ISBN 978-92-64-04202-5
International Investment Law:
Understanding Concepts and Tracking Innovations

Chapter 4

The Interaction Between Investment and Services Chapters in Selected Regional Trade Agreements*

This report analyses the interactions between the investment and services chapters of 20 regional trade agreements. It classifies agreements into two broad categories of NAFTA-inspired and GATS-inspired agreements and identifies four major types of interaction between the investment and trade in services chapters. The report then looks at the implications of the services/investment interface for levels of investment protection and liberalisation.

* This study has been prepared by Marie-France Houde and Akshay Kolse-Patil of the OECD Directorate for Financial and Enterprise Affairs (DAF) and Sébastien Miroudot of the OECD Trade and Agriculture Directorate (TAD), under the supervision of Dale Andrew, Head of the Trade Policy Linkages and Services Division of TAD and Pierre Poret, Head of the Investment Division of DAF. It has been discussed in the Investment Committee and Working Party of the Trade Committee and was declassified on the responsibility of the Secretary-General. The authors wish to thank Martin Molinuevo and Martin Roy for helpful comments and discussions during the preparation of this study. The study is also available as OECD Trade Working Paper No. 55.

Key findings

This report analyses the interactions between the investment and services chapters of 20[1] Regional Trade Agreements (RTAs), in terms of the implications for levels of investment protection and liberalisation.

RTAs can generally be classified into two broad categories of NAFTA-inspired and GATS-inspired agreements. Investment disciplines in the former are lodged in the investment chapter and there is limited interaction with the services chapter. In GATS-inspired agreements, investment disciplines are divided between the services and the investment chapters and as a consequence interactions between them are more prevalent and are governed in either the investment or in the services chapter.

The level of investment protection is determined by the scope and coverage of the investment protection provisions and not by the type of interaction between the two chapters. In both types of RTAs, investment in services industries may benefit from the protections provided by the investment chapter (such as on expropriation, transfers, compensation for losses or investor-to-state dispute settlement). As investment provisions vary from one RTA to another, some countries have decided to maintain a former BIT alongside the more recently negotiated RTA.

Concerning the level of investment liberalisation, NAFTA-inspired agreements tend to have an advantage in terms of the number of sectors covered by non-discrimination disciplines and the degree of transparency and predictability through a "one-shot" liberalisation encompassing all sectors and a "ratchet" mechanism that locks in future reforms. GATS-inspired agreements are often favoured by countries that want to preserve a certain flexibility and progressiveness in their liberalisation, while they reform and establish new regulatory frameworks. But the differences between the two approaches should not be overstated. Provisions on future liberalisation and transparency can add transparency and predictability in the context of GATS-inspired agreements,

1. The list includes one North/North agreement (AUSFTA), 13 North/South agreements (NAFTA, US-CAFTA-DR, US-Morocco, Japan-Singapore, Japan-Mexico, Japan-Malaysia, TAFTA, EC-Chile, EC-Jordan, EFTA-Korea (EFTA-Singapore, TPSEP and ANZSCEP) and six South/South agreements (Chile-Korea, India-Singapore, ASEAN agreements, COMESA and Andean Community Decisions).

while flexibility also exists in NAFTA-inspired agreements through reservations on existing and future non-conforming measures.

An ambitious level of investment liberalisation in a GATS-inspired agreement is possible by taking commitments in additional sectors or by increasing the transparency of schedules. Progressive liberalisation of investment can in principle also be pursued in NAFTA-inspired RTAs. Even more recently, some GATS-inspired agreements provide insights into the possibilities offered by a combination of positive and negative listing.

Several factors influence the choice of a GATS- or NAFTA-inspired approach: existing liberalisation of the negotiating partners' regimes; their administrative capacity; past approaches; and the pace at which they wish to liberalise. Choosing between positive or negative listing (or a hybrid approach) is a matter for negotiation between partners.

Not all agreements include a most-favoured-nation clause (MFN). When they do, GATS-inspired agreements tend to prevent the MFN rule from applying to third parties through a regional economic integration organisation (REIO) exception clause. Nonetheless, new investment liberalisation in third party agreements may be extended to parties of earlier RTAs, following a review of commitments. A difference in NAFTA-inspired agreements tends to be that the MFN rule can apply as regards future agreements that might contain better treatment for investors. However some countries have listed reservations in specific sectors limiting the extension of any possible better treatment. In the light of this, one can question the effectiveness of the MFN rule with respect to investment liberalisation in creating a level playing field between investors from various Parties.

Synthesis

This document presents the results of the joint work carried out in 2006-07 by the Working Parties of the Investment and Trade Committees on the interaction between investment and trade in services provisions in regional trade agreements (RTAs). The study is divided in three parts preceded by a one page summary of the Key Findings and synthesis. Part I analyses the interactions between the investment and services chapters in a representative sample of 20 agreements. Part II analyses their implications for the level of investment protection provided. Part III analyses the implications of the services/investment interface and of the MFN rule for the level of the liberalisation provided.[2]

The embracing trend of RTAs

After the abandonment of the Havana Charter of the International Trade Organisation in 1950, rule-making in international trade and investment largely

evolved along two separate tracks, the first largely dominated by the GATT system, the second by the conclusion of bilateral investment treaties (BITs) aimed at "protecting", "promoting" and in the case of some later agreements, "liberalising" foreign investment. This general pattern started to change, however, with the entry into force of North American Free Trade Agreement (NAFTA) in 1994 and the establishment of the World Trade Organisation (WTO) in 1995. The NAFTA was the first agreement to combine BIT-like disciplines with comprehensive trade in services disciplines. The WTO brought in, for the first time, through the GATS, the supply of services into the realm of multilateral trade rules. These two important developments have expanded the landscape of regional agreements and the possible types of interactions between investment and service disciplines.

Since 1994, some 180 regional agreements combining investment and trade in services rules, mainly in the form of Free Trade Areas (FTAs), have come into existence as compared with 38 RTAs during the previous forty years altogether. The pace has markedly picked up since 2000. Over forty per cent of the cumulative total has come into being since 2000, cutting across countries or regions increasingly further apart and with more diversified economic backgrounds. Some 70 more agreements are reported to be under active consideration or negotiation. Mexico, Chile, Singapore, the United States, Australia and New Zealand are leading in terms of agreements concluded. EFTA, the EU and ASEAN stand out as the most active country groupings.

Two distinct cultures and sets of disciplines

RTA investment chapters essentially take their origins in BITs introduced in the late 1950s or early 1960s to provide absolute standards of protection for the foreign investor and their investments as regards transfers, expropriation and compensation, fair and equitable treatment, and investor-to-state-arbitration of investment disputes. Comprehensive obligations on national treatment and MFN treatment obligations at all phases of operation including establishment as well as the prohibition of performance requirements were later introduced in the US and Canadian treaties in the early 1990s. Today's RTA investment chapters typically provide broad investment coverage, strong protection and non-discrimination commitments and recourse to investor-state international arbitration.

2. In the present study, the term "investment protection" is intended to cover the typical core protections found in BITs while the term "investment liberalisation" is principally intended to cover the non-discrimination obligations found in OECD liberalisation instruments as well as the WTO and other trade liberalisation agreements. The BITs and FTA/RTA investment chapters of some OECD countries also include some of the non-discrimination obligations characterised here as "investment liberalisation" provisions.

Investment disciplines lodged in RTA services chapters, are, on the other hand, usually based on the GATS. Investment is covered only in the narrower form of a "commercial presence". Transparency and MFN treatment are the only general obligations. Obligations on market access and national treatment arise only to the extent liberalisation commitments are listed in separate schedules. Because of the importance they play in the ability to supply a service, domestic regulatory issues are also addressed. Avoidance of restrictions on international payments and transfers is the only significant "protection" provided by the trade in services chapters, and even so, only in sectors where liberalisation commitments are scheduled.

The Investment and Services chapters of NAFTA-inspired and GATS-inspired agreements differ, therefore, in their coverage of investment in services.[3] This leads to four major types of interaction between these chapters.

1) *NAFTA-inspired agreements – Limited interaction*

The first type of interaction is characterised by a clear separation between the Investment chapter and Cross-Border Trade in Services (CBTS) chapters designed to limit the interaction between the two chapters. The Investment chapter acts as the depositary of, or controls, all the investment provisions of both goods and services (except for financial services). The CBTS chapter, which is partly inspired by the GATS, is uniquely devoted to the liberalisation of services provided without a commercial presence. Both chapters use a negative list approach for lodging reservations to their respective obligations.

NAFTA provides the classical example of no interaction between the Investment and Services chapters. More recent NAFTA-inspired agreements (US-CAFTA-DR or US-Morocco for example) allow for a limited interaction. In this latter case, the Market Access, Domestic Regulation and Transparency articles of the CBTS chapter apply to the Investment chapter subject to certain limitations.

The Financial Service chapters may incorporate from the Investment chapter and the Trade in Services chapters the provisions to be applied to this sector.

A "Relations to Other Chapters" clause states that in the event of any inconsistency between the Investment chapter and other chapters, these other chapters shall prevail to the extent of the inconsistency.

3. The two EU agreements examined here due to their specificities are separately discussed in paragraph 25.

2) *GATS-inspired agreements where the interaction is stated in the Investment chapter*

GATS-inspired agreements also generally have separate chapters on investment and services. However, investment in services is typically covered by both chapters. Liberalisation of the supply of services, including through commercial presence is controlled by the Trade in Services chapter whereas the protection of investments in services, notably the clauses on expropriation, compensation for losses, investor state dispute resolution, is located in the chapter on Investment. In addition, these agreements also usually employ a positive list approach for specific commitments for Trade in Services.

A majority of these agreements have adopted a second type of interaction between the investment and services chapters which is stated in the Investment chapter. The Trade in Services chapter comes first and contains the market access and non-discrimination obligations on commercial presence. The Investment chapter – which has a broader coverage based on an asset-based definition of investment – identifies the scope of its application and rules to deal with potential inconsistency between this chapter and the Trade in Services chapter(s). The Financial Service chapters however are responsible for the core obligations on financial services.

EFTA agreements provide clear examples of this mode of interaction. In these agreements, the limitations mainly take the form of the non-application of the National Treatment and Most Favoured Nation Treatment obligations to Mode 3 (commercial presence) operations. A similar approach is followed by other agreements such as TAFTA or New Zealand-Singapore Agreement. Japan's Economic Partnership Agreements also generally fall in this category as the Investment chapter's scope article describes how inconsistencies between overlapping provisions should be resolved. In the case of Japan-Singapore FTA, the interaction is not stated in the Investment chapter but in the parties' reservations to this chapter.

3) *GATS-inspired agreements where the interaction is stated in the Trade in Services chapter*

In a third type of interaction between the investment and services chapters, it is the Trade in Services chapter through a "Service-Investment" linkage clause which determines which provisions from the Investment chapter listed therein would apply. This approach has recently been introduced by the India-Singapore CECA. The specific provisions borrowed from the Investment chapter concern compensation for losses, expropriation, repatriation, subrogation, measures in public interest, special formalities and information requirements, access to courts of justice, senior management, investment disputes, other obligations and performance requirements. This

type of interaction seeks to minimize any possible conflict between the two chapters by listing the various liberalisation and protection obligations that would apply to investment in services.

4) *GATS-inspired agreements where no interaction is stated*

A fourth group of agreements are silent on the interaction. This approach solely relies on the rules of interpretation of international law to sort out the relationship between the investment and services provisions. This case mainly concerns separate agreements on investment and trade in services (ASEAN agreements and Andean Community Decisions). But this situation may also arise within individual agreements. For example, in the Japan-Singapore or EFTA-Korea agreements, the clause on transfers is contained in two chapters, the Trade in Service and Investment chapters, with one less permissive than the other. However, this duplication does not necessarily lead to conflict. Rather, both these obligations apply simultaneously to investments in services, which are subject to the obligations of both chapters. More recent agreements, however, are abandoning this approach in favour of an explicit and more precise mode of interaction between the investment and services chapters.

EC Trade Agreements

Even though European Communities (EC) Association Agreements with non-European partners generally follow the GATS approach, other features set them apart from the GATS-inspired agreements described above. The European Community and the member states share competence in the investment area. The coverage and structure of EC agreements are also unique. For example, the EC-Chile Agreement, which is the most comprehensive agreement concluded so far, has separate chapters on Trade in Services (covering all four modes of supply of services), Financial Services, Establishment and Current Payments and Capital Movements. In this case, it is the establishment chapter which excludes services from its coverage. In the EC-Jordan Association Agreement, however, the services chapters only cover the cross-border supply of services while the establishment chapter applies to all investments. The methodology for listing liberalisation commitments also differs in the two agreements, the EC-Chile agreement follows a positive list approach while the EC-Jordan agreement list the reservations to the obligations. EC agreements provide for national treatment (and MFN in some cases) on post-establishment and for protection of transfers-capital movements. Other protection issues are addressed by the BITs concluded by member States.

Level of investment protection provided

The level of investment protection does not seem to be affected by the types of interaction chosen. In all the agreements reviewed with dual coverage of investment in services, all investment in services benefits from the basic protections provided by the Investment chapter (such as on expropriation, transfers, compensation for losses or investor-to-state dispute settlement). This is because the "asset-based" definition of investment normally used for applying the basic standard protections of the Investment chapter obligations includes the narrower concept of "commercial presence", which is used for the liberalisation of investment in services in GATS-inspired agreements. This broad-asset based definition typically includes, in addition to majority or controlling participations in an enterprise, minority interests, intellectual property rights, concessions and other forms of property.

If the level of investment protection is indifferent to the type of RTA adopted, it is certainly determined by the scope and coverage of the investment protection provisions. Judging from the sample, the level of investment protection provided by RTAs is largely comparable if not interchangeable to that traditionally provided by BITs (as in the case of US BITs and RTA Investment chapters). Nonetheless, the investment provisions may still vary from one RTA to another. For a significant number of agreements reviewed (such as NAFTA, AUSFTA, Japan EPAs, India-Singapore CECA, Australia-Thailand), these obligations are new in the absence of former BITs between the parties. But in a number of other agreements reviewed, BITs remain in place alongside RTAs, with both sets of rules complementing each other (EC agreements, ASEAN agreements, Andean Community Decisions). BITs have been replaced by RTAs only when the latter's contents and coverage are clearly superior to that of BITs (for example EFTA-Korea Investment Agreement, as compared to Korea-Switzerland BIT).

Levels of liberalisation commitments achieved

The study provides a detailed analysis of the schedules of commitments