether certain performance requirements are maintained in the telecommunications sector, or whether the establishment of foreign investors in mining is allowed.

The nature of the measures listed in reservations under this approach depends on the scope and substantive obligations of the relevant IIA. If an agreement features specific provisions addressing various types of investment impediments (e.g. discrimination, performance requirements, restrictions on key personnel, quantitative restrictions on entry), the reservation lists will also tend to document non-conforming measures linked to various types of restrictions. On the other hand, if the IIA encompasses various categories of impediments solely under overarching non-discrimination principles (national treatment and MFN treatment), the information generated by the reservation lists will lack specificity and therefore generate more limited gains in terms of transparency and policy predictability.

IIAs that follow this alternative approach to scheduling typically require contracting parties to specify: whether restrictions relate to the pre- and/or post-establishment phases of an investment; to obligations on MFN treatment and national treatment; to performance requirements (usually encompassing technology transfers) or to the movement of key personnel.

In its Foreign Investment Protection Agreements (FIPAs), Canada, for instance, records non-conforming measures relating to national treatment as follows:

- *"National Treatment Exceptions* (covers national treatment obligations in regard to obligations concerning pre- and post- establishment treatment, as well as particular provisions in regard to movement of key personnel)*:*
  - social services (i.e. public law enforcement; correctional services; income security or insurance; social security or insurance; social welfare; public education; public training; health and child care);
  - services in any other sector;
  - residency requirements for ownership of oceanfront land;
  - measures implementing the Northwest Territories Oil and Gas Accord;
  - government securities."[9]

Unlike for NAFTA-type agreements, countries following this intermediate approach do not need to be as detailed with regard to the legal description of the non-conforming measures they wish to maintain. Rather, in some cases, contracting parties have agreed merely to indicate the economic sector (e.g. financial services) and the obligation (e.g. national treatment) to which the reservation pertains. Such an approach may make the scheduling process easier: the task for host countries to scan their domestic laws and regulations prior to entering into an agreement in order to lodge reservations becomes less demanding. Moreover, such an approach allows for the maintenance of what may be called "precautionary" reservations that need not correspond to existing measures. It thereby preserves broad regulatory discretion for future measures destined to secure the attainment of national policy objectives, such as environmental or developmental purposes.

There can, however, also be potential downsides to this intermediate approach to negative listing. They would stem from the fact that reservations, if lodged too broadly, may generate sub-

optimal gains in regulatory transparency and reduce an IIA's ability to enhance a host country's investment climate. For this reason, attention could be given to yet another alternative approach to scheduling, one that would aim to combine the best features of the various approaches of negative and of GATS-type listing.

B. OTHER ALTERNATIVE FOR FLEXIBILITY

As mentioned above, a third option may be available for prospective IIA contracting parties who are interested in reaping the potential governance and transparency-enhancing features of a negative list approach while avoiding the possible negative effects concerning the reduction of flexibility that such an approach might entail. Such a third approach would retain a GATS-like positive/hybrid list approach for purposes of lodging legally binding sector-specific liberalization commitments and qualifications thereto. It would also preserve host countries' flexibility with regard to future measures by allowing them to lodge "unbound" commitments or to keep particular sectors or activities out of their schedules or to schedule commitments below the regulatory status quo. In addition, countries would agree to exchange (and append to their IIA obligations) comprehensive (but not legally binding) lists of all non-conforming investment-related measures (i.e. measures that violate obligations such as national treatment, absence of market access/non-discriminatory quantitative restrictions, most-favoured-nation treatment, absence of local presence requirements, among others) for those sectors and sub-sectors which they have either not scheduled, scheduled as unbound or scheduled at less than the regulatory status quo. Such an approach would help prevent situations in which a host country's inability to properly reflect all potentially "non-conforming" measures would inadvertently result in obligations under the IIA – a risk most likely to arise in countries with weak administrative resources. A non-binding negative list of this sort

could nonetheless generate important transparency enhancing effects.

Thus, the purpose of such lists would be two-fold, both of them related to the enhanced transparency this approach would generate. First, it would encourage host countries to perform a domestic audit of their existing investment regimes. And second, it would provide a precise overview of existing impediments to investment. These lists could be used as a roadmap for preparing future negotiations aimed at increasing liberalization and could help prospective foreign operators to make informed investment decisions. The non-binding nature of such lists, the preparation of which might benefit from technical assistance for developing countries, would avoid the risk of (inadvertently) loosing future regulatory sovereignty, a problem implicit in IIAs based on elaborated negative listing.

Countries may also consider the possibility of setting up an institutional framework for the purposes of reviewing the implementation of the agreement. This may include the establishment of a committee responsible for the agreement and a timetable for its implementation. Such a common institution should ideally have the effect of supporting the negotiating process and of facilitating the review of the agreement according to the needs of the parties and its subsequent evolution – over time – in light of the developmental and other impacts it brings about. A large number of preferential trade and investment agreements signed to date contain such mechanisms.

Notes

[1] IIAs following either of these approaches feature obligations on pre-establishment rights. European BITs, for their part, do not generally

include any list of reservations nor enshrine pre-establishment rights. See on this UNCTAD 2004, Solé 2003, and Torrent and Molinuevo 2004.

[2] GATS-type positive listing requires signatory countries to take two steps when undertaking commitments: first, to identify the economic activities (services industries, and, in the case of the GATS also for the mode of supply) where they will take a commitment; second, to specify for each industry (and in the GATS also for the mode of supply) the particular restrictions they wish to apply, if any. The GATS-type approach is therefore called a hybrid approach. In principle, a third approach would be possible: that of "pure" positive lists, where countries would indicate the economic sectors that they wish to subject to the agreement's disciplines, with no further qualifications. It would be equivalent to entering a "none" limitation in each sector and sub-sector the country has listed in its schedule, without inserting any particular conditions or limitations on national treatment, market access or additional commitments for each of them. Such an approach has not, however, been used in IIAs concluded to date.

[3] Formula-based negotiations on investment liberalization may take into account, for instance, sectoral participation, contribution to GDP, total number of measures restricting FDI, and/or other quantitative elements. Thus, they may help to ensure a common basic degree of mutual liberalization between the parties, while deeper and more specific commitments can be pursued on a request-offer approach. While formulas can be used in the context of GATS-type positive lists as well, the binding of the regulatory status quo normally attained through negative listing would provide a more adequate background for their use as a liberalization mechanism. For a fuller discussion of formula-based approaches to services and investment liberalization, see Thompson 2000.

[4] In this context, the regulatory role of sub-national entities (states and provinces) is of considerable importance, particularly in federal countries. In fact, sub-national entities usually retain regulatory competences in a number of investment-related matters. In this regard it is instructive that NAFTA granted sub-national governments (states and provinces) two additional years to complete their negative lists of non-conforming measures, albeit without providing for technical assistance in the preparation of the lists. During the two-year period, NAFTA parties had agreed on a standstill clause for non-conforming measures applied at the sub-national level. At the request of Canada, and owing to concerns

expressed by a number of provincial governments over the extent to which all potentially non-conforming measures would need to be listed, including in the field of public services, NAFTA parties agreed not to produce negative lists at the sub-national level but to allow the maintenance of (i.e. to "grandfather") existing non-conforming measures.

[5] Such a provision can be found in Article 1108.1.c (Reservations and Exceptions) of the NAFTA, which reads as follows:

"Article 1108 Reservations and Exceptions

*1.*Articles 1102 (National Treatment), 1103 (Most-Favored Nation Treatment), 1106 (Performance Requirements) and 1107 (Senior Management and Boards of Directors) do not apply to:

(a) any existing non-conforming measure that is maintained by (i) a Party at the federal level, as set out in its Schedule to Annex I or III; (ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2; or (iii) a local government;

(b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or

(c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107. "

[6] This distinction refers to the difference between a host country's actual FDI policies (i.e. "applied") and the degree to which it subjects these policies to international commitments (i.e. "bound"). For instance, while a host country currently allows foreign investment in a certain economic sector without restrictions, it may nevertheless wish to preserve flexibility for introducing limitations in the future, and therefore take a reservation in the IIA.

[7] Such an approach can be found in a number of IIAs, notably those concluded among countries in the Western Hemisphere, starting with the North American Free Trade Agreement (see the depiction of so-called "Annex II" reservations of the NAFTA in the following section).

[8] Note that this is the case, except for activities to which Annex II reservations apply.

[9] While the exceptions cited correspond to the Canada-Croatia FIPA of 1997, they tend to be found in all IIAs entered into by Canada, whether at the bilateral, regional or multilateral levels.