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**A General Investment Agreement in the WTO?
Lessons from Chapter 11 of NAFTA and
the OECD Multilateral Agreement on Investment**

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**A General Investment Agreement in the WTO?
Lessons from Chapter 11 of NAFTA and
the OECD Multilateral Agreement on Investment**

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Abstract

At the recent Ministerial Conference at Doha in Qatar, the WTO member states agreed to commence investment negotiations at the next Ministerial Conference in 2003. Yet it was only in 1998 that similar negotiations in the OECD towards a Multilateral Agreement on Investment (MAI) ended without result. The MAI provisions in turn were heavily influenced by the detailed investment provisions in Chapter 11 of the North American Free Trade Agreement (NAFTA).

This paper examines the experience of both NAFTA Chapter 11 and the MAI to draw some suggestions for the investment negotiations within the WTO. The paper argues that there are two fundamental challenges negotiators face in creating investment rules in the WTO. Firstly, it is argued that a WTO agreement must reflect the interests of developing countries. In this respect, WTO negotiators should avoid a MAI-type scenario of simply replicating the very strong investment liberalization and protection provisions of NAFTA Chapter 11. The paper examines the way in which host states typically regulate foreign investment as a means to suggest realistic ways in which to craft an investment agreement broadly reflective of both North and South members of the WTO. The paper also puts forward a second formidable challenge for WTO negotiators. This is to address some of the concerning jurisprudence that has emerged from the NAFTA Chapter 11 arbitral case law. The paper focuses on the way in which some arbitral cases have extended the coverage of NAFTA Chapter 11 beyond *de jure* discriminatory measures to encompass seemingly legitimate regulations with little adverse impact on foreign investors.

The paper concludes with a modest but realistic set of recommendations for a WTO investment agreement.

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I. Introduction

Unlike the system of trade liberalization in the World Trade Organization (WTO)¹, there has never been a comprehensive, multilateral agreement on foreign investment. Binding international initiatives on foreign investment exist largely at the bilateral², regional³ and sectoral⁴ levels. This is despite exponential growth in rates of foreign investment and the increasing complementarity of trade and investment as strategies for penetrating domestic markets.

At the Fourth WTO Ministerial Conference at Doha in Qatar, agreement appears to have been reached to commence investment negotiations at the Fifth Ministerial Conference in Mexico in 2003.⁵ Yet, it was only in 1998 that similar negotiations in the Organisation for Economic Co-Operation and Development (OECD) towards a Multilateral Agreement on Investment (MAI) ended without result. The MAI provisions themselves were heavily influenced by the detailed investment provisions in Chapter 11 of the North American Free Trade Agreement (NAFTA). This paper will examine both of these instruments and attempt to draw some suggestions for the investment negotiations within the WTO. The paper will argue that there are essentially two challenges that negotiators face in creating investment rules in the WTO.

Firstly, a WTO agreement must reflect the interests of developing countries. Historically, developing countries (as largely host countries for foreign investment) have resisted

¹ Marrakesh Agreement Establishing the World Trade Organization, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1144 (1994). .

² See generally RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES (1995) (for a comprehensive discussion of the use and coverage of bilateral investment treaties).

³ See, e.g., North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., chs. 1-9 32 I.L.M 289; chs. 10-22, 32 I.L.M 605 [hereinafter *NAFTA*]. The member states of NAFTA are the United States, Canada and Mexico. The investment provisions are found in Chapter 11 of NAFTA.

⁴ E.g. Energy Charter Treaty, Dec. 17, 1994, Part III, 33 I.L.M. 381 (1995). The Energy Charter Treaty provides for the liberalization of investment restrictions and investment protection amongst a large number of OECD and Eastern European states within the energy sector.

⁵ WTO, *Ministerial Declaration: Ministerial Conference Fourth Session Doha, 9-14 November 2001*, WT/MIN(01)/DEC/1 20 (Nov. 14, 2001), at ¶ 20-22 [hereinafter *Doha Ministerial Declaration*].

initiatives to develop investment rules at the multilateral level. Indeed, the choice of the OECD (a grouping of developed states) as the negotiating forum for the MAI was driven by a desire to exclude developing countries from negotiations due to the concern their demands would dilute the MAI commitments. Yet, the options for negotiations should not be viewed in absolutist terms as either full liberalization of discriminatory regulation or full protectionism. A more subtle approach is warranted. In part, the answer to this question depends on understanding the different rationales and methods by which states regulate foreign investment. The paper will undertake such an analysis so as to suggest realistic ways in which to craft a WTO investment agreement broadly reflective of both North and South members of the WTO.

But there is a second formidable challenge. The NAFTA Chapter 11 model (and that of the MAI) provides for a trinity of strong investment liberalization, protection and dispute settlement provisions. In recent years, there has been a proliferation of arbitral cases brought by investors under NAFTA Chapter 11. The jurisprudence that has emerged from some of these cases extends the coverage of NAFTA Chapter 11 beyond clearly discriminatory measures to seemingly legitimate regulations with little adverse impact on foreign investors. This raises the difficult issue of drafting a WTO investment agreement in such a way as to preserve core components of regulatory autonomy. The paper will argue that WTO negotiators should not simply look to the NAFTA precedent as the only model available. Instead, the paper will suggest ways in which negotiators can define commitments in a WTO initiative to avoid some of the problems that have arisen under NAFTA Chapter 11.

The paper will be organised as follows. Section II offers some background material. It examines some statistical evidence that shows developing countries are largely host states for foreign investment. It also details the shifting policy attitudes of host states towards foreign investment and the way in which those changes have influenced the content of existing international rules on investment. Section III then outlines the way in which states typically regulate foreign investment under a complex mix of political and economic motives. A particular focus is on the common (but distortive) practice of using

incentives to attract foreign investors. Section IV then examines the NAFTA Chapter 11 model and the jurisprudence that has emerged from some of the NAFTA arbitral cases. Section V examines the MAI, its heavy reliance on the NAFTA model and belated attempts to rectify some of the problems inherent in that model. Section VI considers the Doha negotiating agenda and prospects for concluding an investment agreement in the WTO. It ties together the lines of enquiry and puts forward a series of suggestions for WTO negotiators. Section VII concludes.

II. Background

A. Foreign Investment in the Global Economy

The last decades have witnessed exponential growth in foreign investment particularly foreign direct investment (FDI). FDI is normally defined as ownership together with some form of control of a business or part of a business in another country.⁶ The key determinant is that the foreign investor has a degree of managerial control over the business.⁷ The relatively long-term nature of FDI is often distinguished from portfolio investment where a foreign investor purchases securities or debt instruments but without the desire to control or manage the domestic firm.⁸

⁶ See INTERNATIONAL MONETARY FUND (IMF), BALANCE OF PAYMENTS MANUAL ¶ 408 (4th ed. 1977) (“[FDI] is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor’s purpose being to have an effective choice in the management of the enterprise.”).

⁷ However, there is difference in approaches between international economic organizations in setting the quantum of managerial control in order for an investment to qualify as FDI. Compare OECD, BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT ¶ 7-8 (3d ed. 1996) (“The numerical guideline of ownership of 10 per cent of ordinary shares or voting stock determines the existence of a direct investment relationship. An effective voice in the management, as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor.”) with *id.* ¶ 411-3 (finding that the required quantum of control may vary depend on whether ownership in the enterprise is concentrated or diffused).

⁸ IMF, *supra* note 6, ¶ 409 (“In contrast, portfolio investors are primarily concerned about the safety of their capital, the likelihood of an appreciation in its value, and the return that it is bringing them. They will evaluate the prospects separately...and may often shift their capital with changes in these prospects.”).

Global FDI inflows rose from \$202 billion in 1990 to \$1.27 billion in 2000.⁹ Most FDI originates from and is destined for developed countries. In fact, within the developed world, the so-called Triad of the European Union (EU), the United States and Japan, accounted for 71 per cent of global FDI inflows in 2000.¹⁰ These countries also account for most of the world's outflows of FDI with 82 per cent of global outflows coming from the Triad countries in 2000.¹¹ This concentration is also evidenced by the fact that about 90 of the world's largest 100 non-financial transnational corporations (a primary mechanism for delivering FDI) are headquartered in the Triad.¹²

In comparison, developing countries accounted for only 19 per cent of global FDI inflows in 2000.¹³ This represents a decline since 1994 when the share of those countries accounted for 41 per cent of global FDI inflows.¹⁴ Also, flows of FDI are heavily concentrated within particular parts of the developing world. Of the \$240 billion of FDI flows into the developing world in 2000, \$64 billion went Hong Kong (China) and \$41 billion to China.¹⁵ In comparison, Africa remained severely marginalized as a host continent for FDI with its share in total inflows falling below 1 per cent.¹⁶ Developing countries also remain largely capital importers or host states for FDI. They only accounted for approximately 8% of FDI outflows in 1999.¹⁷

From the perspective of a possible WTO investment agreement, there is also a close relationship between foreign investment and trade. Intra-firm trade among transnational corporations (TNCs) accounts for approximately one-third of world trade while TNC exports to non-affiliated entities account for another one-third of world trade.¹⁸ There is increased recognition that trade and FDI are two – sometimes alternative, but

⁹ UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), WORLD INVESTMENT REPORT 2001: PROMOTING LINKAGES 10 (2001).

¹⁰ *Id.* at 9.

¹¹ UNCTAD, *supra* note 9.

¹² UNCTAD, *supra* note 9, at xv.

¹³ UNCTAD, *supra* note 9, at 9.

¹⁴ UNCTAD, *supra* note 9.

¹⁵ UNCTAD, *supra* note 9, at xiii-xiv.

¹⁶ *Id.*

¹⁷ UNCTAD, WORLD INVESTMENT REPORT 2000: CROSS-BORDER MERGERS AND ACQUISITIONS AND DEVELOPMENT 20 (2000).

¹⁸ WTO, ANNUAL REPORT 1996 44 (1996).

increasingly complementary – ways of servicing foreign markets. This is probably best recognized in the WTO General Agreement on Trade in Services which includes the concept of “commercial presence” in the definition of trade in services (recognizing that FDI is a prerequisite for exporting many services).¹⁹

Despite the growth in FDI and linkage to trade, developing countries (as net capital importers or host states for FDI) are not naturally *demandeurs* of multilateral investment rules. In fact, during the GATT Uruguay Round negotiations from 1986 to 1994, a number of developing countries opposed a US proposal to include a comprehensive investment agreement on the negotiating agenda. Indeed, this perceived recalcitrance of developing states motivated the United States to advocate investment negotiations under the *aegis* of the OECD in the early 1990s. The tension between North and South has characterized much of the history of international rulemaking on foreign investment. But the policy perspectives between North and South have remained neither absolute nor static. The next section will examine the shifting policy pendulum on foreign investment and the way in which it has influenced the content of the existing international framework on foreign investment.

B. International Investment Rules: A Fragmented Landscape

In recent years, investment has often been debated as one of the new issues for a future WTO negotiating agenda. However, the first attempt to create multilateral treaty-based rules on foreign investment can be traced to the immediate post-Second World War period. In 1948, the Charter for an International Trade Organization (ITO) was presented to a meeting of fifty-six states in Havana.²⁰ The ITO was to have been the third pillar of

¹⁹ General Agreement on Trade in Services, Apr. 15, 1994, art. 1, Agreement Establishing the World Trade Organization, Annex 1B, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, 33 I.L.M. 1167 (1994).

²⁰ For extracts from the Havana Charter, *see* UNCTAD, INTERNATIONAL INVESTMENT INSTRUMENTS: A COMPENDIUM 3 (1996).

post-war economic cooperation together with the International Monetary Fund and the World Bank.²¹

Despite the opposition of developing countries, the United States delegation eventually succeeded in including provisions within the Charter dealing with foreign investment.²² However, the rights eventually granted to foreign investors in the Charter were substantially diluted from earlier articles put forward by the United States.²³ From the perspective of the American business community, the overall structure of the Charter appeared to favor host over home countries. There was particular objection by the American business community to the Charter provisions regulating anti-competitive behavior of private enterprises.²⁴ These objections were a major reason for the eventual failure of the United States Congress to ratify the Charter. As the United States accounted for roughly half of the world trade at that time this meant that the ITO became in effect stillborn and the ITO project was eventually abandoned.

²¹ It is instructive to note that, whilst much of the Charter provisions dealt with trade liberalization (Chapter IV), there were also provisions on employment (Chapter II), development (Chapter III), restrictive business practices (Chapter V) and agriculture (Chapter VI). This reflected a conception of the ITO as a regime to advance economic liberalization but in a broader regulatory context. The regulatory dimension of the ITO appears to be linked to the concept of the regulatory state embodied in President Roosevelt's 'New Deal'. With the eventual demise of the ITO, the role of regulation has come to be primarily viewed more as a domestic rather than multilateral concern. *See generally* Ann-Marie Burley, *Regulating the World: Multilateralism, International Law, and the Projection of the New Deal Regulatory State*, in *MULTILATERALISM MATTERS: THE THEORY AND PRAXIS OF AN INSTITUTIONAL FORM* 125 (John Ruggie ed., 1993).

²² For an overview of the negotiations towards the Havana Charter, *see* CLAIRE WILCOX, *A CHARTER FOR WORLD TRADE* 37-53 (1949). *See also* Daniel M. Price & P. Bryan Christy, III, *Agreement on Trade Related Investment Measures (TRIMS): Limitations and Prospects for the Future*, in *THE WORLD TRADE ORGANIZATION: THE MULTILATERAL FRAMEWORK FOR THE 21ST CENTURY AND US IMPLEMENTING LEGISLATION* 439, 443-45 (Terence P. Stewart ed., 1996).

²³ The early articles proposed by the US delegation at a meeting in Geneva in 1947 set out extensive rights for investors including the obligation of host states to accord national treatment as well as unqualified most-favored-nation treatment. These extensive rights provoked opposition by a number of countries including the Czech government which refused to give German investors the same status as investors of other countries. This is a very early illustration of the point (which will be raised later in this paper) that national regulation of foreign investment is often motivated by overtly sovereignty concerns. The resulting compromise is reflected in Article 12 of the Charter which significantly dilutes the liberalization commitments proposed by the US delegation. For example, Article 12(2) merely requires member states to "give due regard to the desirability of avoiding discrimination as between foreign investments". *See* UNCTAD, *supra* note 20; THOMAS L. BREWER & STEPHEN YOUNG, *THE MULTILATERAL INVESTMENT SYSTEM AND MULTINATIONAL ENTERPRISES* 67 (1998).

²⁴ Sylvia Ostry, *Looking Back to Look Forward: The Multilateral Trading System After 50 Years*, in *WTO, FROM GATT TO THE WTO: THE MULTILATERAL TRADING SYSTEM IN THE WTO* 100 (2000).

In the aftermath of the defeat of the Charter, the General Agreement on Tariffs and Trade (GATT) (a temporary measure of the ITO) was the only body left standing. The GATT was drawn up and signed as an interim tariff reduction agreement in 1947 and was intended to operate until the ITO was formally established. The GATT made no attempt to deal with foreign investment issues. This institutional separation of trade from investment issues in the multilateral arena continued until the Uruguay Round in the 1980s. Indeed, the failure of the ITO marked a shift away from multilateralism in the coverage of investment instruments. By the late 1960s, bilateral investment treaties (BITs) had become the primary instruments for reaching agreement on foreign investment between developed and developing countries.²⁵ As many developing countries gained political independence, rates of expropriation of foreign investment increased markedly.²⁶ Developed states sought ways in which to guard their investors against the increased threat of expropriation. The conclusion of BITs between developed and developing countries became a primary tool to effect this goal. A core component of most BITs are strong provisions on investment protection and particularly, the guarantee of compensation by the host state in the event of the expropriation of investment.²⁷ Despite the reduction in expropriatory behavior in recent years²⁸, the exceptionally strong investment protection provisions in later initiatives such as NAFTA and the MAI continue to reflect the preoccupation with the hostile attitude of developing countries towards foreign investment in the late 1960s.

By the end of the 1970s, the international policy landscape on investment had shifted with a particular impact on developing countries. The debt crisis of the 1980s limited the supply of loan finance to excessively indebted developing states and made FDI a more

²⁵ See generally UNCTAD, WORLD INVESTMENT REPORT 1996: INVESTMENT, TRADE AND INTERNATIONAL POLICY ARRANGEMENTS 147-148 (1996) (figures V.2 and V.3 chart the exponential growth of BITs from 1959 to 1996). From less than 200 completed at the end of the 1960s, the number of BITs had grown to a total of 1941 at the end of 2000. UNCTAD, *supra* note 9, at 6-7.

²⁶ BREWER & YOUNG, *supra* note 23, at 53. Table 2.3 summarizes trends in expropriation from 1960 to 1992. For example, the mean number of expropriations in 1960-4 was 11, in 1965-9 16, in 1970-4 51, 1975-9 34, 1980-4 3, 1985-9 0.4 and 1990-2 0.

²⁷ For a discussion of the typical investment protection provisions in BITs that provide for compensation in the event of expropriation, see DOLZER & STEVENS, *supra* note 2, at 97-117.

²⁸ See *supra* text accompanying note 26. See also M. Minor, *The Demise of Expropriation as an Instrument of Developing Countries' Policy* 25 J. INT'L BUS. STUD. 177 (1994).

desirable source of foreign capital. In addition, the process of acquiring control by these countries over their natural resources had progressed since the immediate post-war period and was no longer a strong priority. The risk of large-scale expropriation of foreign investment in these countries significantly diminished.²⁹ Indeed, contemporary independence movements have even begun to forge links with foreign investors to ensure economic viability were an independent state to result.³⁰ Thus, the interests of developing countries has shifted away from an attitude of hostility towards foreign investors to the need to attract and retain FDI. At the national level, numerous countries were taking unilateral steps to liberalize restrictions on the entry and operation of FDI.³¹ In recent years and especially since the Asian financial crisis of 1997-1998, developing countries have found FDI to be more stable than short-term portfolio investment and bank lending. FDI inflows remained almost unchanged during the crisis in the five most seriously affected Asian countries, when other private capital flows such as bank loans and debt securities fell dramatically.³² The trend of liberalization at the national level

²⁹ For evidence of the decline in direct expropriatory behavior, *see supra* text accompanying note 26. However, threats to expropriate foreign investment continue to occur on occasion. A recent example was the threat by President Robert Mugabe of Zimbabwe to expropriate foreign owned mines in the lead up to Zimbabwe's parliamentary elections in June 2000. *See* Ed O'Loughlin, *Mugabe Turns His Sights to Business*, THE AGE (Melbourne, Australia), Jun. 17, 2000, at 27.

³⁰ This was evidenced in the recent discussions between the Council of OPM (Free Papua Organization) - which is campaigning for independence for the Indonesian province of Irian Jaya - and investors in Irian Jaya including Freeport (one of the world's largest mining companies). The attitude of OPM towards investors and investor certainty in Irian Jaya is illustrated by the following statement by Mr Franzalbert Joku, the international moderator for OPM:

We are talking about establishing a modern and viable State, and to do that we have to deal with developers. Any sensible leader would want to see such relationships continue. We are already holding discussions with Freeport and other investors, present and potential. The business world is very sensitive to the kind of events unfolding in West Papua and wants to see its interests protected. We shall do everything possible, in our power and within reason, to see this happens.

See Rowan Callick, *Independence Leader Forges Links with Foreign Investors*, AUST. FIN. REV., Jan. 12, 2001, at 24.

³¹ *See*, UNCTAD, WORLD INVESTMENT REPORT 1999: FOREIGN DIRECT INVESTMENT AND THE CHALLENGE OF DEVELOPMENT 115 (1999). Table IV.1 charts the changes in national regulation of FDI in various developed and developing countries from 1991 to 1998. The table shows that 94 per cent of the regulatory changes made during this period were in the direction of creating a more favorable environment for FDI. But within this broad trend, there can be a gulf between the form and effect of the liberalization measure. For example in Laos, the government recently lifted a rule requiring every foreign investment - no matter how small - to be approved by the Prime Minister. Despite this change, regulatory approvals for foreign investment projects in Laos still take typically more than a year. Wayne Arnold, *Mining Gold in Laos Where Bombs Once Rained*, N.Y. TIMES, Mar. 5, 2002, at C8.

³² UNCTAD, *supra* note 31, at 9, 20-3.

was also mirrored at the bilateral level. The 1990s witnessed the strongest growth in the conclusion of BITs. The total number of BITs had reached 1941 by the end of 2000.³³

The 1990s were also characterized by a strong push to conclude regional rules to liberalize investment flows. Of these various regional initiatives, NAFTA Chapter 11 is notable for setting extremely high standards of investment liberalization, protection and dispute settlement. In comparison, little attention was given to investment issues at the multilateral level until the mid 1980s. An attempt by the United States to include investment on the GATT Tokyo Round negotiations (1973-9) failed due to the opposition of developing countries.³⁴ In the lead up to the Punta del Este GATT Ministerial Meeting in March 1986, the United States again put forward a proposal for a comprehensive agreement on investment in the GATT.³⁵ This approach was resisted by developing countries³⁶ with the resulting compromise to limit negotiations to “trade-related investment measures”. Developing countries (with some exceptions) also opposed the US proposal to include trade in services in the negotiations.³⁷ However, these countries eventually agreed to the inclusion of trade in services in the Punta del Este declaration on condition that negotiations in that area would take place on a separate track from those on goods, with a clear development orientation.³⁸

By the end of the Uruguay Round negotiations in 1994, only two of the final fifty legal instruments to result include direct provisions dealing with foreign investment issues. These are the Agreement on Trade-Related Investment Measures (TRIMS Agreement)

³³ See *supra* text accompanying note 25.

³⁴ See BREWER & YOUNG, *supra* note 26, at 122

³⁵ See generally THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY 2069 (Terence P. Steward ed., 1993) [hereinafter *GATT Uruguay Round*] (“On June 10, 1986, the United States introduced a proposed text for the ministerial declaration on investment. This document reviewed the importance of investment issues to international trade; past GATT actions related to investment measures...the competence of the GATT to establish and oversee a multilateral agreement on investment measures, as well as proposals to define the scope of an agreement.”). The text proposed by the United States can be found in GATT Doc. No. PREP.COM(86)/W/35 (June 11, 1986).

³⁶ *Id.* at 2070 (“The goals of the [first draft ministerial declaration] reflect the views of several South American and other developing countries already presented to the Preparatory Committee, namely that GATT negotiations should be restricted to trade in goods, not services, or policy-related issues such as investment regulation and intellectual property rights.”).

³⁷ *GATT Uruguay Round*, *supra* note 35, at 2354-8.

³⁸ See Murray Gibbs & Mina Mashayeki, *The Uruguay Round Negotiations on Investment: Lessons for the Future* ¶ 16 (UNCTAD, Mar. 14, 1998).

and the General Agreement on Trade in Services (GATS). Both of these agreements only deal with investment in fragmented manner adopting an issue or sector-specific approach. The TRIMS Agreement focuses only on the imposition of certain performance requirements on an investor after entry into the host state. Whilst the GATS ostensibly pertains to “trade in services” (Article I(1)), it contains detailed some concerning foreign investment. This reflects the fact that FDI tends to be especially important in service industries as it is a way for firms to enter and service a foreign market. Indeed, “trade in services” is defined as including the supply of services “by a service supplier of one Member, through commercial presence in the territory of any other Member” (Article I(2)(c)). FDI through “commercial presence” is thereby included as one of the modes of supply of services covered by the GATS.

The system that emerged by the mid 1990s can be thus described as a patchwork of international rules on foreign investment. Strong provisions on investment liberalization and protection are particularly evident at the bilateral and regional levels. The emphasis on investment protection in these instruments reflects the hostile attitude of host states and attendant expropriatory behavior evident in the late 1960s. Since then, developing countries have adopted a more welcoming attitude to FDI as a source of development capital. Despite this, the Uruguay Round negotiations evidence the traditional resistance of developing countries towards attempts to include investment on the GATT/WTO negotiating agenda. This is perhaps not altogether surprising given the record of increasing investment flows that do not appear to correlate to the absence of multilateral rules on investment.

The next section will examine the way in which states typically regulate the entry and operation of investors. A central focus of the next section is to identify what potential advantages would accrue to developing states from the liberalization of these regulatory measures in a potential WTO investment agreement.

III. Host State Regulation of Foreign Investment

The range of policies used by host states to regulate foreign investment is immense. Once a foreign investor enters into a host state, it becomes subject – like any domestic party – to the full range of regulatory measures passed by the host state. But within this broad category, there are normally measures which discriminate (in a positive or negative sense) between foreign and domestic participants in the market. It is these discriminatory measures that most international investment agreements attempt to discipline. However, as section IV of this paper will show, foreign investors have become recently active under Chapter 11 of NAFTA in challenging even seemingly non-discriminatory regulatory measures.

At this stage, it is possible to categorize most discriminatory forms of national regulation of foreign investment into one of three categories. These comprise: (i) pre-admission restrictions on establishment of foreign investment, (ii) post-admission restrictions once the foreign investor has entered the host state and (iii) incentives to attract foreign investors into the host state. Vastly different rationales exist for imposing these different categories of restrictive measures. WTO negotiators will need to carefully consider these different rationales as a means in which to judge the political appetite of member states to the depth of coverage of a WTO investment agreement.

A. Pre-Admission Restrictions: The Political Sphere

States have traditionally imposed restrictions over the admission of foreign goods, services and capital. In recent years, the GATT and later WTO agreements have significantly reduced barriers to trade in goods (such as tariffs) and to a lesser extent, barriers to trade in services. Despite this powerful trend towards trade liberalization, states at all stages of the development process still retain some restrictions on the admission of foreign investors. These restrictions can take various forms³⁹ such as

³⁹ For a comprehensive list of the myriad of forms of restrictions on admission, see UNCTAD, *supra* note 25, at 176-7.

closing certain sectors of a nation's economy to FDI⁴⁰, quantitative restrictions on the number of foreign investors admitted into a specific sector or screening and registration procedures⁴¹. These admission restrictions are often connected to sovereignty concerns based on the perceived harm believed to flow from ownership of a country's productive resources by foreign investors. These political concerns cannot be understated and apply to host states at all stages of development (albeit at different levels).

Even some developed states still exclude the entry of FDI into strategic sectors such as media, publishing and films or other core industries involved in national defense and securities.⁴² These restrictions are more substantive for developing countries many of whom only began to orientate their domestic policies toward FDI in the late 1970s. For developing countries, the tension between modernizing their economies through the admission of foreign investment and the desire to retain control over strategic economic sectors is a constant one.⁴³ This raises an important but sometimes overlooked point. In the realm of foreign investment, political and economic considerations interact extremely closely. Put simply, foreign investment (as a means of long-term ownership of national

⁴⁰ For example, the version of the Indonesian Negative Investment List issued by Presidential Decree on 2 July 1998 excludes foreign investment in sectors such as freshwater fish, forest utilization, local shipping, taxi and bus transport and medical services. See OECD, *FOREIGN DIRECT INVESTMENT AND RECOVERY IN SOUTHEAST ASIA* (1999).

⁴¹ For example, proposals by foreign investors to invest in Australia over certain monetary thresholds require notification to the Australian Foreign Investment Review Board. That Board will examine proposals to acquire existing business (with total assets over AUD\$50 million) and will raise no objection to a proposal unless it is "contrary to the national interest". See Foreign Acquisitions and Takeovers Act, 1975, c. § 18-21A (Austl.) (and accompanying Ministerial statements).

⁴² For a comprehensive analysis of the exclusion of national defense and security sectors from the entry of FDI into the US, see MICHAEL J. TREBILCOCK & ROBERT HOWSE, *THE REGULATION OF INTERNATIONAL TRADE* 342-4 (2d ed. 1999). See also D Nance & J Wassermann, *Regulation of Imports and Foreign Investment in the US on National Security Grounds* 11 MICH. J. INT'L L. 926 (1990).

⁴³ For a very recent example of this tension, see Tim Weiner, *As National Oil Giant Struggles, Mexico Agonizes over Opening It to Foreign Ventures*, N.Y. TIMES, Feb. 17, 2002 at 6. After nationalization of Mexico's oil operations in 1938, the Mexican Constitution was amended to forbid foreign exploitation of its oil and gas reserves. Mexico's state-run energy company, Pemex, was at one time a symbol of nationalistic pride. "Schoolchildren still learn that the creation of Pemex after the oil expropriation was the culmination of their nation's independence." But, in recent years, it has also been used as a source of lucrative funds for the Mexican government. Taxes and duties on Pemex finance more than one-third of the Mexican federal budget. Faced with increasing pollution and a poor safety record, the current President Vicente Fox is considering modernizing the company by allowing some foreign participation. But the opposition to change at Pemex remains a powerful force with the fear that Mexico's prime natural resource might once again be used to enrich foreigners.

assets and resources) is much more politically sensitive than foreign trade.⁴⁴ This political sensitivity is heightened by the manner in which liberalization is effected in the foreign investment sphere. Trade restrictions such as tariffs can be reduced incrementally and the value of those reductions can be translated relatively easily into a common denominator.⁴⁵ This is much more difficult in the context of regulatory impediments to foreign investors.

These sovereignty concerns have shaped the structure of most pre-MAI investment agreements. Within most international investment regimes, it is generally only Chapter 11 of NAFTA and BITs involving the US that explicitly apply the non-discriminatory norms of national and most-favored-nation treatment to the entry of foreign investment.⁴⁶ In contrast, most non-US BITs reserve the right of the host state to regulate the entry of foreign investors and only apply liberalization conditions to the post-establishment phase of the investment process⁴⁷.

B. Post-Admission Restrictions: Capturing Economic Gains

Once a foreign investor is permitted to enter the host state, restrictions can still be imposed on the ownership or operation of the foreign investment. But most of these restrictions are designed to capture the economic benefits of the investment process rather

⁴⁴ This point is argued forcefully by AV Ganesan, a former Commerce Secretary to the Government of India. See AV Ganesan, *Developing Countries and a Possible Multilateral Framework on Investment: Strategic Options* 7 (2) TRANSNAT'L CORP. 1 (1998).

⁴⁵ For an overview of the mechanics and negotiating techniques for reducing tariffs, see BERNARD M. HOEKMAN & MICHEL M. KOSTECKI, *THE POLITICAL ECONOMY OF THE WORLD TRADING SYSTEM: THE WTO AND BEYOND* 122-33 (2d ed. 2001).

⁴⁶ *NAFTA*, *supra* note 3, arts. 1102-1104. Under these articles, each NAFTA state must provide the better of national and most-favored-nation treatment to investors of another NAFTA state "with respect to the *establishment, acquisition*, management, conduct, operation, and sale or other disposition of investments" (emphasis added). The reference to "establishment, acquisition" explicitly includes the admission phase of the investment process.

⁴⁷ See, e.g., Agreement for the Promotion and Protection of Investments, Mar. 14, 1994, Ind.-U.K., 34 I.L.M. 935 (1995). Unlike NAFTA, under Article 4 (1) of this BIT, there is no explicit reference to wording such as "establishment" or "acquisition". Instead, each contracting party is required to provide national treatment to investments of investors of the other party dealing with "their operation, management, maintenance, use, enjoyment or disposal by such investors". See also DOLZER & STEVENS, *supra* note 2, at 53-85; FREE TRADE AREA OF THE AMERICAS – NEGOTIATING GROUP ON INVESTMENT, *INVESTMENT AGREEMENTS IN THE WESTERN HEMISPHERE: A COMPENDIUM* (1999).

than on sovereignty grounds. The range of post-admission restrictions is enormous⁴⁸ and can encompass techniques as diverse as compulsory joint ventures with host state participation through to performance requirements on the operation of the foreign investment. Performance requirements deserve particular emphasis given their inclusion in the TRIMS Agreement. These are conditions imposed on investors (often linked to the grant of an incentive by the host state) such as local content requirements (mandating that products produced by the investor in the host state contain a certain level of local materials), the employment of local personnel and mandatory technology transfer (often through compulsory licensing requirements).

As a home state for many of the world's TNCs, it is not particularly surprising that the US has long been an advocate of the elimination of performance requirements.⁴⁹ In fact, the economic case for liberalizing these restrictions is, on first view, very strong. Some performance requirements may restrict economic growth in host states by acting as a disincentive to the entry of investors. For example, a common objective in imposing joint venture requirements on the entry of investors is the hope of achieving greater technology transfer to host states. One effect of this requirement is that it may discourage investors whose proprietary technology is a significant asset and one which they are reluctant to share with other (and potentially rival) firms. A large body of research has found that these requirements do not in fact lead to the objective of enhancing the transfer of technology to the host state.⁵⁰ The research shows that technology transferred to joint ventures is significantly older and the speed of upgrading is slower than to wholly-owned subsidiaries of investors.⁵¹ But the evidence is not absolute for all forms of performance

⁴⁸ For a detailed list, see UNCTAD, *supra* note 25, at 177-9.

⁴⁹ See, e.g., REPORT OF THE COMMISSION ON UNITED STATES-PACIFIC TRADE AND INVESTMENT POLICY, BUILDING AMERICAN PROSPERITY IN THE 21ST CENTURY: US TRADE AND INVESTMENT IN THE ASIA PACIFIC REGION 20-2 (1997) [hereinafter *Building American Prosperity*] (criticizing various performance requirements imposed by Japan, China, Malaysia, Indonesia, South Korea and the Philippines).

⁵⁰ For a summary of the empirical work conducted by economists on the effect of performance requirements, see Theodore H. Moran, Foreign Direct Investment and Development: A Reassessment of the Evidence and Policy Implications, Paper presented at the OECD Conference on the Role of International Investment in Development, Corporate Responsibilities and the OECD Guidelines for the Multinational Enterprises (20-21 September 1999).

⁵¹ *Id.*

requirements.⁵² In contrast, local content requirements are often imposed in an attempt to develop clusters of industries in a given country.⁵³ These are groups of industries that are interdependent and according to a prominent theory of industrial competitiveness, contribute significantly to a host state's economic development.⁵⁴ When an investor enters a host state, it may continue to simply source its inputs from its home base. The imposition of local content requirements is often intended to counteract this tendency by ensuring that clusters of local manufacturers (supporting the foreign investor's activities) develop in the host state.

Whilst this is by no means an exhaustive analysis of the economic effects of the large range of performance requirements, it does militate against the conceptual trap of treating all of these requirements as welfare-reducing for both home and host states. Indeed, it is clear that some developing countries have underestimated the relatively limited impact of the Uruguay Round TRIMS Agreement on their use of performance requirements.⁵⁵ In the context of a future WTO investment agreement, it is likely that developing countries will resist strengthened disciplines in this area without some corresponding concession to their interests in the Doha negotiations. Part VI of this paper will examine the scope of the Doha agenda to deliver concessions to developing countries in issues other than investment. Aside from this sort of cross-issue linkage as a means of achieving consensus in the Doha negotiations, the WTO negotiators will also need to consider

⁵² For an analysis of situations in which export performance requirements may increase host state welfare, see Dani Rodrik, *The Economics of Export-Performance Requirements*, 102 Q. J. ECON. 339-67 (1987). See also Patrick Low & Arvind Subramanian, *Beyond TRIMs: A Case for Multilateral Action on Investment Rules and Competition Policy?*, in *THE URUGUAY ROUND AND THE DEVELOPING COUNTRIES* 381-8 (Will Martin & L. Alan Winters eds., 1996).

⁵³ See TREBILCOCK & HOWSE, *supra* note 42, at 338-9.

⁵⁴ *Id.*

⁵⁵ The Annex to the TRIMS Agreement sets out an "Illustrative List" of performance requirements that are inconsistent with the agreement. The agreement provides for notification, national treatment and the phased elimination of this limited set of performance requirements. In early 2000 (which marked the expiration of the transition period for the elimination of TRIMS for developing countries), a group of developing countries began to lobby the WTO Council for Trade in Goods for an extension to the transition period. In July 2001, an agreement was reached whereby the requests of nine countries – Argentina, Chile, Colombia, Malaysia, Mexico, Pakistan, the Philippines, Romania and Thailand – were to be granted extensions to be approved by the Goods Council by October 2001. However, opposition from the US and Canada to the detail of the Malaysian and Colombian plans to phase-out non-conforming measures prevented agreement from being reached in October 2001. See *Rift over Malaysia, Colombia Holds Up Approval of TRIMS Extensions* 19 (42) *INSIDE U.S. TRADE*, Oct. 19, 2001, 11-2.

possible intra-issue tradeoffs within the general topic of investment. One possible solution to may be to link further disciplines on post-admission restrictions in a WTO investment agreement with new disciplines on the use of investment incentives by host states.⁵⁶ The role of investment incentives in national investment policies and the relative disadvantage of developing countries in the use of incentive is considered next.

C. Incentives: A Competitive Dilemma

Incentives to attract investors into the host state are often linked to performance requirements by host states. In other words, they act as an economic carrot to sweeten the imposition of the stick.⁵⁷ The range of incentives offered by host states is extensive. However, there are broadly two main categories; fiscal incentives (whose objective is often to reduce the tax burden for an investor by, for example, reducing the standard corporate income tax rate) and financial incentives (which normally involve the provision of funds directly to the investor in the form of direct subsidies, loan guarantees or export credits).⁵⁸ Developed states normally favor the use of financial incentives over fiscal ones in part because fiscal incentives generally require change to domestic legislation and hence parliamentary approval. In contrast, developing states tend to prefer the use of fiscal incentives as they generally lack the resources needed to provide direct financial resources.⁵⁹

⁵⁶ This type of grand bargain has been oft mooted but because of its importance deserves reconsideration and analysis. See, e.g., E.V.K. FitzGerald, *Developing Countries and Multilateral Investment Negotiations*, MULTILATERAL REGULATION OF INVESTMENT 60-2 (E.C. Niewuwenhuys & M.M.T.A. Brus eds., 2001).

⁵⁷ For a useful analysis of the linkage between performance requirements and investment incentives at the national level, see Rachel McCulloch, *Investment Policies in the GATT* 13 WORLD ECON. 541, 545-8 (1990).

⁵⁸ For a concise summary of the range of incentives used by host states, see UNCTAD, *supra* note 25, at 180.

⁵⁹ A typical example of the use of fiscal incentives occurred recently in Laos to attract the development of a gold mine by Oxiana Resources, a small Australian mining company. See Arnold, *supra* note 31, at C.8 (“As incentives, Laos has exempted Oxiana from corporate taxes for two years as well as its employees from having to pay income taxed. It has waived duties on imported equipment and is permitting Oxiana to hire a customs official to be posted on site, eliminating long waits for shipments at the border.”).

There are various theoretical arguments used by host states to justify the issue of incentives.⁶⁰ In particular, host states view the use of these incentives as a means of influencing the decisions of investors to locate in a particular region. The assumption is that this can then lead to associated investments by other investors thus creating roll-on benefits for the host state. Ultimately however, these incentives may only be successful to the extent that they succeed in attracting investment into one state away from another. As such, there is a real risk of competition amongst states in the use of incentives.⁶¹ In such competition, it is obviously the poorer countries that are relatively disadvantaged. In a bidding contest using fiscal and financial incentives, the winner is likely to be the country that has the “deepest pockets”.⁶² The use of incentives can thereby act to distort the allocation of global FDI (based, in part, on the comparative advantages of host states) particularly discriminating against developing countries. Somewhat ironically, the empirical evidence suggests that incentives only play a limited role in the decisions of investors to invest among different states.⁶³ In this respect, instead of enabling wealthy countries to attract investors, some incentives may simply act as a form of wealth transfer from the host state to the investor.

Unlike the restrictions considered earlier, there are effectively no rules at the international level to discipline the use of investment incentives.⁶⁴ The foregoing analysis suggests

⁶⁰ For a theoretical analysis of the use of incentives, see UNCTAD, INCENTIVES AND FOREIGN DIRECT INVESTMENT 9-16 (1996).

⁶¹ For example, during the course of 1996-2000, General Motors entered into negotiations for the construction of a new US\$250 million engine plant with five possible suitors: Brazil, Germany, Sweden and two Australian sub-federal states, South Australia and Victoria. Towards the end of negotiations, only Victoria and South Australia remained as suitors. Eventually, Victoria’s bid of US\$30 million (in comparison to South Australia’s bid of US\$12 million) succeeded in attracting General Motors to locate the plant in Victoria. *Holden’s Decision*, THE AGE (Melbourne, Australia), Dec. 14, 2000, at 4.

⁶² UNCTAD, *supra* note 60, at 14.

⁶³ In a 1984 survey of 52 TNCs, out of 19 factors identified by TNCs as influencing their decision to invest in a host state, incentives offered by the host state ranked seventh in importance for investments in developing states and eighth in developed states. GROUP OF 30, FOREIGN DIRECT INVESTMENT 1973-1987 (1984). See also UNCTAD, *supra* note 60; Edward M. Graham, *Trade and Investment in the WTO: Just Do It!*, in LAUNCHING NEW GLOBAL TRADE TALKS: AN ACTION AGENDA 153-4 (Jeffrey J. Schott ed. 1998). But cf. Bernard Hoekman & Kamal Saggi, *From TRIMs to a WTO Agreement on Investment?*, in DEVELOPING COUNTRIES AND THE WTO: A PRO-ACTIVE AGENDA 206-7 (Bernard Hoekman & Will Martin eds. 2000) (questioning the rationale for disciplines on all incentives).

⁶⁴ See OECD, *The OECD Declaration on International Investment and Multinational Enterprises 1976* (as reviewed and amended), DAFFE/IME (2000) 20. This Declaration comprises a Statement on National Treatment, a Statement on International Investment Incentives and Disincentives and a set of voluntary

clear benefits to developing countries in the negotiation of rules limiting the use of incentives given their relative disadvantage in any bidding context using incentives. But, given political realities, it will be more difficult for developed countries to agree to such rules.⁶⁵ If the developed world simply accepts the economic evidence of the distortive effects of incentives, then incentive competition would constitute a “prisoner’s dilemma” for the world as a whole (instead of only implying losses for developing countries). In turn, this would create impetus for all states to act co-operatively to design rules limiting the use of incentives.

But it is more likely that developed countries will continue to oppose the inclusion of incentives in negotiations rules on FDI. Aside from the perceived success of incentives in some developed home states⁶⁶, the political economy aspect of this issue would most likely see the business community of developed home states (as losers from such rules) lobby vigorously against this proposal. A more realistic approach to limits on incentives is that of, at least in perception, a zero-sum game which would increase welfare in developing countries but reduce welfare in developed states.

However, there is still clearly room in a WTO initiative to create an incentive for WTO members to cooperate in this area. In essence, this would involve linking disciplines on incentives to that of performance requirements. An offer by developed states to consider rules on incentives could act as a powerful inducement for developing countries in turn to agree to other restrictions in such a general agreement. This type of reciprocal, intra-

Guidelines for Multinational Enterprises. The Statement on International Incentives and Disincentives enables a member state to consult with another member state when it “considers that its interests may be adversely affected by the impact of...official incentives and disincentives to international direct investment”. However, to date, little consultation has taken place as few OECD states have wanted to take the competitive risk of exposing their use of incentives. *See generally* OECD, *The OECD Declaration and Decisions on International Investment and Multinational Enterprises: 1991 Review* (1992).

⁶⁵ One particular aspect of the political sensitivity of developed states to disciplines on the use of incentives arose in the MAI negotiations. The US opposed the inclusion of the use of subnational incentives in the negotiations on the basis that it could (or should not) bind state governments to obligations regarding incentives. *See* Graham, *supra* note 63, at 153.

⁶⁶ For example, Ireland has used a variety of financial incentives in its successful campaign to attract FDI and develop its computer and electronic sector. *See* UNCTAD, *WORLD INVESTMENT REPORT 1998: TRENDS AND DETERMINANTS* 105 (1998).

issue linkage is precisely what may be needed to overcome the resistance by developing countries to general rules on investment.

Reciprocity within and across issues is not the only strategy that will need to be pursued by negotiators to guarantee the success of any WTO investment agreement. Aside from disciplines on directly discriminatory measures such as those explored above, the WTO negotiators will also need to consider the delicate balance between investment rules and legitimate regulatory measures with an incidental impact on foreign investors. The difficulty in drawing a line between effective investment rules and broader host state regulatory autonomy is best illustrated by on-going difficulties under Chapter 11 of NAFTA. These will be considered next.

IV. The NAFTA Chapter 11 Model

In considering prospects for a WTO investment agreement, an analysis of Chapter 11 of NAFTA is essential for three reasons. Firstly, NAFTA Chapter 11 contains the most detailed and comprehensive rules on foreign investment in any international treaty. Secondly, the drafters of the MAI relied heavily on the NAFTA provisions when formulating the substantive provisions of the MAI. This leads to the obvious point that the WTO member states are likely to look to the NAFTA experience when considering whether and how to negotiate WTO investment rules. Thirdly, there has been an explosion in recent years in the number of arbitral challenges brought by investors under Chapter 11 against regulatory measures imposed by NAFTA states. Chapter 11 is arguably the best tool available to consider the way in which to frame the delicate relationship between a multilateral investment agreement and regulatory autonomy. In particular, such an analysis enables a normative assessment of the advantages or otherwise of using a Chapter 11 NAFTA model as a guide for a WTO investment agreement on this question.

A. Overview

There are four essential components to Chapter 11 of NAFTA; scope of application, investment liberalization, protection and dispute settlement. Of the discriminatory measures considered in Part III of this paper, the NAFTA Chapter 11 model primarily aims to discipline the use of pre and post-admission restrictions by a NAFTA state. In comparison, there are few provisions limiting the use of investment incentives.

1. Scope of Application: Article 1101

The coverage of the substantive provisions of NAFTA is delineated by Article 1101. This provides two separate planes of application. Firstly, all the Chapter 11 disciplines apply to measures of a NAFTA state relating to “investors” of a NAFTA state and to “investments” by investors of a NAFTA state. In addition, the particular disciplines in Article 1106 (Performance Requirements) and 1114 (Environmental Measures) apply to all investments (that is, including domestic investments and investments from non-NAFTA countries).

The key definition in appreciating the coverage of Chapter 11 of NAFTA is that of “investment” in Article 1139. The NAFTA model adopts a very broad, asset-based definition of “investment” extending to most forms of capital such as equity security, debt security, debt finance and real estate in a NAFTA country. Indeed, the NAFTA approach goes beyond FDI to include portfolio investment by virtue of the fact that “equity security” is included in limb (b) of the definition without any percentage limitation on ownership. This also bolstered by limb (e) of the definition which would go beyond direct ownership of equity security (where the quantum of ownership is not sufficient to characterize the investment as FDI) to include beneficial ownership of the underlying interest (through, for example, holding units in a listed investment trust).⁶⁷

⁶⁷ NAFTA, *supra* note 3, art. 1139. Limb (e) of the definition of “investment” includes “an interest in an enterprise that entitles the owner to share in income or profits of the enterprise” (emphasis added).

But there are tendencies within the interpretation that counter this broad approach. Firstly, the Article 1139 definition sets out an exhaustive list of interests that would qualify as an investment.⁶⁸ Even within this list, there are limiting factors within the definition of certain interests. For example, loan finance is only covered under item (d) of the definition if the loan is made to an enterprise that is an affiliate of the investor or where the original maturity of the loan is at least three years. Thus, this approach only covers intra-firm debt flows or debt with a relatively long-term perspective. In other words, the NAFTA approach explicitly excludes shorter-term debt (whose volatility led to liquidity problems in the Asian financial crisis) from attracting the benefit of the disciplines in Chapter 11.⁶⁹ A similar theme is evident in item (h) of the definition which tries to isolate key characteristics of an investment not necessarily related to an enterprise (whether through equity or debt) or real estate. Item (h) of the definition of “investment” in Article 1139 includes:

- interests arising *from the commitment of capital or other resources* in the territory of a Party to economic activity in such territory such as under
- (i) contracts involving *the presence of an investor’s property* in the territory of the Party, including turnkey or construction contracts; or
 - (ii) contracts *where remuneration depends substantially on the production, revenues or profits of an enterprise.* (emphasis added)

This approach of trying to identify the characteristics of an investment (thereby delineating what forms of capital get the benefit of Chapter 11) is also bolstered by the limited exclusions to the definition of “investment” in items (i) and (j) of Article 1139. These are essentially claims to money arising from trade in goods or services or related forms of financing (such as trade financing).

2. Investment Liberalization: Articles 1102 to 1104 and 1106

The first substantive discipline on national measures affecting investors and investments of a NAFTA state are the liberalization commitments in Chapter 11. Liberalization is effected primarily through the application of non-discriminatory standards of treatment.

⁶⁸ NAFTA, *supra* note 3, art. 1139. “[I]nvestment means:...” In comparison, the MAI definition was much broader by adopting a non-exhaustive list of interests that would qualify as an investment.

⁶⁹ See *infra* Part V.A for an examination of the volatility of loan finance and portfolio investment (when compared to FDI) in the Asian financial crisis of 1998 in the context of the MAI negotiations.

But the NAFTA model is a typically American conception of non-discrimination as applied to investment restrictions. Like most BITs involving the US, investors are provided with the better of national and most-favored nation treatment which extend to both proposed investments (pre-admission) as well as established investments in a NAFTA state (post-admission).⁷⁰ The extension of liberalization commitments to the pre-establishment phase is a striking aspect of NAFTA and one which separates it from other international initiatives such as the Energy Charter Treaty.⁷¹ The top down structure of NAFTA Chapter 11 means that these substantive commitments cover all economic sectors and national laws of a NAFTA state unless specifically exempted by the submission of a negative-list of non-conforming measures.⁷² In contrast to this strict approach, the GATS adopts a hybrid structure which involves elements of a bottom up approach. WTO members can either make horizontal commitments (across all services sectors) or sector-specific commitments (which cover a particular economic sector) to the national treatment obligation in Article XVII. This complicated structure provides WTO members with significant discretion in determining in what manner to open up their service sectors to foreign competition. However, analyses to date of commitments scheduled under the GATS show only limited results in effecting liberalization in the services area.⁷³

The NAFTA liberalization commitments extend beyond imposing non-discriminatory standards of treatment to encompass an outright prohibition on the use of certain

⁷⁰ NAFTA, *supra* note 3, arts. 1102 (National Treatment), 1103 (Most-Favored-Nation Treatment) and 1104 (Standard of Treatment). The obligation to accord national and most-favored-nation treatment to the proposed investments is indicated by the inclusion of the words “establishment, acquisition” in Articles 1102 and 1103.

⁷¹ In the negotiations towards the Energy Charter Treaty from 1992 to 1994, the negotiators could not agree on a binding regime for the pre-admission phase and decided to postpone the negotiation of such a regime to a supplementary stage. Instead, under the pre-admission phase, member states are subject to a soft law, best efforts obligation under Articles 10(2) and (3). In comparison, investors are provided with full national and most-favored-nation treatment in the post-admission phase under Article 10(7). See Thomas W. Wälde, *Introductory Note European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects*, 33 I.L.M. 360, 361-2 (1995).

⁷² NAFTA, *supra* note 3, art. 1108 (Reservations and Exceptions); Annexes I-IV.

⁷³ See, e.g., Bernard Hoekman, *Assessing the General Agreement on Trade in Services*, in THE URUGUAY ROUND AND THE DEVELOPING COUNTRIES 88-124 (Will Martin & L. Alan Winters eds., 1996); Pierre Sauvé, *Assessing the General Agreement on Trade in Services – Half-Full or Half-Empty?* 29 (4) J. WORLD TRADE 125, 125-46 (1995).

performance requirements by NAFTA member states.⁷⁴ In this respect, the NAFTA provisions go beyond the WTO approach in the TRIMS Agreement. The NAFTA list of prohibited performance requirements includes, for example, technology transfer requirements which are not explicitly covered by the TRIMS Agreement.⁷⁵ Article 1106 is also the only part of Chapter 11 to deal with the use of investment incentives. Of itself, Article 1106 does not prevent a NAFTA party from using incentives. It simply restricts their ability to link the use of incentives to certain performance requirements.⁷⁶

3. Investment Protection: Articles 1110 and 1105

Like most investment agreements, NAFTA contains specific rules on investment protection. Part II.B of this paper traced the development of guarantees of investment protection in BITs to the incidents of increased expropriation of investments in the wake of decolonization efforts in the 1960s. The actual content of these guarantees have been the subject of divergence of opinion between developed and developing countries.⁷⁷ None the less, investment protection provisions have been accepted by developing host states for several decades in BITs although those states have resisted their incorporation into multilateral instruments.⁷⁸

⁷⁴ NAFTA, *supra* note 3, art. 1106.

⁷⁵ NAFTA, *supra* note 3, art. 1106(f).

⁷⁶ NAFTA, *supra* note 3, arts. 1106(3). The four performance requirements which cannot be linked to the use of incentives are domestic content (art. 1106(3)(a)); domestic purchase requirements or preferences (art. 1106(3)(b)); relationship between imports and exports to foreign exchange inflows (art. 1106(3)(c)); and relationships of domestic sales to exports or foreign earnings (art. 1106(3)(d)).

⁷⁷ The content of international rules governing expropriation has historically been characterized by competing positions between developed and developing states. Developed states have generally insisted on specific requirements before an expropriation would be regarded as lawful in international law. These have typically been that the expropriation is in the public interest, not discriminatory and accompanied by full compensation. Developed states have insisted that the quantum of compensation, in turn, should reflect the so-called Hull formula of "prompt adequate and effective compensation". In contrast, until relatively recently, developing states have asserted that the question of expropriation is subject to the exclusive jurisdiction of the host country which determines how and to what extent compensation is to be paid. This approach was often motivated by ideology especially in the former socialist states of Eastern Europe that held to the Marxist philosophy that nationalization did not require any payment of compensation. For a history of the development of the Hull formula and a comparison of the approach of developed and developing states to the question of compensation for expropriation, see M SORNAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 359-413 (1994).

⁷⁸ See generally Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998) (analyzing the factors behind the agreement of developing countries to agree to strong provisions on investment protection in BITs).

However, since the 1980s, there has been a dramatic reduction in incidences of direct expropriation of foreign investment.⁷⁹ Despite this lessening of expropriatory behavior, the NAFTA incorporates extremely strong guarantees of investment protection in Article 1110(1):

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

Article 1110 clearly provides an obligation to compensate in the event of direct expropriation of an investment in a NAFTA state. But host states can always impose other regulatory measures that may incrementally impact on an investor but are not as immediately serious as expropriation. The words “tantamount to nationalization” in Article 1110 are clearly intended to deal with this type of progressive or indirect expropriation. The critical problem that has arisen with Article 1110 is that there is no clear definition of what will constitute an indirect expropriation. There is no guidance within NAFTA as to when legitimate governmental regulation which in some way adversely impacts on a foreign investor constitutes indirect expropriation. This has led to a number of arbitral cases under Chapter 11 brought by investors arguing that seemingly normal regulatory measures are “tantamount to nationalization”.⁸⁰ The flaw in the drafting of these clauses was also replicated in the MAI negotiating draft and stringently opposed by NGOs in their campaign against the MAI.⁸¹

Article 1110 is also not the only provision in NAFTA which provides investors with guarantees of investment protection. Article 1105 provides investors with a minimum standard of treatment “in accordance with international law, including fair and equitable treatment and full protection and security”. This approach sets a minimum ceiling in

⁷⁹ See discussion *supra* Part II.B, note 26 and accompanying text.

⁸⁰ See *infra* Part IV.B for an analysis of some of the main cases brought by investors under NAFTA Chapter 11.

⁸¹ See *infra* Part V.C for an analysis of the NGO campaign against the MAI.

which to treat foreign investors. In other words, even if a NAFTA host state treats foreign and domestic investors equally under its domestic law, it may still breach Article 1105 if an arbitral tribunal finds that the actual level of treatment violates international law standards of treatment. The problem is that there is little consensus on what this standard constitutes and there is similar uncertainty as to the exact standard required by the phrases “fair and equitable treatment” and “full protection and security”.⁸² The problem is compounded by the fact that little guidance is given within the NAFTA text as to the interpretation of such general phraseology. The uncertainty in scope of application of Article 1105 has seen investors increasingly use this provision as an alternative means to Article 1110 in bringing arbitral cases to challenge regulatory measures imposed by NAFTA states.⁸³

4. Dispute Settlement

The fourth limb of the Chapter 11 model constitutes the procedures relating to the settlement of investment disputes. Under Section B of Chapter 11, an investor of a NAFTA state may commence arbitral proceeding for breach of any of the provisions in Section A of Chapter 11.

There are strong normative justifications for the inclusion of an investor-state dispute resolution procedure in an agreement of this sort. Normally, disputes between a state and a private entity (rather than foreign government) would be subject to the jurisdiction of the host country. But in many developing host states, the legal system may not have the resources or judicial traditions to deliver certainty in the resolution of disputes.⁸⁴ In

⁸² See generally DOLZER & STEVENS, *supra* note 2, at 58-61 (discussing similar provisions in BITs and acknowledging the lack of certainty in quantum of treatment provided by this type of clause).

⁸³ See also *infra* Part IV.B.

⁸⁴ The tenor of investor concern with using the courts in developing states is evidenced by a recent statement from an investor in Cambodia:

The court system just doesn't work...we're seeing more business disputes being resolved in antagonistic and adversarial ways than ever...[R]esolutions of disputes are lawless, it's law of the jungle...investors end up having to pay off judges, get some police involved and flail and push people to resolve even simple business disputes.

See Phelim Kyne, *Fear Grips Business in Cambodia*, THE AGE (Melbourne, Australia), Jul. 22, 2000, at 18.

addition (even for host developed states), once an investor has entered into the host state through a bricks and mortar-type of FDI, they are effectively a form of hostage to the host state which can extract rents through discriminatory conduct. With this form of relatively immobile investment, it is not normally a feasible option for investors to quit the host state in response. Direct dispute resolution procedures provide investors with a legitimate avenue in which to enforce commitments made by member states in the substantive component of the investment agreement.

This is an important point because there has been much criticism by NGOs and others of these dispute resolution procedures both in NAFTA and the draft MAI. However, the real concern about the breadth of some of the cases being brought by investors under NAFTA Chapter 11 should not be simply grounded in the existence of dispute resolution procedures. Instead, a more justifiable critique would focus on the broad and often undefined scope of the liberalization and protection commitments in the NAFTA model.

5. Absences: Incentives and GATT Article XX-type Safety Valve

Before examining the evolving jurisprudence from some of the NAFTA cases, it is worthwhile briefly highlighting two absences in the NAFTA model.

Firstly, there are no direct substantive limitations on the use of investment incentives despite their clearly discriminatory purpose and distortive effect. There is, however, an interesting provision in Article 1114 which limits the ability of the NAFTA parties to lower their health, safety or environmental measures as an inducement for a foreign investor. The basis for this article is the fear that using this type of regulatory incentive to attract investors could lead to competitive downward pressure (or a race to the bottom) on regulatory standards. Interestingly, there appears to be little empirical justification for fears of a race to the bottom at least on environmental standards.⁸⁵ Yet, Article 1114 is notable from a normative perspective as integrating broader public values than simply

⁸⁵ See David Vogel, *Environmental Regulation and Economic Integration*, in REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPETING PERSPECTIVES 330-347 (Daniel C. Esty & Damien Geradin eds. 2001).

economic liberalization goals. In the MAI episode, the OECD only belatedly considered similar provisions after sustained attack by NGO groups and growing public concern of the legitimacy of the agreement. Further, Article 1114 is not an overly ambitious mechanism for integrating broader values; it is an instrument of negative integration (in the sense of specifying what must not be done) rather than positive integration (which could, for example, set what environmental standards states must maintain).

Secondly, unlike the trade liberalization commitments in the GATT⁸⁶, there is no Article XX-type⁸⁷ safety valve in Chapter 11 which would provide a general exception to the prohibition against discrimination. But as will be seen next, there have been attempts in the evolving jurisprudence of the NAFTA cases to try and implant the kinds of reasoning employed in the Article XX cases of the GATT/WTO dispute resolution procedures. Inserting an Article XX-type exception— by arbitral fiat or otherwise – may not be the best way in which to counter the artificial use of investors of the Chapter 11 dispute resolution procedures. GATT panels themselves have struggled with the application of Article XX and its constituent parts leading to a variety of inconsistent interpretations.⁸⁸ These inconsistencies have in turn led to questions about the underlying legitimacy of the

⁸⁶ General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Agreement Establishing the World Trade Organization, Annex 1A, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, 33 I.L.M. 1154 (1994) [*hereinafter* GATT].

⁸⁷ *Id.*, art. XX. This article provides a number of exceptions from GATT obligations to enable member states to adopt measures designed to achieve certain non-trade goals. In part, Article XX provides:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

...

(b) necessary to protect human, animal or plant life or health;

....

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

⁸⁸ See, e.g., *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, Report of the Panel Adopted on 7 November 1990 (DS/O/R-37S200); *United States – Restrictions on Imports of Tuna* 30 I.L.M. 1594 (1991); *United States – Restrictions on Imports of Tuna: Report of the Panel* 33 I.L.M. 936; *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Panel, WT/DS2/R (29 January 1996); *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, WT/DS2/9 (20 May 1996); *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Panel, WT/DS58/R (29 January 1996); *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Panel, WT/DS135/R (18 September 2000).

GATT and the capacity of GATT panels to manage complex tradeoffs between free trade and broader public values.⁸⁹ From the perspective of a possible WTO investment agreement, this paper will consider an alternative approach. It will use the evolving NAFTA jurisprudence to illustrate the uncertain scope and conflicting interpretations of the substantive commitments in the NAFTA Chapter 11 model. In turn, the MAI simply replicated and extended many of these substantive commitments. It is submitted that WTO negotiators may be able to best balance the fine line between elimination of discriminatory measures whilst preserving core regulatory autonomy by carefully defining and delineating the substantive commitments within a WTO investment agreement (rather than relying on exceptions to otherwise undefined liberalization commitments).

B. Some Problematic Chapter 11 NAFTA Case Law⁹⁰

The focus of this part of the paper will be on the evolving and inconsistent way in which arbitral tribunals have interpreted the broad liberalization and protection commitments in Chapter 11. For reasons of space, the paper will not consider all of the arbitral cases under Chapter 11.⁹¹ Instead, three cases have been chosen to illustrate worrying trends in

⁸⁹ The literature on the Article XX cases is voluminous. For thoughtful analyses of the difficulties in drawing the line between free trade goals and broader regulatory autonomy, see Michael Trebilcock & Robert Howse, *Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics*, EUR. J. L. ECON. 5 (1998); Robert Howse, *Managing the Interface between International Trade Law and the Regulatory State: What Lessons Should (and Should Not) Be Drawn from the Jurisprudence of the United States Dormant Commerce Clause*, in REGULATORY BARRIERS AND THE PRINCIPLE OF NON-DISCRIMINATION IN WORLD TRADE LAW 139 (Thomas Cottier & Petros C. Mavroidis eds. 2000).

⁹⁰ There is no central repository of documents submitted in Chapter 11 cases. For Chapter 11 cases involving Canada, the website of the Canadian Department of Foreign Affairs and International Trade (<http://www.drait-maeci.gc.ca>) maintains a comprehensive list of documents submitted in relation to such cases. For Chapter 11 cases involving other NAFTA states, the best source of documents are two websites maintained by attorneys that are active in this area, <http://www.appletonlaw.com> and <http://www.toddweiler.com>. However, these sites are not complete and some documents involved in NAFTA cases can be difficult to locate.

⁹¹ For analyses which mainly focus on NAFTA Chapter 11 cases and particularly their impact on national environmental measures, see J. Martin Wagner, *International Investment: Expropriation and Environmental Protection*, 29 GOLDEN GAT U. L. REV. 465 (1999); David A Gantz, *Potential Conflicts Between Investor Rights and Environmental Regulation under NAFTA's Chapter 11*, 33 GEO. WASH. INT'L L. REV. 651 (2001). For a comparative overview between the NAFTA approach and other investment treaties on this question, see Thomas W. Wälde, *International Disciplines on National Environmental Regulation: With Particular Focus on Multilateral Investment Treaties*, in

the interpretation of Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment) and 1110 (Expropriation). Indeed, growing concern of the breadth of interpretation afforded to these provisions recently led the NAFTA Free Trade Commission to issue an interpretation to try and limit the operation of Chapter 11.⁹²

1. Metalclad Corporation v United Mexican States

In this case, Metalclad Corporation (a US company), bought land in order to establish a waste disposal facility in the Mexican Municipality of Guadalupe located in the Mexican State of San Luis Potosi.⁹³ In January 1993, Metalclad was granted a federal permit to construct a waste landfill and construction started soon thereafter. However, opposition arose from the state government as well as municipal authorities on environmental grounds.⁹⁴ In October 1994, the municipal authorities ordered the cessation of building activities due to the absence of a municipal construction permit.⁹⁵ Federal officials told Metalclad to apply for a municipal construction permit because it would be issued as a matter of course and would facilitate amicable relations with the Municipality. Metalclad applied for a permit, continued construction and completed the landfill site in March 1995. But on December 1995, the Municipality denied Metalclad's application for a permit in a process that was closed to Metalclad.⁹⁶ In September 1997, the Governor of the State issued an ecological decree declaring the site of the landfill a

INTERNATIONAL INVESTMENTS AND PROTECTION OF THE ENVIRONMENT: THE ROLE OF DISPUTE RESOLUTION MECHANISMS 29, 64-70 (Int'l Bureau of the Perm. Court of Arbitration ed., 2001). See also David Lopez, *Dispute Resolution under NAFTA: Lessons from the Early Experience*, 32 TEX. INT'L L.J. 163 (1997); Chris Tollefson, *Games without Frontiers: Investor Claims and Citizen Submissions under the NAFTA Regime*, 27 YALE J. INT'L L. 141 (2002); Ari Afilalo, *Constitutionalization Through the Back Door: A European Perspective on NAFTA's Investment Chapter*, 34 N.Y.U. J. INT'L L. & POL. 1 (2002).

⁹² On 31 July 2001, the NAFTA states, through the auspices of the NAFTA Free Trade Commission, agreed to clarify the operation of some of the Chapter 11 provisions particularly Article 1105. See *U.S., Canada, Mexico Agree to Clarify NAFTA's Investor-State Provisions*, 19 (31) INSIDE U.S. TRADE, Aug. 3, 2001, at 1, 21-3 [hereinafter *NAFTA Free Trade Commission Interpretation*]. The components of the Free Trade Commission Interpretation are examined further in Part IV.C.

⁹³ For a summary description of the facts in this dispute, see *Abstract of ICSID (Additional Facility): Metalclad Corp. v United Mexican States*, 40 I.L.M. 35, 37-43 (2001) [hereinafter *Metalclad*].

⁹⁴ *Id.* at 42-4.

⁹⁵ *Metalclad*, *supra* note 93, at 42.

⁹⁶ Metalclad was not notified of the Town Council meeting which considered the permit application nor was it given an opportunity to participate in that meeting. Metalclad's request for reconsideration of the denial of the permit was also rejected. See *Metalclad*, *supra* note 93, at 44.

“Natural Area” for the protection of rare cactus further preventing the possibility of Metalclad’s use of the waste operation facility.

Metalclad argued that Mexico (through the acts of its State and Municipal authorities) breached Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation). The arbitral Tribunal found in favor of Metalclad and awarded US\$16.7 million in damages against Mexico in August 2000.⁹⁷

The Tribunal firstly found that Mexico breached its obligation to accord Metalclad “fair and equitable” treatment under Article 1105. The primary basis for this finding was the lack of “transparency” in the application processes at the various federal, state and local levels required to obtain approval for the project.⁹⁸ The Tribunal was also influenced by the fact that Metalclad’s application for a local permit was denied without any notice or opportunity to appear at the hearing.⁹⁹ Thus, the Tribunal in this case is interpreting the standard of treatment required by Article 1105 by reference to concepts of transparency and due process. The conclusion on transparency is particularly grounded by reference to the general transparency commitment in Article 102(1) of NAFTA.¹⁰⁰

The Tribunal also found that the actions of the Mexican authorities breached the prohibition on expropriation in Article 1110. In doing so, the Tribunal gave a very broad interpretation of the coverage of protection under Article 1110 which it decided:

Includes not only open, deliberate and acknowledged takings of property...but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property *even if not necessarily to the obvious benefit of the host state.* (emphasis added)¹⁰¹

On the facts, the Tribunal found that as the federal government had approved the project within its authority to do so and by permitting the Municipal authority to hinder the

⁹⁷ *Metalclad, supra* note 93, at 54.

⁹⁸ “The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA.” *Metalclad, supra* note 93, at 49.

⁹⁹ *Metalclad, supra* note 93, at 49.

¹⁰⁰ *Metalclad, supra* note 93, at 47.

¹⁰¹ *Metalclad, supra* note 93, at 50.

operation of the project, Mexico had taken a measure “tantamount to expropriation” in breach of Article 1110. Interestingly, the Tribunal went on to consider the effect of the ecological decree of the site as a “Natural Area”. It basically viewed this decree as a “further ground for a finding of expropriation” given its effect of barring the operation of the landfill.¹⁰² But an inkling of the breadth of the protection for indirect expropriation under Article 1110 can be gleaned from the Tribunals view that “the implementation of the Ecological Decree would, *in and of itself*, constitute an act tantamount to expropriation” (emphasis added).¹⁰³

2. *S.D. Myers, Inc. v Government of Canada*

In this case, S.D. Myers (a US company) operated a Canadian entity to transport PCB hazardous waste from Canada to its treatment plants in Ohio. S.D Myers claimed that Canada’s banning of PCB exports from November 1995 to February 1997 breached Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment), 1106 (Performance Requirements) and 1110 (Expropriation). In November 2000, the arbitral Tribunal in this case found breaches of the first two claims but rejected the remainder.

In examining national treatment obligation in Article 1102, the Tribunal held that it is necessary to take into account both whether the measure is on its face discriminatory as well as its practical effect.¹⁰⁴ In other words, the Tribunal followed long-standing GATT/WTO jurisprudence in finding that national treatment (albeit in the investment context) extends to both *de jure* and *de facto* discrimination. The measure before the Tribunal was by no means discriminatory on its face as it was a blanket ban on all PCB exports (whether by domestic participants or foreign investors) out of Canada. Intriguingly, the Tribunal went on to indicate that the quantum of *de facto* discrimination necessary to ground breach of the national treatment norm is whether the measures

¹⁰² *Metalclad*, *supra* note 93, at 51.

¹⁰³ *Metalclad*, *supra* note 93, at 51.

¹⁰⁴ *North American Free Trade Agreement (NAFTA) Arbitration: S.D. Myers, Inc. v Government of Canada*, 40 I.L.M 1408, 1437 (2001) [hereinafter *S.D. Myers*].

creates “a disproportionate benefit for nationals over non-nationals”.¹⁰⁵ This type of reasoning does not have an equivalent in the jurisprudence that has developed around the Article III national treatment norm of the GATT.¹⁰⁶ Unfortunately, the Tribunal did not go on to apply this approach to the facts. Instead, there is a troubling emphasis on the role of protectionist intent in grounding a breach of Article 1102.

Although the Tribunal states that protectionist intent is not necessarily enough to breach Article 1102¹⁰⁷, the structure of the judgment tends to contradict this statement. There is a lengthy analysis early in the judgment where the Tribunal reviews large amounts of evidence to find that the Canadian government passed the export ban as an attempt to protect domestic Canadian producers rather than on environmental grounds.¹⁰⁸ In contrast, there is little substantive analysis of the discriminatory impact of the export ban. At most, the Tribunal characterized the desire to retain the ability to process PCB waste in Canada as a legitimate goal but indicated that there were other ways in which Canada could have favored domestic PCB facilities without breaching NAFTA rules.¹⁰⁹

This textual emphasis on intent in the judgment is problematic. In passing regulatory measures, governments often attempt to broaden public support for measures by statements designed to appeal to vocal interest groups in the community. But these statements, by themselves, should not be enough to substantiate an allegation of discrimination. Further, this kind of analysis of governmental intent is problematic from a legitimacy perspective whereby an arbitral Tribunal is seen as second-guessing the deliberations of a representative government. These concerns have long been expressed in prominent cases in the GATT/WTO analyzing the national treatment norm in Article

¹⁰⁵ *Id.*

¹⁰⁶ In fact, this point was raised in a later case initiated by Pope & Talbot, Inc. against the Government of Canada. The Tribunal in that case rejected the application of the “disproportionate benefit” test to Article 1102. See *In the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement Between Pope & Talbot Inc and the Government of Canada, Award on the Merits of Phase 2*, para. 43-72 Apr. 10, 2001, at <http://www.dfait-maeci.gc.ca>.

¹⁰⁷ *S.D. Myers*, *supra* note 104, at 1437.

¹⁰⁸ *S.D. Myers*, *supra* note 104, at 1424-8. The Tribunal also emphasizes the somewhat unfortunate words of the Canadian Minister of the Environment that it was Canada’s policy that PCB waste should be disposed of “in Canada by Canadians”. See *S.D. Myers*, *supra* note 104, at 1425.

¹⁰⁹ The two examples given are procurement preferences by Canadian governmental departments and the grant of subsidies to the Canadian industry. See *S.D. Myers*, *supra* note 104, at 1437.

III.¹¹⁰ It is surprising that the arbitrators in this case failed to heed these long-standing concerns.

In its analysis of Article 1105 (Minimum Standard of Treatment), the Tribunal's approach seems somewhat contradictory to the strong emphasis on intent under Article 1102.¹¹¹ The Tribunal goes on to consider that a breach of Article 1105 occurs only if an investor has been "treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective".¹¹² That treatment has to be "made in light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders".¹¹³ But, unlike *Metalclad* with its emphasis on transparency and due process, little attention is given to exactly what this level of treatment should be to ground a breach of Article 1105. Instead, the Tribunal simply finds that "on the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well".¹¹⁴ This seemingly simplistic approach of linking a breach of Article 1102 to a breach of Article 1105 underscores the uncertainty inherent in its application.

¹¹⁰ See, *Japan – Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS8/R; WT/DS10/R; WT/DS11/R (11 July 1996), at para. 6.10 ("The Panel also noted that very often there is a multiplicity of aims that are sought through enactment of legislation and it would be a difficult exercise to determine which aim or aims should be determinative...Moreover, access to the complete legislative history...could be difficult or even impossible for a complaining party to obtain. Even if the complete legislative history is available, it would be difficult to assess which kinds of legislative history (statements in legislation, in official legislative reports, by individual legislators, or in hearings by interested parties) should be primarily determinative of the aims of the legislation."). See also *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8/AB/R; WT/DS10/AB/R; WT/DS11/AB/R (4 October 1996), at para. H.2.c. *But cf. Chile – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS/97/AB/R (13 December 1999) (emphasizing the permissibility of taking into account the statutory purposes or objectives expressed in the design, architecture and structure of the regulatory measure for the purpose of examining the issue "so as to afford protection" in the context of Article III.1 of GATT).

¹¹¹ *S.D. Myers*, *supra* note 104, at 1438.

When interpreting and applying the "minimum standard", a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making.

Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections

¹¹² *S.D. Myers*, *supra* note 104, at 1438.

¹¹³ *S.D. Myers*, *supra* note 104, at 1438.

¹¹⁴ *S.D. Myers*, *supra* note 104, at 1438.

The Tribunal found no breach of Article 1110 on expropriation. Unlike Metalclad, the Tribunal appeared uncomfortable with extending protection from expropriation to the impact of normal regulatory measures. The Tribunal found that the term “expropriation” carries with it the connotation of a “taking” by a governmental authority of a person’s property with a view to transferring ownership to another person.¹¹⁵ In fact, the Tribunal went so far as to conclude that regulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110.¹¹⁶ The Tribunal found that the PCB ban did not amount to an “expropriation” because it was temporary and the evidence did not support a transfer of property or benefit directly to others.¹¹⁷

Finally, a notable aspect of this arbitral decision is the fact that a separate opinion was prepared by one of the arbitrators.¹¹⁸ Within this lengthy opinion, the arbitrator addresses the tension between regulatory autonomy and the liberalization and protection provisions of NAFTA. In particular, the arbitrator argues that the analysis employed to determine whether there has been breach of Article 1102 (National Treatment) may be similar to that used in an Article XX case under GATT/WTO auspices.¹¹⁹ The intention of the arbitrator on this point is laudable; to use the reference to “in like circumstances” in Article 1102 as a meaningful way for respondent governments to justify legitimate

¹¹⁵ *S.D. Myers, supra* note 104, at 1440.

¹¹⁶ *S.D. Myers, supra* note 104, at 1440. The greater deference to regulatory autonomy is clearly evident in the following statement:

Expropriations tend to involve the deprivation of ownership rights, regulations a lesser interference. The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject o claims as they go about their business of managing public affairs. An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some context and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary

¹¹⁷ *S.D. Myers, supra* note 104, at 1440.

¹¹⁸ The separate opinion was prepared by Dr Bryan Schwartz and concurs with most of the findings in the arbitral award but provides some additional reasoning. See *S.D. Myers, supra* note 104, at 1447-89.

¹¹⁹ “Article 1102 (National Treatment) of NAFTA is not made subject to an equivalent of Article XX (General Exceptions) of GATT. Read in its proper context, however, the phrase “like circumstances” in Article 1102 in many cases does require the same kind of analysis as is required in Article XX cases under the GATT. The determination of whether there is a denial of national treatment to investors or investments “in like circumstances” under Article 1102 of NAFTA may require an examination of whether a government treated non-nationals differently in order to achieve a legitimate policy objective that could not be reasonably accomplished by other means that are less restrictive to open trade”. See *S.D. Myers, supra* note 104, at 1454.

regulatory measures with limited effects on free trade and investment goals.¹²⁰ But the problem with this approach is that it grafts an exception model (such as Article XX in the GATT) to Chapter 11 as a means of resolving this question. Within GATT/WTO jurisprudence, the Article XX exception has been interpreted in a variety of inconsistent ways.¹²¹ In particular, the analysis of whether a given measure is the least trade-restrictive measure available to achieve a non-free trade goal (such as the protection of public health) has led to the curious (and potentially dangerous) situation of some GATT Panels ignoring the realities of the regulatory decision-making process.¹²²

3. *Methanex v United States*

In this on-going action, Methanex (a Canadian company) with some facilities located in the United States has brought a Chapter 11 action against an Executive Order in which the State of California provided for the removal of a gasoline additive known as MBTE by no later than 31 December 2002.¹²³ The basis for the decision to ban MBTE was a study undertaken by the University of California which concluded that there were significant risks and costs associated with water contamination due to the use of

¹²⁰ In comparison, the other members of the arbitral Tribunal take a much more restricted view of the operation of the words “in like circumstances” in Article 1102. Initially, the members find that interpretation of the phrase must take into account general principles that emerge from the legal context of the NAFTA including its environmental provisions. They go on to say that this assessment “must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest”. However, these broad interpretative principles are not applied to the facts of the case. Instead, the Panel members focus largely on whether the foreign investor complaining of discrimination is in the same economic or business sector as that of the domestic participant in the market. See *S.D. Myers*, *supra* note 104, at 1437.

¹²¹ See cases cited *supra* note 88 and sources cited *supra* note 89.

¹²² In particular, see *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, Report of the Panel Adopted on 7 November 1990 (DS/O/R-37S200). In this case, Thailand attempted to defend import restrictions and discriminatory tax treatment imposed against American cigarettes as “necessary” for public health reasons under Article XX(b). Thailand had adopted a variety of measures to achieve its public health objectives including advertising bans, health warnings on cigarette packets as well as the discriminatory measures. Thailand justified the discriminatory measures on the basis of evidence put forward by the World Health Organization that the US cigarette industry had the resources to avoid non-inconsistent measures such as advertising bans. The Panel simply ignored this evidence in finding that least-restrictive alternatives such as advertising bans were adequate to meet Thailand’s public health objectives.

¹²³ For a summary description of the facts in the case, compare *Methanex Corporation v The United States of America*, Claimant Methanex Corporation’s Draft Amended Claim, Feb. 12, 2001, 4-33, <http://www.toddweiler.com> [hereinafter *Methanex Amended Claim*] with *Methanex Corporation v The United States of America*, Statement of Defense of Respondent United States of America, Aug. 10, 2000, 6-26, <http://www.toddweiler.com> [hereinafter *US Defense*].

MBTE.¹²⁴ Methanex claims to be the one of the world's largest producers and marketers of methanol, a principal ingredient of MTBE.¹²⁵

Methanex originally brought an action under Chapter 11 on the basis that the Californian measure breached Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) and claimed damages of US\$970 million. The United States vigorously opposed this claim with a particular emphasis on its impact on the regulatory autonomy of the NAFTA states.¹²⁶ On 12 February 2001, Methanex lodged an amended claim that builds on some of the worrying trends discerned in earlier NAFTA cases especially S.D. Myers.

The amended claim now includes an assertion that the Californian measure breaches Article 1102 (National Treatment). In raising its argument, the amended claim relies heavily on the analysis of the national treatment norm in S.D. Myers.¹²⁷ As in S.D. Myers, Methanex attempts to ground its case for breach of Article 1102 by adducing evidence of a protectionist intent or purpose within the Californian measures. The protectionist purpose is framed as a desire to prefer the Californian ethanol industry, a substitute product for MTBE.¹²⁸ Yet, the evidence adduced is not nearly as strong as that provided for in S.D. Myers. For example, this part of the claim relies on relatively innocuous statements within the Executive Order suggesting further analysis on fostering a domestic ethanol industry and labeling requirements at the pump that the gasoline does

¹²⁴ See *US Defense*, *supra* note 123, at 18-22.

¹²⁵ See *Methanex Amended Claim*, *supra* note 123, at 4-5.

¹²⁶ The tenor of US defense is evident in the following extract:

Methanex's claim does not remotely resemble the type of grievance for which the States Parties to the NAFTA created the investor-state dispute resolution mechanism of Chapter 11. Methanex's case is founded on the proposition that, whenever a State takes action to protect the public health or environment, the State is responsible for damages to every business enterprise claiming a resultant setback in its fortunes...Plainly put, this proposition is absurd. If accepted by the Tribunal, no NAFTA Party could carry out its most fundamental governmental functions unless it were prepared to pay for each and every economic impact occasioned by doing so. The NAFTA Parties never intended the NAFTA to bring about such a radical change in the way that they function, and Methanex cannot show otherwise

US Defense, *supra* note 123, at 2.

¹²⁷ See *Methanex Amended Claim*, *supra* note 123, at 45-7.

¹²⁸ See *Methanex Amended Claim*, *supra* note 123, at 47.

not contain MTBE.¹²⁹ In contrast, there is no attempt to prove the discriminatory impact of the Californian measure.

Methanex's revised argument on the basis of Article 1105 (Minimum Standard of Treatment) is of even greater concern. Methanex attempts to define the scope of operation of Article 1105 but does so in an extremely broad manner. Methanex makes the preliminary point that the reference to "international law" in Article 1105 includes both customary and treaty-based forms of international law.¹³⁰ The reference to treaty-based forms of international law is then used to try to bring in certain GATT/WTO disciplines within the coverage of Article 1105. This represents a logical link to the approach taken in S.D. Myers particularly in the separate opinion on Article 1102. On the whole, Methanex argues that Article 1105 covers a minimum of four separate principles.¹³¹

On the first purported principle, Methanex attempts to argue that the decision to ban MTBE was unfair because of alleged campaign contributions provided to the Californian governor by a leading US-based ethanol producer.¹³² In other words, Methanex is using the largely undefined principles inherent in Article 1105 to impugn the process of domestic rule-making rather than its effects on a foreign investor. The third purported principle follows the curious (and seemingly simplistic) S.D. Myers approach of finding a breach of Article 1102 (National Treatment) as sufficient of itself to ground breach of Article 1105. The fourth purported principle also runs on S.D. Myers lines by arguing that Article 1105 includes treaty-based forms of international law.¹³³ Methanex uses this

¹²⁹ See *Methanex Amended Claim*, *supra* note 123, at 47.

¹³⁰ See *Methanex Amended Claim*, *supra* note 123, at 48.

¹³¹ These are: (i) that a decision maker purportedly acting independently and in the public interest must not be biased by pecuniary considerations; (ii) state officials must act reasonably and in good faith; (iii) non-discrimination and (iv) that a regulatory measure taken by a state must not be a disguised form of protection but instead must be the least trade-restrictive of the reasonably alternative measures See *Methanex Amended Claim*, *supra* note 123, at 49

¹³² See *Methanex Amended Claim*, *supra* note 123, at 49-51.

¹³³ The influence of the separate opinion in S.D. Myers is apparent throughout Methanex's amended claim. For example, "[a]s Dr. Bryan Schwartz stated in his S.D. Myers separate opinion: 'The interpretation and application of Article 1105 *must*, I tend to think, also take into account the letter or spirit of widely, though not universally, accepted international agreements like those in the WTO system and those typical of BITs.'" See *Methanex Amended Claim*, *supra* note 123, at 58.

preliminary point to structure an argument based on the WTO Agreement on Technical Barriers to Trade and Agreement on the Application of Sanitary and Phytosanitary Measures. The essence of these arguments is the use of a “least restrictive means” analysis to suggest that the Californian ban on MBTE violated these agreements because there were less restrictive means of solving the problem of contamination of drinking water, such as fixing leaking storage tanks.¹³⁴ Thus, Methanex is using the opening made in *S.D. Myers* to argue that the approach of specific exceptions to the free trade goals inherent within GATT/WTO framework applies to the Chapter 11 NAFTA model. But it is then, somewhat cynically, using that exception approach to argue that the Californian measures do not satisfy the conditions necessary in which to justify an exception to the NAFTA commitments.

Finally, Methanex’s claim that the Californian measure constitute an expropriation under Article 1110 also seems to be artificially stretched. The basis of the expropriation is a claim for loss of business or profits rather than an outright “taking” of an investment.¹³⁵ Aside from the debatable proposition that these are interests that can be expropriated under Article 1110, there is also the problem that Methanex is claiming an expropriation even though the ban on MTBE will only take effect in 2003.

C. A Limited Retreat: The NAFTA Free Trade Commission Interpretation

The submissions put forward in *Methanex* represent a very aggressive and broad interpretation of the Chapter 11 commitments. But they are partly based on broad and sometimes conflicting interpretations by past NAFTA tribunals. Concern as to the breadth of these approaches has led the NAFTA states to actively consider ways in which to limit the scope of the protections offered by Chapter 11. Canada has long been an

¹³⁴ “The principle of international law most applicable in this case is the widely-accepted WTO/GATT rule that regulatory measures are only acceptable if they meet certain conditions. Such measures are legal if: (1) they are intended to achieve a legitimate objective, (2) they are the least trade-restrictive alternative that can achieve the legitimate objective, and (3) they do not constitute a disguised restriction on international trade. These requirements are found in at least two multilateral treaties (1) the WTO Agreement on Technical Barriers to Trade...and (2) the WTO Agreement on Sanitary and Phytosanitary Measures...”. See *Methanex Amended Claim*, *supra* note 123, at 58-9.

¹³⁵ See *Methanex Amended Claim*, *supra* note 123, at 69-70.

advocate for clarifications to Chapter 11 but, until Methanex, the US had not been as supportive for such an approach.¹³⁶ In fact, since the end of the Clinton administration, there had been an “inter-agency” deadlock on this question of investment protections in future trade deals. The US Environmental Protection Authority, Interior Department and Justice Department have favored scaling back the investment protections but faced opposition by the US Trade Representative and the Departments of Commerce and Treasury.¹³⁷

On 31 July 2001, the NAFTA states agreed, through the auspices of the NAFTA Free Trade Commission (FTC), to clarify the operation of some of the Chapter 11 provisions.¹³⁸ Of most interest for the purposes of this discussion is the interpretation relating to Article 1105. Firstly, the interpretation issued by the FTC limits the operation of Article 1105 to require member states to only provide “the customary international law minimum standard of treatment of aliens”.¹³⁹ Unfortunately, the FTC interpretation goes no further to provide guidance on exactly what this standard constitutes. But the obvious intent is to deal with the tendency in some of the Chapter 11 cases (especially in *S.D. Myers*) to bring in principles from treaty-based forms of international law particularly from the GATT/WTO agreements. The FTC interpretation also attempts to deal with the *SD Myers* approach to Article 1105 by finding that “a determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)”.¹⁴⁰ Canada also sought restrictions on the ways in which a Chapter 11 panel could approach the question of expropriation under Article 1110.¹⁴¹ But the interpretation is silent on this point and it is

¹³⁶ Compare *Zoellick Cool to Restrictions on Investor State Disputes*, 19 (16) *INSIDE U.S. TRADE*, Apr. 20, 2001 at 5-6 (discussing the resistance of the U.S. Trade Representative to the Canadian push for limits on the Chapter 11 model) with *U.S. Cites NAFTA Party Agreement to Limit Investor-State Disputes*, 19 (20) *INSIDE U.S. TRADE*, May 18, 2001 at 11-2 (noting U.S. concerns about the breadth of the Methanex claims under Chapter 11).

¹³⁷ *Zoellick Cool to Restrictions on Investor State Disputes*, 19 (16) *INSIDE U.S. TRADE*, Apr. 20, 2001, at 11-2.

¹³⁸ A copy of the interpretation can be obtained from the web site of the Canadian Department of Foreign Affairs and International Trade (<http://www.dfait-maeci.gc.ca>). For a brief analysis of the interpretation, see *NAFTA Free Trade Commission*, *supra* note 92.

¹³⁹ See *NAFTA Free Trade Commission*, *supra* note 92, at 21.

¹⁴⁰ See *NAFTA Free Trade Commission*, *supra* note 92, at 22.

¹⁴¹ See *NAFTA Free Trade Commission*, *supra* note 92, at 22.

unclear whether the US and Mexico favor this approach.¹⁴² There is also no guidance on what will potentially be the most difficult issue for future Chapter 11 panels; developing a test to apply the national treatment norm in the investment context without unduly impinging on host state regulatory freedoms.

Unfortunately, this is not the end of the story. In January 2002, Methanex challenged the ability of the parties to limit the operation of Chapter 11 in this manner.¹⁴³ To support its claims, Methanex submitted an affidavit from a former Mexican negotiator that the negotiating history of Chapter 11 contradicts the interpretation adopted by the FTC.¹⁴⁴ In any event, Methanex's case has recently suffered a new blow with a proposal before the US Senate for a national ban on the use of MTBE as an oxygenate in gasoline.¹⁴⁵ However, the on-going uncertainty as to the breadth of the Chapter 11 provisions has forestalled finalizing the investment provisions in future initiatives particularly proposed free trade agreements with Singapore and Chile as well as the regional Free Trade Area of the Americas initiative.¹⁴⁶

The next part of the paper will consider the failed negotiations within the OECD towards the MAI. Although most (but not all) of the NAFTA case law post-dates the MAI negotiations, the MAI provisions themselves largely replicated the NAFTA Chapter 11 model. It was only towards the end of the failed negotiations that the negotiators recognized some of the problems inherent in this model and made a belated attempt to rectify them.

¹⁴² See *NAFTA Free Trade Commission*, *supra* note 92, at 22.

¹⁴³ *Methanex Questions New Limits on NAFTA Investor Protections*, 20 (1) *INSIDE U.S. TRADE*, Jan. 4, 2002 at 1, 22-5.

¹⁴⁴ *Id.* at 23-5.

¹⁴⁵ See David E. Rosenbaum, *With Alaska Exploration Rejected, Senate Looks to Ethanol*, *N.Y. TIMES*, Apr. 23, 2002, at A16.

¹⁴⁶ See generally *U.S. Industry Pushes NAFTA Investment Model in Future Agreements*, 19 (17) *INSIDE U.S. TRADE*, Apr. 27, 2001, at 1, 22; *Investment Remains a Hole in U.S.-Singapore FTA Negotiations*, 19 (35) *INSIDE U.S. TRADE*, Aug. 31, 2001, at 5-6; *House Democrats Seek New Limits to Investor-State Disputes*, 19 (40), *INSIDE U.S. TRADE*, Oct. 5, 2001, at 22-23; *Business, Environmentalists Clash over TPA Investor Protections*, 19 (42) *INSIDE U.S. TRADE*, Oct. 19, 2001, at 9-10; *Zoellick Warns Against Changes to Investor-State Provision*, 19 (43) *INSIDE U.S. TRADE*, Oct. 26, 2001, at 19-20; *Group Faces Decision on Investor Protections for Chile FTA*, 19 (47) *INSIDE U.S. TRADE*, Nov. 23, 2001, at 1, 18-20; *Administration Mulls Government Veto Option for Investor Disputes*, 20 (11) *INSIDE U.S. TRADE*, Mar. 15, 2002, at 1, 22-3.

V. The MAI Episode: A Cautionary Tale

A. Overview

In 1991, the OECD commenced work on the idea of a multilateral agreement on investment.¹⁴⁷ The decision to study the possibility of such an agreement was driven by three factors examined earlier in Part II of this paper; rapid growth in investment flows by the early 1990s, the trend towards unilateral liberalization of national restrictions on foreign investment in both developed and developing states and the patchwork of investment instruments at the international level.¹⁴⁸

The results of the technical analysis were presented as a report to the OECD Council of Ministers in May 1995.¹⁴⁹ Based on this report, the OECD Council agreed to commence negotiations towards an MAI with the mandate that the agreement was to:

- provide for a broad multilateral agreement for international investment with high standards for the liberalization of investment regimes and investment protection with effective dispute settlement procedures;
- be a free-standing international treaty open to all OECD Members and the European Communities and to accession by non-OECD Member countries, which will be consulted as negotiations progress.¹⁵⁰

The first part of the mandate highlights the relatively limited scope of the MAI exercise. Its primary aim was to build upon existing OECD instruments to set “high standards” on established norms of investment liberalization and protection backed up by an effective process of dispute settlement.¹⁵¹ Thus, the conception of the MAI was based along the lines of the NAFTA Chapter 11 model of an investment agreement. The US was also

¹⁴⁷ OECD, A MULTILATERAL AGREEMENT ON INVESTMENT: REPORT BY THE COMMITTEE ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES (CIME) AND THE COMMITTEE ON CAPITAL MOVEMENTS AND INVISIBLE TRANSACTIONS (CMIT), 1995 DAF/CMIT/CIME(95)133/FINAL, at Annex [hereinafter *CIME/CMIT Report*]. On February 19 2002, the OECD publicly released a large quantity of documents relating to the MAI negotiations (including the last version of the draft negotiating text) on its web site (<http://www.oecd.org/daf/mai>).

¹⁴⁸ See generally *CIME/CMIT Report*, *supra* note 147, § 1 [The Case for a Multilateral Agreement on Investment] (discussing each of these factors).

¹⁴⁹ *CIME/CMIT Report*, *supra* note 147.

¹⁵⁰ See *CIME/CMIT Report*, *supra* note 147, § 3 [Mandate].

¹⁵¹ See *CIME/CMIT Report*, *supra* note 147, at § 2 [Features of a Multilateral Agreement on Investment].

strongly in favor of having the OECD as the forum for the MAI negotiations.¹⁵² The basis for the US preference for the OECD appears to be linked to the relatively modest results of the Uruguay Round TRIMS Agreement which was often attributed to the recalcitrance of developing states.¹⁵³ The MAI was intended to avoid this problem by negotiating strong, comprehensive rules amongst the supposedly like-minded developed countries of the OECD.¹⁵⁴

The view of the MAI at its inception in 1995 as an uncontroversial, somewhat technical exercise of building upon existing norms is also reflected in the time assigned for the conclusion of negotiations. The report set an objective of two years for the conclusion of negotiations in time for the meeting of the OECD Council of Ministers in 1997.¹⁵⁵ This two-year time frame for the conclusion of negotiations proved overly ambitious.¹⁵⁶ Two problem areas soon arose. The first was internal as the political commitment of the OECD member states to the liberalization commitments within the MAI began to erode. On-going disputes between the US, Canada and the European Union (EU) member states began to shadow negotiations.¹⁵⁷ The MAI negotiators found it impossible to resolve

¹⁵² The role of the US in spearheading negotiations within the OECD is examined in Elizabeth Smythe, *Your place or mine? States, international organizations and the negotiation of investment rules*, 7 (3) TRANSNAT'L CORP. 85, 101 (1998). The author bases her various assertions, in part on interviews conducted with MAI negotiators.

¹⁵³ See TREBILCOCK & HOWSE, *supra* note 42, at 358.

¹⁵⁴ During the negotiations towards the MAI from 1995 to 1998, there were 29 member states of the OECD. These were Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, the Republic of Korea, Luxembourg, Mexico, Poland, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States of America. The OECD also identified certain countries as likely candidates for accession and invited them to sit in as observers at the negotiations in 1997 and 1998. There were initially Argentina, Brazil, Chile, Hong Kong, China and the Slovak Republic. The three Baltic countries – Estonia, Latvia, Lithuania – were also later invited to join as observers. See OECD, MULTILATERAL AGREEMENT ON INVESTMENT: REPORT BY THE CHAIRMAN OF THE NEGOTIATING GROUP, Apr. 20, 1998, DAF/MAI(98)9/FINAL, at 3

¹⁵⁵ See CIME/CMIT Report, *supra* note 147, at § 3 [Mandate].

¹⁵⁶ Aside from the delays which developed within the MAI negotiations, history has shown that negotiations towards multilateral investment instruments proceed slowly, if at all. Within the WTO, negotiations towards the TRIMS Agreement (which deals with performance requirements) were only concluded after what has been described as “five years of tough negotiations”. See JOHN CROOME, RESHAPING THE WORLD TRADING SYSTEM: A HISTORY OF THE URUGUAY ROUND 309 (1995).

¹⁵⁷ For further analysis of these so-called “deal breakers”, see Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Lessons for the Regulation of International Business*, in FOUNDATIONS AND PERSPECTIVES OF INTERNATIONAL TRADE LAW 114, 129-31 (Ian Fletcher et al. eds., 2001).

three particular issues; the extra-territorial impact of the US Helms Burton Act¹⁵⁸, the desire of France and Canada (opposed by the US) to include a general exemption for culture in the MAI¹⁵⁹ and the EU proposal for an exemption for regional economic organizations¹⁶⁰. The second problem was the onset of an aggressive campaign by NGOs opposing the MAI in early 1997. A striking feature of the structure of this campaign was the use of the Internet to coordinate and link up a vast array of NGOs opposed to the MAI. At the height of the NGO campaign, there were an estimated 50 web sites devoted to the MAI together with 200 news group postings.¹⁶¹ Aside from general concerns about economic globalization, NGOs also opposed the MAI on a more substantive critique of the similarities between the MAI provisions and the NAFTA Chapter 11 model.

¹⁵⁸ In the middle of the MAI negotiations in March 1996, the Helms Burton Act – the *Cuban Liberty and Democratic Solidarity Act* – entered into law in the United States. Title III of the Act allows US citizens and corporations whose property was expropriated by the Cuban government any time after 1 January 1959 to sue for damages against anyone who “traffics” in their former property after 1 November 1996. Title IV prohibits entry into the US by persons who “traffic” in confiscated property after 12 March 1996. This Act led to a fierce policy conflict between the US, EU and Canada in the middle of the MAI negotiations. The underlying problem was that the Helms Burton Act potentially operated both extraterritorially and in a discriminatory manner against foreign investors from non-US states operating in Cuba. After the filing of a complaint by the EU against the US over the Helms Burton Act in the WTO, an understanding was eventually reached on this issue between the US and EU in May 1998 (but with significant restrictions on its scope which also envisaged amendments to the MAI negotiating text). But by that time, the Lalumière Commission had already begun its investigation into the MAI leading to France’s withdrawal from negotiations in October 1998. It is notable that the conflict over the Helms Burton Act shadowed the MAI episode from early in the negotiations (in 1996) right up until 1998. *See generally* the Cuban Liberty and Democratic Solidarity Act 1996 U.S. Public Law 104-114, Mar. 12, 1996, 35 I.L.M. 357 (1996); EDWARD M GRAHAM, *FIGHTING THE WRONG ENEMY: ANTIGLOBAL ACTIVISTS AND MULTINATIONAL ENTERPRISES* 28 (2000); European Union-United States, *Understanding with Respect to Disciplines for the Strengthening of Investment Protection* (May 19, 1998), at <http://www.europa.eu/int/news/summit/Summit9805/invest.htm>.

¹⁵⁹ The proposed exception would preserve the right of a Contracting Party from taking any measure to regulate investment of foreign companies and the conditions of activity of these companies, in the framework of policies designed to preserve and promote cultural and linguistic diversity. This proposal was strongly opposed by US entertainment and media interests (the second largest US export industry). *See* OECD, *THE MAI NEGOTIATING TEXT*, Final Version, Apr. 24, 1998, DAF/MAI(98)7/REV1, at 128 [hereinafter *MAI Negotiating Text*]. *See also* William Dymond, *The MAI: A Sad and Melancholy Tale, in CANADA AMONG NATIONS* 35 (Carleton University, 1999).

¹⁶⁰ This proposal exempted defined regional economic organizations from the most-favored-nation obligation under the MAI. This clause was strongly opposed by the US which argued that exemptions from the MFN standard should only be permitted as listed country-specific exceptions. *See MAI Negotiating Text, supra* note 159, at 118-9; UNCTAD, *LESSONS FROM THE MAI* 14-5 (1999).

¹⁶¹ Stephen Kobrin, *The MAI and the Clash of Globalizations*, 112 *FOREIGN POL’Y* 97, 97 (1998). *See also* Guy de Jonquières, *Network Guerillas*, *FINANCIAL TIMES*, Apr. 30, 1998, at 12; Madelaine Drohan, *How the Net Killed the MAI*, *THE GLOBE AND MAIL* (Toronto), Apr. 29, 1998, at 14.

These difficulties caused the negotiations to outrun the original two-year completion date. At the OECD Ministerial Council meeting in May 1997, the Ministers agreed to extend the completion date of negotiations to the May 1998 Ministerial meeting. But by 1998, the political climate which had led the OECD to commence MAI negotiations had dramatically changed. By that year, the world witnessed in South East Asia “the strongest financial panic since the Great Depression”.¹⁶² The currency crisis affecting the Thai baht in July 1997 led to a dramatic drop in loan finance and portfolio investment into Indonesia, Korea, Malaysia and to some extent the Philippines over the course of 1998.¹⁶³ Comparatively, FDI flows proved to be relatively stable.¹⁶⁴ In September 1998, Malaysia imposed controls on some capital outflows in response to the crisis.¹⁶⁵ Two weeks prior to the Malaysia announcement, Russia had not only imposed controls on capital outflows but had also defaulted on its loan obligations by announcing a 90 day moratorium.¹⁶⁶

Against these dramatic changes in the global economy, the prospects for the MAI as a treaty which aimed to liberalize all forms of capital flow looked less certain.¹⁶⁷ The new and less favorable atmosphere was reflected in the April 1998 OECD Ministerial meeting. Contrary to past practice, the MAI became the single focus for discussion in the meeting.¹⁶⁸ Ministers reaffirmed “the importance they attach to achieving a comprehensive framework for investment” but went on to announce “a period of assessment and further consultation between the negotiating parties and with interested

¹⁶² Helmut Reisen, *After the Great Asian Slump: Towards a Coherent Approach to Global Capital Flows*, Policy Brief No. 16, OECD Development Centre (1999) at 5.

¹⁶³ *Id.* at 9.

¹⁶⁴ See generally WTO, ANNUAL REPORT 1999 8, 28-30 (1999); UNCTAD, *supra* note 31, at 161-2; UNCTAD, *supra* note 17, at 17-23 (these sources detail statistical evidence of the stability of FDI (in terms of outflows) when compared to other forms of capital in the period following the Asian financial crisis).

¹⁶⁵ These measures were aimed primarily at short-term capital flows such as portfolio investment undertaken by hedge funds and other institutional investors. The restrictions explicitly excluded FDI which was something that the Malaysian authorities were at pains to publicize. See IMF & World Bank Group, *Statement by Dato' Mustapa Mohamed, Second Finance Minister of Malaysia*, Press Release No. 45 (October 6-8 1998).

¹⁶⁶ Reisen, *supra* note 162, at 21.

¹⁶⁷ The MAI definition of “investment” was even broader than that adopted in NAFTA Chapter 11. See *infra* Part V.B.1.

¹⁶⁸ DAVID HENDERSON, THE MAI AFFAIR: A STORY AND ITS LESSONS 42 (1999).

parts of their societies” in preparation for the next meeting of the negotiators in October 1998.¹⁶⁹

But by that time the NGO campaign had succeeded in raising public opposition to the MAI. Five prominent member states of the OECD had instituted some form of parliamentary review of the MAI.¹⁷⁰ The review commissioned by the French government was highly critical of both the negotiation procedure and provisions of the MAI.¹⁷¹ This report coupled with a strong concern as to the treatment of cultural industries under the MAI led to France’s withdrawal from negotiations on 14 October 1998 (one week before the MAI negotiations were set to resume). The French withdrawal signaled the death-knell for the agreement. Less than two months later, the OECD announced that negotiations would cease with no final agreement to result.¹⁷²

B. The MAI Provisions: Extending the NAFTA Chapter 11 Model

Various draft texts of the MAI were produced between 1997 and 1998.¹⁷³ This part of the analysis is based on the last version of the agreement which was produced on 24 April 1998 and released by the OECD on the Internet.¹⁷⁴ The draft MAI contains twelve chapters and encompasses 145 pages. Despite its length, the majority of clauses in the draft text deal with recognized disciplines in investment liberalization, investment protection and dispute settlement.¹⁷⁵ The MAI negotiators referred to these disciplines as the “three key areas of foreign direct investment rule-making”.¹⁷⁶ This is not surprising given that the mandate of the MAI exercise was to deliver an agreement with “high

¹⁶⁹ OECD, *Ministerial Statement on the Multilateral Agreement on Investment* (27-28 April 1998).

¹⁷⁰ These member states were Australia, Canada, France, Great Britain and the United States.

¹⁷¹ See Catherine Lalumière and Jean-Pierre Landau, *Rapport sur l’Accord Multilatéral sur l’Investissement* (1998).

¹⁷² OECD, *Informal Consultations on International Investment: Press Release* (3 December 1998).

¹⁷³ For an overview of the negotiating process leading to the last version of the agreement, see Dymond, *supra* note 159, at 28-33.

¹⁷⁴ *MAI Negotiating Text*, *supra* note 159. See also OECD, THE MULTILATERAL AGREEMENT ON INVESTMENT: COMMENTARY TO THE CONSOLIDATED TEXT, Apr. 22, 1998, DAF/MAI(98)/9/REV1 [hereinafter *MAI Commentary*].

¹⁷⁵ *MAI Negotiating Text*, *supra* note 159, at 13-56 (chp. III Treatment of Investors and Investments), 57-62 (chp. IV Investment Protection) and 63-70 (chp. V Dispute Settlement).

¹⁷⁶ William Wetherell, *Opening Address*, in OECD, MULTILATERAL AGREEMENT ON INVESTMENT: STATE OF PLAY IN APRIL 1997 OECD Working Papers, Vol V (1997), at 13.

standards” in those areas. The MAI negotiators did go beyond these core issues to consider disciplines in what they termed “new matters”.¹⁷⁷ However, these “new matters” were, at least initially, further disciplines of interest to foreign investors including prohibitions or limits on performance requirements;¹⁷⁸ the ability to freely transfer both profit and capital out of the host state;¹⁷⁹ and rights of access and residence for key foreign personnel.¹⁸⁰

The next part of the paper will consider the key components of the MAI on scope of application, investment liberalization, protection and dispute settlement. Within these core disciplines, the MAI provisions represented almost a facsimile (albeit strengthened in some respects) of the NAFTA Chapter 11 model. In turn, the facsimile included many of the problems identified in Part IV of this paper that are inherent in the NAFTA model.

1. Scope of Application

Like NAFTA, the MAI adopted an asset-based definition of “investment”.¹⁸¹ But the MAI went beyond the NAFTA approach in several important respects. Firstly, the MAI

¹⁷⁷ William Dymond, *State of Play of the MAI Negotiations*, in OECD, MULTILATERAL AGREEMENT ON INVESTMENT: STATE OF PLAY IN FEBRUARY 1997 OECD Working Papers, Vol V (1997), at 8.

¹⁷⁸ *MAI Negotiating Text*, *supra* note 159, at 18-26.

¹⁷⁹ *MAI Negotiating Text*, *supra* note 159, at 59-60.

¹⁸⁰ *MAI Negotiating Text*, *supra* note 159, at 14-7.

¹⁸¹ Article 2 of Chapter II of the MAI defines “investment” as:

Every kind of asset owned or controlled, directly or indirectly, by an investor, including:

- (i) an enterprise (being a legal person or any other entity constituted or organised under the applicable law of the Contracting Party, whether or not for profit, and whether private or government owned or controlled and includes a corporation, trust, partnership, sole proprietorship, branch, joint venture, association or organisation);
- (ii) shares, stocks or other forms of equity participation in an enterprise and rights derived therefrom;
- (iii) bonds, debentures, loans and other forms of debt, and right derived therefrom;
- (iv) rights under contracts, including turnkey, construction, management, production or revenue-sharing contracts;
- (v) claims to money and claims to performance;
- (vi) intellectual property rights;
- (vii) rights conferred pursuant to law or contract such as concessions, licenses, authorisations, and permits;
- (viii) any other tangible and intangible, movable and immovable property, and any related property rights, such as leases, mortgages, liens and pledges.

MAI Negotiating Text, *supra* note 159, at 11.

definition is an open definition; it lists items that are included and implies that non-listed items are also covered. In contrast, Article 1101 of NAFTA adopts a closed definition which states what is included in the definition and what is not.¹⁸² There is also a more subtle distinction between the two definitions. The NAFTA definitions require certain assets to have particular characteristics before they will be defined as an investment and enjoy the benefits of coverage under that treaty. Characteristics such as the commitment of capital and the assumption of risk delineate the coverage of investment under the NAFTA.¹⁸³ There is no consideration of these characteristics in the MAI definition.¹⁸⁴ Again, this may have been due to the confidence of the negotiators at the commencement of MAI negotiations. In 1995, the global economy had been marked by a continuous growth in investment flows since the mid 1980s. This stability and the desire to draft a “high standards” agreement may have led MAI negotiators to try to cover as many forms of capital flow as possible.

This broad approach is unlikely to be acceptable to developing countries which have traditionally insisted on the right to regulate forms of investment less permanent than FDI. Concern as to the rate of outflow of portfolio investment during the Asian financial crisis led Malaysia to introduce currency restrictions in September 1998.¹⁸⁵ Further, the 1998 Framework Agreement on the ASEAN Investment Area explicitly excludes portfolio investment from the coverage of that agreement.¹⁸⁶ Even within the supposedly like-minded OECD states, certain delegations argued for the exclusion of portfolio

¹⁸² See *supra* Part IV.A.1.

¹⁸³ *Id.*

¹⁸⁴ There is, however, a footnote to the draft Article 2 of Chapter II (which defines “investment” in the MAI) suggesting that an interpretative note will be required to set out these characteristics. See *MAI Negotiating Text*, *supra* note 159, at 11.

¹⁸⁵ See *supra* notes 162-6 and accompanying text.

¹⁸⁶ Article 2 of the Framework Agreement on the ASEAN Investment Area delineates the coverage of the agreement along the following lines:

This Agreement shall cover all direct investments other than –

- a. portfolio investments; and
- b. matters relating to investment covered by other ASEAN Agreements, such as the ASEAN Framework Agreement on Services.

See Framework Agreement on the ASEAN Investment Area, Oct. 8, 1998, art. 2, *available at* <http://www.aseansec.org>.

investment from the MAI definition and others found it difficult to accept an open definition.¹⁸⁷

2. *Investment Liberalization*

Like NAFTA, the MAI aimed to liberalise restrictions imposed on investors by requiring member states to not discriminate between foreign and domestic investors. And again, like NAFTA the MAI applied the non-discriminatory standards of national treatment and most-favored-nation treatment to both the pre and post-admission phase of the investment process.¹⁸⁸

The incursion of the MAI model into these sovereignty-based grounds for excluding entry of foreign investors was also magnified by the way in which the agreement effected liberalization commitments. Like NAFTA, the MAI adopted a top down model of liberalization; the starting point was the rights set out in the agreement which ostensibly applied to all economic sectors in the host state unless exempted in the agreement by the contracting party. Aside from general exceptions which applied to all or most of the MAI¹⁸⁹, member states could also lodge country-specific exceptions to carve out particular discriminatory legislation from the operation of the MAI.¹⁹⁰

The top down structure of the MAI was particularly problematic in terms of the rights of entry provided under the agreement. Given the often sensitive political grounds for restricting entry, the top down approach forces contracting parties to be overly cautious and lodge extensive exceptions to liberalization commitments. Indeed, in early 1997, the Chairperson of the MAI Negotiating Group proposed that member states table their proposed exceptions prior to completion of the Agreement. The purpose of this was to

¹⁸⁷ UNCTAD, *supra* note 160, at 11.

¹⁸⁸ See *MAI Negotiating Text*, *supra* note 159, at 13. The reference to “establishment” and “acquisition” in the national treatment and most-favored-nation treatment clauses indicate that these provisions were intended to extend to both pre and post-admission of foreign investment.

¹⁸⁹ These general exceptions enabled member states to impose restrictions on foreign investment on national security, public order, balance of payment, prudential and taxation grounds. See *MAI Negotiating Text*, *supra* note 159, at 77-89.

¹⁹⁰ *MAI Negotiating Text*, *supra* note 159, 90-5.

reach the highest level of liberalization at the outset by negotiating away proposed country specific exceptions. Indeed, the negotiators took the view that:

these [country specific] reservations will be the essential measuring rod against which can be judged the value of the rights and obligations of the MAI and, in large measure, *determine the readiness of countries to adhere to the MAI*¹⁹¹ (emphasis added)

But the Chairperson's proposal led to a surprisingly high number of exceptions amongst supposedly liberal, like-minded states.¹⁹² The potentially unwieldy outcome of this approach was also exacerbated by the fact that negotiators had not reached final agreement on how the MAI would progressively liberalize (or "rollback") non-conforming country-specific measures.¹⁹³

This point reinforces a fundamental difference between applying non-discriminatory standards in the trade rather than investment field. A commitment to reduce tariffs on entry of goods will never involve the political sensitivity of agreeing to the entry of a foreign investor to the host state. This makes it inherently more difficult to engender the public and political support for a top down rather than GATS-like bottom up approach to investment liberalization. Indeed, the MAI experience has shown that contracting parties are likely to act cautiously in this respect and submit a veritable telephone book of non-conforming measures.

Aside from the non-discriminatory standards of treatment, the MAI also replicated NAFTA in terms of an absolute prohibition on the use of a number of performance requirements.¹⁹⁴ But the MAI prohibition encompasses an even larger number of performance requirements than NAFTA.¹⁹⁵ These requirements go substantially beyond

¹⁹¹ William Dymond, *The Main Substantive Provisions of the MAI*, in OECD, PROCEEDINGS OF THE SPECIAL SESSION OF THE MULTILATERAL AGREEMENT ON INVESTMENT HELD IN PARIS ON 17 SEPTEMBER 1997 OECD Working Papers, Vol. V (1997), at 16.

¹⁹² See UNCTAD, *supra* note 160, at 12. See also Commonwealth of Australia (Department of Treasury), *Australia: Revised Schedule of Preliminary Reservations* (October 1997). Australia's reservations essentially preserved most of its current system of regulating and screening the entry of foreign investors under its Foreign Acquisitions and Takeovers Act, 1975 (Austl.) (and accompanying Ministerial statements).

¹⁹³ *MAI Commentary*, *supra* note 174, at 60.

¹⁹⁴ *MAI Negotiating Text*, *supra* note 159, 18-26.

¹⁹⁵ For example, the MAI goes beyond the NAFTA approach in prohibiting a member host state from imposing performance requirements such as location of headquarters, research and development,

the illustrative list in the TRIMS Agreement and include common mechanisms such as technology transfer requirements used by developing countries in their economic planning processes.

3. Investment Protection

Chapter IV of the MAI sets out the investment protection provisions of the draft MAI. Like NAFTA, the MAI contains strong provisions requiring host states to compensate investors in the event of expropriation of their investment.¹⁹⁶ These provisions cover direct as well as indirect expropriations, with the latter covering governmental measures “having a equivalent effect” to a direct expropriation.¹⁹⁷ But the MAI provisions replicate the drafting flaw in Article 1110 of NAFTA. There is no guidance within the MAI provisions as to whether normal regulatory changes that negatively affect the value of an investment would be covered within the concept of an indirect expropriation. Instead, the MAI negotiators simply assumed that this broad formulation would be accepted as:

the draft [expropriation provision] has many similarities with well-known investment protection provisions found in hundreds of bilateral investment protection agreements. This is no surprise because it was never the intention of the negotiating partners to “re-invent the wheel”, but rather to add some more spokes in order to strengthen the whole vehicle.¹⁹⁸

The investment protection provisions also duplicate NAFTA Article 1105 by requiring member states to provide “fair and equitable treatment and full and constant protection and security” while ensuring a minimum standard of treatment of “that required by international law”.¹⁹⁹

This unwillingness to critically assess the broad NAFTA approach to investment protection is symptomatic of the approach of the negotiators to the MAI exercise generally. It was only in 1998 that the MAI negotiators made a belated attempt to

employment of nationals, domestic joint venture participation and minimum and maximum level of equity participation. *See id.* arts 1(g), (i), (j), (k) and (l) respectively.

¹⁹⁶ *MAI Negotiating Text*, *supra* note 159, at 57-8.

¹⁹⁷ *MAI Negotiating Text*, *supra* note 159, at 57.

¹⁹⁸ Joachim Karl, *Investment Protection*, in OECD, *supra* note 177, at 14.

¹⁹⁹ *MAI Negotiating Text*, *supra* note 159, at 57.

address some of the public concerns (engendered largely by the NGO campaign) about the broad operation of the NAFTA-inspired investment protection provisions.

4. Dispute Settlement

Like NAFTA, the MAI contains both state-to-state and investor-to-state dispute settlement procedures.²⁰⁰ It is notable that some countries objected to the extension of the investor-state dispute resolution procedure to the pre-establishment phase of the investment process. There was some concern about giving potential investors the standing to file a claim against a host state in which they were planning to invest.²⁰¹

5. Absences

Like NAFTA, the MAI largely ignored the question of investment incentives. The provisions on performance requirements explicitly condone the use of incentives if linked to certain performance requirements.²⁰² For incentives not linked to performance requirements, there are a variety of bracketed texts within the MAI. These range from texts which state that several delegations believe that no provisions are necessary²⁰³, a proposal for considering the disciplines on incentives as part of the MAI built-in agenda for future work²⁰⁴ to a variety of articles which try to restrict the use of incentives from applying non-discriminatory standards of treatment to notification requirements under the MAI.²⁰⁵

The MAI also did not initially include a broad GATT Article XX-type exception. Instead, the MAI approach reflected that NAFTA model of strong liberalization and protection provisions with the ability of host states to exempt particular national measures as country specific exceptions. But this limited approach changed dramatically late in the

²⁰⁰ *MAI Negotiating Text*, *supra* note 159, at 63-76.

²⁰¹ *See* UNCTAD, *supra* note 160, at 19.

²⁰² *MAI Negotiating Text*, *supra* note 159, at 22.

²⁰³ *MAI Negotiating Text*, *supra* note 159, at 46.

²⁰⁴ *MAI Negotiating Text*, *supra* note 159, at 46.

²⁰⁵ *MAI Negotiating Text*, *supra* note 159, at 48.

negotiations in March 1998. In the face of growing NGO and public opposition, the Chairperson of the MAI Negotiating Group released a package of changes to the text in an attempt to address the impact of the strong MAI provisions on core aspects of regulatory competency.²⁰⁶ The Chairperson's package is notable as the MAI is arguably the first ever multilateral commercial agreement to directly amend its provisions to take into account NGO concerns. It is considered next.

C. Another Retreat: The Chairperson's Package Proposing Changes to the MAI

A draft of the MAI was leaked to Public Citizen, a US consumer NGO in February 1997.²⁰⁷ Up until that date, the MAI had previously been a confidential working document. Public Citizen immediately published the draft negotiating text on the Internet where it became "available to anyone with a computer and a modem".²⁰⁸ The release of the negotiating text on the Internet led to an explosion of concern about the MAI amongst a bewildering range of NGOs. Environmental groups joined with domestic trade unions, international human rights groups, developmental bodies, religious organizations and churches in opposing the MAI.²⁰⁹

Much of the NGO opposition to the MAI was based on a general anxiety about the process of economic globalization and focused on issues such as the increasing economic power of transnational corporations²¹⁰ and the impact of the MAI on the sovereignty of

²⁰⁶ OECD, CHAIRMAN'S NOTE ON ENVIRONMENT AND RELATED MATTERS ON LABOUR, Mar. 9, 1998, DAF/MAI(98)10 [hereinafter *Chairman's Note*].

²⁰⁷ Kobrin, *supra* note 161, at 98.

²⁰⁸ *Id.*

²⁰⁹ For an indication of the types of NGOs which opposed the MAI, *see generally* Kobrin, *supra* note 161; MAUDE BARLOW & TONY CLARKE, MAI: THE MULTILATERAL AGREEMENT ON INVESTMENT AND THE THREAT TO AMERICAN FREEDOM (1998) (examining the North American NGO campaign against the MAI); STOPPING THE JUGGERNAUT: PUBLIC INTEREST VERSUS THE MULTILATERAL AGREEMENT ON INVESTMENT (James Goodman & Patricia Ranald eds., 2000) (examining the different NGOs opposed to the MAI in Australia and their interaction with groups in other countries).

²¹⁰ For example, a prominent Canadian NGO characterized the MAI as "a power grab for transnational corporations that would end up hijacking the fundamental democratic rights and freedoms of peoples all over the world". The Council of Canadians, *Towards a Citizens' MAI: An Alternative Approach to Developing a Global Investment Treaty Based on Citizens' Rights and Democratic Control*, at <http://www.canadians.org/citizensmai.html> (last visited Jul. 13, 1999).

host states.²¹¹ But aside from their broad concerns with economic globalization, NGOs also used a more specific argument against the MAI; its facsimile of the NAFTA model and likely impact on the regulatory autonomy of host states. NGOs particularly focused on the close similarity between the investment protection provisions between NAFTA and the MAI. The settlement of the arbitral dispute brought by Ethyl Corporation against Canada under NAFTA Chapter 11 towards the end of the MAI negotiations also brought impetus to these claims.²¹² The concern that the MAI (by replicating NAFTA Article 1110-type protection against indirect expropriation) would inhibit normal regulatory measures underlined much of specific NGO opposition to the MAI:

Perhaps the greatest environmental threat the MAI poses is that, under the investor-state dispute procedure, *any new laws to protect the environment, wilderness, species or natural resource production could be considered a form of "expropriation"* and foreign investors would have the right to sue for compensation before an international tribunal made up of unelected trade bureaucrats. (emphasis added)²¹³

The NGO campaign reaped dividends on this point late in the negotiations. On 9 March 1998, the Chairperson of the MAI Negotiating Group released a package proposing

²¹¹ For example, the Western Governors' Association, an American advocacy NGO, prepared a report easily accessible on its Internet web-site which detailed state-by-state specific laws that might be threatened were the US to sign the MAI. Western Governors' Association, *Multilateral Agreement on Investment: Potential Effects on State & Local Government*, at <http://www.westgov.org/wga/publicat/maiweb.htm> (last visited Jul. 13, 1999). The same approach was taken by Friends of the Earth, an international environmental NGO, which cited a variety of pro-environmental laws which it claimed would be contrary to the MAI. Friends of the Earth, *Examples of Laws That Would Conflict with the MAI*, <http://www.foe.org/international/trade/mai/shortlaws.html> (last visited Jun. 8, 1999). In contrast, the text of the MAI which was released by the OECD on the Internet, did not include the country-specific exceptions lodged by member states to the MAI. See *MAI Negotiating Text*, *supra* note 159. This led to the mistaken perception that all laws that discriminated against foreign investors (even in sensitive policy areas) would be liberalised.

²¹² In 1997, the Canadian government banned the import and inter-provincial transport of a fuel additive known as MMT. The purpose of the ban was ostensibly environmental; the Canadian government took the view that MMT was a direct source of harmful air pollutants and also caused more sophisticated automotive pollution control devices to malfunction. The ban did not however prohibit the production and sale of MMT in Canada. As such, this legislative approach effectively prevented the sale of foreign-made MMT but not domestically-made MMT in Canada. Ethyl Corporation, a US company, was an importer and distributor of MMT in Canada. Ethyl challenged the ban under Chapter 11 of NAFTA arguing that the ban breached Articles 1102 (National Treatment), 1106 (Performance Requirements) and 1110 (Expropriation) claiming damages of US\$251 million. Canada responded to Ethyl Corporation's claims by challenging the jurisdiction of the arbitral tribunal. In June 1998, the arbitrators rejected most of Canada's challenge and postponed the rest to a consideration with the merits of the case. But the tribunal never reached a decision on the merits. In July 1998, presumably in response to the adverse decision on jurisdiction, Canada agreed to settle the dispute, lift its ban on MMT and pay Ethyl Corporation US\$13 million in compensation. The settlement occurred at the height of the NGO campaign against the MAI. For a summary description of the facts in the dispute, see *NAFTA Chapter 11 Arbitral Tribunal: Ethyl Corporation v The Government of Canada (Award on Jurisdiction)*, 38 I.L.M. 708, 710-17 (1999).

²¹³ BARLOW & CLARKE, *supra* note 209, at 60.

changes to the draft MAI “to achieve balance between MAI disciplines and other important areas of public policy of concern to MAI Parties and to avoid unintended consequences on normal regulatory practices”.²¹⁴

The package contains a variety of different initiatives varying in degrees of strength and specificity. At one end of the spectrum, it proposed the inclusion of preambular references to international declarations on the environment and labor. But there were more substantive attempts to address some of the problems of replicating the NAFTA Chapter 11 model. Within the liberalization commitments, the package proposed an interpretative note to the national treatment and most-favored-nation treatment provisions regarding the impact of the phrase “in like circumstances” within those provisions.²¹⁵

The intent of this note was to deal with the difficult problem of determining when *de facto* discrimination will ground breach of the national treatment norm. The underlying aim of the interpretative note was to “preserve the necessary scope for non-discriminatory regulation”.²¹⁶ Of itself, there is little substantive guidance within the note. However, it may have provided an arbitral tribunal with a mandate to consider a broad range of circumstances (possibly including the policy objectives evident from the design and structure of a given regulatory measure) in its deliberative process. In comparison, NAFTA tribunals to date have largely taken a very restrictive view of similar wording in Article 1102.²¹⁷

²¹⁴ *Chairman’s Note, supra* note 206, at 2.

²¹⁵ The relevant part of that interpretative note reads “governments may have legitimate policy reasons to accord differential treatment to different types of investments...The fact that a measure applied by a government has a different effect on an investment or investor of another Party would not in itself render the measure inconsistent with national treatment and most favoured nation treatment. The objective of “in like circumstances” is to permit the consideration of all relevant circumstances, including those relating to a foreign investor and its investments, in deciding to which domestic or third country investors and investments they should appropriately be compared.” *Chairman’s Note, supra* note 206, at 5.

²¹⁶ *Chairman’s Note, supra* note 206, at 2.

²¹⁷ See *supra* note 120 and accompanying text on the analysis of “like circumstances” in the S.D. Myers case. See also *In the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement Between Pope & Talbot Inc and the Government of Canada, Award on the Merits of Phase 2*, para. 73-104 Apr. 10, 2001, at <http://www.dfait-maeci.gc.ca>.

The Chairperson's package also proposed an interpretative note to deal with the broad coverage of the MAI investment protection provisions.²¹⁸ But this interpretative note attempts to remedy the broad scope of the MAI provisions with similarly broad interpretative language. This could conceivably lead to the kind of second-guessing of governmental intent in passing regulatory measures evident in the NAFTA Chapter 11 cases such as S.D. Myers. For example, an arbitral tribunal considering whether a given regulatory initiative is a "measure tantamount to expropriation" could then, under the interpretative note, try to discern whether it could be justified as being "in the public interest". It is difficult to see how an arbitral tribunal (summoned, in part, by the initiation of an action by a foreign investor) is qualified to make this kind of judgment. This highlights the problem of trying to tinker with the edges of a substantive provision that has its origins in another time and place. The strong guarantees of investment protection in both the MAI and NAFTA have their bases in similar BIT language developed in response to threats of expropriation in the 1950s and 1960s. Within the context of a proposed WTO investment agreement, WTO negotiators should consider carefully whether such broad language is warranted in a global economy marked by increasing competition to attract foreign investment.

The Chairperson's package extended beyond proposing interpretative notes to suggesting direct amendments of provisions in the MAI text. These included a NAFTA-inspired provision requiring member states not to lower domestic standards to attract investment²¹⁹ and a proposal to annex the non-binding OECD Guidelines for

²¹⁸ The interpretative note reads:

*Interpretative Note: Articles – on General Treatment, and – on Expropriation and Compensation, are intended to incorporate into the MAI existing international legal norms. The reference in Article IV.2.1 to expropriation or nationalisation and "measures tantamount to expropriation or nationalisation" reflects the fact that international law requires compensation for an expropriatory taking without regard to the label applied to it, even if title to the property is not taken. *It does not establish a new requirement that Parties pay compensation for losses which an investor or investment may incur through regulation, revenue raising and other normal activity in the public interest undertaken by governments.* Nor would such normal and non-discriminatory government activity contravene the standards in Article--1 (General Treatment) (emphasis added)

Chairman's Note, supra note 206, at 6.

²¹⁹ "A Contracting Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from its domestic health, safety, environmental or labour measures, as an encouragement to the

Multinational Enterprises²²⁰ to the text of the MAI. Other amendments addressed existing provisions such as the proposal for a limited exception to the prohibition on performance requirements to allow certain requirements to be undertaken for environmental reasons.²²¹ But these was not the only substantive changes. The package goes even so far as to suggest a provision affirming the right of member states to pass domestic regulatory measures otherwise consistent with the MAI:

A Contracting Party may adopt, maintain or enforce any measure that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns *provided such measures are consistent with this agreement* (emphasis added).²²²

This proposal is somewhat puzzling. It is largely meaningless as it only applies to measures consistent with the MAI. If a regulatory measure complies with the non-discriminatory and other norms in the MAI, it will already be valid under the agreement. If the intention was to provide some form of exception for domestic regulatory measures, then the exception would logically have to apply to initiatives inconsistent with the MAI (which is the approach underlying GATT Article XX). The Chairperson's package describes this proposal as a "targeted approach" but notes that "another approach would be a general exception inspired by GATT Article XX".²²³ Thus, in other words, the proposal is conceived as a form of exception but one that is largely semantic.

The Chairperson's package encapsulates some of the problems in trying to deal with the impact of broad liberalization and protection provisions on regulatory autonomy through an exception-type amendment. In the context of a possible WTO investment agreement, the next part of the paper will posit an alternative and, it is suggested, more stable response to this problem by suggesting a series of proposals to carefully delineate and define the operative provisions of such an agreement.

establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition of an investment of an investor." *Chairman's Note, supra* note 206, at 6.

²²⁰ *Chairman's Note, supra* note 206, at 7.

²²¹ *Chairman's Note, supra* note 206, at 6-7. This proposed change basically replicates Article 1106(6) of NAFTA.

²²² *Chairman's Note, supra* note 206, at 5-6.

²²³ *Chairman's Note, supra* note 206, at 2.

VI. The WTO, Foreign Investment and the Doha Agenda

With the specter of the failed Seattle WTO Ministerial in 1999 and on-going public demonstrations against economic globalization, WTO members were under great pressure to reach agreement at the Doha Ministerial in late 2001. In the lead up to the Doha talks, a number of proposals were floated to breach expected developing country opposition to the inclusion of investment rules on the negotiating agenda. Most notably, the EU put forward a proposal for an essentially plurilateral approach enabling countries to opt out of final investment rules.²²⁴ Interestingly, at least in the initial stages of preparatory discussion before the Doha Ministerial, the large caucus of developing countries under the “Group of 77” umbrella did not seem as implacably opposed to the inclusion of investment rules as expected.²²⁵ Yet, within this broad grouping, there was strong opposition by the so-called “Like Minded Group” of India, Malaysia and Pakistan who resisted commencing negotiations on investment and merely sought further study on the possibility.²²⁶ But on the whole, developing countries were more concerned with matters such as the elimination of agricultural export subsidies,²²⁷ reform of the use of anti-dumping and countervailing duty laws²²⁸, further talks on textiles²²⁹ and the reform of the Agreement on Trade-Related Aspects of Intellectual Property Rights to enable

²²⁴ See *Neue WTO-Runde Dank EU-Flexibilität*, NEUE ZÜRCHER ZEITUNG, Feb. 24-25, 2001, at 10; *Draft Declaration Presses for Decision on Investment, Competition*, 19 (39) INSIDE U.S. TRADE, Sep. 28, 2001, at 17.

²²⁵ *Group of 77 Pushes Concessions in Agriculture, Open to Investment Talks*, 19 (43) INSIDE U.S. TRADE, Oct. 26, 2001, at 17-18.

²²⁶ *Decision on Investment, Competition Talks Likely to be Delayed*, Special Report INSIDE U.S. TRADE, Nov. 13, 2001 at 3-4. In particular, India has long opposed the inclusion of investment on the negotiating agenda of the WTO. For a critique of the Indian negotiating position on this issue, see Satya P. Das, *An Indian Perspective on WTO Rules on Direct Foreign Investment*, World Bank (Dec. 1999).

²²⁷ *Group of 77 Pushes Concessions in Agriculture, Open to Investment Talks*, 19 (43) INSIDE U.S. TRADE, Oct. 26, 2001, at 17-18.

²²⁸ The anti-dumping procedure under the Uruguay Round Antidumping Agreement (which can lead to the imposition of anti-dumping duties) tend to be typically initiated by developed states – particularly the US, Australia, Canada and the EU – whilst developing countries are most often defenders rather than complainants. See WTO, ANNUAL REPORT 21 (2000); TREBILCOCK & HOWSE, *supra* note 42, at 166-71. The desire of developing countries to commence negotiations for reform of the anti-dumping rules to prevent disproportionate use of anti-dumping measures is detailed in *Group of 77 Pushes Concessions in Agriculture, Open to Investment Talks*, 19 (43) INSIDE U.S. TRADE, Oct. 26, 2001, at 17; *WTO Draft Declaration Proposes AD Negotiations, Delays Environment*, Special Report INSIDE U.S. TRADE, Oct. 30, 2001, at 1, 9.

²²⁹ *Group of 77 Pushes Concessions in Agriculture, Open to Investment Talks*, 19 (43) INSIDE U.S. TRADE, Oct. 26, 2001, at 17-18.

governments to take necessary steps to protect public health.²³⁰ Not surprisingly, developing countries opposed the inclusion of environmental rules in the WTO, an area promoted strongly by the EU.²³¹

In a break from the past, the United States was not as strong a *demandeur* for the commencement of investment negotiations in the Doha agenda.²³² This may have been as a result of the failure of the primarily US-backed MAI, the on-going difficulties in the interpretation of Chapter 11 of NAFTA and the inter-agency disputes within the Bush administration on the extent to which language for future bilateral agreements with Singapore and Chile and even the regional FTAA should diverge from the NAFTA Chapter 11 model.²³³ Instead, the other members of the Triad – Japan and the EU – pushed forcefully for the commencement of negotiations on investment.²³⁴ The strategic interests of the US appear to have been to resist the push for negotiations to reform the use of anti-dumping and countervailing duty measures while advocating reform agricultural rules to assist US producers.²³⁵

A. The Doha Ministerial Declaration

The broad divergences between WTO member states in the lead up to the Doha Ministerial set the scene for trading compensatory bargains across separate issues to achieve consensus for the start of negotiations. Unlike the failed Seattle Ministerial in 1999, WTO Ministers succeeded in agreeing to an agenda to commence negotiations. The overall outcome of the Doha Ministerial was to launch immediate negotiations on

²³⁰ *TRIPS –Public Health Declaration Splits Developing, Developed Nations*, 19 (39) INSIDE U.S. TRADE, Sep. 28, 2001, at 11-12.

²³¹ *Lamy Says EU Must Have Ability to Negotiate Environment in WTO*, 19 (45) INSIDE U.S. TRADE, Nov. 9, 2001, at 11-12.

²³² *At Doha, U.S. Aims to Postpone Decision on Dumping, Weighs EU Plan*, 19 (45) INSIDE U.S. TRADE, Nov. 9, 2001, at 2.

²³³ *See supra* Part IV.C.

²³⁴ *See Decision on Investment, Competition Talks Likely to be Delayed*, Special Report INSIDE U.S. TRADE, Nov. 13, 2001, at 3-4 (details last-minute efforts by the EU and Japan to secure support from developing countries for the inclusion of investment in the Doha agenda).

²³⁵ *Zoellick Raises Two Objections to WTO Draft Declaration*, 19 (44) INSIDE U.S. TRADE, Nov. 2, 2001, at 21-22.

nine different topics²³⁶, eight of which are to be concluded as a single undertaking²³⁷ by 1 January 2005. The eight are implementation, agriculture, services, industrial tariffs, subsidies, anti-dumping, regional trade agreements and the environment. Negotiations on reform of the dispute settlement rules are to be concluded by May 2003.

From the perspective of developing countries, it might be slightly ambitious to describe the Doha agenda as a development round of negotiations. However, there were three primary areas of interest for developing countries included in the single undertaking negotiations. Firstly, implementation of existing commitments is an issue for negotiations in its own right together with a separate Decision on Implementation-Related Issues and Concerns.²³⁸ Developing countries have expressed concern with the lack of implementation of existing commitments virtually since the coming into force of the Uruguay Round set of agreements. Further, developing countries succeeded in including anti-dumping and subsidy reform amongst the topics for immediate negotiation. The Doha declaration also contains long substantial sections on topics such as technical assistance, capacity building and least-developed-countries.²³⁹ Aside from the negotiating program, a general work program was also launched on priority issues for developing countries such as trade and debt,²⁴⁰ finance and technology transfer,²⁴¹ as well as special and differential treatment.²⁴²

On the opposite side of the ledger, developing countries failed to include legally-binding language in the TRIPS Agreement to enable them to address public health emergencies.

²³⁶ These are Implementation (¶ 12), Agriculture, (¶ 13), Services (¶ 15), Industrial tariffs (¶ 16), Subsidies (¶ 28), Anti-dumping (¶ 28) Regional Trade agreements (¶ 29), Environment (¶ 31) and on a separate track, the Dispute Settlement Understanding (¶ 30). See *Doha Ministerial Declaration*, *supra* note 5. For an analysis of these topics as well as the Doha Declaration generally, see International Centre for Trade and Sustainable Development, *The Doha Declaration's Meaning Depends on the Reader*, 5 (9) BRIDGES, Nov./Dec. 2001, at 1-20.

²³⁷ The concept of a single undertaking means that nothing is finalized until negotiations are concluded in all areas. See *Doha Ministerial Declaration*, *supra* note 5, ¶ 47.

²³⁸ See *Doha Ministerial Declaration*, *supra* note 5, ¶ 12; WTO, *Implementation-Related Issues and Concerns: Ministerial Conference Fourth Session Doha, 9-14 November 2001*, WT/MIN(01)/17 20 (Nov. 14, 2001).

²³⁹ See *Doha Ministerial Declaration*, *supra* note 5, ¶ 38-44.

²⁴⁰ See *Doha Ministerial Declaration*, *supra* note 5, ¶ 36.

²⁴¹ See *Doha Ministerial Declaration*, *supra* note 5, ¶ 37.

²⁴² See *Doha Ministerial Declaration*, *supra* note 5, ¶ 44.

This was strongly resisted by the pharmaceutical industry on the basis that it would act as a giant carve-out for the TRIPS Agreement.²⁴³ Instead, a separate Declaration on the TRIPS Agreement and Public Health contains a political statement supportive of public health.²⁴⁴ Outside of the context of implementation issues, no substantial progress was made on a long-standing issue of interest for developing countries being further market access for textile products. This remains an inherently sensitive topic in many developed states particularly the US. Similarly, the issue of movement of people (rather than movement of goods or capital) was not addressed in the Doha agenda. Whilst this is not surprising (given the even more politically sensitive aspects of this topic especially since the September 11 disaster), this issue is of considerable interest to developing countries given their comparative advantage in this area.²⁴⁵

Within the developed states, the EU scored a major victory with the immediate launch of negotiations on certain, albeit limited, environmental initiatives.²⁴⁶ As a trade-off, the EU agreed to relatively strong language in the agricultural mandate particularly on reducing export subsidies.²⁴⁷ This is an area which pits the European Union against most of the

²⁴³ See *WTO Countries in Deadlock on TRIPS*, 19 (43) *INSIDE U.S. TRADE*, Oct. 26, 2001, at 1, 22-3; *Fight Over TRIPS Narrowed to Whether Declaration Would Be Binding*, Special Report *INSIDE U.S. TRADE*, Nov. 13, 2001, at 3.

²⁴⁴ The relevant part of this Declaration reads “[w]e agree that the TRIPS Agreement does not and should not prevent Members from taking measures to protect public health. Accordingly, while reiterating our commitment to the TRIPS Agreement, we affirm that the Agreement can and should be interpreted and implemented in a manner supportive of WTO Members’ right to protect public health and, in particular, to promote access to medicines for all.”. See *WTO, Declaration on the TRIPS Agreement and Public Health: Ministerial Conference Fourth Session Doha, 9-14 November 2001*, WT/MIN(01)/DEC/2 (Nov. 20, 2001), at ¶ 4.

²⁴⁵ See generally *TREBILCOCK & HOWSE*, *supra* note 42, at 484-99 (analyzing the welfare implications of greater immigration flows and the absence of international rules on this issue). The on-going negotiations between the US and Chile on a proposed FTA highlight the tensions involved in this area. Chile (with the support of the US service industry) has consistently pushed for the inclusion of rights providing temporary entry for services personnel. This has been stringently opposed by the US out of concern over their impact on immigration. See *U.S. Resists Chile Services Visa Push, But Looks for Model Accord*, 20 (2) *INSIDE U.S. TRADE*, Jan. 11, 2002, at 1, 20-21.

²⁴⁶ The agreement to commence negotiations on the environment are limited to three approved areas; (i) the relationship between existing WTO rules and to the trade obligations in multilateral environmental agreements; (ii) the reduction of trade barriers to the sale of environmental goods and services; and (iii) to clarify and improve WTO disciplines on fisheries subsidies. See *Doha Ministerial Declaration*, *supra* note 5, ¶ 31.

²⁴⁷ The relevant part of the negotiating agenda reads “[b]uilding on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export

rest of WTO member states (and to a large degree, the United States). For the purposes of this paper, investment (pushed largely by the EU) was not included in the set of topics for immediate negotiations. However, there is reference to the start of negotiations on investment rules in the future. Unexpectedly, ambiguity surrounds the exact parameters of this part of the Doha agenda.

B. Is There Really Agreement to Commence Negotiations on Investment?

The most confusing aspect of the Doha Ministerial revolves around the so-called Singapore issues of investment, competition policy, government procurement and trade facilitation.²⁴⁸ On each of these issues, the Doha declaration provides that members “agree that negotiations will take place after the fifth Session of the Ministerial Conference *on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations*” (emphasis added).²⁴⁹

Developed members of the WTO such as the US viewed this language as a mandate to launch negotiations at the fifth Ministerial in Mexico in 2003. But some developing countries have opposed this interpretation. In the last hours of the Doha conference, India extracted a statement from the Qatari trade minister Youssef Kamal in his role as the Chair of the Ministerial that:

[M]y understanding is that at that [fifth Ministerial]...a decision would indeed need to be taken by explicit consensus before negotiations on [the Singapore issues] could proceed...In my view, this would give each member the right to take positions on

subsidies; and substantial reductions in trade-distorting domestic support.”. *See Doha Ministerial Declaration, supra* note 5, ¶ 13.

²⁴⁸ In the lead up to the WTO Ministerial Meeting in Singapore in 1996, developed countries pushed for the commencement of negotiations on each of these topics. The resistance of developing countries led to a compromise whereby Ministers only agreed to establish working groups to study the issues surrounding these topics. *See* WTO, *World Trade Organization: Singapore Ministerial Declaration* WT/MIN(96)/DEC (Dec. 13, 1996), 36 I.L.M. 218 (1997), ¶ 20-3. For an overview of negotiations between developed and developing countries on investment in the lead up to the Singapore Ministerial, *see also* Zdenek Drabek, *A Multilateral Agreement on Investment: Convincing the Sceptics*, WTO ERAD-98-05 (1998), at 9; Smythe, *supra* note 152, at 108-12.

²⁴⁹ *See Doha Ministerial Declaration, supra* note 5, ¶ 20 (Investment); ¶ 23 (Competition Policy); ¶ 26 (Government Procurement); ¶ 27 (Trade Facilitation).

modalities that would prevent negotiations from proceeding after the Fifth Session of the Ministerial Conference until that Member is prepared to join an explicit consensus.²⁵⁰

The legal status of this statement is unclear. It is not attached to the official Ministerial Declaration itself. Further, this interpretation seems at odds with the agreement in the Doha Declaration to treat “the negotiations to be pursued under the terms of this Declaration” as “parts of a single undertaking”.²⁵¹ This issue is also linked to the reciprocal balance of concessions within the overall Doha agenda. If the commencement of negotiations (rather than the modalities on which they proceed) on these issues were blocked, then *demandeur* countries like the EU and Japan could justifiably see the negotiating package as unbalanced and resist negotiations in other areas.

Given the historical resistance of some developing countries to the issue of multilateral investment rules, it would seem that the *demandeur* countries will practically need to do two things to ensure negotiations start on investment in Mexico in 2003. Firstly, careful consideration to developing countries’ interests on issues other than investment within the agreed negotiating agenda (such as long-standing concerns on implementation of existing commitments) will go a long way to building consensus for the start of investment negotiations. Secondly, in the lead up to the 2003 WTO Ministerial, the work undertaken by the WTO Working Group on the Relationship between Trade and Investment in developing a framework for a proposed WTO investment agreement could also play a significant role in ensuring the start of negotiations in 2003.²⁵² This will depend upon the extent to which the proposed framework for a WTO investment agreement balances both developed and developing country interests. The next part of the paper will put forward a series of suggestions for a WTO investment agreement which attempt to achieve this aim. In doing so, the proposals tie together the lines of inquiry and lessons discerned from the analyses of NAFTA Chapter 11 and the MAI in the earlier parts of this paper.

²⁵⁰ For a description of the Indian position as well as an extract of the Chairman’s statement, *see Note from Qatar Chairman Yields Uncertainty on New WTO Issues*, 19 (47) *INSIDE U.S. TRADE*, Nov. 23, 2001, at 15-6.

²⁵¹ *See Doha Ministerial Declaration, supra* note 5, ¶ 45-7.

²⁵² The Doha Declaration explicitly envisages that the Working Group on Trade and Investment undertake this type of work in the period leading up to the Fifth Ministerial in 2003. *See Doha Ministerial Declaration, supra* note 5, ¶ 22.

C. Suggestions for a WTO Investment Agreement

There are four principles that should shape any effort in structuring a framework for a WTO investment agreement.

Firstly, developing countries are unlikely accept a “high standards”, NAFTA or MAI-like model on investment liberalization and protection. Indeed, there is a need to shift away from the perception that negotiation of investment rules is a zero-sum game with the only outcomes being either full liberalization or full protectionism.²⁵³ Liberalization of investment restrictions (especially on the question of admission of foreign investment) is an inherently politically sensitive process. Further, unlike tariff negotiations, these restrictions cannot be negotiated incrementally and there is uncertainty as to the quantification of the benefits in removing some restrictions such as certain performance requirements. A WTO investment agreement will need to balance the clear benefits that can result from increased liberalization (and investment flows) with the reality that some countries will continue to take restrictive measures whether for political or developmental purposes.²⁵⁴

Secondly, the foregoing analysis has revealed a number of on-going difficulties with the NAFTA Chapter 11 model particularly in regard to the issue of regulatory autonomy. The WTO negotiators should not simply look to the NAFTA precedent as the only model available. This was the approach within the MAI initiative only for the OECD negotiators to belatedly try and rectify some of the clear problems that have arisen from the NAFTA model. This also raises a much more fundamental issue. The NAFTA Chapter 11 model of extremely strong provisions on liberalization, protection and dispute settlement is rooted in another time and place. In particular, the broad wording of the

²⁵³ This valuable point on the way past investment negotiations have been perceived is set out in Muchlinski, *supra* note 157, at 133.

²⁵⁴ This point is also replicated in the Doha agenda itself. The proposed work to be undertaken in the WTO Working Group on the Relationship Between Trade and Investment in advance of the Mexico Ministerial in developing a framework “should reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest”. See *Doha Ministerial Declaration*, *supra* note 5, ¶ 22.

investment protection provisions (largely borrowed from similar US BITs) were designed to deliver stability in the face of hostile expropriatory behavior by newly independent states in the Cold War era. In the last few decades, most developing countries have moved away from this type of behavior and have unilaterally begun to liberalize their national investment policies (within developmental parameters such as the use of performance requirements). The type of broad and often undefined coverage of provisions in NAFTA such as Article 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) seems somewhat anachronous in the current international environment. Foreign investors are now more interested in gaining entry and freedom to operate in a host state. Thus, the strategic focus of a WTO framework on investment should be more on the way in which liberalization commitments are structured than setting down guarantees of investment protection.

The third underlying principle in structuring the framework for a proposed WTO investment agreement is the likely prospect of NGO oversight. The perceived success of the NGO campaign against the MAI episode (as well as on-going concern by many NGOs with NAFTA Chapter 11) will spark similar interest by these groups in future investment initiatives. At a minimum, WTO negotiators should strive for a greater degree of transparency in the negotiating process than that shown in the MAI episode. A clear explanation of the objectives and components of a WTO investment agreement may in fact pre-empt some NGO concerns.

Fourthly, NGO oversight is in many ways linked to the greater emphasis in developed states (particularly the EU) on the so-called linkages between international economic initiatives and matters such as the environment and labor. These issues should not be simply dismissed as protectionist tendencies driven by interest groups in developed states. Instead, WTO negotiators should aim to recapture some of the broadness of vision encapsulated within the Havana Charter that set down a mix of liberal and regulatory initiatives. This may, to some degree, conflict with the interests of developing countries who have historically resisted initiatives in this area. But increasingly, matters such as the relationship between investment flows and domestic environmental and labor

standards cannot be artificially separated. The key to resolving this tension will be to devise reasonable proposals that again balance divergent interests in this area.

Using these underlying themes, the following are modest but realistic suggestions for the drafting of a WTO investment agreement:

1. Scope: A Narrower Definition of “Investment”

The way in which “investment” is defined will be crucial in delineating the scope of operation of a WTO investment agreement. Developing countries are unlikely to accept coverage of short-term (and often speculative) capital flows such as portfolio investment. Given this, it seems that WTO negotiators should aim to develop a narrower, asset-based definition of “investment” than that set out in NAFTA and the MAI. At one end of the spectrum, negotiators could simply limit the coverage of the agreement to FDI. Alternatively, the definition of “investment” could go beyond FDI to encompass a closed list of assets which the negotiating group is able to reach consensus on. This list of assets could again try to isolate the key characteristics of the types of capital flow of most benefit to developing states. For example, other assets which could conceivably fall within this category are intra-firm debt or even debt with a relatively long-term perspective. The advantage for developing states going beyond FDI to include other forms of capital flow is that it could possibly provide for further concessions by developed countries in other matters of interest to developing countries such as disciplines on the use of investment incentives.

2. Liberalization

The non-discriminatory standards of national and most-favored-nation treatment should remain as the cornerstone of a WTO investment agreement. However, the question is to what forms of national regulation should these standards apply. This difficult question in turn breaks down into two sub-questions. Firstly, to which of the *de jure* discriminatory measures (as described in Part III) should the liberalization provisions apply? For

example, should a WTO agreement extend to pre-admission restrictions? Further, should there be some limitation on the use of investment incentives? Secondly, how should a WTO investment agreement deal with the problem of *de facto* discriminatory measures; those regulatory measures which do not on their face discriminate against foreign investors but have some incidental, adverse impact. The following possibilities are suggested to these questions.

(a) Pre-Admission Restrictions: A GATS Bottom-Up Structure

The question of entry of foreign investors into a host state is inherently politically sensitive. As such, a WTO agreement could simply exclude the coverage of national and most-favored-nation treatment from the pre-admission phase of the investment process. This would free host states to regulate the question of entry of investors. But, as an alternative option (considering the likelihood of the *demandeurs* pushing forcefully for some kind of treatment of pre-establishment restrictions), the WTO negotiators could consider a GATS-like, bottom up approach to scheduling commitments on pre-establishment matters.²⁵⁵ This would then give host states significant discretion to specify what economic sectors of the national economy would be open to the entry of foreign investors.

(b) Post-Admission Restrictions: A Top Down Structure

Most restrictions imposed once an investor enters into a host state are motivated by the desire to fully capture the economic benefits of the foreign investment. For these restrictions, a WTO agreement should follow the stricter NAFTA and MAI approach of applying liberalization conditions on a top down basis. Under this approach, the liberalization conditions would apply across all economic sectors and national laws of a WTO member unless specifically exempted by the submission of a negative-list of such measures. Careful consideration will need to be given as to the techniques in which to

²⁵⁵ Indeed, this is envisaged in the set of issues to be addressed by the WTO Working Group on Trade and Investment in the lead-up to the Mexico Ministerial. See *Doha Ministerial Declaration*, *supra* note 5, ¶ 22.

effect a system of progressive liberalization of these non-conforming measures. Again, the guiding principle should be one of caution by specifying realistic time periods in which to initiate such procedures.

(c) The Grand Bargain: Investment Incentives/Performance Requirements

A WTO investment agreement should discipline the use of investment incentives. This is easily the area in which developing countries have potentially the most to gain from an investment agreement. Incentives are arguably as economically distortive as negative restrictions on foreign investors such as performance requirements. Developing states are also at a comparative disadvantage to developed countries in their use of incentives. But the absence of such disciplines in both the MAI and NAFTA evidences the historical resistance in the OECD states to disciplining these forms of positive discrimination in favor of foreign investors.

However, on the other side of the ledger, it would not be unexpected for developed states to seek to expand the list of performance requirements subject to the TRIMS Agreement in a WTO investment agreement.²⁵⁶ This scenario would provide WTO negotiators with the type of intra-issue linkage to meet the strategic interests of both sets of parties; some discipline on the use of investment incentives against further commitments to limit the use of performance requirements.

(d) National Treatment and the Difficult Question of De Facto Discrimination

A national treatment obligation in a WTO investment agreement should clearly apply to regulatory measures that discriminate on their face against foreign investors. The more difficult question is how a national treatment norm in an investment agreement should deal with *de facto* discriminatory measures. To date, this issue has not received the

²⁵⁶ For example, the United States has long opposed the use of technology transfer requirements (which are not explicitly covered by the TRIMS Agreement. See *Building American Prosperity*, *supra* note 49, at xii. (“Recommendation 6: Foreign Direct Investment Liberalization...[F]orced technology transfer as a precondition for foreign direct investment should be actively opposed by the U.S. government.”))

attention it deserves in existing institutional *fora*. Within NAFTA case law, the implications of the operation of the national treatment norm have largely been overshadowed by analyses of the broad wording of the investment protection provisions in Articles 1105 (Minimum Standard) and 1110 (Expropriation). The primary focus of the interpretation issued by the NAFTA Free Trade Commission was to limit the operation of Article 1105. However, within the context of a proposed WTO investment agreement, it will be relatively easy to proscribe the operation of investment protection provisions by carefully defining their application. On a conceptual level, this is much more difficult to do with the application of the national treatment norm. Thus, this is where the WTO Working Group on Trade and Investment should focus their efforts in the lead-up to the Mexico Ministerial.

There is no ready and simple answer to this difficult issue. However, there are two fundamental points which should be considered. Firstly, protectionist intent (as discerned through statements made by regulators) should not be enough to constitute a finding of *de facto* discrimination. This was the path taken in *S.D. Myers* and, as has long been recognized in WTO jurisprudence, is a path beset by dangers particularly from a legitimacy perspective. Thus, as a second principle, the focus should be on the discriminatory impact of the particular measure. In turn, should it be enough to simply identify (rather than quantify) an adverse impact on a foreign investor to ground breach of the national treatment norm? This has long been the approach within the GATT/WTO in the oft-stated principle that the focus of GATT Article III on national treatment is to protect competitive opportunities and expectations.²⁵⁷ However, GATT Article III.4 in turn is limited in its operation by the fact that national treatment is only applied to “like products”. Thus, the overall scope of Article III.4 is restricted by an analysis of whether two products are sufficiently similar (whether in their physical characteristics or through

²⁵⁷ See, e.g., *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8/AB/R; WT/DS10/AB/R; WT/DS11/AB/R (4 October 1996), at para. F. (“The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures... Toward, this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products... Moreover, it is irrelevant that the “trade effects” of the tax differential between imported and domestic products, as reflected in the volume of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.” (emphasis added))

other criteria such as tariff classifications) to justify the application of the national treatment norm. In contrast, the national treatment clause in NAFTA Chapter 11 uses the formulation “in like circumstances” which, to date, has not been used by arbitral panels as a means in which to draw some boundary around the operation of that clause. Accordingly, it is difficult to conceptually see any real limit to the operation of a national treatment clause along the lines of NAFTA Article 1102. Thus, it is suggested that attention should be given in the WTO Working Group on the issue of quantifying what level of adverse impact on a foreign investor is sufficient to ground breach of national treatment. Again, there is no simple or ready answer to this difficult question. But to some degree, the answer may partly lie in providing guidance (possibly in the form of interpretative note and careful drafting of the “in like circumstances” qualification) to a panel considering the application of a national treatment provision in a WTO investment agreement. It is essential that a WTO panel considering the impact of a given regulatory measure not approach its task with an assumption of protectionism. This is a worrying trend evident in some of the NAFTA Chapter 11 cases.²⁵⁸ As has been pointed out elsewhere, regulation of risk is a norm in the modern regulatory state and not an inherently suspicious intervention in free markets.²⁵⁹

3. Investment Protection: A Step Back

In devising clauses dealing with investment protection, negotiators should bear in mind the contemporary environment surrounding foreign investors and host, particularly developing, states. Foreign investors are generally no longer concerned with protecting existing investments in recently decolonized host states but instead, are more interested in gaining entry and freedom of operation in a host state. In other words, the emphasis in a WTO investment agreement should be on investment liberalization rather than protection.

²⁵⁸ See *In the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement Between Pope & Talbot Inc and the Government of Canada, Award on the Merits of Phase 2*, para. 70, Apr. 10, 2001, at <http://www.dfait-maeci.gc.ca>. (“We have already seen that it is not always clear whether a measure is a *de jure* or *de facto* case, but even if it were Canada has presented no reasons to justify treating the two forms of disadvantage differently. Indeed, the recognition that national treatment can be denied through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting.”)

²⁵⁹ Howse, *supra* note 89, at 156.

This is bolstered by the problems that have arisen from the overly broad NAFTA Chapter 11 protection provisions of Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation).

With this in mind, there are two proposals for the investment protection provisions of a WTO investment agreement. Firstly, negotiators should give careful thought to simply not including a minimum standard of treatment clause along the lines of NAFTA Article 1105. If the *demandeur* countries are successful in insisting on such a clause, then the negotiators should carefully define the exact parameters of its application such, as for example, guarantees of transparency and due process in domestic legal proceedings. In contrast, there is much greater justification for the inclusion of a clause along the lines of NAFTA Article 1110 guaranteeing compensation in the event of expropriation. But the scope of that protection should be limited to direct expropriation. Negotiators should strongly resist extending this standard of protection to so-called creeping or indirect expropriation.

4. Dispute Settlement

It is unlikely that the WTO negotiators will develop investor-state dispute settlement procedures in a WTO agreement.²⁶⁰ Indeed, if dispute settlement is limited between WTO member states, this could possibly limit the potential for some of the NAFTA Chapter 11 difficulties as investors would not have a direct route in which to challenge regulatory measures. But, as examined earlier in the paper, there are strong normative justifications for the inclusion of investor-state dispute resolution procedures. If the WTO negotiators do decide to tackle this issue, the likelihood of recreating the problems that have arisen in NAFTA will be reduced if the substantive provisions of a WTO investment agreement are carefully delineated.

²⁶⁰ In the lead-up to the Mexico Ministerial, the Doha agenda only countenances further work on the clarification of “consultation and the settlement of disputes between Members”. See *Doha Ministerial Declaration*, *supra* note 5, ¶ 22.

5. Investor Responsibilities

The theme of preferring the interests of foreign investors (rather than their responsibilities) underlined much of NGO opposition to the MAI. This is a theme which should not be simply rejected out of hand by WTO negotiators. For example, consideration should be given to the approach taken late in the MAI of the annexation of the OECD Guidelines on Multinational Enterprises to a WTO investment agreement.²⁶¹ It is also clear that NGO groups will once again push strongly for wording on the impact of foreign investment on domestic environmental and labor standards. On these issues, a degree of caution is warranted. Clearly, developing states will most likely resist this approach as an unjustified attack on areas of legitimate comparative advantage. If the WTO negotiators decide to tackle these areas of linkage, they would best be served by working within the traditional GATT/WTO formulation of negative integration (devising disciplines on what member states should not do) rather than moving towards any suggestion of positive harmonization (imposing positive obligations) on these questions. In this vein, one possible approach is to include provision requiring WTO members not to lower their labor or environmental standards with a view to attracting investment. The advantage of this approach is that it does not force WTO members to adopt a particular standard of environmental or labor protection but to simply not lower their chosen standards to attract foreign investors. There is a similar provision in NAFTA. On a slightly more ambitious note, such a commitment could even be framed to build in some role for NGO oversight (just as in NAFTA side-agreements on labor and environment) on the question of identifying countries that have dropped domestic standards to attract foreign investors. Whilst this type of proposal will no doubt provoke opposition amongst some WTO member states, it would be an ideal opportunity in which to constructively harness NGO expertise as well as possibly build NGO support for such a WTO investment agreement.

²⁶¹ For a creative suggestion to counter the perception of bias in favor of investor rights, see TREBILCOCK & HOWSE, *supra* note 42, at 366. The authors suggest that, in a future investment agreement, the right to investor-state dispute settlement could be conditioned on agreement by investors to abide by the OECD Guidelines.

VII. Conclusion

The obstacles to the successful conclusion of investment negotiations in the WTO seem formidable. Since the end of the Second World War, investment rules have largely been negotiated at the bilateral and regional levels in part due to the perceived resistance of developing countries to the prospect of multilateral investment rules. However, the failure of the OECD MAI highlights the fallacy that it is somehow easier to forge deep levels of liberalization amongst developed countries.

There are two essential challenges which negotiators face in negotiating investment rules in the WTO. Firstly, a WTO agreement must reflect the interests of developing countries. This will require negotiators to think creatively and especially to avoid a MAI-type scenario of simply replicating the very strong investment liberalization and protection provisions of NAFTA Chapter 11. The options for negotiation should not be perceived as a zero-sum game with either full liberalization of discriminatory regulation or full protectionism. Given the political sensitivity of many investment restrictions, a WTO agreement will most likely have to constitute a compromise with a mix of liberalization provisions whilst preserving a degree of freedom to impose developmental restrictions. The last part of the paper has put forward a series of suggestion in which to effect such a compromise including the architecture of the agreement and its impact on pre-admission restrictions, coverage of the damaging use of investment incentives and sensitivity to use of some performance requirements by host states.

The second challenge WTO negotiators face is possibly the more difficult one. This is to address some of the concerning jurisprudence that has developed out of the NAFTA Chapter 11 case law. Many of these cases seem to represent an extension of the coverage of NAFTA Chapter 11 beyond clearly discriminatory measures to encompass seemingly legitimate regulations with little adverse impact on foreign investors. In part, much of the case law derives from the broad scope of the investment protection provisions in NAFTA Chapter 11. The broad scope of these provisions seems somewhat anachronous in the current international environment when investors are more interested in gaining access

and freedom to operate in host states. As such, the WTO negotiators should consider carefully the utility of overly strong and undefined investment protection provisions. It is submitted that a better approach would be to merely focus on protection from direct expropriation. However, of itself, this approach will not solve all of the problematic tendencies flowing from the NAFTA case law. The most difficult issue which WTO negotiators will need to address is the way in which a national treatment norm should apply in an investment context. The NAFTA experience and the MAI approach have followed the long-standing practice in BITs of importing the national treatment norm from the GATT. However, little attention to date has been given to the potentially broad application of the concept of *de facto* discrimination in the investment context. It is essential that a WTO investment agreement manage the task of delineating the coverage of *de facto* discrimination in such a way as to preserve core components of regulatory autonomy. The suggestions put forward in the final part of this paper are not intended to be exhaustive in this respect. They are, however, an invitation to examine this difficult issue further.