Analytical Note
SC/TDP/AN/EPA/24
April 2010

Original: English

THE EUROPEAN UNION AND UNITED STATES' APPROACH TO INTERNATIONAL INVESTMENT AGREEMENT WITH DEVELOPING COUNTRIES: FREE TRADE AGREEMENTS AND BILATERAL INVESTMENT TREATIES

SYNOPSIS

The purpose of this Analytical Note is to contribute to a better understanding of the changes that are taking place in the international normative framework on investment through surveying the European Union and United States' FTAs with developing countries. This Note analyses the EU and US approach to investment issues in FTAs and examines the interactions between their provisions and those of BITs. In this manner it is hoped that the study will assist policymakers in making informed decisions regarding the negotiation and application of all types of international investment agreements (IIAs).

April 2010
Geneva, Switzerland

The South Centre thanks the Heinrich Boell Foundation (HBF) for collaborating in the research of this paper.

This Analytical Note is produced by the Trade for Development Programme (TDP) of the South Centre to contribute to empower the countries of the South with knowledge and tools that would allow them to engage as equals with the North on trade relations and negotiations.

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TABLE OF CONTENTS

I. INTRODUCTION

1. The recent expansion of Free Trade Agreements (FTAs) covering a variable range of economic transactions has been identified in the literature as a major new phenomenon with potentially profound implications for international economic relations. North-South Agreements, notably FTAs involving the United States and the European Union have been important drivers. Over the last decade, more than 130 FTAs have come into existence, a large number of which the United States (U.S.) and the European Union (EU) negotiated with developing countries. Examples involving the United States are FTAs with Chile, Central American States, Jordan, Singapore and Morocco. The EU engagement in FTAs is even more intensive, with more than 100 FTAs (completed or underway) as of August 2009. An important characteristic of recent FTAs is that, while trade remains their principal component, they increasingly address an expansive set of investment issues.[1]

2. At the same time, there are about 2,619 Bilateral Investment Treaties (BITs) in force. However, since 2001 the number of BITs concluded annually has shown a constant downward trend. This development contrasts with the surge in FTAs and other treaties on economic cooperation containing investment provisions. [2]

3. Mainly owing to the emergence of the FTAs, the scope of issues covered by investment-related treaties is expanding. They are no longer limited to investment issues per se, but also deal with related matters such as trade in services, competition, intellectual property and industrial policy. This trend is a manifestation of the globalization strategies being pursued by the more developed countries in response to the increasing global competition for resources and markets facing national economies.

4. Investment rules in FTAs are increasingly comprehensive and complex, and especially since investment is only one of various disciplines addressed by these agreements, investment provisions of FTAs sometimes interact such that the full impact of a provision cannot be determined by reading that provision alone.

5. The purpose of this Analytical Note is to contribute to a better understanding of the changes that are taking place in the international normative framework on investment through surveying the European Union and United States' FTAs with developing countries. This Note analyses the EU and US approach to investment issues in FTAs and examines the interactions between their provisions and those of BITs. In this manner it is hoped that the study will assist policymakers in making informed decisions regarding the negotiation and application of all types of international investment agreements (IIAs).

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[1] UNCTAD (2006) *Investment Provisions in Economic Integration Agreement* at p. 1
[2] UNCTAD (2008) *The Development Dimensions of International Investment Agreements* at p. 2

II. DEFINITION OF TERMS

6. FTAs that define investment have used three types of definitions:

a. **Asset-based definition.** FTAs that are directed at the protection of investment tend to define "investment" broadly, covering the various types of assets that might need to be protected during the life of the investment. They use an asset-based definition similar to that which appears in BITs. Such agreements tend not to include a right to establish investment. The broad, asset-based definition typically defines investment as "every kind of asset" and then adds an illustrative list of assets that are included in the definition. As this language indicates, the broad definition includes portfolio as well as direct investment.
b. **Transaction-based definition**. This type of definition is found in FTAs that concern the liberalization of cross-border financial flows through which an investment is made.
c. **Enterprise-based definition**. FTAs that concern the liberalization of investment have tended to define investment in narrow terms, insisting on the element of control over the enterprise as a key element of the concept. An example is the FTA between Chile and the US. Article 10.6 of that FTA provides that a Party may require that a majority of the board of directors, or any committee thereof, of an enterprise of that Party that is a covered investment, be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment.

7. These definitions are not mutually exclusive. In fact the EU and US approach to FTAs contains elements of all three definitions. As will be elaborated upon in the following sections, the EU and US practices in FTAs with developing countries seek both to liberalize and to protect investments. A lot of difficulties arise when an FTA both protects and liberalizes investment flows, since in these cases the host country surrenders a significant part of its ability to exclude undesirable investment.

III. THE EU AND US APPROACH TO INVESTMENT

A. Scope and Coverage

8. As compared to FTAs, BITs address a more limited number of issues and tend to be quite uniform in their approach to investment issues. BITs mainly deal with minimum standards of treatment, including fair and equitable treatment and protection and security. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. Therefore BITs usually cover post-establishment investment measures, or in other words, the treatment

of foreign investments after they have been established or admitted in the host country. For example the BIT between Namibia and Spain specifically refers to this post-establishment phase by stating that the MFN and national treatment principle applies with regard to the "management, maintenance, use, enjoyment or disposal" of investments. BITs do not usually regulate the access or admission of foreign investments into the host country and typically allow for investments in accordance with the domestic regulatory framework.[3] For BITs that do not give protection to pre-establishment, domestic laws and regulations will therefore still have to be consulted to determine the precise conditions for the entry and establishment of foreign investments.[4] FTAs, on the other hand, reflect more variation in their scope and content. The CARIFORUM – EC EPA for example deals very extensively with investment and trade in services, and there are provisions or chapters in it on topics such as competition policy, intellectual property and government procurement.

9. A basic common characteristic of the EPA –and one that is not found in BITs – is that these agreements typically set in motion a dynamic process whereby they will achieve their aims of opening up a domestic market to foreign investors. As the impossibility of implementing an ambitious agenda at the time of conclusion of the agreement is realized, procedures are established with the help of institutional mechanisms that are intended to ensure the implementation of the agreement's objectives over time. Article 62 of the CARIFORUM EPA ensures that there is an inbuilt requirement for new negotiations to begin within five years to 'enhance' the overall commitments on investment and trade in services. Thus the 'final' comprehensive EPA is only the first stage of a process of ongoing negotiations between CARIFORUM and the EC for the liberalization of investment and trade in services. Another negotiating round must begin within five years. This is the approach followed by the agreements between the EU and developing countries.

10. Furthermore, the EU's proposals include provisions intended to regulate investment. The most common provision of this kind is one intended to limit practices that restrict or distort competition. Chapter 1 of Title IV (on Trade Related Issues) of the CARIFORUM EPA text is a separate chapter on competition. It obligates the EPA parties to (i) proscribe "anticompetitive

[3] As will be mentioned later in the paper, there are BITs, such as those by the United States, and also Canada and Japan where national treatment to investors wishing to establish and invest or to make an acquisition of an existing enterprise have been granted. In the case of Canada, decisions taken by host states in relation to questions about establishment, however, are not always eligible for arbitration under the BITs' dispute settlement rules. (Peterson, E 2004, 'Bilateral Investment Treaties and Development Policy-Making', IISD).

[4] Once an investor is established however, some BITs do prohibit certain performance requirements. For instance, Japanese BITs prohibit rules which dictate that individuals of a given nationality be appointed to executive, managerial or directorial roles; duties to achieve a given level of research and development in a given territory; and requirements that a regional or world headquarters be located in the host state's territory (Peterson L 2004 'Bilateral Investment Treaties and Development Policy-Making', IISD).

business conduct", (ii) requires each party to maintain an authority responsible for enforcing its national competition laws, and (iii) to reform state enterprises or the conditions under which they operate to refrain from discriminating against EU firms, goods and services. Essentially, this means that foreign investors are to be given national treatment or equally competitive conditions as domestic investors. There are also competition provisions littered throughout Title II – the Investment, Trade in Services and E-Commerce section of the EPA. Such competition regulations requiring national treatment and equal conditions for foreign investors are not likely to be suitable for countries that are still trying to nurture their fledgling domestic suppliers.

11. Scheduling of investment commitments in the FTAs differs depending on the Agreement signed. The US NAFTA introduced the negative list approach, where all sectors are opened except sectors and subsectors where non-conforming measures are listed.

12. In the CARIFORUM-EU EPA, scheduling was complex and rather messy. There are two separate schedules covering investment liberalised by the CARIFORUM. One (Annex IV E) deals with only what is called 'non-services' sectors, and the other (Annex IV F) deals with investment relating to services sectors. Like the EU in its services/ investment schedule, both these CARIFORUM schedules list country-specific market openings or limitations.

13. The CARIFORUM's non-services investment sector schedule (Annex IV E) was drawn up on a negative list basis. That is, investment is unrestricted across all the listed *non-services* sectors (A-E), unless scheduled limitations indicate otherwise.

14. This is opposed to the positive listing used in the WTO's GATS agreement, in which only sectors that parties have expressly identified are subject to market opening undertakings. For countries which are still in the process of regulatory development (i.e. most if not all developing countries), the positive list approach is more appropriate as it is less likely that mistakes will be made in the scheduling process where countries inadvertently liberalise an existing sub-sector (or one that is yet to emerge in the future) because they had not listed a limitation to it.

15. Annex IV E, known as the List of Commitments on Investment (Commercial Presence) in Economic Activities other than Services Sectors includes the following sectors and sub-sectors elaborated upon in Box 1:

Box 1: Liberalising Non-Services Sectors and Sub-sectors by CARIFORUM countries in the CARIFORUM EPA

A. **Agriculture, hunting and forestry**
   I. Agriculture, Hunting,
   II. Forestry and logging

B. **Fishing**

C. **Mining and quarrying**
   I. Mining of coal and lignite; extraction of peat
   II. Extraction of crude petroleum and natural gas
   III. Mining of metal ores
   IV. Other mining and quarrying

D. **Manufacturing**
   I. Manufacture of food products and beverage
   II. Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials
   III. Manufacture of refine petroleum products
   IV. Manufacture of chemicals and chemical products other than explosives
   V. Manufacture of machinery and equipment
   VI. Manufacture of furniture; manufacturing n.e.c

E. **Production, transmission and distribution on own account of electricity, gas, steam and hot water**
   I. Production of electricity; transmission and distribution of electricity on own account
   II. Manufacture of gas; distribution of gaseous fuels through mains on own account
   III. Production of stream and hot water; distribution of steam and hot water on own account

This negative-list Schedule sets out the reservations taken by the signatory CARIFORUM States with respect to measures that do not conform with obligations set out in Title II of the EPA (market access and national treatment on investment and services). Only sectors in which there are reservations or limitations are listed but the Schedule covers all sub-sectors of the sectors A-E. That is, sub-sectors of A -E that are not listed are also open in all signatory CARIFORUM States without limitations in market access and national treatment.

16. Investment liberalization contained in CARIFORUM countries' second schedule (Annex IV F) includes investment or commercial presence (i.e. what is known as GATS 'Mode 3' liberalization) of *services* sectors. The Annex also covers

services liberalization commitments through other modes of supply (cross border – Mode 1, and consumption abroad – Mode 2).

17. The Annex lists modes of supply in services sectors and sub-sectors where liberalization commitments have been made and modes of supply where no commitments have been taken. The Annex (or Schedule of Commitments) also lists the 'non-conforming measures' i.e. regulations that limit liberalization.

18. This schedule needs to be read in conjunction with the 'standstill' CARIFORUM countries committed, which complicates the reading of Parties' commitments. The 'standstill' – Explanatory Note no. 9 of Annex IV F - notes that

'With regard to the economic activities covered in Chapters 2 and 3 of Title II, other than public services, without prejudice to the content of the list of commitments on commercial presence and on cross-broder supply in this Annex, the Signatory CARIFORUM States *maintain the conditions of market access and national treatment* in the meaning of Articles 67 and 68, and Articles 76 and 77 applicable according to their respective legislation to services, service suppliers, investors and commercial presences of the EC Party at the time of the signature of this Agreement' (italics added).

19. The broad range of *services* sectors and sub-sectors in Annex IV F are listed in Box 2.

BOX 2: Liberalising Investment in Services Sectors and Sub-Sectors by CARIFORUM countries in the CARIFORUM EPA.

1. SERVICES

A. PROFESSIONAL SERVICES
   a. Legal Services; Legal documentation and certification, Legal Services Consultancy in international law, Legal services– consulting in Home Law of the Services Provider, Legal advisory and information services
   b. Accounting, Auditing and Book-keeping Services
   c. Taxation
   d. Architectural services
   e. Engineering services
   f. Integrated engineering services
   g. Urban Planning and Landscape Architectural services; Geological, geophysical and other scientific prospection services
   h. Medical and Dental Services; Neurosurgery, Epidemiological services, CATSAN services
   i. Veterinary services
   j. Services provided by mid-wives, nurses, physiotherapists and para-medical personnel
   k. Other

B.Computer and Related Services
   a. Consultancy services related to the installation of computer hardware
   b. Software Implementation Services
   c. Data Processing Services
   d. Data base services
   e. Other

C. Research and Development Services
   a. Research and Development on natural sciences
   b. Research and Development on social science and humanities
   c. Inter-disciplinary Research and Development services

D. Real Estate Services
   a. Involving owned or leased property
   b. Real Estate service – On a fee or contact basis

E. Rental/Leasing Service without operators
   a. Relating to ships
   b. Relating to aircraft
   c. Relating to other transport
   d. Relating to other machinery and equipment

F. Other Business services
   a. Advertising services
   b. Market research and public opinion polling services
   c. Management consulting services
   d. Services related to management consulting
   e. Technical testing and analysis services
   f. Services incidental to agriculture, hunting and forestry
   g. Services incidental fishing

h. Services incidental to mining
i. Services incidental to manufacturing
j. Services incidental to energy distribution; Exploration and development of energy services, Energy marketing services and other services important to energy services
k. Placement and supply services of personnel
l. Investigation and Security
m. Related scientific and technical consulting services
n. Maintenance and repair of equipment; (not including maritime vessels, aircraft or other transport equipment)
o. Building cleaning services
p. Photographic Services
q. Packaging services
r. Publishing and printing on a fee or contract basis
s. Convention Services
t. Other business services

2. COMMUNICATION SERVICES

B. COURIER SERVICES

C. TELECOMMUNICATION SERVICES (Public and non-public use)

a. Voice telephone services
b. Packet-switched data transmission services
c. Circuit-switched data transmission services
d. Teletex services
e. Telegraph services
f. Facsimile Services
g. Private leased circuit services
h. Electronic mail
i. Voice mail
j. Online information and data base retrieval
k. Enhanced/value added facsimile services including store and retrieve
l. Code and protocol conversion
m. Online information and/or data processing (including transaction processing)
n. Online information and/or data processing (including transaction processing)
o. Electronic Data interchange
p. Other; Internet and Internet access; Personal Communication services; Telecommunication equipment sales, rental, maintenance, connection, repair and consulting services; Trunked Radio system services; Paging; Teleconferencing services; Mobile data services; Mobile services; Mobile services (satellite based); Fixed satellite services; International voice, data and video transmission services supplied to firms involved in information processing located within free zones; Video transmission services (satellite based); Connection and interconnection; Mobile maritime and air-to-ground telecommunication services

3. CONSTRUCTION AND RELATED ENGINEERING SERVICES

A. GENERAL CONSTRUCTION WORK FOR BUILDINGS
B. GENERAL CONSTRUCTION WORK FOR CIVIL ENGINEERING
C. INSTALLATION AND ASSEMBLY WORK
D. BUILDING, COMPLETION AND FISHING WORK
E. OTHER ; Special trade construction

4. DISTRIBUTION SERVICES

A. COMMISSION AGENTS' SERVICES

B. WHOLESALE TRADE SERVICES

C. RETAILING SERVICES ; Sale maintenance and repair services of motor vehicles; sales of related parts and accessories ; Sale, maintenance and repair services of motorcycles and snowmobiles; sales of related parts and accessories ; Retail sales of motor fuel

D. FRANCHISING

5. EDUCATIONAL SERVICES

A. PRIMARY EDUCATION SERVICES
B. SECONDARY EDUCATION SERVICES
C. HIGHER EDUCATION SERVICES
D. ADULT EDUCATION
E. OTHER EDUCATION SERVICES

6. ENVIRONMENTAL SERVICES

A. SEWAGE SERVICES

B. REFUSE DISPOSAL SERVICES; Hazardous waste collection services ; Hazardous waste treatment and disposal services

C. OTHER; Cleaning services of exhaust gases ; Noise abatement services ; Remediation and clean-up of soil and waters ; Protection of biodiversity and landscape ; Other environmental services – Closed loop pollution control system for factories ; Waste and waste water management ; recycling services

7. FINANCIAL SERVICES

A. ALL INSURANCE AND INSURANCE RELATED SERVICES
   a. Life, accident and health insurance services
   b. Non-life insurance services
   c. Reinsurance and retrocession
   d. Services auxiliary to insurance; Actuarial services ; Consultancy, actuarial, risk assessment and claim settlement services

B. BANKING AND OTHER FINANCIAL SERVICES (Excluding insurance)
   a. Acceptance of deposits and other repayable funds
   b. Lending of all types including inter alia consumer credit, mortgage credit,

factoring and financing of commercial transactions
   c. Financial leasing
   d. All payment and money transmission services
   e. Guarantees and commitments
   f. Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or other-wise
   g. Participation in issues of all kinds of securities, including underwriting and placement as agents
   h. Asset management, such as cash or portfolio management, all forms of collective investment management
   i. Advisory and other auxiliary financial services on all the activities listed in MTN.TNC/W/50, including credit reference and analysis, investment and portfolio research and advice on acquisitions and on corporate restructuring
   j. Provision and transfer of financial information and financial data processing and related software by providers of other financial services

C. OTHER ; Registration of offshore companies and trust (not including insurance companies and banks) to do off-shore business ; Central Bank deposit services and Central Bank reserve management ; Financial leasing with option to buy and factoring ; Investment and property unit trust services ; Mutual funds venture capital services

8. HEALTH RELATED AND SOCIAL SERVICES (Other than those listed in 1. h-j)

A. HOSPITAL SERVICES
B. OTHER HUMAN HEALTH SERVICES
C. SOCIAL SERVICES

9. TOURISM AND TRAVEL-RELATED SERVICES

A. HOTEL AND RESTAURANTS (incl. catering) ; Letting services of furnished accommodation ; Meal serving with full restaurant ; Meal serving in self-service facilities ; Beverage serving services with entertainment
B. TRAVEL AGENCIES AND TOUR OOPERATORS SERVICES
C. TOURIST GUIDE SERVICES
D. OTHER ; Hotel Development ; Hotel Management ; Marina Services ; Spa services

10. RECREATIONAL, CULTURAL AND SPORTING SERVICES (Other than audiovisual)

A. ENTERTAINMENT SERVICES (including theatre, live bands and circus services)
B. NEWS AGENCY SERVICES
C. LIBRARIES, ARCHIVES, MUSEUMS AND OTHER CULTURAL SERVICES
D. SPORTING AND OTHER RECREATIONAL SERVICES
E. OTHER

11. TRANSPORT SERVICES

A. MARITIME TRANSPORT SERVICES
   a. Passenger transportation
   b. Freight transportation
   c. Rental of vessels with crew

   d. Maintenance and repair of vessels
   e. Pushing and towing services
   f. Vessels salvaging and refloating services ; Ship Surveys ; Ship Registration; Navigation Aid and Communications / Meteorological Services ; Home-porting, Bunkering, Short-sea, and Ship Chandlering

B. INTERNAL WATERWAYS TRANSPORT
   a. Passenger transportation
   b. Freight transportation
   c. Rental of vessels with crew
   d. Maintenance and repair of vessels
   e. Pushing and towing services

C. AIR TRANSPORT SERVICES
   a. Passenger transportation
   b. Freight transportation
   c. Rental of aircraft with crew
   d. Maintenance and repair of air-craft
   e. Supporting services for air transport; Computer Reservation System services ; Selling and marketing of air transport services ; Groundhandling services ; Airport operation services, excluding cargo handling

D. RAIL TRANSPORT SERVICES
   a. Passenger transportation
   b. Freight transport
   c. Pushing and towing services
   d. Maintenance and repair of rail transport equipment
   e. Supporting services for rail transport services

E. ROAD TRANSPORT SERVICES
   a. Passenger Transportation
   b. Freight Transportation
   c. Rental of commercial vehicles with operator
   d. Maintenance and repair of road transport equipment
   e. Supporting services for road transport services

F. SERVICES AUXILIARY TO ALL MODES OF TRANSPORT
   a. Cargo handling services
   b. Storage and warehouse services
   c. Freight transport agency services
   d. Other; Other supporting and auxiliary transportation services ; Free Zone Operation ; Trans-shipment services

G. OTHER TRANSPORT SERVICES ; Container station and depot services; Maritime agency services

12. OTHER SERVICES NOT INCLUDED ELSEWHERE; Funeral, cremation and undertaking services; Services of membership organization; Dyeing and coloring services; Dry cleaning services; Cosmetic treatment, manicure and pedicure

20. Annex IV F of the CARIFORUM schedule seems to be a positive list approach to services and investment liberalization. However, read together with

Explanatory Note no. 9 on the 'standstill', the schedule is in fact a hybrid of both a positive and negative list approaches. Sectors where there are no existing regulation limiting foreign investors are assumed to be open, even if the schedule in Annex IV F does not state such a market opening. It is therefore quite confusing to ascertain the exact extent to which a CARIFORUM country has actually opened its services and investment.

21. For those CARIFORUM countries that have not adequately regulated a sector, the standstill represents a regulatory freeze. Deeper analysis of the EU and CARIFORUM's schedules are required but given the lower level of regulation in most developing countries, it could be ascertained that the level of market opening for investment (and services) by CARIFORUM in the EPA went much further than the EU.[5] It should be noted that the EU did not have a similar standstill explanatory note in its Schedule.

22. When a sector or sub-sector is open for liberalization (i.e. no limitations are listed in Annex IV F of the CARIFORUM EPA), this means that a variety of instruments that are commonly used to limit or screen foreign investment, to enhance the benefits for the local, national, or regional economy are prohibited. The countries that commit full market access in a sector/sub-sector shall not impose: (a) limitations on the number of commercial presences whether in the form of numerical quotas, monopolies, exclusive rights or other commercial presence requirements such as economic needs tests; (b) limitations on the total value of transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (c) limitations on the total number of operations or on the total quantity of output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test ; (d) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment; and (e) measures which restrict or require specific types of commercial presence (subsidiary, branch, representative office) or joint ventures through which an investor of the other Party may perform an economic activity. Amongst other implications, this means that in the absence of reservations, the foreign firm shall be allowed to have 100 per cent ownership and be able to choose the nature of its corporate form.

23. Annex I of the US-Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) is an example of a negative list approach to scheduling investment in an FTA. It encompasses existing measures with respect to cross-border trade in services and investment. Annex I entry sets out the following elements:

a. **Sector** refers to the sector for which the entry is made

[5] A reading of the EU schedule shows that whilst the EU listed market openings for many sectors and sub-sectors, these openings are usually conditioned on economics needs tests (ENTs). The criteria used for these ENTs, and how decisions are made

b. **Obligations Concerned** specifies the obligations that do not apply to the listed measures
c. **Level of Government** indicates the level of government maintaining the listed measures
d. **Measures** identifies the laws, regulations, or other measures for which the entry is made
e. **Description** provides a general, non-binding, description of the **Measures**. This section sets out commitments for the progressive future liberalization of the measures.

24. The non-conforming measures in Annex I are listed at their level of actual application and are supported by references to laws, regulations or other measures. Each Party is bound to apply such measures on a basis not more restrictive than what is indicated in the description of the measure.

25. The table below shows the total number of existing non-conforming measures listed by each Party in Annex I.

Costa Rica	**I4 Sectoral Measures**	**No Horizontal Measures**
Dominican Republic	**12 Sectoral Measures**	**1 Horizontal Measure**
El Salvador	**7 Sectoral Measures**	**2 Horizontal Measures**
Guatemala	**3 Sectoral Measures**	**5 Horizontal Measures**
Honduras	**14 Sectoral Measures**	**3 Horizontal Measures**
Nicaragua	**4 Sectoral Measures**	**No Horizontal Measures**
USA	**3 Sectoral Measures**	**3 Horizontal Measures**

Note: Sectoral measures are non-conforming measures limiting the level of market opening in relation to a particular sector or subsector. Horizontal measures are limitations that apply across all sectors.

26. The non-conforming measures that affect investment in services with respect to market access are included in the section on Cross-Border Trade in Services.

27. The obligation that both Parties invoke most often in their non-conforming measures is that of National Treatment.

At the horizontal level, both Parties list measures with respect to investment that affect various obligations of the Agreement. The following are some examples:

- **Dominican Republic: National Treatment**

28. Only Dominican nationals may perform activities related to the disposal of toxic, hazardous, or dangerous or radioactive waste produced outside the Dominican Republic.

- **El Salvador: National Treatment / MFN Treatment**

29. Rural land may not be owned by a foreign person, if the person is a national of a country or is organized under the law of a country that does not permit Salvadoran persons to own rural land, except in the case of land to be used for industrial plants. An enterprise organized under Salvadoran law, a majority of whose capital is owned by foreign persons, or a majority of whose partners are foreign persons, is subject to the preceding paragraph.

- **El Salvador: National Treatment / MFN Treatment**

30. Only the following persons may engage in small scale commerce, industry, and the supply of services in El Salvador: (a) Salvadoran nationals born in El Salvador; and (b) nationals of Central American Parties. An enterprise organized under Salvadoran law, a majority of whose capital is owned by foreign persons, or a majority of whose partners are foreign persons, may not establish a small scale enterprise to engage in small scale commerce, industry, and the supply of services ("small scale enterprise"). For purposes of this entry, a small scale enterprise is an enterprise with a capitalization not greater than 200,000 U.S. dollars.

- **Guatemala: National Treatment**

31. Only the following persons may be granted title to, rent, or use state-owned lands in the Department of El Petén: (1) Guatemalan nationals who do not own rural real estate anywhere in the country that exceeds 45 hectares; and (2) Guatemalan nationals who do not own industrial, mining or commercial enterprises. Enterprises owned 100 percent by Guatemalan nationals that meet the requirements set out in the preceding paragraph may be granted title to, rent, or use state-owned lands in the Department of El Petén.

- **Honduras: National Treatment / MFN Treatment**

32. Small-scale industry and trade are reserved to Honduran persons. Foreign investors cannot engage in small-scale industry or trade unless they are naturalized citizens and their country of origin grants reciprocity. "Small-scale industry and trade" means an enterprise with capital, excluding land, buildings, and vehicles, of less than 150,000 Lempiras.

- **Honduras: National Treatment / MFN Treatment**

33. Non-Honduran cooperatives may establish in Honduras if they receive authorization from the *Instituto Hondureño de Cooperativa*s. Authorization will be granted if: (a) reciprocity exists in the country of origin; and (b) the non-Honduran cooperative has at least one permanent legal representative in Honduras.

- **United States: National Treatment / MFN Treatment**

34. The Overseas Private Investment Corporation insurance and loan guarantees are not available to certain aliens, foreign enterprises, or foreign-controlled domestic enterprises.

- **United States: National Treatment / MFN Treatment**

35. Foreign firms, except for certain Canadian issuers, may not use the small business registration forms under the Securities Act of 1933 to register public offerings of securities or the small business registration forms under the Securities Exchange Act of 1934 to register a class of securities or file annual reports.

- **United States: National Treatment / MFN Treatment / Performance Requirements / Senior Management and Boards of Directors**

36. The United States reserves National Treatment, MFN Treatment, Performance Requirements, and Senior Management and Boards of Directors for all existing non-conforming measures of all states of the United States, the District of Columbia, and Puerto Rico. It is the only measure taken at the regional level of government.

37. The non-conforming measures on investment in Annex I are set out by each Party to the Agreement according to the various sectors or sub-sectors, and with reference to the core discipline(s) invoked in the measure. The tables below illustrate the incidence of the non-conforming measures (represented by an X) taken by Guatemala, Honduras, Nicaragua and the United States.

Guatemala
Existing Non-Conforming Measures for Investment

Keys

NT: *National Treatment*

MFN: *Most Favoured Nation Treatment*

PR: *Performance Requirements*

SM: *Senior Management*

	Type of Obligation			
Sector / Sub-Sector	**NT**	**MFN**	**PR**	**SM**
Forestry	X			
Professional Services	X			
Air Transportation	X			X

Honduras
Existing Non-Conforming Measures for Investment

	Type of Obligation			
Sector / Sub-Sector	**NT**	**MFN**	**PR**	**SM**
Customs Agents and Customs Agencies	X			
Agricultural	X			
Radio, Television, and Newspaper Services				X
Construction or Consulting Services and Related Engineering Services - Civil Engineering	X			
Distribution Services - Petroleum Products (liquid Fuel, Automotive Oil, Diesel, Kerosene, and LPG)	X			
Education Services - Private Preschool, Primary, and Secondary Educational Services				X
Entertainment Services - Music Entertainers	X			
Amusement, Cultural, and Sports Services - Casinos and Gambling (Encompasses Roulette, Cards, Punter, Baccarat, Slot Machines, and the Like)	X			
Investigation and Security Services	X			X
Fisheries	X			
Air Transportation	X			X
Maritime Transportation - Coastal Navigation	X	X		
Land Transportation	X			
Transportation - Railways	X			X

Nicaragua
Existing Non-Conforming Measures for Investment

	Type of Obligation			
Sector / Sub-Sector	**NT**	**MFN**	**PR**	**SM**
Radio Broadcast, Free Television Reception	**X**			
Fisheries and Services Incidental to Fishing	**X**		**X**	
Air Transportation	**X**			**X**
Regime on Free Zones and Regime on Active Improvement			**X**	

United States
Existing Non-Conforming Measures for Investment

	Type of Obligation			
Sector / Sub-Sector	**NT**	**MFN**	**PR**	**SM**
Atomic Energy	X			
Mining	X	X		
Air Transportation	X	X		X
Air Transportation	X	X		X
Transportation Services-Customs Brokers	X			
Communications - Radiocommunications	X			

38. It is worth emphasizing that FTAs with a negative listing allow for the scheduling of two categories of limitations: existing non-conforming measures and future measures. Existing non-conforming measures include all current laws and regulations that a country seeks to maintain, but which would be inconsistent with one or more of the obligations enshrined by the agreement. By definition, limitations scheduled in this category reflect status quo policies. The tables above therefore reflect such intent to have DR-CAFTA States bind status quo policies by stipulating that the schedule of commitments sets out reservations taken by them with respect to measures that do not conform with their market access and national treatment obligations.

39. Thus we see that the EU and US new generation FTAs with developing countries focus mainly, or almost entirely, on liberalization. They contain specific liberalization obligations covering a wide range of investment issues, including typically issues of investment entry, establishment and operation (e.g. post-establishment national treatment) and entry of managerial personnel, as well as trade in services and competition policy. That is, whilst the BITs protect investors once they are in a country, the FTAs complement the BITs by ratcheting open the

market so that investors can get into a market and establish themselves in a whole range of services sectors and non-services sectors and sub-sectors.

40. In the case of Central America, BITs had been concluded between El Salvador, Honduras, Nicaragua and the United States even before the CAFTA with the US was signed. Similarly, individual CARIFORUM states and individual major European capital-exporting states also had BITs before the CARIFORUM EPA. The FTAs are therefore subsequent agreements to these existing BITs between states that are also parties to the FTAs. The CARIFORUM EPA for example expressly preserves the rights of investors under existing or future investment treaties between CARIFORUM states and EU states.[6] Thus, the CARIFORUM EPA expands upon, and does not limit, the restraints and liabilities that existing BITs place on the CARIFORUM states in the regulation of European investors. These aspects are critical to understanding the cumulative impact of the market access commitments undertaken in the FTAs.[7]

B Most Favoured Nation Treatment (MFN)

41. The MFN treatment in the CARIFORUM EPA requires the Parties to make available any more favourable treatment to which they agree, in a future economic integration agreement with a major trading economy, to investments and investors covered by the CARIFORUM EPA. The commitment acts primarily as a hedge for the EU states against the possibility that CARIFORUM states might grant more generous market access to other major economies. A 'major trading economy' is any industrialized country accounting for more than one percent of world merchandise exports, or any group of countries accounting for more than 1.5 percent of world merchandise exports. However, it could be read expansively in order to incorporate into the FTA a host of substantive and procedural obligations from BITs (e.g. duties to compensate foreign investors for regulatory expropriation or unfair treatment) and access to investor-state arbitration. This expansive approach to the concept of MFN treatment is surprisingly common in arbitration awards to date.[8]

C. Transparency

42. The EU's approach includes methods intended to remove informational barriers to entry. These are transparency provisions that require the host country to make available certain information about the investment climate in its territory. Article 86 of the CARIFORUM EPA states that "the Parties and Signatory CARIFORUM States shall respond promptly to all requests made by the other Party for specific information on any of their measures of general

[6] Article 10
[7] Gus Van Harten, *Investment Provisions in Economic Partnership Agreements*, (2008) at page 3
[8] Ibid

application or international agreements which pertain to or affect this Agreement. The Parties shall also establish one or more enquiry points to provide, upon request, specific information to investors and services suppliers of the other Party on all such matters."

43. Article 18. 2 of DR-CAFTA on the other hand not only requires the US and Central American States to ensure that its laws, regulations, procedures and administrative rulings of general application respecting any matter covered by this FTA are promptly published but also to ensure that each Party shall publish in advance any such measure that it proposes to adopt and provide interested persons and Parties a reasonable opportunity to comment on such proposed measures.

44. Such an expanded concept of transparency – particularly when materializing in legally binding rules – may create administrative burdens and costs for developing countries. Indeed, many developing countries' legal systems do not provide for such consultations. Likewise, developing countries are concerned about any undue influence that foreign companies and governments could exert on their domestic regulatory processes. Careful consideration of such a broadened notion of transparency is needed.

D Free transfer of foreign capital

45. In addition, EU and US FTAs that seek to liberalise investment flows usually contain provisions intended to grant free transfer of funds related to such investment. Article 123 of the CARIFORUM – EC EPA provides that with regard to the transactions on the capital account of balance of payments, the Signatory CARIFORUM States and the EC Party undertake to impose no restrictions on the free movement of capital relating to direct investments made in accordance with the laws of the host country and investments established in accordance with the provisions of the Agreement and the liquidation and repatriation of these capitals and of any profit stemming therefrom.

46. Article 10.8 of DR-CAFTA stipulates that each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory. Such transfers include contributions to capital, profits, dividends, capital gains and proceeds from the sale of all or any part of the covered investment, interest, royalty payments, management fees and technical assistance and other fees, payments made under a contract, including a loan agreement; and payments arising out of a dispute.

47. Transfer of funds provisions are among the investment provisions that often give rise to the greatest concerns on the part of developing host countries. The adverse consequences of capital flight can be severe. Given the present global financial crisis, and its lessons about the risks posed by deregulation and

liberalization, the dangers of this obligation on extreme financial liberalization cannot be overstated.

48. Some may argue that Article 124 of the CARIFORUM EPA provides safeguard measures which says that where in exceptional circumstances, payments and capital movements between the parties cause or threaten to cause serious difficulties for monetary or exchange rate policy, safeguard measures with regard to capital movements that are "strictly necessary" may be taken for up to six months. However, there are several problems with this safeguard clause. Firstly, they can be taken only when a financial crisis or emergency occurs; it cannot be used to enable policies that in the main prevent such crisis by being anchored on caution and aimed at stability. Secondly, exceptional circumstances and serious difficulties are not clearly defined. Thirdly, while current payments and capital movements are identified as possible causes of the difficulties, the safeguard measures can be allowed only in respect of capital movements, and thus measures relating to current payment are not allowed. Fourthly, the measures must face the necessity test, i.e. that they are "strictly necessary". And finally, the measures can be taken for only six months, which is a very short period since crises may continue for years.[9]

E. Admission and Establishment of Investment

49. The issue of admission and establishment refers to the entry of investments of investors of a contracting party into the territory of another contracting party. According to customary international law, countries have the right to regulate the admission of foreign investors and their investments in their territories. Most countries refrain from granting foreign nationals and companies an unrestricted right to invest in their economies.

50. Access limitations imposed on foreign investment have been justified on economic, social, political or national security grounds.

51. Two basic models are currently used in BITs. One makes the admission and establishment of foreign investment subject to the domestic laws of the host country (called the "admission clause" model), and the other grants foreign investors a right of establishment, although not in an absolute manner (hereinafter called the "right of establishment" model).[10]

52. The implication of the admission clause is that, regardless of whether the host country maintains any admission and screening mechanism for foreign investment — and unless the BIT states otherwise — there is no obligation on the part of the host country to eliminate discriminatory legislation affecting the

[9] Third World Network (September 2008) *CARIFORUM – EU Economic Partnership Agreement: Implications for Economic and Social Development* at p. 25
[10] UNCTAD (2006) *Investment Provisions in Economic Integration Agreement* at p. 76

establishment of foreign investment. For example, if the domestic legislation reserves certain economic activities to national investors or even to foreign investors of a particular nationality, this is part of the legal context that foreign investors have to respect when admitted to the host country.

Besides those BITs containing an admission clause, there is a second category of agreements that grant certain rights of entry to investors of the other contracting party. This approach consists of providing foreign investors with national treatment and MFN treatment not only once the investment has been established, but also with respect to establishment (i.e. the entry of new investments, including the participation in existing enterprises, by foreign or non-resident investors). This means that investors of one party will receive treatment no less favourable with regard to investing in the territory of the other party than domestic investors and investors of any other third country.

53. The use of this approach was traditionally limited to BITs concluded by the United States after the mid-1990s when the NAFTA had entered into force. As a result, a growing number of developing countries actually apply two different BIT models, depending on who their treaty partners are: the "admission clause" model (mostly in BITs with European countries) and the "right of establishment" model (mainly in treaties concluded by the United States).

54. The fact however remains that most BITs have not been conceived as instruments to provide foreign investors with a right of establishment. Rather, these agreements only impose a duty on the contracting parties to admit foreign investment in accordance with their national legislation.[11] BITs are primarily about protecting an investment. Germany having lost almost all of her foreign investment during the Second World War signed the very first BIT with Pakistan in 1959 as a measure to protect its future investments abroad.

55. Yet the EU FTAs with developing countries, and in sharp contrast to the traditional European BIT "admission clause" model, now includes a right of establishment in both services and non-services sectors. The EU's approaches to investment with developing countries therefore have both sets of provisions - rights of entry/establishment i.e. market access, and post-establishment protection. In this respect, the market access commitments in the EU FTAs are meant to 'fill a gap' in the BIT programmes of European capital-exporters by opening host economies to European investment in the manner of a US BIT. However, once markets are opened by the FTA, the post-establishment protections available to European investors in European BITs will be triggered.[12]

[11] *Ibid*
[12] Gus Van Harten, *Investment Provisions in Economic Partnership Agreements*, (2008) at page 9

F. Dispute Settlement

56. With respect to the settlement of investment disputes, BITs almost invariably allow for direct settlement of Investor-State disputes through international arbitration. FTAs do not allow for international arbitration of Investor – State disputes. Instead, investment disputes are often dealt with implicitly in these FTAs under general provisions for the settlement of disputes arising between the States parties (State-State) that apply to all aspects of the agreement.

57. The CARIFORUM EPA provides for the settlement of disputes by means of consultations and negotiations between the parties. Where the parties have failed to resolve the dispute by recourse to consultations, the dispute is then taken to an arbitration panel.[13] Therefore, the EC proposals in the EPAs do not include special provisions on the settlement of investment disputes such as the right to Investor-State dispute resolution. Instead, investment disputes arising from these agreements are dealt with under the general disputes settlement provisions, which are at a State-to-State level.

58. Nevertheless, the EPAs and BITs can work together so that issues in the EPA can be taken up by the BITs Investor-State dispute resolution provision. Although Investor-State dispute resolution provisions originate from BIT practice, several provisions in the EPA dispute resolution provision reflect the fact that an agreement with more than two parties (an EU State and a Signatory CARIFORUM State) may be used to raise concerns that do not originate from a BIT.

59. Footnote 2 to article 66 (on coverage) of the CARIFORUM – EC EPA makes it clear that " measures relating to expropriation and investor-to-state dispute settlement such as those covered in bilateral investment treaties are not deemed to affect commercial presence." In addition, article 71 provides that nothing in the CARIFORUM EPA shall be taken to limit the right of investors of the Parties to benefit from any more favourable treatment provided for in any existing or future international agreement relating to investment to which a Member State of the EU and a CARIFORUM State are parties**.** This ensures the additional privileges that EU investors have under current or future BITs are safeguarded.

60. Article 10 (15) of DR-CAFTA stipulates that in the event of an investment dispute, the claimant (an investor of a Party that is a party to an investment dispute with another Party) and the respondent should initially seek to resolve the dispute through consultation and negotiation, which may include the use of non-binding, third-party procedures such as conciliation and arbitration. In the event that a disputing party considers that an investment dispute cannot be settled by consultation and negotiation the claimant may submit to arbitration a claim that the respondent has breached an obligation of this Agreement or any

[13] Articles 202 - 210

other investment agreement. Any other investment agreement means a written agreement that takes effect on or after the date of entry into force of this Agreement between the government of a Party and a covered investment or an investor of another Party that grants the covered investment or investor rights with respect to natural resources or other assets that the government controls.

61. When a claim is submitted to arbitration, the tribunal shall apply the rules of law specified in the pertinent investment agreement or investment authorization; or if the rules of law have not been specified or otherwise agreed, the law of the respondent should be adhered to. The law of the respondent means the law that a domestic court or tribunal of proper jurisdiction would apply in the same case.

62. It is therefore possible that the same investment dispute may be submitted to multiple forums, which will thus require the host State to respond to the same claims more than once and raise the possibility of inconsistent decisions. Of special concern is that the investor may submit a dispute to the domestic courts of the host state, to international arbitration and to the dispute settlement mechanism of the FTA. The interactions can be complex. For example, the MFN clause of an investment agreement could entitle an investor of one State to treatment guaranteed to investors of another State by a different agreement, with the result that the dispute resolution provision could be used ultimately to interpret and apply to the circumstances of an investor commitment made to other States in other agreements.

G. Expropriation:

63. A corollary of the above point is the issue of expropriation. In BITs, provisions on expropriation recognize the right of the host State to expropriate investment, but impose conditions that must be satisfied when an expropriation occurs. These provisions raise two principal issues. These issues are specific to BITs, but their significance may increase in the context of FTAs, as these agreements address a wider range of investment related issues.

i) Scope of the expropriation provision

The first issue is to define the sort of host country actions to which the provision applies. The classic example of an expropriation is an act that transfers ownership or possession of an investment to the State. An act that completely destroys the value of an investment is also typically regarded as an expropriation. Acts that only partially devalue an investment, however, may be viewed by the host State as merely routine regulatory acts that are not the equivalent of an expropriation. The issue of what constitutes an expropriation is thus important to host countries because a definition that is too broad could be interpreted to the effect that routine regulatory acts constitute an expropriation, requiring that all investments affected by the regulations be compensated.

ii) Conditions for lawful expropriation

The second issue is to define the requisites imposed on a host country for the expropriation to be considered legal. In Article 10 (7) of DR-CAFTA, no Party may expropriate an investment either directly or indirectly through measures equivalent to expropriation except for a public purpose, in a non-discriminatory manner, on payment of prompt, adequate, and effective compensation, and in accordance with due process of law. The most debated of these conditions is the requirement of compensation.

64. Recently, the scope of expropriation provisions has raised great concerns. Host countries rightfully fear that a regulatory action, such as the enactment of socio-economic measures that impair the value of an investment may be regarded as an expropriation requiring payment of compensation that a developing country in particular may not be able to afford.

65. In 2007, three Italian mining firms (Marlin Holdings Ltd, Marlin Corporation and Red Graniti Pty Ltd, sought compulsory international arbitration against the South African government by the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) in Washington. Hearings in the case, were slated for December 2009. The dispute arose out of the May 2004 entry into force of the Mineral and Petroleum Resources Development Act 2002, which placed previously privately-owned mineral resources under State custodianship. For miners to convert their rights from the old private mineral-rights regime to the new order, they now had to satisfy certain criteria, including the sale of a 26 per cent equity stake to previously-disadvantaged South Africans. This is within the framework of South Africa's policy of black economic empowerment, which is a core policy for redressing the iniquities of the past apartheid economic system. The Italian claimants say that the Minerals and Petroleum Resources Development Act 'extinguished their ownership of mineral rights in South Africa without providing prompt, adequate and effective compensation' as required under the BIT between Italy and South Africa. They are seeking damages amounting to 266 million euros. If successful, this Italian lawsuit could be a catalyst for other mining companies to bring similar actions against the government and could set a new precedent in the country with implications for South African mineral rights.

66. It is obvious then that the provisions in an FTA that emphasize objectives of sustainable development, food security, social benefits, labour standards, and safeguards for the balance of payments, will be of little use to the host state in an investor-state arbitration under a BIT. For example Article 2 of the CARIFORUM-EU EPA provides that the application of this Agreement shall fully take into account the human, cultural, economic, social, health and environmental best interests of their respective population and of future generations. A BIT dispute, though it relates to an investment made possible by the EPA, will be resolved with reference to the terms and purposes of the BIT. Thus, once an investor is

admitted to a state's territory, any post-establishment regulation by the state that implicates a BIT (to which the investor has access) will not be protected by EPA exceptions on human health, food security, resource conservation and so on.[14]

IV. Historical Survey of the Experience of Some EU States

67. Based on a historical survey of the experiences of the EU member states during their early stages of development, the now developed countries systematically discriminated between domestic and foreign investors in their industrial policy. They used and are still to an extent using a range of instruments to regulate foreign investment in order to build up national industry. They included limits on ownership; performance requirements on exports; technology transfer or local procurement; insistence on joint ventures with local firms; and barriers to 'brown-field investments' through mergers and acquisitions.[15] These findings are particularly important because the EU insists that the core principles of non-discrimination, and in particular national treatment and most favoured nation treatment, should be a central aspect of any FTA. National treatment requires that the treatment of foreign investors should not be less favourable than that for domestic firms. The EU, for example argues that 'non-discrimination, transparency and predictability of domestic laws applicable to FDI should be the guiding principles for the investment framework that we envisage to negotiate.'[16]

68. Until the early 20th century, the UK, France and Germany were net suppliers of capital to the less-developed countries, including the USA, Canada and Russia. Therefore, during this period, the main concern for these countries, especially the UK from the late 19th century onwards, when it was rapidly losing its industrial supremacy, was how to control inward investment.[17]

69. In the few decades following the end of the Second World War, however, controlling inward foreign investment became a major new challenge for these countries. If they were to close the newly-emergent technological gap with the USA, they had to accept American investment, especially FDI.[18]

70. Until the 1980s, since these countries did not adopt laws explicitly discriminating against foreign investors except in sensitive areas (e.g. defence, cultural activities), the most important element in their control of foreign investment was foreign exchange control, which gave their governments the ultimate say over foreign investment. Of course, this does not necessarily mean

[14] Gus Van Harten, *Investment Provisions in Economic Partnership Agreements*, (2008) at page 10
[15] South Perspectives (June 2003), *The Northern WTO Agenda on Investment : Do as we Say, Not as we Did* at page 3
[16] Exploring the Issues Relating to Trade and Investment, paper for regional seminar on new issues, Chile, December 2000, http://europa.eu.int/comm/trade/miti/invest/conswtoag_inv.htm.
[17] South Perspectives (June 2003), op. cit. at page. 13
[18] Ibid

that their governments used the control to the same effect. For example, the UK, took a more permissive attitude towards FDI and rarely used its foreign exchange control law to influence FDI, whereas France was more active in the management of its FDI flows.[19]

71. First, in all of these countries (except the UK after the 1980s), the significant presence of state-owned enterprises (SOEs) in key sectors in the economy has acted as an important barrier to FDI.[20] Also, while not technically SOEs, some of their key enterprises have had significant government ownership – for example, the state government of Lower Saxony was the biggest shareholder in Volkswagen, with a 20 per cent share ownership. Moreover, even when privatizing some of the SOEs in the 1980s, the French government was careful to ensure that control of these enterprises remained French by reserving a significant proportion of share for "hard core" institutional investors close to the government.[21]

72. Second, in the case of Germany, the barriers to hostile takeover, because of the presence of close industry-bank relationships as well as the power of labour exercised through the supervisory board,[22] have acted as a significant barrier to FDI. Given that in the UK, where hostile takeover is easy, the bulk of FDI has consisted of "brown-field" investment based on takeovers rather "green-field" investment, based on the establishment of new facilities.

73. Third, all these countries, including the ostensibly FDI-friendly UK, have used informal performance requirements for key FDI projects. For example, in the UK, since the 1970s in certain industries, a variety of informal "undertakings" and "voluntary restrictions" have been used to regulate foreign investment. These were mostly, although not exclusively, targeted at Japanese companies, especially in the automobile and electronic sectors. It is widely believed that all investments by Japanese electronics giants in the 1970s and the early 1980s – Sony in 1974, Matsushita in 1976, Hitachi and Mitsubishi in 1979, Sanyo and Toshiba in 1981 were subject to some form of voluntary restraint agreement with the Department of Industry on local sourcing of components, production volumes and exporting.[23] Several of the companies reported particular difficulties in implementing local procurement policies and in the slow build up of production which they were allowed. This prompted one observer to remark in 1977 that "every Japanese company which has so far invested in Britain had been required to make confidential assurances, mainly about export ratios and local

[19] Ibid
[20] According to an authoritative study by the IMF published in 1984, the average share of the SOE sector in GDP among the industrialized countries as of the mid-1970s was 9.4%. The share was 10.3 % for West Germany (1976-7), 11.3 % for the UK (1974-7), and 11.9 % for France – all above average.
[21] South Perspectives (June 2003), op. cit. at page 14
[22] In Germany, corporations are governed not simply by a Board of Directors, but also by a supervisory board, which contains equal numbers of representatives of the labour force and of the management. This is called the co-determination system and has been a foundation stone of Germany's "social market economy" since the Second World War.
[23] Ibid

purchasing."[24] When Nissan established a UK plant in 1981, it was forced to procure 60 per cent of value added locally.

74. Until the late 19th century, Finland was one of the poorest economies in Europe. However, it is today one of the richest. Finland's impressive growth performance was built with a regime of draconian restrictions on foreign investment in place – arguably the most restrictive in the developed world.

75. As a country that had been under foreign rule for centuries and as one of the poorest economies in Europe, Finland was naturally extremely wary of foreign investment and duly implemented measures to restrict it. Already by 1851, Finland had enacted a law prescribing that any foreigner, Russian nobles excepted, had to obtain permission from the Tsar, then the supreme ruler of the country, in order to own land. Later laws were added, including an 1883 law that subjected mining by foreigners to licensing, an 1886 ban on banking business by foreigners, and an 1889 ban on building and operation of railways by foreigners. In 1895, it was stipulated that the majority of the members on the board of directors of limited liability companies had to be Finish. All these laws remained valid until at least the mid-1980s.[25]

76. After gaining independence from Russia, Finland's restrictions on foreign investment were strengthened. In 1919, it was stipulated that foreigners had to get special permission to establish a business and guarantee in advance the payment of taxes and other charges due to the central and the local states. In the 1930s, it was legislated that a foreigner could not be a member of the board of directors or the general manager of a firm. Companies with more than 20 per cent foreign ownership were officially classified as "dangerous companies" and therefore foreign ownership of companies was effectively restricted to 20 per cent. As a result, while there was considerable foreign borrowing, there was little FDI during this period, a pattern that persisted at least until the 1980s.

77. There was some liberalization of foreign investment thereafter. Foreign banks were allowed for the first time to found branches in Finland in the early 1980s. The foreign ownership ceiling of companies was raised to 40 per cent in 1987, but this was subject to the consent of the Ministry of Trade and Industry.[26] General liberalization of foreign investment did not come until 1993, as part of the preparations for its EU accession.[27]

78. This suggests that countries have used and indeed should use different policies towards foreign investment according to their role as investment providers or receivers. Since developing countries are today almost always at the receiving end, it follows that they too need, and should be allowed to have

[24] Ibid
[25] Ibid at page 18
[26] Ibid.
[27] www.investinfinland.fi/topical/leipa_survey01.htm

significantly more freedom to regulate foreign investment in their long-term interest than do the developed countries. When today's advanced countries were in "catching-up" positions and trying to establish their industries against competition from the more efficient producers of the time, almost all of them restricted the entry of foreign investment. Very often, the entry restrictions were directly imposed, ranging from a simple ban on entry into particular sectors to allowing entry on certain conditions (e.g. requirements for joint ventures, ceilings on foreign ownership). Bans on entry created space for local producers to establish themselves, while conditional entry made it possible to extract greater benefit from permitted foreign investment.

79. When entry was permitted, governments placed numerous performance requirements on investors in order to maximize the benefits to their economies. Some of the requirements were imposed balance of payment reasons, such as export requirements or ceilings on licensing fees. However, most were put in place in order to ensure that local businesses picked up advanced technologies and skills from their interaction with foreign investors, either through direct transfer or through indirect spillovers. Local content requirements and explicit requirements for technology transfer were the most obvious means to ensure this.

80. Historical evidence shows that a strategic and flexible approach is essential if countries are to use foreign investment to pursue long-term national interests. Rather than sticking to one rigid recipe, most successful economies have changed their policies towards foreign investment according to changes in their stages of development, national priorities, and the world economic environment.

V. DO BIT'S AND FTAS ATTRACT MORE FOREIGN DIRECT INVESTMENT?

81. There is no doubt about the importance of FDI as a source of funds to developing countries. When capital flows to developing countries began to rise in the late 1990s following the decline in overall development assistance from the developed world, the flows were increasingly composed of FDI.[28]

82. During 2003-2007, FDI flows followed an upward trend with inflows reaching a historic record of $1.9 trillion. In light of the proliferation of BITs and FTAs between the North and the South, the extent to which these two phenomena are causally related warrants careful scrutiny. In the first place we will look at studies that find a positive correlation between international investment agreements and FDI.

[28] H. Zebregs, *Can the Neoclassical Model Explain the Distribution of Foreign Direct Investment Across Developing Countries*? IMF Working Paper WP/98/139

1. Positive Impacts

83. A study by Salacuse and Sullivan provides three cross-sectional analyses of FDI inflows to up to 99 developing countries in the years 1998, 1999 and 2000, respectively, as well as fixed effects estimation of the bilateral flow of the FDI from the US to 31 developing countries over the period 1991 to 2000.[29] They find the signature of a BIT with the US to be associated with higher FDI inflows in both types of estimations, whereas the number of BITs with other OECD countries is always statistically insignificant in terms of FDI inflows.

84. Neumayer and Spess argue that developing countries which have concluded an FTA with a developed country might receive more FDI as it is easier to export goods back into the developed or other countries. Such agreements sometimes also contain provisions on policies that might be beneficial to foreign investors.[30] This study does not include the Lome Conventions or the follow-on Cotonou Agreement between the EU and ACP countries since it is highly unlikely that these had any major impact on FDI.

85. The study concludes that developing countries that sign more BITs with developed countries receive more FDI inflows. Furthermore the signing of BITs sends out a signal to potential investors that the developing country is generally serious about the protection of foreign investment. The encouragement of FDI inflows therefore need not be restricted to investors from developed countries that are BIT partners of the developing country. Instead BITs can have positive spill-over effects. However the study finds it impossible to tell whether the demonstrated benefits of signing up to BITs in the form of increased FDI inflows are higher than the substantial costs developing countries incur in negotiating, signing, concluding and complying with the obligations typically contained in such treaties.

2. Negative Impacts

86. A study undertaken by Hallward-Driemeier, looking at the bilateral flow of FDI from 20 OECD countries to 31 developing countries over the period 1980 to 2000 finds that the existence of a BIT between two countries does not increase the flow of FDI from the developed to the developing signatory country.[31] This is true whether the dependent variable is measured as absolute flows, flows divided by host country's GDP or the share of the source countries' FDI outflow. Interacting the BIT variable with various measures of institutional quality, she finds a positive coefficient of the interaction term that is often statistically significant. This would suggest that contrary to theoretical expectations, BITs are complements to good institutional quality and therefore do not perform their

[29] J. Salacuse and N. Sullivan (2005), *Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, Harvard International Law Journal, 46, 67-130

[30] E. Neumaye and l. Spess (2005), *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries*, London School of Economics and Political Science.

[31] M. Hallward-Driemeir (2003) *Do Bilateral Investment Treaties Attract FDI ? Only a bit…and they could bite*, World Bank Policy Research Paper WPS 3121

original function, namely to provide guarantees to foreign investors in the absence of good domestic institutional quality.

87. In the second study, Tobin and Rose-Ackerman analyse the impact of BITs on general FDI inflows, also in a panel from 1980 to 2000 covering 63 countries.[32] Whilst both studies draw upon data provided by International Country Risk Guide (ICRG), Hallward-Driemeier uses individual components of institutional quality, whereas Tobin and Rose-Ackerman use the aggregate political risk measure, which includes many more components than institutional quality, including some that are not directly related to political risk (such as, among others, religious and ethnic tensions, armed conflict and socio-economic conditions such as unemployment and poverty). In a fixed effects model, Tobin and Rose-Ackerman find that a higher number of BITs either in total or signed with a high income country lowers the FDI the country receives as a share of global FDI flows at high levels of risk and raises the FDI only at low levels of risk.

88. In conclusion one must ask whether developing countries really need to use international law to attract foreign investment by constraining their governments at the domestic level. The evidence is inconclusive that existing investment treaties actually draw in foreign investment. Without such evidence, it is not advisable for states to relinquish their regulatory flexibility and policy space in a wide range of fields, in exchange for an elusive promise of beneficial investment that could in all likelihood be secured by other means.[33]

VI. INVESTMENT – AGENDA OF NEXT WTO ROUND

89. Over the last several years, the developed countries have been stepping up their efforts to formulate a viable multilateral investment agreement (MIA) that would restrict countries' ability to control FDI, and possibly portfolio investments. Initially, this was mainly pursued through the OECD, where it was proposed that the developed countries adopt an MIA to which willing developing countries would also be allowed to sign up. Since this move was thwarted in 1998, the main battleground then moved to the WTO, where the possibility of a multilateral investment agreement involving all member countries was under serious discussion.[34] There was a lot of opposition to starting negotiations on investment at Cancun in 2003 (from India, Malaysia, Indonesia and the Philippines). In July 2004, the WTO General Council agreed that there would not be any negotiations on them during the Doha work programme period. Many developing countries opposed the introduction of an investment agreement in the WTO, as they were concerned this would prevent or

[32] J. Tobin and S. Rose-Ackerman (2005) *Foreign Direct Investment and the Business Environment in Developing Countries : the Impact of Bilateral Investment Treaties*, Yale Law School Center for Law, Economics and Public Policy Research Paper No. 293
[33] Gus Van Harten, *Investment Provisions in Economic Partnership Agreements*, (2008) at page 10
[34] South Perspectives (June 2003), *The Northern WTO Agenda on Investment : Do as we Say, Not as we Did* at p. 1

reduce their policy space to determine their own investment policies, such as choice of and conditions for foreign investment, including entry requirements, equity requirements, performance requirements, regulation on funds transfer, etc.

90. However, the proliferation of FTAs containing binding rules on investment weakens the position of developing countries negotiators at the multilateral forum. Granted, investment is not negotiated in the Doha Round. Yet should the developed countries want to include it in the next round, this could be easily done given that the majority would have already gotten concessions from the developing countries at the bilateral level. Not only will these greatly reduce the margin of maneuver of developing country negotiators in future rounds, but it will also be tantamount to the developing countries giving away a round for free.

Alternative Options

91. Developing countries are today confronted squarely with the issue of international investment agreements. It is South Centre's view that these countries must be as well prepared as possible to deal with all aspects of the topic, notably the impact on development and alternative options available. In this regard, there are currently three positions actively being taken now outside the traditional investment approach propagated by Brazil, Ecuador and South Africa.

i. Brazil

92. The Brazilian position focuses on domestic legal and policy improvements. Over the last few decades, FDI has played a very relevant role in Brazilian industrialization, attracted especially by the large domestic market – but also by government policies – and directed preferentially towards capital and technology-intensive industrial sectors. Foreign capital is viewed with sympathy by the large majority of political currents, who see it as a source of employment and modernization of the economy.[35] Despite the importance of foreign investment to its economy, Brazil is not a party to any BITs and has not ratified the ISCID Convention.

93. As a matter of fact, Brazil has signed almost two dozen BITs with OECD countries and developing countries. But none of the BITs signed has been ratified by the Brazilian Congress, where they have been the subject of various questionings, precisely because of their wide scope and because they sanction the presence of components typical of the new paradigm of international treatment of investments: a broad concept of investments and free transfer of resources associated with investments.[36]

[35] P. da Motta Veiga, *Foreign Direct Investment in Brazil: Regulation, Flows and Contribution to Development*, May 2004
[36] Ibid at page 28

94. One of the reasons for Brazil's apparent reluctance to bind itself to such agreements is legal uncertainty.[37] First of all it should be remembered that the essential guideline of Brazil's economic foreign policy throughout the last forty years has been to preserve "national autonomy" and to maintain ample spaces for the national State to exercise its authority, especially in the field of development strategy.

95. It is also widely assessed that mechanisms existing in the investment agreements of the 1990s cause a substantial reduction of the regulatory capacity of national States and that they would bear a negative impact on the possibility of Brazil continuing to practice industrial policies. Furthermore, over the last few decades Brazil has been an important destination of FDI flows without any agreement having been signed. So there is a more or less generalized disbelief among policy-makers concerning the potential benefits of – or the need for – these agreements in order to attract FDI.[38]

96. Finally, the provision of infrastructure services has gone through intense regulatory changes in the last few years, and establishing rules and disciplines typical of a broad investment agreement, such as a loose concept of indirect expropriation and the setting of an investor- State mechanism for settling disputes, tends to be viewed essentially as an important constraint on eventual improvements to the recently implemented regulatory framework.

97. Foreign investors continue to invest in the Brazilian economy with their interests protected by contracts negotiated with the Brazilian government. Therefore in terms of inward investment, Brazil has not suffered any negative consequences from not ratifying BITs. However, Brazil has become a capital exporter, with Brazilian multinationals doing business all over the world, and some argue that the consequence of not ratifying BITs is that Brazilian companies are unprotected.[39]

ia. The investment negotiations in the FTAA

98. The negotiations on investment in the FTAA refered explicitly to the paradigm of the BITs and to the extent that the scope and range of these agreements had a clear influence on the definition of the architecture of the FTAA investment chapter. It seems also true to argue that these negotiations also reflect - through the posture of some of the Parties, and especially Brazil – the process of critical re-assessment of the commitments made by developing countries in the trade negotiations.[40]

[37] E. Whitsitt and D. Vis-Dunbar 'Investment Arbitration in Brazil: Yes or No?' *Investment Treaty News* (Dec. 2008)
[38] P. da Motta Veiga, op. cit. at page 33
[39] Ibid
[40] P. da Motta Veiga, op. cit. at page 30

99. The ambition of the US in the FTAA was quite clearly to reproduce the NAFTA and US BITs model, especially provisions granting to foreign investors high standards of protection, while allowing for sectoral reservations. From the Brazilian point of view, the biggest worries with regard to establishing a hemispheric agreement on investments based on the NAFTA and US BITs model relate to the ambition of such a paradigm, including investment-protecting provisions that today tend to be seen more and more – not only in Brazil – as a source of asymmetries and undesirable constraints for developing countries.[41]

ii. Ecuador

100. Ecuador's new constitution has reviewed the Investment Promotion and Gurantee Act (1997), among others. The new constitution is expected to give the State substantial additional control over revenues from natural resources. In April 2008, the constituent assembly suspended all mining exploration and revoked 80 per cent of unexploited mining concessions. The government of Ecuador also suspended negotiation of new BITs until the enacting of a new constitution, notified nine countries[42] of its decision to denounce such treaties, and will propose renegotiations to another thirteen countries.[43] These renegotiations aim at rebalancing investors' rights with the public interest, restricting access of private foreign investment to certain strategic sectors and limiting future commitments on liberalization and national treatment. Another goal of these renegotiations is to include performance requirements and the definition of expropriation and dispute settlement clauses. On 4 December 2007 Ecuador notified ICSID that it would no longer consent to that body's jurisdiction in investment disputes related to the exploitation of natural resources, such as oil, gas, minerals and others.

iii. South Africa

101. In 2009, the government of South Africa instituted a BIT Policy Framework Review Process. This review was partly necessitated by the various arbitral proceedings initiated against the Republic of South Africa (RSA) and the need to conduct a comprehensive risk assessment. Prior to 1994, the RSA had no history of negotiating BITs. While it was understood that the democratically elected government of the time had to demonstrate that the RSA was an investment friendly destination, the impact of BITs on future policies were not critically evaluated. As a result the Executive entered into agreements that were heavily stacked in favour of investors without the necessary safeguards to preserve flexibility in a number of critical policy areas. In reviewing the various BITs

[41] Ibid
[42] These are Cuba, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Romania and Uruguay.
[43] These are Argentina, the Bolivarian Republic of Venezuela, Canada, China, the United States and eight European countries (Finland, France, Germany, Italy, the Netherlands, Spain, Switzerland and the United Kingdom).

entered into at that time, it became apparent that the inexperience of negotiators at that time and the lack of knowledge about investment law in general resulted in agreements that were not in the long term interest of RSA. To a large extent, the review seeks to correct this misalignment and to place before the Executive the true facts inherent to commitments undertaken by the RSA under BITs whilst at the same time updating the RSA's BIT regime as being contemplated by many developed as well as developing countries whose history and experience of BITs is similar to that of the RSA.

102. The RSA has also emerged as a capital exporter into the African continent and beyond. RSA companies have established a footprint on the continent, a foray that has been fully endorsed and encouraged by the RSA government. In the SADC region the *Protocol on Finance and Investment* (FIP) creates a framework for investment in the SADC region. This instrument seems only to cater for inward FDI and does not cater for intra-SADC investment. There seems to be little or no integration between the FIP and investment protection and promotion policies followed by the RSA. Given the sizeable intra-Africa investments made by RSA companies, the RSA ought to assess how best such investments by its citizens may be safeguarded. Already the issue of diplomatic protection has been raised in the context where no BIT was in place to protect such interests. Different considerations apply in situations where either inward or outward FDI is contemplated. This raises some difficult questions with relation to the appropriate model for investment protection since clearly different needs may be articulated by RSA companies that invest in the African continent and investment entering the RSA. It is recommended that RSA develop an investment law which regulates issues pertaining to sectoral interventions, incentives and the role of Investment Promotion Agencies. Clear policy guidelines must inform approaches to both inward and outward investment.

103. This exercise requires a balanced outcome; a coherent legal framework. It is important to structure national arrangements in a transparent, logical and effective manner and to ensure that investment policies are aligned to the bigger picture.

VII. CONCLUSION

104. In successful economies, only when the domestic industry has reached a certain level of sophistication, complexity and competitiveness can the benefits of non-discrimination and liberalization in investments come to outweigh the costs. As a result, countries have generally moved towards a greater degree of non-discrimination and liberalization as they develop. In that sense, non-discrimination is better seen as an outcome of development, not a cause, and therefore investment agreements founded on models proposed by the EU and the US are more likely to harm developing countries' prospects for development. EU and US investment agreements impose extensive restraints on the regulatory

flexibility of developing countries to decide whether to admit foreign investors and under what conditions, and thus limits the policy space that is available to host governments to manage costs and benefits of investment in light of their own development priorities. In addition, different developing states will be affected by the interaction of FTAs and BITs depending on the degree to which (a) additional investors enter the state's economy as a result of an FTA, and (b) the extent to which these investors have access to post-establishment protections under BITs.

READERSHIP SURVEY QUESTIONNAIRE
South Centre Analytical Note

THE EUROPEAN UNION AND UNITED STATES' APPROACH TO INTERNATIONAL INVESTMENT AGREEMENT WITH DEVELOPING COUNTRIES: FREE TRADE AGREEMENTS VERSUS BILATERAL INVESTMENT TREATIES

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