

**COMMUNICATION FROM JAPAN**

The following communication, dated 27 June 2002, has been received from the Permanent Delegation of Japan.

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**MODALITIES FOR PRE-ESTABLISHMENT COMMITMENTS**

**I. SIGNIFICANCE OF FURTHER LIBERALIZATION**

1. As noted in our submission on non-discrimination (WT/WGTI/W7124), the reduction of foreign investment constraints and the creation of a freer investment environment will bring greater predictability for investors and, consequently, lead to greater investment inflow in the future. Further liberalization of foreign investment would therefore offer considerable benefits to both foreign investors and host countries, improving the economic welfare of the host countries as well as the entire world.
2. The reality is that WTO members stand at different levels of development, and we can understand the concern expressed by a number of developing countries over a balance between the amount of discretion left to them with regard to national development policies and their commitments under the WTO and other international agreements. At the same time, with the advance of globalization, taking corporate economic activities beyond national borders to enable companies to select the best production sites in the world, and placing constraints on investment would not seem to be an appropriate decision even from the perspective of development policy. National development objectives are better achieved by promoting liberalization and thereby stimulating domestic investment activities.
3. This is not to underestimate the fact that governments are feeling the need to limit the entry of foreign capital in specific sectors and economic activities within their national territories. The desire to introduce or maintain temporary constraints on foreign investment in light of a country's industrial policy priorities or social system constraints is understandable.
4. As this holds true not only for developing countries but also for developed countries, virtually all countries would probably have some concern over including non-discrimination, particularly national treatment obligations, in an investment agreement.
5. In examining the prospects for an investment agreement, we will therefore need to take into consideration each country's particular circumstances in terms of the need for particular liberalization reservations.
6. Naturally, aside from these individual national circumstances, certain restrictions based on special reasons such as national security and maintaining public order will need to be instituted as general exceptions for both developed and developing countries.

## II. POINT OF VIEW ON LIBERALIZATION RULES

7. Given the above considerations, it would seem vital that any WTO investment framework has the flexibility to respond to member countries' specific circumstances. The WTO embraces more than 140 members. Given the differences in their stages of development, economic structures, and policy priorities, how to secure the flexibility to deal adequately with such differences must be a key point.

8. Paragraph 22 of the Doha Ministerial Declaration calls for "modalities for pre-establishment commitments on a GATS-type, positive list approach", and directs the Working Group to clarify this. Here we examine four key issues in considering possible approaches.

### A. PRE- AND POST-ESTABLISHMENT

9. National treatment and liberalization of foreign investment could be considered in two stages, namely the stage before a foreign investor has established a presence in the host country (pre-establishment), and the stage following the establishment in the host country where the foreign investor engages in business activities (post-establishment).

10. Detailed discussion will be required on how to technically distinguish the pre- and post-establishment status of investment activities. With regard to the post-establishment stage, it is familiar to both foreign investors and host countries to have the national treatment rule included in international investment rules. Considering that foreign companies have established a presence in the host country, creating jobs and producing economic benefits there, it is difficult to find a rational reason for according to them unfavourable treatment compared to domestic companies.

11. On the contrary, the issues which need more careful consideration by WTO members, are the kind of rules which should be applied to the pre-establishment stage of investment, and the degree of liberalization which should be pursued.

12. For example, some recent bilateral and regional investment agreements that covers liberalization prescribes the extension of national treatment on "establishment or admission of foreign investment" and thereby include liberalization at the pre-establishment phase..

13. Pre-establishment rules are a key element for investors in that they determine the degree of investment risk they face when entering a new market. Obviously, clear and transparent rules increases predictability. At the same time, there is the question of to what extent host countries are prepared to admit "alien" parties which (potentially) have an impact on the domestic industry, and how these investors should be placed in relation to the host countries' domestic development policies. These are not issues which should be determined on a case-by-case basis; rather, they need to be decided considering the country's plans for its industrial structure and the impact on domestic industry from a medium- to long-term perspective.

14. In considering a future WTO investment framework, we need to aim for a highly effective framework which will increase predictability for investors and, at the same time, respond to the concerns of the host countries.

### B. POSITIVE LIST APPROACH AND NEGATIVE LIST APPROACH

15. To date, international investment agreements which includes national treatment and liberalization at the pre-establishment stage have generally adopted lists and schedules indicating specific reservations and commitments related to the fulfilment of agreement obligations, as appendixes to the agreement.

16. The modalities adopted for these reservations and commitments can be broadly divided into two types. Under the negative list approach, member countries grant national treatment for all areas in principle, registering particular areas as exceptions. In contrast, the positive list approach registers in commitment schedules only those areas where countries' parties have agreed to national treatment and liberalization.

17. For example, some recently concluded investment treaties, such as bilateral investment treaties (BITs) and the investment chapters in free trade agreements (FTAs), have opted for the negative list approach (e.g., Japan-Korea BIT, Japan-Singapore EPA are examples involving Japan). GATS, on the other hand, features a positive list approach.

18. The choice between these two approaches should be made with reference to factors such as the member countries, the objectives of the agreement, and rights and obligations under the agreement. As the positive list approach of the GATS allows the registration of national treatment and market access commitments only in those areas where countries are prepared to guarantee these, it seems to be a flexible approach making it easier to accept for developing countries concerned about maintaining a balance with their development policies.

19. Specific schedule formats and items to be listed should be worked out as we move along with the process of examining the overall structure of the investment agreement, but if we do intend to go with a positive list approach, the GATS schedule (see attached) should serve as a useful reference.

#### C. REQUEST AND OFFER FORMAT

20. Where members opt for commitments based on a positive list approach, consideration will also have to be given to the commitments schedule creation process.

21. Here we can learn from the request and offer format currently in use in the GATS negotiations. Liberalization requests for certain sectors or certain activities are submitted by a member country to another member country, which examines these requests and responds with offers. As WTO members will have already worked with this modality in the GATS negotiations, human and other resources will already be available, reducing any additional burden.

#### D. INDUSTRIAL CLASSIFICATIONS<sup>1</sup>

22. Given the possibility that a positive list approach could be adopted for a future investment framework, the Working Group will need to give some consideration to industrial classifications. Industrial classifications on which commitments will be based will obviously have a major impact on the transparency and effectiveness of those commitments.

23. Firstly, we will need to develop a standard industrial classification system among members. For example, the employment of a different descriptive system by each member country for effectively the same sectors would greatly reduce predictability for investors. Recent BITs use a negative list format for registration of exceptions, but generally note their reservations for specific sectors based on the industrial classifications of both countries. Because this system performs adequately where both countries understand each other's system of industrial classification, there is no need to develop a standard system. In the case of the WTO Agreement, however, the WTO's enormous, disparate membership will absolutely require a shared industrial classification system.

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<sup>1</sup> See Japanese Government submission to the April 2002 Working Group meeting (WT/WGTI/W/111).

24. Secondly, we will need to consider the format of industrial classifications. Sectors which are defined too widely or too narrowly will hinder the formation of specific commitments.

25. Our experience in developing the GATS should provide a reference for industrial classification. Under the GATS, schedules are created based on a service classification table (MTN.GNS/W/120) drawn from the United Nations CPC (Central Product Classification).<sup>2</sup> The table divides services into 155 categories, and for national treatment and market access commitments, member countries have denoted those service areas in which they can guarantee their commitments. (As for transparency and most-favoured-nation (MFN), commitments apply in principle to all service areas, although an exception registration system has been adopted for MFN). As was done in GATS, a non- service (or manufacturing) classification table could be newly created to form the basis for schedules for the future investment framework. It would also be worth examining the use of the Harmonized Commodity Description and Coding System which is employed for trade in goods.

26. We expect to see progress made in defining the scope of a future investment framework through the above work.

### **III. EXAMPLES OF EXISTING AGREEMENTS**

#### **A. BITS AND REGIONAL AGREEMENTS (CHAPTERS ON INVESTMENT)**

27. A number of agreements first distinguish between pre- and post-establishment investment and then stipulate different scopes and levels of obligation.

28. One concrete example is the German model BIT. For pre-establishment investment, it provides that “each contracting party shall in its territory promote as far as possible investments by nationals or companies of the other contracting party and admit such investments in accordance with its legislation. it shall in any case accord such investments fair and equitable treatment.” (Article 2.1, German model BIT). In the case of post-establishment investment, Article 4.1 notes that “investment by nationals or companies of either contracting party shall enjoy full protection and security in the territory of the other contracting party”, while for national treatment and MFN treatment, Article 3.1 states that “neither contracting party shall subject investments in its territory owned or controlled by nationals or companies of the other contracting party to treatment less favorable than it accords to investments of its own nationals or companies or to investments of nationals or companies of any third state”.

29. A number of agreements do not distinguish between pre- and post-establishment investment, but rather call for national treatment for all phases of investment activity (in other words, including both establishment and admission). Typical examples are the Japan-Korea BIT, NAFTA, and the US model BIT.

#### **B. FRAMEWORK AGREEMENT ON THE ASEAN INVESTMENT AREA (AIA)**

30. Article 7 of the AIA provides for national treatment. State parties must extend national treatment to ASEAN investors and investment, including both admission and establishment. However, each state party can submit a temporary exclusion list and a sensitive list of industries and measures that have an impact on investment where national treatment cannot be granted and measures

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<sup>2</sup> International classification standard for products. Designed to embrace in principle all goods which could be subject to trade, including not only those goods and services produced by economic activities, but also tangible assets such as land and intangible assets such as patent rights.

that affect investment. The AIA also contains provisions on the review and progressive elimination of these lists.<sup>3</sup>

## C. GATS

### 1. Positive list approach for national treatment and market access

31. Article XVII provides for national treatment, adopting a positive list approach. GATS obligates members to refrain from not only formal discrimination (de jure equality), but also effective discrimination (de facto equality). In other words, the issue is not formal non-discrimination in terms of member countries' measures influencing the supply of services, but rather the need to provide competitive conditions whereby suppliers of services from other state parties will not be less favorable than for domestic service suppliers.

32. In terms of provisions concerning investment entry restrictions, a market access obligation is prescribed in Article XVI. Like national treatment, members' commitments are made based on a positive list basis.

### 2. Most favourable nation treatment and the negative list approach (Reference)

33. Article II of the GATS covers MFN treatment. Member countries take on the general obligation of extending MFN treatment to measures having an impact on trade in services in all service areas. In other words, this is a negative list approach. However, member countries could register measures to be exempted from MFN treatment when the GATS was established. A right is also extended to new members at the time of WTO accession. The exemption period is up to 10 years as a rule.

### 3. General and other exceptions

34. As a general exception from the above commitments applying to all members, Article XIV provides that nothing in the GATS shall prevent the adoption or enforcement by any member of measures taken to protect public morals, maintain public order, or protect human, animal or plant life or health, or for reasons relating to taxation systems.

35. Article XII looks at restrictions adopted to protect the balance of payments, noting that "in the event of serious balance-of-payment and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments."

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<sup>3</sup> Temporary exclusion lists are to be reviewed every two years, and member states other than Vietnam, Laos and Myanmar must progressively eliminate these exclusions by 2003 (accelerated from the original date of 2010), or 2010 in the case of Vietnam, and 2015 for Laos and Myanmar. Sensitive lists are to be reviewed by January 2003.

**ANNEX**  
**EXAMPLE OF SCHEDULE OF SPECIFIC COMMITMENTS UNDER GATS**

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
<b>I. HORIZONTAL COMMITMENTS</b>			
ALL SECTORS INCLUDED IN THIS SCHEDULE	4) Unbound except for measures concerning the entry and temporary stay of a natural person who falls in one of the following categories:  i) Activities to direct a branch office as its head;	3) Unbound for research and development subsidies  4) Unbound except for measures concerning the categories of natural persons referred to in the market access column  Unbound for research and development subsidies	

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
<b>II. SECTOR-SPECIFIC COMMITMENTS</b>			
d) Services related to management consulting	1) Unbound 2) None 3) The number of licences conferred to service suppliers may be limited.  Unbound except as indicated in HORIZONTAL COMMITMENTS	1) Unbound 2) None 3) Unbound except as indicated in HORIZONTAL COMMITMENTS 4) Unbound	