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Working Group on the Relationship between Trade and Investment

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SCOPE AND DEFINITION

EXECUTIVE SUMMARY

In a globalized economy it is increasingly difficult to divorce trade-related from non-trade-related investment activity. Given this dynamic we need to examine the issue of scope and definition in a manner that will enhance the relevance of our work to the development of a framework for the contemporary global economy and international investment's contribution to it.

Consistent with the Doha Declaration, Canada believes that our work in the WGTI would benefit from focussing on a *general approach* to scope and definition. In particular, this would provide a solid basis on which to continue clarifying specific concepts with a view to providing a basis for a decision on the modalities of negotiations, without pre-judging outcomes.

The Secretariat note [WT/WGTI/W/108] does an excellent job of placing our work on scope and particularly definitions in context. It rightly notes that the scope of any prospective definitions – and indeed any treaty itself – is shaped through the interplay among definitions of key terms, substantive provisions, and specific commitments. We would also add that the coverage of some international investment agreements (IIAs) benefits from the clarification provided by a "scope" article that sketches out in general terms the coverage of the agreement.

It must also be recalled that any prospective investment agreement in the WTO would need to be properly anchored by virtue of the fact that it would co-exist and interact with a number of other agreements within the WTO system. These include TRIMs, TRIPs, the ASCM, and of course GATS, all of which contain provisions that to a greater or lesser degree already pertain to investment behaviour in so far as it is trade-related. The reach of the NAFTA definition of investment as outlined in Annex 2 of the Secretariat note is similarly limited, as would the scope of some of the categories of investment in the WTO context as outlined in Annex 1 of the Secretariat note.

It will be important for such a definition to embody flexibility, both for development and other policy objectives. This should be possible not only because of inherent limitations on its scope as identified above, but also the possibility of shaping it through the way it would interact with the other provisions, commitments, and exceptions of any prospective investment agreement itself. This

flexibility would also be consistent with the right of governments to regulate in their economies in the public interest.

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I. INTRODUCTION

1. Canada's approach to "scope and definition" is in the context of paragraph 22 of the Doha declaration, particularly with respect to balancing "… the interests of home and host countries, and to take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest". In this vein, Canada regards the Secretariat's note [WT/WGTI/W/108] as an excellent contribution in summarising issues related to scope and definition for discussion.

2. The following outlines in general terms Canada's examination of relevant considerations regarding the scope of a possible agreement and definitions within it, particularly of investment and investor. Our preference is to proceed on the basis of a *general approach* with respect to these issues. This is with a view to assisting the Working Group to provide a basis for an eventual decision on modalities of negotiations without pre-judging specific outcomes on detailed issues. Nonetheless, it should be noted that adopting a general approach should in itself help to address the issues identified in paragraphs 64-66 of the Secretariat note. This will occur partly by virtue of the scope of any prospective agreement that emerges as a result of our approach to definitions.

II. THE RELATIONSHIP BETWEEN "SCOPE" AND "DEFINITION OF INVESTMENT"

3. In order for our work to be effectively anchored and as relevant as possible to the rapidly evolving international economy, Canada believes that important considerations in determining the definition of investment include: (a) support the principles and objectives of the WTO as outlined in the Doha Declaration and at Marrakesh; (b) reflect business realities and assist in the development of a multilateral rules-based framework for evolving relationships between the state on the one hand and investors and investments on the other; and (c) provide for "flexibility" in the scope of any prospective agreement, including with respect to the development needs of members.

4. It should be pointed out at the outset, however, that the issues of scope and definitions of investment and investors are closely intertwined. This point is illustrated well in the recent UNCTAD study on "Scope and Definition", whereby mechanisms limiting a broad-asset based definition of investment are addressed.[1]

5. Definitions are not the only way in which the scope of a treaty may be limited. Many treaties also contain an article or provision on "scope" itself, whereby the scope and coverage of the agreement is delineated. It is also the relevant place to make clear the extent of obligations is limited to government "measures" that affect or relate to investment. This is part of the approach with respect to scope taken under article I.1 of the GATS, which states that the Agreement applies to "…measures by Members affecting trade in services". (Measures affecting market access commitments are then further defined under article XVI, many of which affect trade in services through commercial presence, including with respect to establishment.) It is also the approach of chapter 11 of the

[1] See "Scope and Definition", section 2, pp. 23-30 (booklet in UNCTAD's Series on Issues in International Investment Agreements", UN Sales no. E.99.II.D.9, 1999). This paper also observes (p. 17): "Recent practice in international investment agreements that seek both to liberalize investment regulations and to protect foreign investment seems to move in the direction of broad definitions."

NAFTA under article 1101.1. (and article 201 for a definition of "measure").[2] Thus, whatever the underlying architecture of the agreement, or approach to commitments and/or exceptions, a scope article, as well as definitions of relevant terminology, can be helpful in setting out the framework for an agreement.

6. Moreover, investment is a horizontal concept of general application to basically all economic activities, as is reflected in other WTO agreements that already deal with elements of it in different ways. In considering the scope of any prospective agreement, including with respect to definitions, we would need to nonetheless avoid too artificial a "compartmentalisation" of activities, as well as to ensure consistency among these agreements.

7. The chief point to be made in this regard is that any prospective investment agreement in the WTO would be anchored within a larger trade and investment framework. NAFTA investment provisions also operate within such a context, and several provisions limit the scope of the investment provisions (chapter 11) *vis-à-vis* other chapters. Some of these lie within chapter 11 itself; others exist elsewhere.[3] This is a fundamentally important constraint on the scope of any definition of investment that – at least with respect to provisions lying outside an investment agreement – does not enter into consideration in stand alone bilateral investment treaties (BITs).

8. All these NAFTA-type provisions are relevant to our discussion on the scope of any prospective comprehensive investment framework elsewhere. Indeed, given investment-related provisions in other WTO agreements, including GATS, TRIPs, TRIMs and the ASCM, they would presumably be necessary. Thus, for instance, there would be a need for appropriate rules of precedence in instances of potentially overlapping issues.

9. Investment activity by foreign firms supplements domestic sources of capital and know-how, and in general is of net benefit to the host economy. While we therefore believe that the international framework should not in general provide for discrimination nor capricious activity, at the same time it should accommodate sufficient flexibility for the state to regulate in the public interest. Companies should also of course continue to be obliged to obey domestic law. Finally, it would be appropriate to limit the scope to economic activities so as to cover only investments acquired in the expectation or used for the purpose of economic benefit or other business purposes. This effectively serves to limit the coverage of any prospective agreement with respect to real estate and other property. Complementary reservations reinforcing this could also be appropriate.

III. DEFINITION OF INVESTOR

10. Briefly, as far as the definition of an investor is concerned, Canada believes that it would need to be sufficiently broad so as to cover the investor's act of investing. In other words, any prospective agreement should apply to the investor while in the process of investing (before and after the point in

[2] Article 201 of the NAFTA also defines measure as including "any law, regulation, procedure, requirement or practice".

[3] For example, Article 1112.1 of the NAFTA states that in the event of any inconsistency between the investment chapter and another chapter, the other chapter shall prevail to the extent of the inconsistency. Article 1101.3 states that chapter 11 does not apply to measures adopted or maintained by a Party to the extent that they are covered by chapter 14 on financial services. Article 1108.5 states that the chapter 11 provisions on national treatment and most-favoured-nation treatment do not apply to any measure that is an exception to, or derogation from, the obligations under Article 1703 (the national treatment article of the chapter on Intellectual Property) as specifically provided for in that article. There are other examples, including chapter 12 on cross-border trade in services, (roughly analogous in terms of underlying coverage to mode 1 and 2 coverage under the GATS), and chapter 16, on temporary entry for business persons (roughly analogous to GATS mode 4).

time at which the act takes place) as well as during the life of the investment. Since presumably there would be an MFN obligation, there is no *a priori* reason to examine issues of ownership or control by nationals of a particular WTO member (except to the extent that there is a need to deny benefits in some well-defined circumstances).

11. In addition, since the Canadian constitution protects the rights of both citizens and permanent residents, Canada would in principle support no distinction between these two entities. This would be roughly analogous to the approach under article XXVIII(k) of the GATS. We also recognise, however, that for constitutional and other reasons country-specific exceptions or reservations may need to be accommodated. Moreover, the issue of the treatment of dual nationals would have to be taken into consideration.

IV. DEFINITION OF INVESTMENT

12. As has been pointed out in other submissions to this group as well as the Secretariat note, limiting ourselves to an FDI or an enterprise based definition, or relying on tests of ownership and control of an investment, can be arbitrary and would not capture the way in which businesses operate. It can effectively exclude from the scope of an agreement an investment as traditional as a 9% (controlling) interest in an enterprise, let alone any of the newer forms of investment such as strategic alliances sometimes used as a means for companies to adapt quickly and compete under rapidly changing market conditions. Nor would a narrow FDI-based definition necessarily include equity or other means of financing enterprises use to finance their investments.

13. This would decrease the utility of any prospective investment agreement considerably. Controlling interests in foreign enterprises represents considerably less than 50% of the investments held by Canadian investors abroad, as well as those held by foreign investors in Canada.[4] However this is not to say that we believe that *all or any types of* investments should fall under the scope of an investment agreement, nor even that all assets that do fall under the umbrella of such an agreement should be covered with respect to all provisions at all times. This will be addressed in further detail below.

14. Thus, if we start with the premise that a definition of investment based on FDI only is insufficient, the issue then becomes what else should be included. The most obvious category would be other kinds of investment associated with enterprises – e.g. any equity participation, debt security or other kinds of interests that entitles the "investor' to have access to the profits of the enterprises or to some part of the liquidation value of an enterprise. By including these elements in the definition of investment, we believe that this would work to ensure that the coverage in goods industries, or indeed any "tradable" more tangible than cross-border trade in services, is at least as secure as investment in services industries through the GATS.

15. Beyond concepts of FDI and enterprise are other elements that reflect the way international investment takes place. In this regard the next "tranche" of elements that could be considered in the context of a broader definition of investment would be other kinds of assets. On its own terms, a broad asset-based definition can encompass new forms of investment such as strategic alliances which may not demand traditional ownership of an enterprise. It simply more closely approximates the way in which investors consider their assets when making investment decisions. It must after all be recalled that one of the reasons we are contemplating investment rules is to provide an appropriate framework under which international investment can take place.

[4] The conceptual framework for Canada's international investment position is consistent with the international conventions and standards of the International Monetary Fund's Balance of Payments Manual (1993). See the Statistics Canada's quarterly series *Canada's International Investment Position*.

16. For clarity with respect to any prospective dispute settlement facilities, and in the interests of clearly delineating the potential scope of the agreement, it may be preferable to envisage an exhaustive (i.e. closed) list of inclusion and exclusion from coverage.

17. An examination of the NAFTA definition of investment in Annex 2 of the Secretariat note provides a number of indications as to how many of the issues identified in paragraph 64 of the Secretariat note can be addressed. Since this definition is included in the Secretariat note, we would like to address a few aspects of it in order to increase understanding and perhaps reduce misconceptions about the scope of an investment agreement that includes assets in its definition of investment.

18. It should also be stated at the outset that although the NAFTA framework is tailored to the NAFTA context, the WTO context is of course different and demands an approach specifically suited to WTO purposes. On the other hand, as far as Canada is concerned the economic context within which investment takes place under both agreements is similar; we would also argue that the flexibility inherent in the NAFTA approach could be of interest to our work in this group.

19. More specifically, as noted in the Secretariat note, neither loans to a state enterprise, loans to an enterprise not an affiliate of the investor, nor loans with a maturity of three years or less are included in the NAFTA definition (paragraph d). Similarly, under paragraph (i) it is expressly stated that among the things investment does not mean is, among other things, the extension of credit in connection with a commercial transaction. Under paragraph h.i and ii, specified contracts, including concessions necessitate "a commitment of capital or other resources in the territory of a Party to economic activity in such territory".[5] All of these provisions, in addition to other articles both within and without NAFTA's investment chapter, complement each other. There is no reason to believe that the same sort of complementarities and circumscriptions would not apply to a broad definition of investment in a multilateral context in the WTO with its own network of agreements and provisions within them that already pertain to investment activity.

20. More broadly (and with respect to some of the points raised in paragraph 64 of the Secretariat note), it is important to realise that financial transactions only fall under the rubric of Chapter 11 of the NAFTA subject to a number of qualifications. NAFTA contains a separate chapter on Financial Services (chapter 14), under which prudential measures are also addressed. There are complementary provisions in the investment chapter as well as in other chapters.[6] In the GATS, articles XI (Payments and Transfers) and XII (Restrictions to Safeguard the Balance of Payments), as well as the Financial Services Annex, are relevant to this issue as well.

21. Added attention to this and related issues (including a balance of payments clause in any prospective investment accord) would require the assistance of international finance experts in our work in the future. The issue of short-term capital movements is not primarily one of discrimination but rather volatility and hence is not one that the WTO oversees in any case. We would note that the work of the Working Group on Trade, Debt and Finance could be relevant to these issues. In any case,

[5] Thus, services as understood under Modes I, II, and IV of the GATS effectively lie outside the scope of NAFTA's chapter 11 coverage. NAFTA has a separate chapter on Cross-Border Trade in Services, however (Chapter 12), and definitions under article 1213.2 further elucidate on the difference in scope and coverage between the two chapters. However NAFTA implicitly recognises linkages between investment and services through the structure of NAFTA reservations to the agreement, which are outlined with respect to specified articles under both Chapter 11 and 12.

[6] For instance, chapter 11 contains an article on "Transfers", which outlines several means of preventing of transfers related to existing or future measures pertaining to bankruptcy, dealing in securities, criminal offences, etc. A chapter on exceptions (chapter 20) also contains a detailed article on Balance of Payments (Article 2104).

we would maintain that considering the inclusion of some financial or other assets in the definition of investment does not open the door to no control over untrammelled short-term capital flows with no connection to a foreign investment.

22. Finally, Canada also fully endorses the notion of "flexibility" in investment agreements, whether for development or other reasons – and which parenthetically is the first issue identified in paragraph 64 of the Secretariat's paper. There is no *a priori* reason why the definition of investment cannot be circumscribed in the agreement, including with respect to pre-establishment market access, particularly in some sectors. One way in which this is possible is through the way in which other relevant commitments, reservations or exceptions are worded.

23. Conversely, Canada recognises that in no treaty do all parties undertake exactly the same commitments in exactly the same manner. While a realistic definition of investment should be compatible with restrictions on the scope of an investment agreement, it should also be flexible enough to encompass new forms of investment apart from tradition ownership and control.

V. CONCLUSION

24. The scope and definition of any prospective investment framework in the WTO would likely be considerably circumscribed by a number of other agreements and understandings affecting international investment behaviour already embodied within WTO agreements. This is an important factor that does not enter into consideration in stand alone bilateral investment treaties. However it can be expected to limit the scope of an agreement on investment within the WTO family of agreements that already affect investment, such as TRIMs, TRIPS, the ASCM and of course GATS.

25. The NAFTA provides one example of how an investment agreement has been drafted to co-exist with other chapters on cross-border trade in services, temporary entry for business persons, telecommunications, trade in goods, and financial services, among others. The relationship of any prospective WTO investment accord to the framework of other investment-related provisions in existing WTO agreements will more sharply emerge as we continue our work.

26. This dynamic needs to be taken into account whenever scope and definitions in an investment accord within the WTO are considered. In addition, definitions are circumscribed through the way in which they interact with substantive provisions *within* any investment agreement, including a "scope" article, as well as exceptions, reservations or commitments.

27. Therefore, given this context, a definition of investor should be flexible enough to encompass the investor's act of investing, including before and after the point in time at which the act takes place. Similarly, any definition of investment should be realistic, practical, and indeed flexible enough to encompass the contemporary business dynamics associated with investing, while providing sufficient policy space for all WTO members to pursue regulatory, development, prudential, and other goals in the public interest. Canada believes these to be realistic and achievable aims.

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