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Working Group on the Relationship between Trade and Investment

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The following communication, dated 2 October 2002, has been received from the Permanent Mission of India.

NON-DISCRIMINATION[1]

1. Non-discrimination in the context of trade includes national treatment (NT) and most-favoured-nation (MFN) treatment. The question of including the MFN and NT standard in any international investment agreements tends to raise more complex issues than including them in trade agreements. This fact has been underlined in the Secretariat Note (WT/WGTI/W/118) as well.

2. Investment essentially involves movement of capital which tends to move in various ways from home country to third countries and then to host countries. There may be many channels of such movement and the ultimate investor may not be the original lender or investor. Hence the question of non-discrimination in capital flows becomes more complex. There is no clear buyer-seller linkage, as is the case of goods and services, and no certainty regarding the source of funds. There is also no certainty regarding the manner in which funds will be retained in the host country and at what point in time, in what manner, and to what extent funds will flow out. Unlike domestic investment, where funds remain within the country, foreign investment can flow in and out, depending on speculative factors and short-term changes in different investment destinations. Many developing countries have, in the recent past, faced economic crises on account of heavy outflow of funds occurring within a short period of time. A certain degree of discrimination between different kinds of investment is unavoidable. The effect of different kinds of foreign capital on the economies of developing countries would obviously vary. The source of funds is also of significance from the economic as well as political point of view. There are, therefore, severe limitations to the extension of the concept of non-discrimination to capital flows.

3. The important issue to be clarified is whether non-discrimination is an absolute principle. While it is universally accepted and endorsed that the principle of non-discrimination underlies the multilateral trading system, issues have been raised by developmental economists whether such non-discrimination provisions have to be treated in an absolute sense. Given the various channels of

[1] Members are in the process of learning in the Working Group on the Relationship between Trade and Investment in accordance with the mandate outlined in paragraphs 20-22 of the Doha Ministerial Declaration read in conjunction with the Chairman's statement at the Ministerial Conference. The paper is a contribution to the learning process without prejudice to India's position on the need to establish any multilateral framework on investment within the WTO. India reserves the right to revert to the subject as and when its technical knowledge increases.

capital flows, characteristics of capital and their different socio-economic impact on the host country, is it not essential that developing countries preserve fully their discretionary authority with regard to investment inflows?

4. Another issue is the relevance of the WTO principles of non-discrimination to international investment agreements. In a paper submitted to the Working Group (WT/WGTI/W/96) Korea had enumerated five fundamental principles of the WTO – non-discrimination; freer trade; predictability; promotion of freer competition; and encouraging development and economic reform – and argued that any rule in the WTO context should conform to these principles. When it comes to "investment" per se as distinct from "trade" per se, the relevance of these principles is neither direct nor evident. Money flows are essentially different in character from flows of services and goods. The money market is considerably more opaque, less predicable, far more subject to purely speculative movements. The principles of free trade in goods and services can not be applied to the movement of capital.

5. It is not appropriate to compare "investment" as defined and dealt with under GATS with "investment" as proposed for negotiation by some members under the aegis of WTO. GATS follows an "enterprise-based" definition of investment and the definition is closely linked to the mode 3 of service delivery vis-à-vis "commercial presence" which in the context of GATS has no other purpose than to facilitate service supply. One of the basic characteristics of service delivery in respect of certain categories of services is the need for the "supplier" and the "receiver" of the service to be in contact. "Commercial presence", therefore, is the only mode of service delivery in the case of certain types of services, e.g. banking and insurance. Another paper by Korea (WT/WGTI/W/123) notes in paragraph 18 that "the GATS deals with trade in services by its nature, not investment per se. Therefore, the "commercial presence" in a host country, even though it includes direct investment, or the establishment of a foreign company, mainly focuses on the supply of services".

6. Commercial presence is covered under GATS only to the extent that it facilitates the delivery of services – and that too is subject to various conditions and exemptions. What is of importance is the commitment for market access for specific service sectors undertaken by a Member. Mistaking it as a commitment to "commercial presence" is mistaking the "medium" for the "message". Therefore, inclusion of commercial presence under GATS in the WTO does not, in any way, justify the inclusion of "investment" under "goods" in the WTO. Not surprisingly, the Korean Paper (WT/WGTI/W/96) on the issue posed a question - How should we bridge the differences in the definition of investment between any multilateral framework on investment (MFI) and the GATS in which investment is defined as "commercial presence"?

7. While looking at the contrast between GATS and GATT it may be noted that specific sectors and modes of supply to be covered under GATS contrasts with the traditional GATT approach based on general principles.

8. When it concerns trade – in goods and in services – national treatment has a special relevance and the multilateral trading system is established on the basis of the non-discrimination principle. On the other hand, traditionally in international law, control of entry and establishment has been the prerogative of national governments. Conventionally countries have treated as their sovereign right the right to control entry and establishment. There are only two countries (the US and Canada) that are known to insist on "pre-establishment national treatment" provisions in their bilateral investment treaties (BITs). International investment agreements (IIAs) also in general do not envisage national treatment at pre-establishment stage. When certain international instruments envisage national treatment at entry stage, i.e. at the pre-establishment stage, it has been noticed that such instruments are non-binding. A case in point is the OECD Code for the Liberalization of Capital Movements in which right of establishment was introduced in 1984. Another instance is that of the APEC non-binding investment principle. A multilateral Agreement on Investment under the auspices of the economically well-off countries of the OECD, which envisaged in the draft agreement binding

national treatment obligations, did not find favour with many of these countries, and had to be abandoned. How then can an agreement of this nature, envisaging national treatment and MFN provision of a binding nature, be considered in a much more heterogeneous group like WTO?

9. It was to bring services under the umbrella of the WTO that it was found necessary to devise a specific architecture involving, *inter alia*, mode based definitions. It would be erroneous logic to now reapply the GATS architecture to the goods sector. GATS is a complex Agreement. Safeguard measures in respect of services have eluded evolution. Protection in respect of goods is possible through tariff and other border measures, while certain modes of services are not amenable to such measures. Given the complex nature of capital flows/investments, application of non-discrimination principle as it exists in goods and services to investment cannot be automatic. Developing countries need to retain the ability to screen and channel foreign direct investment consistent with their domestic interests and priorities. This is the reason why bilateral investment treaties are preferred the world over.