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

CHAPTER II

UNITED NATIONS
New York and Geneva, 2006

II. REVEALED POLICY PREFERENCES: RESERVATION PATTERNS IN SELECTED IIAs

Having discussed the various methods IIA contracting parties can use for scheduling reservations and qualifying liberalization commitments, the study turns to the actual pattern of reservations, as they are found in the sample of negative list agreements. The subsequent analysis maps the investment policy preferences that are revealed by the reservation lists the parties have appended to the sample of eight IIAs. As mentioned above, the sample includes IIAs adopted by countries at various stages of economic development and comprises the following agreements:[1]

- Andean Pact (Decision 510): Bolivia, Colombia, Ecuador, Peru, Venezuela;
- Canada-Chile and United States-Chile Free Trade Agreements;
- G-3 Agreement: Colombia, Mexico, Venezuela;
- Mercosur Colonia Protocol: Argentina, Brazil, Paraguay, Uruguay;[2]
- North American Free Trade Agreement (NAFTA): Canada, Mexico, United States;
- OECD National Treatment Instrument (30 OECD members, plus 9 non-member countries);[3]
- Draft OECD Multilateral Agreement on Investment (negotiated between the Members of the OECD and with a few non-Member countries such as Argentina, Brazil, Chile, Hong Kong (China) and the three Baltic countries participating as observers, but never concluded).

As noted above, the analysis in this chapter is based on a sample of agreements that follow a negative list approach to scheduling non-conforming measures. The choice of this sample of IIAs is based on several considerations. First, agreements featuring a negative list approach are prevalent in number. Second, and especially important for analytical purposes, negative list agreements allow for a significantly clearer depiction of the regulatory preferences of contracting parties in the investment field. This is so because, as mentioned earlier, "top-down" IIAs typically generate reservations that bind the regulatory *status quo* prevailing at the time of an agreement's entry into force and thus imply that the level of policy consolidation can more easily be discerned. Overall, an effort was made to select a set of similar agreements, which should enable comparisons and conclusions to be drawn.

However, particular care must be taken when interpreting the results presented in this chapter of the study. Most importantly, such caution is required because of the inevitable measurement difficulties encountered in this type of exercise. Annex 2 summarizes a number of the methodological challenges faced in preparing the statistical information presented in this study and in the policy conclusions that can be drawn from such data. Along these lines, results should be interpreted more in the sense of describing general trends, rather than in their actual numerical values. Also, it should be kept in mind that different instruments do not necessarily impose identical obligations. Naturally, these differences impact on the content of the reservation lists. Moreover, countries are not always equally precise in their categorization of sectors: while some lodge reservations for specific services, others may prefer to lodge broader exceptions for sub-sectors. These different approaches result in huge differences in absolute numbers of reservations. It is therefore preferable to concentrate on percentages.

The investment-related measures in regard to which a reservation can be taken under the sample IIAs reviewed relate to the following disciplines: a) MFN treatment; b) national treatment; c) market access (i.e. non-discriminatory quantitative restrictions); d) performance requirements; e) movement of key personnel; f) right of establishment; and g) other.[4] The latter category includes measures such as nationality requirements applied to board of directors and measures relating to the operation of the agreements' dispute settlement provisions (especially investor-state dispute settlement).

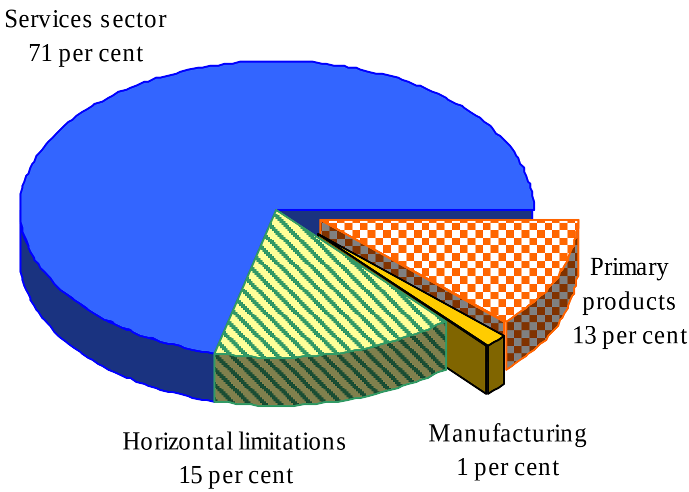
A. OVERALL PATTERNS OF RESERVATIONS

The empirical results (based on the reservation lists appended to the IIAs under review) indicate that out of the 4806 non-conforming measures scheduled under the eight sample IIAs, close to three quarters (71 per cent) are maintained in services. These are followed by so-called "horizontal" measures, which apply to investment in all sectors (the bulk of which also relate to services given their predominance in the gross domestic products of sample countries).[5] The number of reservations for services is six times higher than the number of reservations for primary industries (agriculture, mining and fisheries). Meanwhile, the results depicted in figure 1 reveal the negligible degree of investment restrictions directed towards manufacturing activities, which account for a mere 1 per cent of total non-conforming measures in the sample IIAs.

The above trend is clearly visible in figures 2 and 3, which provide a detailed breakdown of the sectoral incidence of non-conforming measures found in the individual IIAs of the sample. Figure 4 reveals a similar trend when looking across groups involving countries at different levels of development: the share of non-conforming measures in services ranges from 76.9 per cent in the case of Canada and the United States; and 81 per cent in the Latin American sample countries (Argentina, Brazil, Colombia, Chile, Mexico and Venezuela); to 94.1 per cent in the case of former transition economies that are now part of the EU (e.g. Czech Republic, Hungary, Poland). The high share of services reservations in transition economies might – to a large extent – be due to the number of restrictions applied to financial services. In fact, the financial services sector accounts for over a quarter of total reservations in services. Such a trend may not be surprising when one considers that countries transiting from a centrally planned to a market economy may want to preserve greater regulatory flexibility for sectors such as banking and insurance that had not operated as normal, commercially-based industries before. Similarly, a fair dose of regulatory precaution may originate from the adverse, economy-wide repercussions that market failure in this industry may bring about.

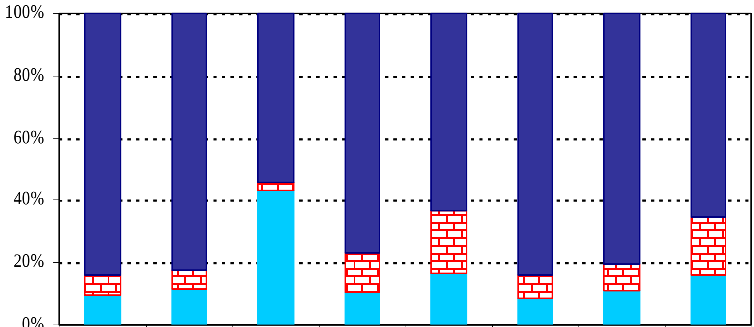
Figure 1. Reservations on investment by economic sector, total of all agreements

US-Chile, NAFTA, Mercosur, G3, Canada-Chile, Andean Pact, OECD NT Instrument, Draft MAI



Source: UNCTAD IIA database.

Figure 2. Composition of reservations on investment, by sector
(All agreements)

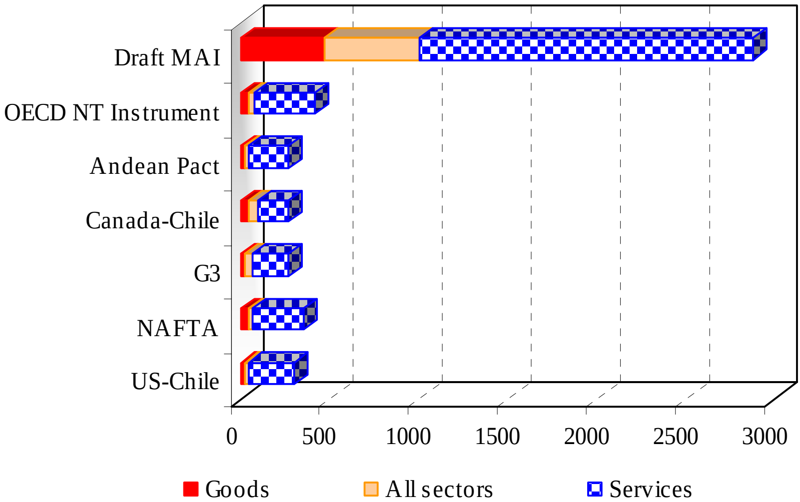


	US-Chile	NAFTA	Mercosur	G3	Canada-Chile	Andean Pact	OECD NT Instrument	Draft MAI
Services	253	295	20	208	174	224	335	1879
All sectors	20	21	1	35	55	20	36	534
Goods	28	42	16	28	45	23	45	469

Source: UNCTAD IIA database.

There may be several reasons for this higher incidence of reservations in the services sector. First, there is little doubt that the prevalence of services reservations reflects the higher average level of regulatory activity (as a result of the greater scope for market failure) encountered in many services markets.[6] The fact that policy sensitivities towards foreign ownership tend to be most pronounced in the services sector may also reflect the central role that industries such as finance, telecommunications and transportation play in economy-wide terms. The more political (and sometimes protectionist) sensitivities that prevail in sectors such as broadcasting, media and audio-visual services may be another reason. Similarly, service industries such as education, health and environmental services (e.g. water distribution) may be

Figure 3. Reservations on investment by agreement and sector[a/]

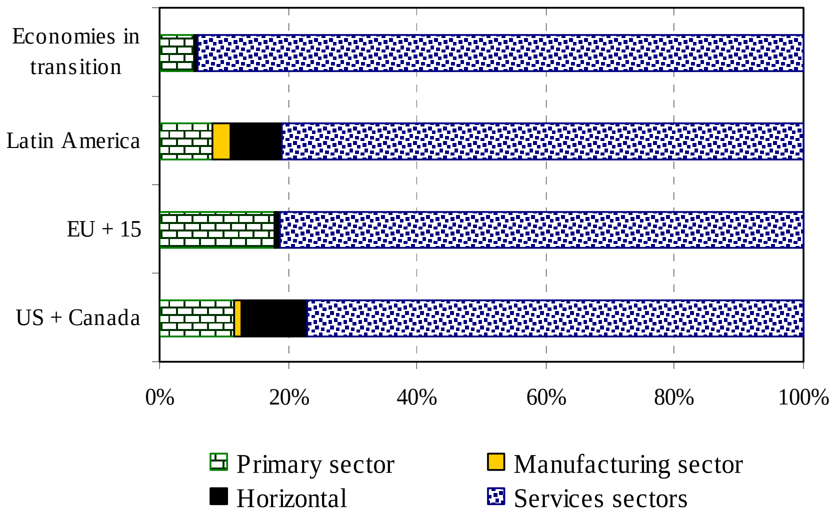


Source: UNCTAD IIA database.

a/ This figure does not include Mercosur due to the small number of reservations lodged under that agreement.

deeply embedded in countries' social contexts. This may often require a higher degree of governmental regulation and give rise to particular sensitivities regarding the role of private providers and foreign suppliers in such activities. Finally, the services sector encompasses a number of activities that have been, or still are, subject to state ownership, where monopolistic or oligopolistic market structures often prevail, or where foreign investment remains subject to close governmental scrutiny and prior approval procedures. To all this, one would need to add the fact that some two-thirds of aggregate FDI flows have in recent years been directed towards the services sector. With this in mind, it is perhaps less surprising that services would assume such prominence in the reservation lists of IIA contracting parties.

Figure 4. Reservations on investment by group of countries



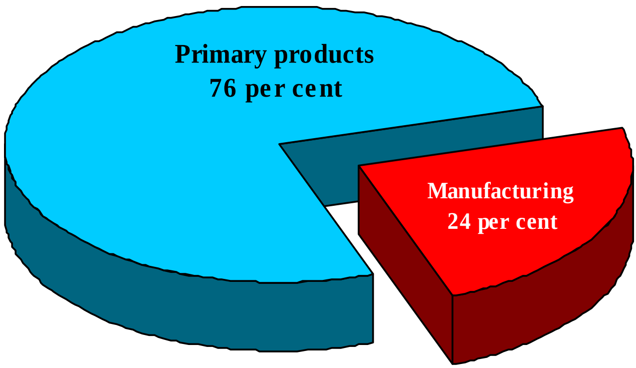
Source: UNCTAD IIA database.

By contrast, and as noted above, the amount of reservations found in the primary sector is comparatively small and in the manufacturing sector truly marginal. Agriculture, fisheries, forestry and mining (resource extraction) activities exhibit a higher degree of restrictions to foreign investment than does manufacturing. In part, this reflects policy sensitivities regarding ownership and exploitation rights in natural resource industries. This may, in turn, be an expression of both strategic and, increasingly, environmental concerns.[7] In fact, a significant number of reservations in the primary sector relate to protective policies concerned with the exploitation of natural resources. This is particularly the case for fisheries and agriculture. There are, however, important differences between these two primary activities: while restrictions to foreign investment in fisheries tend to be maintained by developed and developing countries alike, restrictions on investment in agriculture primarily concern developed countries.[8] As regards limitations on entry and operation in the oil and gas industry, these tend to be more prevalent in developing countries. This also reflects the fact that some developing countries are major exporters of energy, oil- and gas-related products. The exploitation of these energy resources and products is often in the hands of state-owned enterprises or otherwise subject to tight control by host country governments.

The manufacturing sector seems to be almost immune from the high level of explicit entry and post-establishment operation barriers found in services. Figures 5a and 5b document the extent to which goods-related investment restrictions arise in manufacturing as opposed to primary industries. Such a trend is most pronounced in developed countries, where restrictions in primary industries dwarf those applying to manufacturing by a factor of 19 to 1. The corresponding ratio is notably lower for developing countries, where restrictions in primary activities nonetheless still outstrip those found in manufacturing by a 3 to 1 ratio.

The policies of openness and non-discrimination, which countries maintain with respect to investment in these sectors is – to some extent – matched by the circumstances prevailing in international trade in industrial goods.[9] Indeed, manufacturing is the area where foreign investors are most likely to enjoy better than national treatment, benefiting from various targeted fiscal incentives aimed at attracting and retaining foreign investment in host economies. Contrary to performance requirements, the latter policies are generally not subject to specific IIA disciplines. Broadly, this is also true with respect to the WTO. The WTO's Agreement on Subsidies and Countervailing Measures (SCM) introduces only indirect and narrow disciplines on the trade-distorting effects of investment incentives, not covering fiscal incentives (Sauvé 1997).

Figure 5a. Reservations in goods-related activities
Developing countries

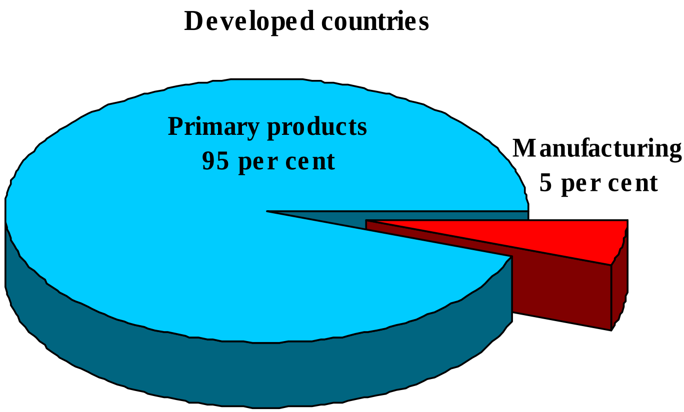


Source: UNCTAD IIA database.

Finally, there are the horizontal reservations, which account for 15 per cent of total reserved measures (see figure 1). Most of them relate to investment screening and prior approval/licensing requirements governing the establishment of foreign-owned enterprises and the acquisition of a domestic enterprise by a foreign one. They also relate to discriminatory requirements for eligibility for domestic subsidy programmes. In fact, such programmes frequently take the form of preferential loans, which are reserved to firms that are owned and/or controlled by nationals. Finally, horizontal limitations are often implemented for statistical and general monitoring purposes.

The overwhelming share of reservations found in the services sector suggests the need to take a closer look at their nature, sectoral incidence and differing patterns (if any) across countries at differing levels of development. The next section will aim to address these aspects.

Figure 5b. Reservations in goods-related activities



Source: UNCTAD IIA database.

B. SERVICE SECTOR RESERVATIONS

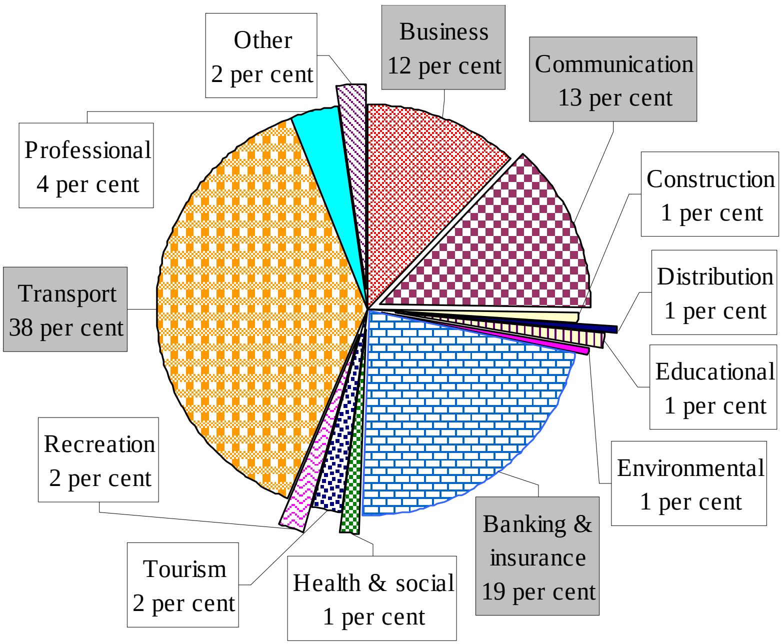
1. Sectoral incidence

Certain services sectors can be particularly sensitive for host countries' social and economic development. Financial (banking and insurance), communications and other infrastructure services, as well as health, educational or sanitation services may serve as examples. As a result, governments may be reluctant to undertake extensive international obligations, if the latter could affect the regulation of these sensitive services activities. Reservation lists provide useful barometers for assessing cross-country differences in the nature and sectoral incidence of policy sensitivities related to investment in services.

As figure 6 reveals, four services industries (out of an aggregate 12 categories) account for an overwhelming share of the total non-conforming investment measures in this study's sample of IIAs. Transportation, banking and insurance, business services[10] and communications account for a combined 82 per cent of total non-conforming measures listed in the services sector. Amongst the four, the transport industry is by far the most restrictive, accounting for close to two out of every five (38 per cent) impediments found in the sample reservation lists. Financial services accounts for another fifth (19 per cent) of total non-conforming measures.

The reservation pattern depicted in figure 6 begs the question why transportation stands out as a sector in which the preference to preserve flexibility is so pronounced. Transport services have long been carved out of broader trade agreements as countries have typically pursued bilateral negotiations (the objective of such bilateral approaches being both to exchange reciprocal market access opportunities and to limit competition in the fields of air, maritime and land transport). The high incidence of transport sector reservations is even more surprising when one considers that the air transport sector is broadly excluded from the scope of most IIAs covering the pre-establishment phase, as is the case under the GATS. In fact, this would suggest that few reservations are actually lodged under this transport mode. Rather, the bulk of non-conforming measures relate to maritime transport services, particularly in respect of cabotage-related matters[11] and inland waterways, as well as land transport (bus, truck and rail services) and to a range of services incidental to both transport modes.

Figure 6. Reservations on investment in services by sector
All agreements



Source: UNCTAD IIA database.

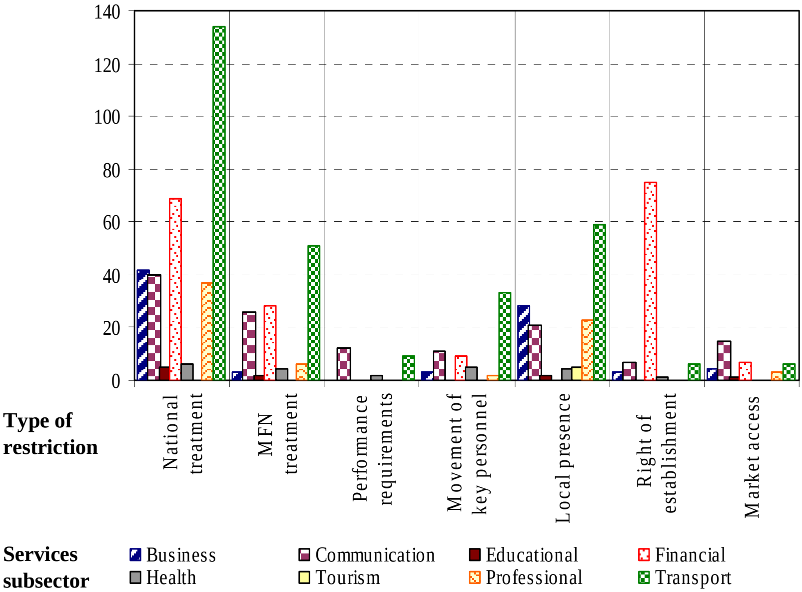
In the IIAs under review, several reservations in transportation services are common across countries and agreements. Figure 7 shows that the most common treaty obligations against which reservations are lodged in the sector relate to national treatment, local presence (i.e. forced establishment requirements), MFN treatment and, to a lesser extent, movement of key personnel. Some of the most common restrictions cover the:[12]

- *maritime transport sector:* 1) maritime transport reserved to national flag vessels; 2) only national companies or persons may acquire national flag vessels.
- *road transport sector*: 1) cabotage and other transport services are reserved to national hauliers, unless otherwise agreed in bilateral and multilateral agreements.

Also financial services exhibit considerable regulatory sensitivities. These sensitivities and the leading role that foreign investment (commercial presence) assumes in contesting financial markets are revealed by the fact that all sample countries, developed and developing, have lodged numerous reservations in this sector. Financial services reservations relate to three core IIA obligations: national treatment, MFN treatment and the right of foreign financial institutions to establish a presence in a host country (see figure 7). Limitations on foreign equity participation top the list of national treatment limitations in the sector. Such limitations aim to ensure some degree of national control over an activity that may constitute the backbone of an entire economy.

Limiting MFN treatment through reciprocity requirements is another frequently encountered measure in the financial industry. These MFN reservations may be due to the large number of reciprocal arrangements (for both market access and prudential reasons) maintained in the sector. The fact that the financial services sector is, among all service sectors, the one where the highest number of entry (i.e. right of establishment) barriers are maintained, particularly by developing countries, suggests that many host countries are concerned about the need to regulate and properly circumscribe the nature and extent of competition in domestic financial markets. However, such limitations may also reflect successful lobbying by incumbents, domestic and (often) foreign, to limit the prevailing level of competition in financial markets either by restricting the number of new entrants or by raising their cost of entry.

Figure 7. Reservations on services by type of measure
(US-Chile, NAFTA, Mercosur, G3, Canada-Chile agreements)



Source: UNCTAD IIA database.

The need for broader national regulatory space can also be found in the areas of business and communication services. In both sectors, national treatment limitations that allow discriminatory measures (those favouring domestic over foreign firms) are the most common types of reservations. They are followed by measures relating to local presence, which is frequently required as a pre-condition for obtaining a license to operate. Such requirements are also prevalent in professional services and typically respond to consumer protection imperatives. Consumer protection measures may respond to the potential for market failures, which, in turn, arise from the considerable information asymmetries between users and suppliers of professional services.

Also the communication sector features a number of reservations limiting MFN treatment. More specifically, these relate to existing (or future) co-production agreements in audio-visual services. Communications is also the service sector with the greatest number of reservations relating to non-discriminatory quantitative restrictions (so-called "market access" limitations). This may reflect the particularities of telecommunications as a sector in which monopolistic and, especially oligopolistic, market structures have prevailed for a long time. Similarly, the high number of such reservations may reveal the fact that in telecommunications, regulatory concerns relate to issues such as anti-competitive practices and the need to guarantee the supply of public services to the domestic population.

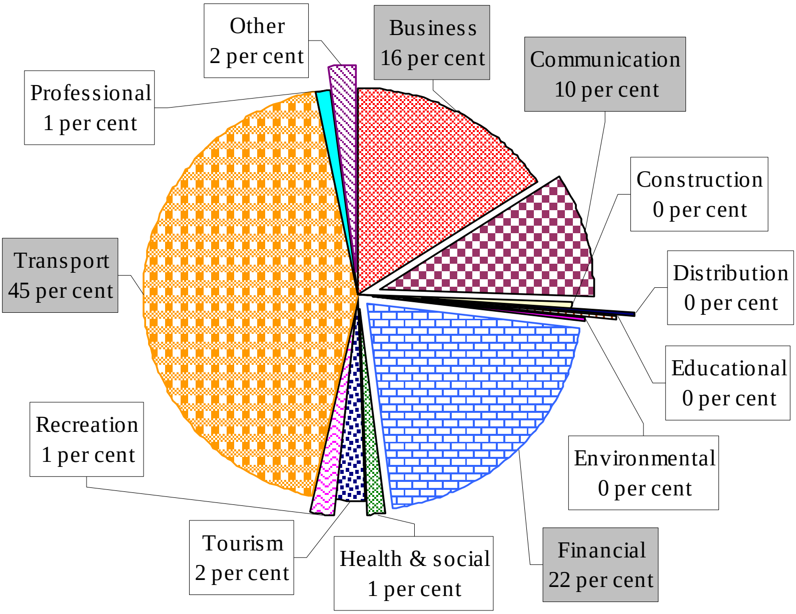
Reservations are also found in sectors such as recreation, tourism, health, social, education, and construction services, but they tend to be less significant in number. Reservations on recreation services relate mainly to gambling services, a sector that is often subject to strict governmental screening and licensing procedures and where the establishment of foreign enterprises and national treatment are of sensitive nature. The limited number of reservations in health, social, education and environmental (water distribution) services may – at a first glance – be surprising. However, the low incidence of reservations must be correlated to the overall paucity of liberalization commitments in these sectors and to the fact that large elements of these sectors are considered to be carved out from the IIA. In many IIAs this happens in a manner analogous to Article I.3.b of the GATS which excludes services supplied in the exercise of governmental authority (OECD 2002, UNCTAD 2004). Many of these services are key to a society's human development and its economic competitiveness and they display strong public goods characteristics. Therefore, governments frequently impose universal service obligations, aimed at extending the service to the poor and marginalized segments of society. While significant policy differences arise across countries regarding the most appropriate means (and adequate market structures) to secure compliance with the above objectives, there seems to be an overall consensus that careful regulation, appropriate flexibility, and precaution under IIAs may be warranted in these sectors.

Also distribution services are noteworthy. Distribution is a sector where, apart from Mexico, hardly any reservations have been lodged by the developing countries in the sample. This is somewhat surprising given the potentially dislocating (e.g. crowding-out) effects that the entry of large-scale distributors can have for smaller domestic competitors. Apart from financial services, distribution services are one sector that features prominently in ongoing discussions, particularly under the GATS, on the desirability of developing emergency safeguard mechanisms. Such mechanisms could constitute a tool to help address unanticipated dislocations resulting from service sector liberalization commitments.

2. Cross-country incidence

The data in figures 8 and 9 offer a contrasting perspective on the sectoral incidence of service sector reservations in developed and developing countries. The figures reveal a series of interesting aspects. First, the four sectors that account for the vast majority of aggregate reservations are transport, finance, business, and communications services (suggesting that these are also the sectors where the bulk of non-conforming measures is found). This applies to both developed and developing countries. However, the relative importance of these sectors differs significantly according to income levels. Finally, the four leading sectors account for a

Figure 8. Patterns of services sector reservations
Developed countries

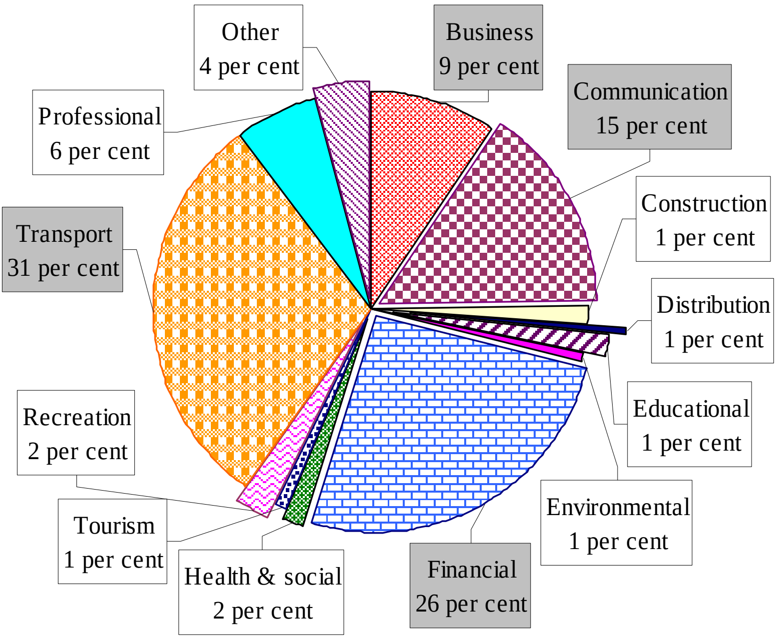


Source: UNCTAD IIA database.

larger share of total reservations in developed countries (93 per cent) compared to developing countries (81 per cent). For developing countries, their preference for preserving flexibility spans a broader set of service sectors.

Figure 9. Patterns of services sector reservations

Developing countries



Source: UNCTAD IIA database.

A comparison along income lines also reveals the significantly higher share of transport-related restrictions in developed countries, where they account for 45 per cent of all service sector reservations, as opposed to 31 per cent in developing countries. Also noteworthy is the greater incidence of non-conforming measures maintained by developing countries in the communications sector, where they account for roughly one in 7 non-conforming measures (or 15 per cent of the total), as opposed to one reservation in ten (10 per cent) in developed countries.

The data also show that the incidence of reservations in financial services is extensive in both developed and developing countries. However, the latter exhibit a higher average share of non-conforming measures in the sector (26 vs. 22 per cent). Such a difference may be expected given the less developed nature of domestic financial markets and regulatory institutions in developing countries and the greater regulatory precaution that financial market turmoil has induced in many emerging market economies in the wake of the 1997-1998 Asian financial crisis.

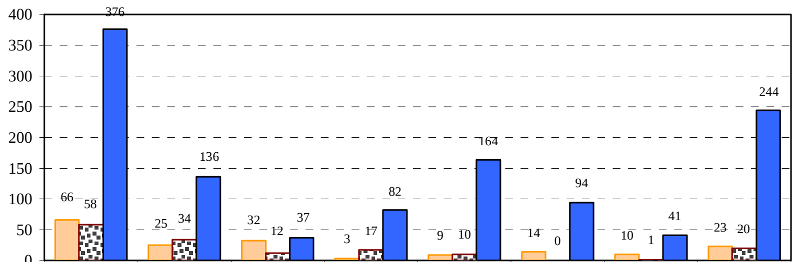
C. RESERVATIONS BY TYPES OF INVESTMENT LIMITATIONS

Figures 10 and 11 offer a closer look at the aggregate number of reservations lodged in the eight IIAs as well as their distribution across broad sectors of economic activity. At the same time, these two figures focus on the types of treaty obligations to which the reservations are linked. The two charts show that national treatment limitations (allowing differential treatment on the basis of nationality with a view to favouring domestic over foreign investors) are the most prevalent form of reserved measures affecting investment in both goods- and services-related industries. Among the other leading types of investment-related reservations, the most frequently encountered concern the MFN treatment principle, local presence (i.e. mandated establishment) requirements, as well as restrictions on the movement of key personnel and on the right of establishment.[13] The figures also reveal that market access limitations (i.e. non-discriminatory quantitative restrictions) and performance requirements stand out as the least scheduled measures.

Figure 10 reveals slight differences in the leading types of non-conforming measures affecting investment in goods- and services-related industries. The top three types of investment regulation in services industries are: first national treatment, then local presence requirements and, finally, MFN treatment. For goods-related investment in turn, the ranking of the principal obligations prompting host country governments to lodge reservations is: first, national treatment; second, prohibition of performance requirements; and third, MFN treatment.

Figure 10. Reservations on investment by type of measure

US-Chile, NAFTA, Mercosur, G3, Canada-Chile agreements - absolute numbers



	National treatment	MFN treatment	Performance requirements	Movement of key personnel	Local presence	Right of establishment	Market access	Other / not identified
Goods	66	25	32	3	9	14	10	23
All sectors	58	34	12	17	10	0	1	20
Services	376	136	37	82	164	94	41	244

Source: UNCTAD IIA database.

The limited extent of market access barriers would appear to suggest that host countries tend to be less concerned with restrictions on the number of entrants in key industries (i.e. on the level of competition in the home market) than with the conditions under which such competition unfolds in the post-establishment phase. The heavy reliance on national treatment limitations and other measures favouring domestic over foreign investors suggests a desire by host country governments to help national firms withstand the competitive pressures stemming from foreign (and new) entry. It may also suggest the political sensitivity of sectors considered to be of strategic importance.

The data presented in figure 10 also reveal that limitations placed on the movement of persons are negligible in goods-related industries. However, their incidence is significantly higher in services-related investment, a pattern that is also typical for local presence requirements. Such differences can be attributed to important differences between services and manufacturing activities. In the case of local presence requirements, one must recall the greater regulatory intensity of service sector activities and the corresponding preference of host country regulatory authorities to see foreign firms establish a presence (so as to facilitate – and indeed make possible – the exercise of jurisdictional authority over their operations and ensure that the latter comply with national policy and regulatory objectives).

As regards the movement of key personnel, the limited number of reservations applied to investments in goods-related industries reflects – to some extent – the horizontal manner in which many host countries' immigration and labour market policies are framed and implemented. Possibly, it also highlights the fact that the occupational categories that most likely require temporary entry in manufacturing (intra-company transferees, specialists, managers) typically encounter few obstacles. Amongst others, this might be due to the fact that they are deemed essential to the establishment and operation of a foreign investment and that they typically account for a small fraction of total employment in foreign manufacturing firms (since key personnel from abroad do not usually compete with factory plant workers). This is not true for FDI in many service sectors, given the higher average level of skills involved, the smaller average size of firms and the greater potential for foreign workers to compete directly with – and possibly displace – skilled local personnel. The latter may explain – to some extent – the relatively high incidence of training-related performance requirements observed in services- industries.

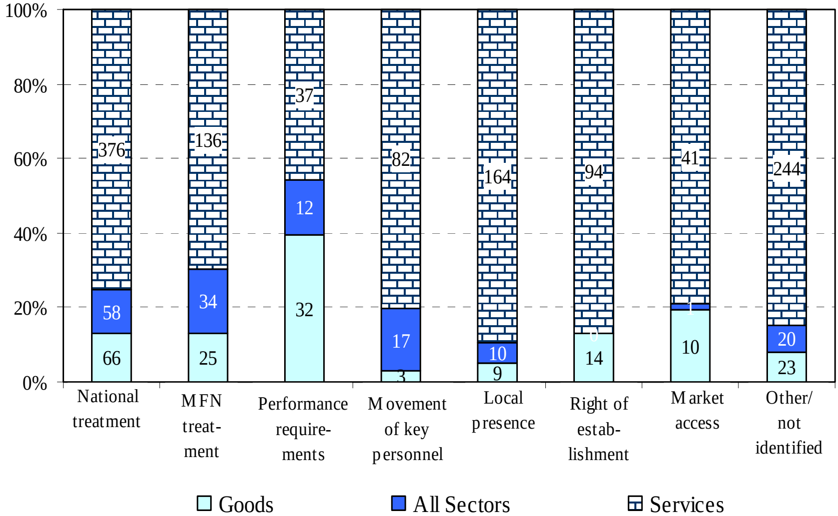
The primacy of services as the main sector of investment-related reservations is clearly visible in figure 11. Two aspects warrant particular attention. First, for services, the prevalence of reservations is highest for measures that mandate a local presence in order to supply host country markets and for measures that restrict or limit the right of foreign investors to establish themselves in host country markets. Second, there is a higher share of performance requirements affecting service industries as opposed to goods-related sectors (primarily manufacturing). While some recent IIAs ban, in principle, the use of performance requirements in both goods- and services-related industries (and hence compel contracting parties to reserve existing non-conforming measures if they wish to maintain them), in the multilateral context, such disciplines currently only apply to investments in goods-related industries under the WTO Agreement on Trade-Related Investment Measures (TRIMs). For the most part, service sector performance requirements relate to training requirements, aimed at enhancing the level and quality of human resources in capital importing countries.

D. NORTH-SOUTH COMPARISON

As regards the most common types of non-conforming measures reserved by countries according to their level of development, the revealed policy preference of host countries appears broadly similar

Figure 11. Reservations on investment by type of measure

US-Chile, NAFTA, Mercosur, G3, Canada-Chile agreements - percentage distribution



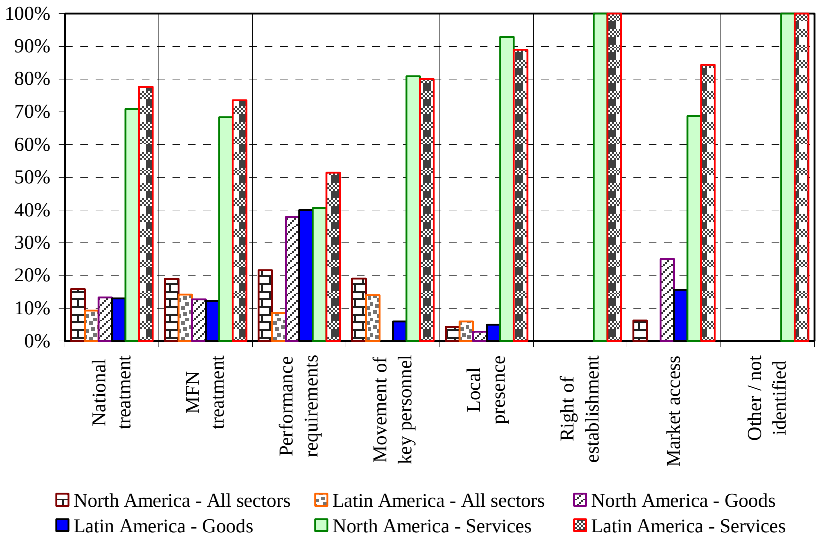
Source: UNCTAD IIA database.

along North-South lines. Such findings emerge from comparing reservation patterns that characterize a subset of developed (Canada and the United States) and developing (Chile, Colombia and Mexico) countries in North and Latin America. Indeed, while some differences along North-South lines can be discerned regarding the sectoral incidence and types of reservations lodged, Figures 12 and 13 reveal remarkably similar reservation patterns between the two country groupings. This trend characterizes investment in both goods- and services-related industries.

The three Latin American countries featured in figures 12 and 13 (the combined size of whose economies is significantly smaller than that of their two Northern neighbours), nonetheless tend to lodge a greater overall number of reservations, and they do so across all covered sectors. This would appear to reflect a cautious policy stance towards FDI in general and towards service sector liberalization in particular. It may also mirror their greater (perceived) need for flexibility, resulting from infant industry-type concerns in a number of key sectors. Finally, it may reflect the wish to preserve flexibility for future regulatory purposes in areas where they may not yet possess solid or fully developed regulatory frameworks and implementation capacities.

Figure 12. Reservation by type of measure, sector, and group of countries

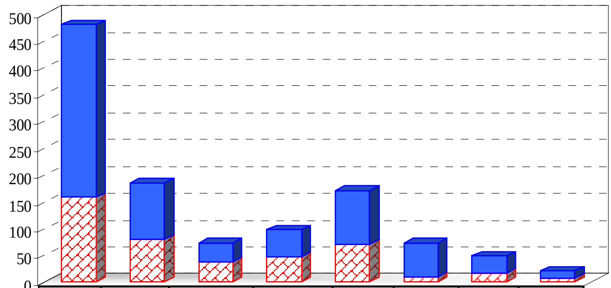
North America = United States, Canada LatinAmerica = Colombia, Chile, Mexico



Source: UNCTAD IIA database.

Figure 13. Reservations by type of measure and group of countries

Absolute numbers



	National treat-ment	MFN treatment	Performance require-ments	Movement of key personnel	Local presence	Right of estab-lishment	Market access	Other/ not identified
Latin American countries (MEX+CHI+COL)	322	106	35	50	100	63	32	12
North American countries (US+CAN)	158	79	37	47	70	10	16	8

Source: UNCTAD IIA database.

Reservations may also correspond to internal pressures for continued protection. Such pressures may originate from economic and political constituencies (including foreign affiliates as well as bureaucracies) that may view investment liberalization and the expected rise in competition as a direct threat to their privileged positions. While such pressures may arise in all countries, developing countries may be particularly vulnerable to them, given the higher degree of political and economic concentration that characterizes many of their economies.

The three Latin American countries seem to make greater use of horizontal measures applying to all sectors. In their Northern counterparts, reservations tend to be lodged with greater sector-specificity across goods- and services-related industries. However, the sectors in which such reservations concentrate tend to be broadly similar, with transport, finance, business, and communications services leading the way in both country groupings.

The data in figure 13 confirm national treatment as the policy instrument most commonly used by host country governments to preserve flexibility. In fact, national treatment accounts for some 37 per cent of reservations for North American countries and for 45 per cent of the three Latin American countries' reservations. Performance requirements are the only category, in which Canada and the United States maintain a higher absolute number of reservations than the three Latin American countries.

The finding that North American countries maintain a share of reservations on performance requirements that is greater than that of their Southern counterparts may come as a surprise: in fact, the elimination of performance requirements has traditionally been considered a Northern interest. This is particularly the case of United States' investors, who fought hard for the establishment of the WTO’s TRIMs Agreement during the Uruguay Round. The scope of the TRIMs disciplines is limited to the trade-distorting effects of investment in goods-related activities but no reservations can be lodged under it – unlike IIAs negotiated at the bilateral or regional level.

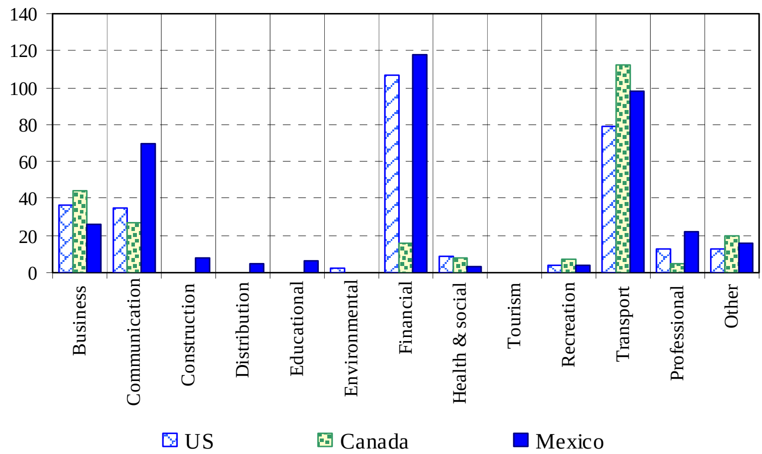
The trends depicted above are confirmed when looking more closely at chapter XI of NAFTA, which features comprehensive disciplines on both the protection and the liberalization of cross-border investment activity and which links the three economies of Canada, the United States and Mexico, at differing levels of development.

The complex set of reservations as established in NAFTA's investment chapter was described in chapter I of the study. Figure 14 provides a synthetic reading of some of the key features of the non-conforming measures related to foreign investment in services scheduled pursuant to Annex I of the chapter (focusing on existing non-conforming measures). It shows, once more, that the bulk of non-conforming measures is found in the same four sectors (i.e. transportation, financial, business and communication services). Financial services concerning Canada are an exception. Here, the lower share under NAFTA masks the fact that many non-conforming measures, especially in insurance and securities services, are maintained at the sub-national (i.e. provincial) level.

Figure 14 also confirms the tendency for developing country IIA contracting parties – Mexico in this case – to preserve a greater overall level of flexibility by inscribing a higher absolute number of non-conforming measures than its two developed country partners. This is the case both in overall terms as well as for all but one of the specific industries in which service sector reservations can be lodged, namely recreation services.

Figure 14. Reservations on investment in services

NAFTA countries - absolute numbers



Source: UNCTAD IIA database.

To sum up, this chapter showed that the overwhelming majority of reservations is found in the services sector, amounting to almost three-quarters of total reservations. This reflects the higher level of regulation at the national level. Reservations in the manufacturing sector are negligible, with a share of just 1 per cent. Limitations on the exploitation of natural resources account for 13 per cent and most of them fall in the areas of fisheries and agriculture. Horizontal measures take the rest, amounting to 15 per cent.

When looking at the sectoral incidence of reservations on services, it is notable that four industries (i.e. transportation, financial, business and communications services) account for 82 per cent of the total limitations. Restrictions on transportation take the lead, with 38 per cent. This is despite the fact that air transport is usually carved out of IIAs. These four sectors also stand out as the most restrictive ones when countries are grouped by income level (i.e. developed/developing). However, their relative importance differs across countries: developing countries tend to lodge more restrictions on communications services and financial services than do developed countries. This tendency is reversed in the case of transport services and business services.

Among the different types of restrictions that countries apply, limitations to national treatment are most frequently used, both by developing and developed countries. Other commonly found restrictions concern MFN treatment, local presence (i.e. mandated establishment), the right of establishment and limitations on the movement of key personnel. Market access limitations and performance requirements stand out as the least scheduled measures.

Limitations on national treatment are the most frequent measures in services and goods; they are also the most frequent among horizontal measures. In services, national treatment limitations are followed in importance by local presence requirements and restrictions to MFN; in goods, these positions are occupied by performance requirements and MFN limitations. Surprisingly, however, a higher absolute number of performance requirements falls on services than on goods-related activities. Limitations on the movement of key personnel fall mostly on services activities, their incidence being negligible in the goods sector.

A North-South comparison limited to the American continent confirms the general finding that reservations from developed and developing countries present similar patterns, but that the latter tend to lodge a greater number of them across all sectors. This seems to reflect the greater need of developing countries for flexibility.

Notes

[1] See Annex 1 for a short depiction of each agreement's key characteristics.

[2] Venezuela has recently been accepted as a new member. However, the Mercosur membership has not yet become effective.

[3] The non-OECD countries that are parties to the National Treatment instrument are Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania, Romania and Slovenia.

[4] See with regard to this categorisation: Annex 2 - A Word of Methodological Caution.

[5] Indeed, if the share of horizontal reservations is apportioned according to the average share of services- and goods-producing sectors in the GDP of the sample countries, then the aggregate share of service sector reservations stands at 82.2 per cent, while that of goods-related reservations stands at 17.8 per cent. Viewed this way, slightly more than

four out of five non-conforming measures maintained in investment agreements affect services industries.

[6] For a fuller discussion of regulatory intensity in services and its impact on trade and investment activity, see Mattoo and Sauvé 2003.

[7] While environmental reasons are frequently cited as a reason for domestic regulation, few of the reservations reviewed relate directly to environmental concerns. To some extent, this may reflect the fact that the potentially trade- and investment-adverse impacts of environmental regulations tend to be addressed by general exception clauses common to most IIAs. It is also a reflection of the fact that, by and large, environmental regulation is essentially non-discriminatory in nature

[8] The bulk of investment restrictions in fishing consists of: a) limitations or bans on the establishment of foreign companies; and b) limitations on the nationality of the vessels (flagged vessels) that can be registered for fishing purposes.

[9] The liberal regime in international trade and FDI in manufacturing contrasts with the significantly more restrictive situation found in agriculture, where restrictions upon foreign investment are common in reservation lists, taking the form of various deviations from national treatment and restrictions on the acquisition of rural land by foreign individuals or corporate entities.

[10] According to the WTO's Services Sectoral Classification List "business services" include professional services, computer and related services, research and development services, real estate services, rental/leasing services without operators, and other business services. For the purpose of the present study, professional services have been listed separately because of their economic importance.

[11] Cabotage refers to the practice whereby a transport services provider may take on transport services between two points within a foreign country.

[12] The transportation-related measures depicted below are taken from the OECD National Treatment Instrument.

[13] IIAs do not generally allow contracting parties to lodge reservations on investment protection clauses, such as those relating to transfer of funds or guarantees against expropriation. Reservations normally relate to liberalization commitments, which originate in the various economic characteristics of host countries and in the political economy of specific sectors. Protection obligations, in turn, are absolute

in nature and apply across the board to all economic activities. The rationale for excluding certain sectors from investment protection is generally weak, as it would imply that a government may expropriate in selected areas without offering affected foreign investors due compensation. Recent BIT models, particularly those of the United States and Canada, include a provision stating that non-discriminatory regulatory initiatives for legitimate public policy objectives would not constitute an expropriation except in extraordinary circumstances. These provisions, however, do not constitute exceptions to such agreements. Rather, they form part of the agreement, for purposes of clarifying the meaning of key policy aspects (such as the scope of indirect expropriation) as well as for interpretative purposes in the case of an investment dispute.