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MODALITIES FOR PRE-ESTABLISHMENT COMMITMENTS BASED ON A GATS-TYPE, POSITIVE LIST APPROACH

Note by the Secretariat

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EXECUTIVE SUMMARY

"Modalities for pre-establishment commitments based on a GATS-type, positive list approach" is one of the seven topics listed in Paragraph 22 of the Doha Ministerial Declaration that is to be clarified by the Working Group. Paragraph 22 also cites a number of other parameters that are to be taken into account in any multilateral framework. One that is relevant to this topic is: "any framework should enable Members to undertake obligations and commitments commensurate with their individual needs and circumstances".

Pre-establishment treatment refers to the laws and regulations of a host country that govern the entry of foreign investment. They determine whether admission (access) is possible at all, and if so then on what terms and conditions foreign investment can establish locally. A series of policy decisions by the host country government is involved, in particular: which categories of foreign investment it is prepared to admit (foreign direct investment (FDI), portfolio investment, etc.); how it selects specific foreign investments to admit (on an *ad hoc* basis, through systematic screening policies, or with an "open-door" policy); whether it permits foreign investment only in certain sectors and industries, or economy-wide; whether and how it applies most-favoured-nation (MFN) and national treatment and what conditions it attaches to the entry of foreign investment and its subsequent activities, for example through investment incentives, foreign ownership limitations, performance requirements, and so on.

International investment agreements (IIAs) generally take one of three different approaches to cover the pre-establishment treatment of foreign investment. UNCTAD describes them as the "investment control", "MFN/national treatment" and "selective liberalization" models.

- Most IIAs, particularly bilateral investment treaties, use an investment control approach. Foreign investment is admitted in accordance with the domestic laws and regulations of the host country. This does not offer any automatic right of admission or establishment to foreign investment, and it therefore provides governments with wide discretion to regulate its entry.

- Some IIAs apply an MFN/national treatment approach. Applying full MFN and national treatment to the admission and establishment of foreign investment would guarantee an open-door investment regime. However, country-specific ("negative") exemptions are usually permitted under this approach in respect of particular measures, as well as sectors or activities in which foreign investment is not admitted, and these can provide Parties with considerable flexibility in setting the *de facto* conditions of pre-establishment treatment.

- A few IIAs apply a selective liberalization approach. They base pre-establishment treatment on specific ("positive") commitments which Parties undertake, on an individual basis, with regard to sectors or activities in which foreign investment is admitted and with regard to the application of certain policy disciplines, notably national treatment. UNCTAD cites the GATS as the prime example of the use of this approach.

The MFN/national treatment approach and the selective liberalization approach will converge if provision is made in an IIA for progressive liberalization, as time-limited exemptions expire, for example, or as a result of successive rounds of negotiations on specific commitments.

The General Agreement on Trade in Services (GATS) addresses policies that WTO Members apply, *inter alia*, to the establishment of a "commercial presence" by foreign service suppliers, which corresponds broadly to the concept of pre-establishment treatment for foreign direct investment. It uses in large part the "selective liberalization" approach to provide access to foreign service suppliers, but it also contains elements of the MFN/national treatment approach, and it relies on the use of both positive lists of commitments and negative lists of exemptions for different purposes.

The GATS allows each Member to decide what specific market-access commitments it will undertake, and to schedule those commitments – "bind" them, in GATT-terms – using a positive-list approach. If a Member does not list a specific commitment to allow foreign service suppliers to establish a commercial presence in a particular service sector, then subject to its MFN obligation it is not required to grant them entry to that sector. Other core policy disciplines of the GATS – notably to avoid certain trade-restricting measures and to apply national treatment – are linked directly to a Member's market-access commitments. They apply only to measures affecting the supply of services in sectors or activities where market-access commitments have been made. Members can attach conditions and qualifications in their schedules, using a negative-list approach, to both their obligation to avoid certain restrictions and to apply national treatment in scheduled sectors.

The GATS MFN obligation also has important implications for pre-establishment treatment. It is a rule of general application. Subject to any (in principle, temporary) exemptions that Members can list at the time of entry into force of the Agreement, it requires a Member to grant MFN treatment unconditionally with respect to any measures affecting trade in services in all sectors where it permits the entry of foreign service suppliers, regardless of whether it has scheduled the sectors as specific commitments.

The GATS-type, positive-list approach to scheduling market-access commitments and related policy obligations has been viewed by many in the Working Group as a realistic way of approaching any eventual multilateral negotiation in the area of investment. In their view, it provides balance between policy discipline and flexibility for developing countries, that allows them to undertake commitments commensurate with their individual development needs and circumstances and to pursue their national economic and social objectives. Some others have expressed reservations about applying this approach to foreign investment, noting that most IIAs that cover the pre-establishment stage of investment today use the "MFN/national treatment" model, based on exemptions from, rather than commitments to, market access and policy obligations. Some have doubted whether either

approach is realistic, and feel that developing countries are not in a position to accept international policy disciplines over the pre-establishment treatment of foreign investment.

I. INTRODUCTION

1. This Note describes the way in which disciplines relating to pre-establishment treatment are structured in international investment agreements (IIAs), and compares it with the way in which they are structured in the GATS. Pre-establishment treatment in an IIA depends not only on the way in which commitments to obligations are undertaken, particularly whether sectors and measures are negotiated "in" or negotiated "out" from the coverage of an IIA's policy disciplines, but also on its definition of covered investments, its general obligations and exceptions, and its development provisions. These additional factors are covered in more depth in separate Secretariat Notes.[1]

II. DISCUSSIONS IN THE WORKING GROUP[2]

2. The Working Group has discussed general standards of legal treatment applicable to the admission and establishment of foreign investment in a host country. It has been noted that there is no rule of customary international law requiring a State to allow entry to foreign investment, and that the concept of an unconditional right of entry does not exist in practice. The narrower concept of right of establishment is used, but only in the context of economic integration agreements that aim for deep, and ultimately complete, integration among parties.

3. It has also been noted that the majority of existing IIAs, and particularly bilateral investment treaties, contain binding policy rules only on the post-establishment treatment of investment and leave access to a host country and the pre-establishment treatment of investment subject to its national laws and regulations.

4. Most IIAs that do contain binding policy rules on the pre-establishment treatment of foreign investment are based on applying MFN and national treatment as rules of general application. A different approach is used in the GATS, which treats admission (market access) and national treatment as specific commitments. With regard to both of these approaches, it has been noted that their scope of application depends crucially on the definition of the term investment that is used, and that each of them can be, and usually is, qualified by exceptions; those mentioned were exceptions relating to screening procedures, national security, public order, privatization, the balance-of-payments, sectoral reservations, performance requirements, and the movement of natural persons.

5. The comparative merits of the "negative list" approach used in some IIAs and the "positive list" approach used in the GATS have been discussed.

6. Some felt that to the extent the purpose of IIAs was to promote transparent and predictable treatment for foreign investment, rules of general application for its core disciplines coupled with a negative list of exemptions was the most suitable approach, particularly in guaranteeing MFN treatment. It also lent itself more readily to the identification of measures that might be amenable to

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[1] See WT/WGTI/W/108, W/109, W/118, and W/119.

[2] Reports on discussions in the Working Group on this topic can be found in WT/WGTI/M/2, paras. 36-37, M/3 para. 33, M/4 para. 10, M/5 paras. 36-37 and 64-65, M/6 paras. 59 and 79, M/8 para. 49, M/9 paras. 41, 44 and 52, M/14 paras. 64-75, and M/15 para. 62. References to this topic in written submissions can be found in WT/WGTI/W/22, W/23, W/28, W/29, W/30, W/33, W/34, W/42, W/47, W/51, W/54, W71, W/79, W/84, W/96, and W/104.

gradual liberalization. Some felt, on the other hand, that it offered less flexibility to host countries in controlling or regulating future investment in sectors and industries whose nature could not be anticipated at the time of compiling a negative list of exemptions. One question raised in this regard was whether permanent, or only temporary, exemptions to the negative list should be provided for.

7. Some felt that an approach based on a positive list of specific commitments was reasonable, it could be made progressive, and it was more appropriate when confidence-building measures were required. Experience with the GATS showed that a positive-list approach was preferable when a new area was for the first time the subject of liberalization at a multilateral level. It was a response to the broad and potentially unforeseen policy implications of the GATS, and to the complexity of regulations in some services sectors such as telecommunications and financial services. Some suggested that this approach provided Members, and particularly developing countries, with flexibility to pursue domestic development policies and to harness FDI in ways that contribute to their economic development goals. It allowed for selective liberalization of entry and establishment in specific activities under defined conditions, giving countries more control over the liberalization and rule-making process. It also minimized the chances of making unforeseen mistakes in binding entry and establishment rights in key sectors. However, it was also suggested that the flexibility inherent in this approach considerably weakened the scope of the national treatment principle, and that this could deter inflows of foreign investment to a host country. In this regard, it was suggested that the positive-list approach required constant updating if it were to assist transparency and support the aim of trade liberalization.

8. It has been pointed out that WTO Agreements use different approaches to market access and to core disciplines, such as national treatment. Some felt, in this regard, that attention would need to be paid to how these approaches could be made compatible under any eventual multilateral framework on investment. Some expressed the view that any approach taken in the WTO in the field of investment should be compatible with the GATS and should not call into question its basic approach.

9. One view has been that the development dimension should be manifest in each of the elements that comprise any set of multilateral rules on investment, so there should not be any automatic right to invest or establish in a developing country. This would ensure that host countries retained the ability to screen and regulate the entry of foreign investments, and allow in only those that best suited their industrial policies and developmental needs, in particular those that would not stifle national investment or development. In this regard, some doubted there was real flexibility inherent in the GATS approach, particularly in light of its provisions on progressive liberalization and of the difficulties it was felt that developing countries would encounter in renegotiating their commitments.

10. The use of screening mechanisms to select which foreign investment projects to admit into a host country has been discussed. One view has been that screening mechanisms create important barriers to the entry of foreign investment. Another view has been that while inappropriate screening mechanisms can retard investment flows, particularly those based on non-transparent procedures, a properly administered screening mechanism which provides for an expeditious assessment of an investment proposal on the basis of transparent criteria is not a hindrance to investment flows. On the contrary, it can provide an element of predictability in a host country's administration of the entry of foreign investment.

11. One view has been to emphasize the importance of providing non-discriminatory treatment to all three phases in the life of an investment: its entry, its operation after establishment, and its liquidation. Entry is crucial, since it is the point at which governments can deny market access altogether, or attach conditions to it, such as local participation in the ownership and control of an investment, or performance requirements. Conditions that apply to market entry often remain in force

throughout the life of an investment. Governments can link the terms of entry to those of a foreign investment's operations, and once conditions have been set it is often too costly or impractical for an investor to subsequently restructure, even if the conditions are later lifted. In the case of trade in goods and services, WTO rules discipline discriminatory treatment both at and inside a host country's border. If a product is able to cross a border free of restrictions but cannot then be sold due to internal restrictions, the value of market access is nullified. The same applies to investment. A commitment not to discriminate at the point of entry is meaningless if *de facto* access is not possible, or if the investment is so handicapped by restrictions and conditions applied to its establishment that it is at a competitive disadvantage *vis-à-vis* its competitors.

III. PRE-ESTABLISHMENT TREATMENT IN INTERNATIONAL INVESTMENT AGREEMENTS

12. This Section draws on UNCTAD's work on "Admission and Establishment" in international investment agreements.[3]

13. Pre-establishment treatment involves a series of related policy decisions by a host country government, starting with the issue of whether it is prepared to grant market access to foreign investment at all, and continuing with what categories of foreign investment it is prepared to admit, how it chooses from among competing foreign investment projects, and what terms, conditions, limitations and qualifications it attaches to those foreign investments that do gain entry: for example, the sectors in which they can operate, the level of foreign ownership and control they are permitted to exercise, the kinds of activities they can undertake in the host country, and the way in which government policies will apply to their activities.

14. In an IIA, pre-establishment treatment refers to the way in which the IIA addresses a host country's laws, regulations and administrative procedures that apply to foreign investment which is entering the country (or seeking entry) for the first time.[4] It is a combined market-access and standard-of-treatment concept, which covers the two separate, but related, legal issues of admission and establishment.[5] Admission deals with the right of foreign investment to cross the border and be present for the purpose of doing business in the host country. Admission may be granted on a temporary basis, which can be sufficient when a foreign investor seeks a short-term presence in the host country for the purpose of conducting a specific transaction, or on a more permanent basis to allow a foreign investor to engage in regular business activities. Establishment deals with the right of a foreign investor to set up a permanent business presence in the host country, in the form for example of a subsidiary. A government can regulate the entry of foreign investment through both admission and establishment. No rule of customary international law requires a state to allow entry to foreign investment, so the concept of rights of admission and establishment are treaty-based – that is to say, they are obligations which countries undertake voluntarily in the context of international agreements.

15. IIAs that contain obligations on the pre-establishment treatment of foreign investment generally focus on three related issues: the removal of investment-restricting or distorting measures;

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[3] UNCTAD, Admission and Establishment, Series on issues in international investment agreements, (1999).

[4] The conceptual distinction between "pre-establishment" and "post-establishment" treatment is not always easy to make in practice. It can blur, for example, when an established investment is expanded or diversified in the host country, and the treatment applied to foreign investment at the pre-establishment stage can affect directly and significantly its post-establishment operations and activities.

[5] UNCTAD, *Ibid*, p. 12.

the application of standards of treatment aimed at eliminating discrimination against foreign investors; and the introduction of measures to ensure the proper functioning of markets.[6]

16. UNCTAD identifies five models of treatment used in IIAs with regard to the pre-establishment stage of investment. One is the "selective liberalization" model, for which UNCTAD cites the GATS as the prime example; this is described in detail in the next Section. Two others – the "regional industrialization programme model" and the "mutual national treatment" model – have been used in certain regional integration agreements to encourage integrated (supranational) investment programmes and to enforce regional preferences. Neither seems relevant to the subject of this Note. The last two – the "investment control" model and the "MFN/national treatment" model – are the ones used most commonly in IIAs, particularly bilateral investment treaties.

17. The "investment control" model is used in the large number of IIAs that are first and foremost investment protection agreements and that focus primarily on post-establishment treatment. The "MFN/national treatment" model is used in most of the IIAs that include binding obligations on the pre-establishment treatment of investment. While these IIAs are for the time being relatively few in number, UNCTAD suggests that host countries are increasingly favouring the incorporation in IIAs of binding policy disciplines covering the pre-establishment as well as the post-establishment treatment of investment.[7]

B. THE "INVESTMENT CONTROL" MODEL

18. Most IIAs whose primary purpose is to protect foreign investment apply binding policy disciplines – usually including MFN and national treatment – on the post-establishment treatment of foreign investment. However, they usually leave a host-country government with a large degree of discretion over the pre-establishment treatment of investment, allowing it to regulate the entry of foreign investment under its domestic laws. This approach does not accord any positive rights of admission and establishment to foreign investors. It recognizes whatever restrictions and conditions on the entry of foreign investment are contained in the laws and regulations of the host country. These may include, for example, restrictions on capital inflows, sectoral limitations on where foreigners can invest, limitations on ownership and control, screening procedures, and the use of investment measures such as performance requirements.

19. A standard version of this approach, particularly in bilateral investment treaties, is to state in the treaty's preamble or in its main text that the parties intend to create favourable conditions for investors of the other contracting party, and/or to include provisions encouraging or requiring parties to promote foreign investment from the other party(s) in their territory as far as possible, and to admit it in accordance with their domestic laws and regulations.[8] Examples are:

> *Each Contracting Party shall, subject to its general policy in the field of foreign investments, promote investments by investors of the other Contracting Party* (Model agreement of Chile on the Reciprocal Promotion and Protection of Investments)

> *Each Contracting Party shall encourage and create favourable conditions for nationals or companies of the other Contracting Party to invest capital in its territory, and, subject to its*

[6] UNCTAD, Trends in International Investment Agreements: an Overview, Series on issues in international investment agreements (1999), p. 58.

[7] UNCTAD, Admission and Establishment, *op. cit.*, p. 4.

[8] See, for example, the approach used in the bilateral investment treaties of the EC Member States (WT/WGTI/W/30), India (W/71), Japan (W/34), Korea (W/42), Peru (W/47), Switzerland (W/28) and Turkey (W/51).

> *right to exercise powers conferred by its laws, shall admit such capital* (Model agreement of the United Kingdom for the Promotion and Protection of Investments)[9]

20. In addition to being used in a large number of bilateral investment treaties, the investment control approach is used in various regional and plurilateral IIAs, in some instances along with best endeavour undertakings on more substantial pre-establishment commitments. For example:

> *Each Contracting Party shall, in a manner consistent with its national objectives, encourage and create favourable conditions in its territory for investments from other Contracting Parties. All investments to which this Agreement relates shall, subject to this Agreement, be governed by the laws and regulations of the host country, including rules of registration and valuation of such investments.* (ASEAN Agreement for the Promotion and Protection of Investments, 1987)[10]

> *Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to Make Investments in its Area..... Each Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, Treatment ... which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.* (The Energy Charter Treaty, 1994)[11]

> *With exceptions as provided for in domestic laws, regulations and policies, member economies will accord to foreign investors in relation to the establishment, expansion, operation and protection of their investments, treatment no less favourable than that accorded in like situations to domestic investors.* (APEC Non-Binding Investment Principles 1994)[12]

21. The 1992 World Bank "Guidelines on the Treatment of Foreign Direct Investment" called the attention of its member countries to the following Guidelines as useful parameters in the admission of private foreign investment (Excerpts):

> *1. Each State will encourage nationals of other States to invest capital, technology and managerial skill in its territory and, to that end, is expected to admit such investments in accordance with the following provisions:*
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> *2. In furtherance of the foregoing principle, each State will:*
>
> > *(a) facilitate the admission and establishment of investments by nationals of other States, and*
> >
> > *(b) avoid making unduly cumbersome or complicated procedural regulations for, or imposing unnecessary conditions on, the admission of such investments.*
>
> *3. Each State maintains the right to make regulations to govern the admission of private investments. In the formulation and application of such regulations, States will note that experience suggests that certain performance requirements introduced as conditions of admission are often counterproductive and that open admission, possibly subject to a*

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[9] For other examples, see UNCTAD, International Investment Instruments: A Compendium, Vol. III, (1996).

[10] UNCTAD, *Ibid*, Vol. II, p. 294.

[11] UNCTAD, *Ibid*, Vol. III, p. 555.

[12] UNCTAD, *Ibid*, Vol. III, p. 535.

> *restricted list of investments (which are either prohibited or require screening and licensing) is a more effective approach. Such performance requirements often discourage foreign investors from initiating investment in the State concerned or encourage evasion and corruption. Under the restricted list approach, investments in non-listed activities, which proceed without approval, remain subject to the laws and regulations applicable to investments in the State concerned.*[13]

C. THE MFN/NATIONAL TREATMENT MODEL ("NEGATIVE LIST" APPROACH)

22. A wide range of domestic laws, regulations and administrative procedures of a host country, that apply generally to investment and business activity in its territory, can affect the admission and establishment of foreign investment (e.g., company law, competition law, privatization law, land law, environment law). A key consideration in an IIA is how these are applied to foreign investment, in particular whether or not they are applied on the basis of non-discrimination – and especially national treatment – in whole or in part.

23. Applying MFN and national treatment in full to the pre-establishment stage of investment guarantees, in principle, a very liberal investment regime that can amount to an open-door policy towards foreign investment. It places foreign investors on an equal footing with national investors to compete for investment opportunities in the host country; while certain limitations may apply – for example over investment in industries controlled by State-owned enterprises – these limitations apply equally to foreign and national investors.

24. According to UNCTAD, no country has yet found itself in a position to do this.[14] Therefore, IIAs that apply the obligations of MFN and national treatment to the entry of foreign investment as rules of general application allow Parties to qualify their obligations, usually by scheduling a "negative list" of exemptions (also referred to as the "top-down" approach) which is annexed to the agreement.

25. The exemptions taken by a host country, under the negative-list approach, from its obligation to provide non-discriminatory pre-establishment treatment of foreign investment can cover a wide variety of policy objectives. For example: maintaining ownership and control of strategic economic assets in the hands of its nationals; protecting certain categories of national investors and producers from foreign competition; strategic economic and social development objectives, such as technological or regional development; or macroeconomic policy objectives, such as fiscal, balance-of-payments, and employment objectives. Consequently, a host country's exemptions may cover which categories of foreign investment it is prepared to admit, and in which sectors, and what terms and conditions it attaches to the entry of foreign investment and its subsequent activities in the host country.

26. A number of IIAs – notably most bilateral investment treaties of the United States and Canada with their partner countries, as well as the NAFTA, the MERCOSUR Protocol on Investments from other MERCOSUR Member Countries, and the Framework Agreement on the ASEAN Investment Area – apply MFN and national treatment obligations to the pre-establishment stage of investment as rules of general application.[15] They also allow Parties to the agreements to take exceptions to these obligations, usually based on specific existing laws of the Party concerned but in some cases also on a sectoral basis. The basic obligation is typically expressed by covering the "establishment, acquisition or expansion" of investments, along with the post-establishment treatment of investments, in an

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[13] UNCTAD, *Ibid*, Vol. I, p. 248.
[14] UNCTAD, National Treatment, Series on issues in international investment agreements, (1999), p. 1.
[15] The practice of the United States is referred to in WT/WGTI/W/29.

agreement's rules on MFN and national treatment. Exceptions to the obligation are typically listed in an annex to each agreement.

27. In the case of the Model Treaty of the United States concerning the Encouragement and Reciprocal Protection of Investment, for example, the model provision on exceptions states:

> *A Party may adopt or maintain exceptions to the [MFN and national treatment] obligations in the sectors or with respect to the matters specified in the Annex to this Treaty. In adopting such an exception, a Party may not require the divestment, in whole or in part, of covered investments at the time the exception becomes effective.*
>
> *Annex*
>
> *The Government of the United States of America may adopt or maintain exceptions to the obligation to accord national treatment to covered investments in the sectors or with respect to the matters specified below:*
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> *atomic energy; customhouse brokers; for broadcast, common carrier, or aeronautical radio stations; COMSAT; subsidies or grants, including government-supported loans, guarantees and insurance; state and local measures exempt from Article 1102 of the NAFTA pursuant to Article 1108 thereof; and landing of submarine cables.*
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> *The Government of the United States of America may adopt or maintain exceptions to the obligation to accord national and most favoured nation treatment to covered investments in the sectors or with respect to the matters specified below:*
>
> *fisheries; air and maritime transport, and related activities; banking, insurance, securities, and other financial services [subject to the other Party undertaking acceptable commitments with respect to all or certain financial services, the U.S. Government will consider limiting these exceptions accordingly].*[16]

28. Other IIAs follow a similar pattern. The NAFTA, for example, requires each Party to accord to investors of other parties and their investments the better of MFN and national treatment concerning, *inter alia,* their establishment in the host country. It gives each Party the right to take individual exceptions to this obligation, which are set out in an annex to the agreement. Exceptions may be taken either in respect of certain host country measures or in relation to sectors, sub-sectors or activities identified in the schedule. Similarly, the Colonia Protocol on Reciprocal Promotion and Protection of Investment within MERCOSUR grants foreign investors of Member countries MFN and national treatment with regard to the admission of their investment, subject to the right of each Party to maintain temporary sector-specific exceptions as identified in an annex to the agreement.

29. In practice of course, the actual exceptions taken to pre-establishment MFN/national treatment obligations vary from one agreement to another.

D. THE SELECTIVE LIBERALIZATION MODEL ("POSITIVE LIST" APPROACH)

30. Instead of applying market access, MFN and national treatment, and other policy obligations to the pre-establishment stage of foreign investment as rules of general application, an alternative approach to accommodate the kinds of host-country concerns described above is to allow Parties to

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[16] UNCTAD, International Investment Instruments: A Compendium, (1996) Vol. III pp. 197 and 206.

choose and schedule their own specific commitments with regard to sectors or activities in which foreign investment is admitted and the application of disciplines over their investment policies.

31. In principle, this can amount to the mirror-image of the MFN/national treatment model; a Party's obligations are negotiated "in" through the specific commitments it takes, rather than negotiated "out" through its exemptions. Indeed, these two approaches can converge, particularly where provision is made in an IIA for progressive liberalization – as time-limited exemptions expire, for example, or through successive rounds of negotiations on specific commitments. Equally, taken to its extreme, the selective liberalization approach could lead to a Party making no commitments and therefore ending up with no binding pre-establishment obligations under an IIA, at which point it would resemble more the investment control approach described above.

32. A crucial element of the selective liberalization approach, therefore, is for the Parties to decide which obligations in an IIA are contained in rules of general application, which are triggered by Parties scheduling their own specific commitments, and what incentives the IIA provides to Parties to undertake specific commitments and expand them over time.

33. The GATS is cited by UNCTAD as the prime example of this approach. It is described in detail in the next Section.

IV. GATS PROVISIONS RELATED TO PRE-ESTABLISHMENT TREATMENT

34. One of the four modes of supply of trade in services under the GATS – and the one which is believed to account for more than half of world trade in services – is the establishment of a "commercial presence" in a host country by a foreign service supplier, known also as mode 3. This approximates to foreign direct investment, and it is in this context that the GATS provisions are most relevant to the concept of pre-establishment treatment.

35. The GATS imposes no obligation on Members to provide market access to foreign service suppliers, and several of its key policy obligations are linked directly to the specific commitments on market access that they undertake. In this respect, it is based in large part on the "selective liberalization" approach to pre-establishment treatment, but it also contains important elements of the MFN/national treatment approach, and it relies on the use of both positive lists of commitments and negative lists of exemptions for different purposes.

36. The core of the GATS provisions related to pre-establishment treatment is its use of a "positive list" approach by Members to schedule individually – "bind" them, in GATT terminology – their specific commitments on market access for foreign service suppliers. Where a Member schedules a market-access commitment in a particular sector, it is required to allow, on an MFN basis, foreign service suppliers to establish a commercial presence in that sector. If it does not schedule a commitment in a particular sector, then subject to its MFN obligation it is not required to grant them entry to that sector.

37. A Member's schedule of specific commitments creates the basis for a number of the Member's other policy obligations under the GATS. In sectors where a Member makes specific commitments, the GATS obliges it not to impose certain prohibited measures and to apply national treatment to measures affecting trade in services. However, the GATS allows a Member to list in its schedule exceptions (in the case of prohibited measures) and conditions and qualifications (in the case of national treatment) to these obligations. A Member's schedule of specific commitments triggers obligations for Members under a number of other GATS provisions too, including transparency, domestic regulation, and international transfers of capital. It is also the point of reference for each Member under the GATS provisions on progressive liberalization. Subject to special terms that apply to developing countries, these provisions create the expectation that specific commitments will be

expanded over time through negotiations among Members with a view to achieving a progressively higher level of liberalization of trade in services.

38. Other GATS provisions which also have an important bearing on the establishment of a foreign service supplier in a host country are applied as rules of general application, notably the obligation of unconditional MFN treatment. Subject to any (in principle, temporary) exemptions that a Member may have taken at the time of the entry into force of the GATS, the GATS MFN obligation requires a Member to grant MFN treatment unconditionally with respect to any measures affecting trade in services. It applies to all sectors where a Member permits the entry of foreign service suppliers, regardless of whether or not the Member has scheduled specific commitments in those sectors.

39. The GATS approach to market access and to national treatment marks a significant departure from the GATT, which in these and other respects is based on rules of general application, not on specific commitments to obligations. One reason for the more selective and controlled approach to liberalising market access in the GATS is the difficulty host countries have in protecting their domestic services and service suppliers through border measures, particularly when foreign service suppliers compete directly in the host-country market through a local commercial presence. Full market access and national treatment, in this case, can translate into free trade in services. The positive-list approach to scheduling specific commitments to market access and national treatment is designed to provide flexibility to host-country governments to apply differentiated policies in favour of their national producers.

B. General Obligations

1. Most-Favoured-Nation Treatment

40. The GATS requires Members to accord immediately and unconditionally to services or services suppliers of all other Members "treatment no less favourable than that accorded to like services and services suppliers of any other country" with respect to any measure covered by the Agreement.

41. However, a Member may maintain a measure inconsistent with MFN treatment provided that it listed the measure as an exemption at the time of the entry into force of the GATS, and provided that it complies with the conditions listed in the Agreement's Annex on Exemptions. The Annex makes it clear that no new exemptions can be granted after a country becomes a WTO Member: any future requests to apply a measure inconsistent with the MFN obligation can only be met through the WTO waiver procedures. Some listed exemptions are subject to a specific termination date. Others should not, in principle, be maintained longer than for ten years, and in any event they are subject to negotiation in subsequent trade-liberalizing rounds. All exemptions granted for a period of more than five years are subject to review in the Council for Trade in Services.

2. Transparency

42. Members are required, *inter alia*, to publish promptly all regulations of general application that pertain to or affect the operation of the Agreement, and to establish national enquiry points to provide, upon request, specific information to other Members. They are required also to report annually any new measures which significantly affect trade in services in sectors covered by specific commitments in their schedules.

3. Domestic Regulation

43. In sectors where specific commitments are undertaken, Members must ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. Members must maintain tribunals or procedures to provide, on request, for judicial review and, where justified, for appropriate remedies for administrative decisions affecting trade in services. Where authorization is required for the supply of a service on which a specific commitment has been made, applications to supply services must receive a decision within a reasonable period of time.

4. Monopolies and Exclusive Service Suppliers

44. A Member must ensure that any monopoly supplier of a service in its territory does not act in a manner inconsistent with the Member's obligations on MFN treatment and its specific commitments. Moreover, a Member must ensure that its monopoly supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with its specific commitments, where the monopoly supplier competes, directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights.

5. Business Practices

45. On request, a Member shall enter into consultations with a view to eliminating certain business practices of service suppliers (other than monopolies or exclusive service suppliers) that restrain competition and thereby restrict trade in services.

6. Payments and Transfers

46. Other than to safeguard its balance-of-payments position, a Member must not impose restrictions on international transfers and payments for current transactions relating to its specific commitments, nor impose restrictions on any capital transactions inconsistently with its specific commitments unless requested to do so by the IMF.

C. SPECIFIC COMMITMENTS

47. The GATS methodology for scheduling specific commitments is based on a detailed classification of service activities. This classification was developed by the Secretariat, based on the United Nations Central Product Classification (CPC) system, which identifies 11 basic service sectors and a twelfth category for miscellaneous services.[17] These sectors are subdivided into some 160 sub-sectors or separate service activities. The 12 sectors are: business (including professional and computer) services; communication services; construction and related engineering services; distribution services; educational services; environmental services; financial services; health-related and social services; tourism and travel-related services; recreational, cultural and sporting services; transport services; and other services not included elsewhere. By way of an example, the tourism category breaks down into sub-sectors for hotels and restaurants, travel agencies and tour operators, and tourist guide services.

48. With respect to each of the four GATS modes of supply of trade in services, including mode 3, Members may indicate in its schedule that it undertakes no commitment with regard to market access, in which case it lists the mode/sector as "unbound". Where a Member includes a sector in its schedule, it will identify any limitations to market access or to national treatment which it wishes to maintain for each of the four modes of supply. Where a Member wishes to maintain limitations on either

[17] There is no legal obligation that Members use this list.

market access or national treatment across all sectors, it records these limitations – by mode of supply – in a horizontal section of its schedule. Commitments can be subject to terms, limitations and conditions. In the case of a mode 1 commitment – the cross-border supply of a service – the Member is committed to allow the cross-border movement of capital if it is an essential part of the service itself; similarly, in the case of mode 3 commitments, the Member is committed to allow related transfers of capital into its territory.

2. Market Access

49. A mode 3 market-access commitment involves a Member listing in its schedule the sectors or activities in which it will allow foreign service suppliers to establish a commercial presence in order to supply services. It requires the Member to accord to those foreign service suppliers treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its schedule. Commitments are therefore comparable to tariff "bindings" under the GATT, in that they set out the minimum permissible standard of treatment of the foreign service supplier but do not preclude better treatment from being given in practice, subject to it being applied on an MFN basis.

50. In sectors where a market-access commitment is undertaken, a Member must not maintain or adopt market-access restrictions through measures that are set out in the Agreement unless the Member specifies otherwise in its schedule. The measures in question are quantitative limitations on the number of service suppliers, service operations or quantity of service output, the total value of service transactions, and the total number of natural persons that may be employed in that sector; measures that restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service in that sector; and 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.

3. National Treatment

51. In the sectors inscribed in its schedule, and subject to any conditions and qualifications set out in the schedule, each Member shall accord to foreign service suppliers, in respect of all measures affecting the supply of services, treatment no less favourable than it gives to its own service suppliers. Formally different treatment of foreign suppliers may be consistent with the national treatment obligation provided that it is "no less favourable in effect".

4. Additional Commitments

52. Members may negotiate and inscribe in their schedules additional commitments with respect to measures affecting trade in services that are not subject to scheduling under their specific commitments on market access or national treatment. These can include, for example, undertakings with respect to qualifications, technical standards, licensing requirements or procedures, and other domestic regulations.

D. PROGRESSIVE LIBERALIZATION

1. Negotiation of Specific Commitments

53. Members shall periodically enter into successive rounds of negotiations with a view to achieving a progressively higher level of liberalization of trade in services. Although in practice Members engage in similar rounds of negotiations to liberalize trade in goods, they are under no obligation to do so. The GATS negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. The

process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.

54. The process of liberalization shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing-country Members for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in GATS Article IV (Increasing Participation of Developing Countries in world trade). Negotiating guidelines and procedures for each round of negotiations are to be established, which *inter alia* are to establish modalities for the special treatment of least-developed country Members.

2. Modification of Schedules

55. A Member may modify or withdraw any commitment in its Schedule, subject to it entering into negotiations with any other Member that so requests and whose GATS benefits may be affected, with a view to reaching agreement on any necessary compensatory adjustment.

E. ANNEXES

56. Annexes to the GATS apply to measures affecting trade in specific services sectors, whether the sectors have been inscribed in a Member's schedule or not. Two sectors are of interest from the point of view of this Note.

2. Financial Services

57. In the area of financial services, Members are not prevented from taking measures for prudential reasons, including to protect investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.

58. A separate Understanding on Commitments in Financial Services sets out an alternative approach for Members to take on specific commitments in this sector. It includes, *inter alia*, a commitment by each Member to grant financial-service suppliers of any other Member the right to establish or expand a commercial presence within its territory, including through the acquisition of existing enterprises. Terms, conditions and procedures for authorizing this can be imposed insofar as they do not circumvent the commitment itself and are not inconsistent with other GATS obligations.

3. Telecommunications

59. Each Member is required to ensure that any foreign-service supplier seeking to take advantage of commitments included in its GATS schedule is accorded access to, and use of, public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions.

60. Notwithstanding this obligation, a developing-country Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services. It must specify these conditions in its schedule.

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