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CONCEPT PAPER ON MODALITIES OF PRE-ESTABLISHMENT

This concept paper is intended as a suggestion on the pre-establishment provisions that could be included in a Multilateral Investment Framework. It should not be read as a text proposal.

1. WTO Ministers have recognised at the Doha Ministerial Conference the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade. Paragraph 22 of the Doha Ministerial Declaration mentions, inter alia, "modalities for pre-establishment commitments based on a GATS-type, positive list approach" as one of the issues to be clarified in the Working Group on the Relationship between Trade and Investment, in the period until the Fifth Ministerial Conference.

2. Among the issues listed in the Ministerial Declaration, this is probably the one on which Ministers have given the clearest indications about the possible way forward. The issue of the admission of investment has already been addressed in papers presented in this Working Group since 1997.[1] In this context, this submission aims at outlining the EC view on how the admission of investment could be addressed in a multilateral framework on FDI.

3. Since 1999 the EC and its Member States have made clear their position according to which, in the context of a multilateral framework on investment, the question of admission should be addressed following a GATS-type approach based on positive commitments.

4. We believe that this approach would allow enough flexibility for all WTO members. Each WTO member would be able to decide to open up (i.e. to commit) the sectors in which it wished to attract foreign investors in accordance to its needs and to its level of development. This would guarantee legal certainty and policy stability for potential investors. But no member would be forced to take commitments in any given sector. This was the suggestion given by Ministers of WTO Members at Doha.

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[1] See, for instance WT/WGTI/W/22, W/23, W/28, W/29, W/30, W/33, W/42, W/47, W/51, W/54, W/71, W/79, W/84, W/96, and W/104.

I. CLEAR RULES ON THE ADMISSION OF FOREIGN INVESTORS ARE IMPORTANT

5. In order to analyse modalities of pre-establishment commitments based on a GATS-type positive list, the starting point for admission of investment has to be defined. Subject to admission rules in any international agreements, governments have the right to control entry and establishment of foreign companies within their territory. They can restrict the admission of investment in a two-fold way:

(i) They prohibit or restrict the entry of FDI, or discriminate among investors on the basis of their nationality or other elements.

(ii) They impose entry conditions[2] to permitted FDI.

6. Firstly, when such restrictions are in place foreign investors either have no rights or only conditional rights to enter the market. Secondly, when their possibilities to launch an undertaking are conditional, this by definition entails that foreign direct investors are not treated under the same conditions as domestic investors, and in some cases as other third country investors. They might be excluded to invest in certain sectors which are only open to domestic investors or other foreign investors, and/or they might be subject to additional conditions.

7. During the last decade several host countries have unilaterally liberalised their investment climate and increased the opportunities for foreign companies to invest in their territory. However, a host of barriers world-wide still prevent foreign investors from entering markets in many countries. The rules that regulate the entry of foreign investors as provided for both in the domestic legislation and in the admission rules included in international agreements concluded by a potential host country are important factors when investors consider entering new markets. The admission rules may increase the legal certainty for companies that plan to set up an undertaking in a new host country by confining the wide area of discretion of host countries into a more predictable pattern.

8. Generally speaking, open and transparent admission rules for foreign investment can significantly contribute to a better allocation of capital by creating a level playing field among potential host countries and among investors. At the same time, host-country governments usually keep a certain control on the entry of foreign investors in order to preserve national development goals, security, public health, the protection of the environment, safety and public morals. These two objectives are not incompatible and can co-exist in a multilateral investment framework, as they do already in most international investment agreements.

II. DIFFERENT WAYS TO REGULATE THE ENTRY OF FOREIGN INVESTMENTS

9. Host countries can regulate the admission and/or market access, of foreign investors in many different ways and for a number of reasons. Some sectors of the economy might be closed to any private investment either domestic or foreign. In other cases host countries might wish to restrict specifically foreign investment in certain areas, to screen the entry of foreign capital or to impose certain conditions on foreign enterprises who wish to establish their activities in the host-country's territory.

10. UNCTAD[3] has classified the different host-country measures affecting the entry of FDI in two groups: (a) measures relating to the admission and establishment, and (b) measures relating to

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[2] Provided they comply with existing international obligations such as for instance, the TRIMs provisions.

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

ownership and control. Within these two broad categories, the different categories of measures can be classified under the following headings (see Annex): (a) Controls over access to the host-country economy; Conditional entry into the host-country economy; (b) Controls over ownership; Controls based on limitation of shareholder powers; Controls based on governmental intervention in the running of the investment; Other types of restrictions.

III. HOW INTERNATIONAL AGREEMENTS DEAL WITH THE ENTRY OF FOREIGN INVESTMENT

11. While on the one hand most host countries wishing to attract FDI have liberalised unilaterally the entry conditions for foreign investors, on the other hand, it is only through international investment agreements that host governments are bound to provide the entry conditions that give investors the predictability and security they seek. As already discussed in a number of meetings of this working group, there are two basic approaches to address the pre-establishment phase of FDI in international investment agreements: non-discrimination (NT and MFN) and market access.

1. Non-discrimination: Most-Favoured-Nation (MFN) and National Treatment (NT)

12. MFN treatment for the entry of FDI ensures a level-playing field among foreign investors. This ensures that any more favourable treatment on the entry of investors from one country are automatically extended to all other foreign investors. This does not affect the internal economic policy of the host country, for instance, whether it liberalises or not certain economic sectors.

13. NT at the pre-establishment stage prevents discrimination between foreign and domestic investors. However, this does not affect the right of the host country to completely exclude private investments in certain sectors of its economy.

Both, the MFN and NT may be subject to exemptions, conditions and qualifications.

2. Market access

14. Unlike MFN and NT, which are relative standards of treatment, market access provisions address the host country's regulations on the entry and establishment of investment in absolute terms. In other words, in addition to the principles of non-discrimination, a host country may commit to refrain from applying certain specific restrictive measures to the entry of foreign investment, regardless of whether they are discriminatory or not.

IV. THE GATS MODEL

15. The GATS includes both the non-discrimination and the market access principles. It is the prime example of a multilateral agreement that provides for pre-establishment rules on FDI in the services sectors based on a positive-commitments (or positive list) approach. While the MFN principle applies across the board, the NT principle and market access rules apply only in those sectors in which WTO members have taken specific commitments in their schedule.

1. Most-Favoured-Nation

16. According to GATS Article II, the MFN obligation applies across the board (pre- and post-establishment) to all services sectors unless an exception is contained in the country list of MFN exemptions.

2. National Treatment

17. In addition to MFN, the GATS includes a mixed approach for pre-establishment obligations: national treatment combined with market access. There is no general obligation to remove all barriers concerning the entry and establishment of foreign service providers. According to Art. XVII NT only applies in the sectors where commitments have been made. The NT obligation refers to treatment, in respect of measures affecting the supply of services, which should be "no less favourable" than that of like national services and service suppliers. This does not always mean formally identical treatment, as long as it is ensured that the treatment applicable which covers both pre- and post-establishment measures does not result in less competitive market conditions for the foreign services or service suppliers. Any treatment will be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the member (host country) compared to like services or service suppliers of any other member. This means that the NT principle covers both *de facto* and *de jure* discrimination. Thus, while the NT principle in the GATT only applies to the products in question, the GATS NT provision applies to the competitive conditions imposed on the service supplier. WTO members, through their schedule of commitments, set out any limitations to NT in each sector listed.

3. Market Access

18. Market access for services in the sectors in which a Member has undertaken commitments provides that these service suppliers will be treated no less favourably than as specified in the Member's schedule. Article XVI (2) gives a list of market access barriers, such as for instance, limitations on the participation of foreign capital, limitations on the number of service suppliers or measures which restrict or require specific types of legal entity or joint venture. Members shall not maintain or introduce those limitations listed in Article XVI (2) in sectors where they have undertaken market access commitments, unless if specified in their schedule of commitments. In any case these limitations cannot violate the MFN principle.

19. The NT and market access provisions in the GATS cover "measures affecting the supply of services", which includes all measures affecting, directly or not, the conditions under which the service provider operates.

V. CONCLUSION

20. The EC and its Member States believe that the GATS approach provides a useful model for addressing pre-establishment rules in a multilateral investment framework. On the one hand, governments can keep full control of the sectors in which they wish to commit market access and NT to foreign operators and of the sectors in which they do not feel ready to do so. On the other hand, it provides a transparent and predictable picture of the rules affecting the admission and establishment of investors in each host country. This approach has the merit of incorporating enough flexibility to allow a gradual and progressive liberalisation of FDI, fully compatible with any development strategy adopted by WTO members.

21. As in the GATS, a multilateral investment framework in the primary (i.e. agriculture, fisheries and mining) and secondary (i.e. manufacturing) sectors could incorporate a general MFN obligation (including exceptions), as well as market access and NT obligations in accordance with a schedule of commitments, sector-by-sector. The schedule of commitments would enumerate each member's limitations to market access and NT.

22. Since FDI in services sectors, according to UNCTAD calculations, accounts for approximately half of world FDI stocks and flows[4], the GATS approach for pre-establishment

[4] UNCTAD World Investment Report, 2001.

commitments already applies to a large chunk of FDI and could therefore serve as a useful model for multilateral pre-establishment commitments in the primary and secondary sectors. Moreover, since WTO members have far fewer market access and discriminatory restrictions in the manufacturing sector than in the services sectors, the adoption of the GATS model to the manufacturing sector with respect to the pre-establishment phase would not seem to represent a major difficulty for host countries. Even for the primary sectors such as agriculture, fisheries and mining, which are usually more regulated and politically sensitive, the "positive list" approach used in GATS would allow for sufficient flexibility to take into account and accommodate each specific domestic situation. It is understood, however, that the relationship between pre-establishment rules in a multilateral framework on investment in the WTO and the GATS mode 3 provisions as well as those in other international agreements covering investment will need to be carefully assessed.

Annex

Examples of host-country measures affecting the entry of FDI (as identified by UNCTAD[5]):

A. MEASURES RELATING TO THE ADMISSION AND ESTABLISHMENT

1. Controls over access to the host-country economy

- Absolute ban on all forms of FDI.
- Closing certain sectors, industries or activities to FDI for economic, strategic or other public policy reasons.
- Quantitative restrictions on the number of foreign companies admitted in specific sectors, industries or activities for economic, strategic or other public policy reasons.
- Investment must take a certain legal form.
- Compulsory joint ventures either with State participation or with local private investors.
- General screening/authorisation of all investment proposals; screening of designated industries or activities; screening based on foreign ownership and control limits in local companies.
- Restrictions on certain forms of entry (e.g. mergers and acquisitions).
- Investment not allowed in certain zones or regions within a country.
- Admission to privatisation bids restricted, or conditional on additional guarantees, for foreign investors.
- Exchange control requirements.

2. Conditional entry into the host-country economy

General conditions:
- Conditional entry upon investment meeting certain development or other criteria based on outcome of screening evaluation procedures.
- Investors required to comply with requirements related to national security, policy, customs, public morals as conditions of entry.

Conditions based on capital requirements:
- Minimum capital requirements.
- Subsequent additional investment or reinvestment requirements.
- Restrictions on import of capital goods needed to set up investment possibly combined with local souring requirements.
- Investors required to deposit certain guarantees.

Other conditions:
- Special requirements for non-equity forms of investment (e.g. build-operate-transfer agreements, licensing of foreign technology).
- Investors to obtain licenses required by activity or industry specific
- regulations.
- Admission fees (taxes) and incorporation fees (taxes).
- Other performance requirements (e.g. local content rules, employment quotas, export requirements).

[5] UNCTAD Series on issues in international investment agreements, "Admission and Establishment", 1999.

B. MEASURES RELATING TO OWNERSHIP AND CONTROL

1. Controls over ownership

- Restrictions on foreign ownership (e.g. no more than 50 per cent
- foreign-owned capital allowed).
- Mandatory transfers of ownership to local firms usually over a period of time (fade-out requirements).
- Nationality restrictions on the ownership of the company or shares thereof.

2. Controls based on limitation of shareholder powers

- Restrictions on the type of shares or bonds held by foreign investors (e.g. shares with non-voting rights).
- Restrictions on the free transfer of shares or other proprietary rights over the company held by foreign investors (e.g. shares cannot be transferred without permission).
- Restrictions on foreign shareholders rights (e.g. on payment of dividends, reimbursement of capital upon liquidation, on voting rights, denial of information disclosure on certain aspects of the running of the investment).

3. Controls based on governmental intervention in the running of the investment

- Government reserves the right to appoint one or more members of the board of directors.
- Restrictions on the nationality of directors, or limitations on the number of expatriates in top Managerial positions.
- Government reserves the right to veto certain decisions, or requires that important board decisions be unanimous.
- "Golden" shares to be held by the host Government allowing it, for example, to intervene if the foreign investor captures more than a certain percentage of the investment.
- Government must be consulted before adopting certain decisions.

4. Other types of restriction

- Management restrictions on foreign-controlled monopolies or upon privatization of public companies.
- Restrictions on land or immovable property ownership and transfers thereof.
- Restrictions on industrial or intellectual property ownership or insufficient ownership protection.
- Restrictions on the use of long-term (five years or more) foreign loans (e.g. bonds).

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