WORLD TRADE ORGANIZATION

WT/WGTI/W/118
4 June 2002

(02-3057)

Working Group on the Relationship between Trade and Investment

NON-DISCRIMINATION
MOST-FAVOURED-NATION TREATMENT AND NATIONAL TREATMENT

Note by the Secretariat

EXECUTIVE SUMMARY

Non-discrimination is a core policy-making principle of international trade and investment agreements. It is the principle that underwrites most directly the process of international economic integration, since it binds a treaty's participants together by guaranteeing that none of them will be picked out and treated unfavourably on the grounds of their nationality. It also brings a number of important commercial, legal and administrative benefits to a treaty's participants.

The two most widely used standards of non-discrimination are most-favoured-nation (MFN) treatment and national treatment. These developed originally in the context of trade agreements, but they are now routinely incorporated also in international investment agreements. Many investment agreements contain other standards, such as "fair and equitable treatment", that are not familiar in trade agreements but that can have a bearing on the application of the principle of non-discrimination.

The GATT and the GATS apply the principle of non-discrimination both at the border and inside the border, covering market access as well as conditions of competition in the domestic market. Some international investment agreements follow the same pattern, and apply the rule of non-discrimination at both the pre-establishment (market access) stage and the post-establishment stage of investment. However, the majority of them, particularly bilateral investment treaties, apply the rule of non-discrimination only inside a host country's border, after an investment has already been admitted and established. In these agreements, MFN and national treatment do not apply to the pre-establishment stage of an investment, and they do not limit a government's ability to restrict or regulate the entry of foreign investment.

In international trade and investment agreements, governments aim to strike a balance between the benefits of applying the principle of non-discrimination on the one hand, and their need for flexibility to use discriminatory measures at times for specific purposes on the other. Most agreements therefore contain exceptions to the rule of non-discrimination, usually subject to carefully defined conditions. These allow governments to give preferential treatment to domestic products, producers and investors, or to certain of their commercial partners but not others, or to pursue domestic policy objectives that cannot be realized without practising some degree of discriminatory treatment.

Exceptions can be grouped into four categories: systemic exceptions – which carve out particular activities, sectors, or measures altogether from application of the rule of non-discrimination; general exceptions – which allow the use of discriminatory measures in certain circumstances, for example when regulating in the public interest or when participating in a regional integration agreement; country-specific exceptions – which allow individual participants to choose to exempt themselves from (or, depending on the legal formula used, to commit themselves to) the rule of

non-discrimination for particular activities, sectors or measures, sometimes with the expectation that these exemptions will be reduced (or commitments increased) over time; or *ad hoc* exceptions – which can be used to respond to unforeseen circumstances.

Securing protection against foreign competition for domestic producers can be an overriding policy objective, in certain sectors at least, for developed and developing countries. Generally speaking, this can be done in conjunction with a high, unconditional standard of MFN treatment, since MFN treatment does not interfere directly with a host country's ability to offer preferential treatment to domestic producers.

In the case of trade in goods, it can generally also be done in conjunction with a high, unconditional standard of national treatment – protection against imports can usually be achieved effectively through border measures such as import tariffs, making it unnecessary to differentiate the treatment of imported goods from locally produced goods once they have crossed into the domestic market.

However, in the case of trade in services and of foreign investment, border measures often cannot play the same role of protecting domestic producers and investors. Once a foreign service supplier or a foreign investor is established in a host country, no further cross-border transactions are necessarily involved, and competition takes place directly on the domestic market. The principal means for a government to offer protection to domestic producers and investors against foreign competition, then, is through the differential application of domestic laws and regulations inside the border. As a result, investment agreements deal with the national treatment standard in a variety of ways, from not including it at all to applying full or qualified national treatment at the pre-establishment and/or post-establishment stage of an investment. In the case of the GATS, for example, and many investment agreements too, the national treatment obligation is hedged with conditions and subject to country-specific exceptions, which can be extensive.

Scheduling country-specific exceptions takes on considerable importance for parties to an international investment agreement in arriving at a balanced outcome, between application of the principle of non-discrimination on the one hand, and flexibility for governments to pursue their economic development and public interest objectives on the other. In this context, three questions relating to the use of country-specific exceptions to the rule of non-discrimination in investment agreements can arise: do exceptions deter foreign investment?; should exceptions be scheduled "top-down", as in most investment agreements, or "bottom-up", as in the GATS?; and should exceptions be phased-out (or commitments phased-in) so that they operate only for a transitional period?[1]

As is the case of other individual topics listed in Paragraph 22 of the Doha Ministerial Declaration, non-discrimination needs to be viewed in conjunction with other elements of an international treaty: the treaty's scope and definition, its other substantive provisions, and, above all in the case of the GATS and international investment agreements, the specific commitments made under the treaty's provisions by individual member governments. Specific commitments can be crucial in qualifying the meaning and scope of application of the principle of non-discrimination.

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[1] For a discussion of these three questions in the context of the application of national treatment, see UNCTAD, National Treatment, Series on Issues in International Investment Agreements, 1999, pp. 63-69.

I. INTRODUCTION

1. This Note focuses on the ways in which the two main standards of non-discriminatory treatment – most-favoured-nation treatment and national treatment – have been applied in the GATT and the GATS and in international investment agreements, and reviews the discussions that have taken place in the Working Group on this issue.[2]

II. THE PRINCIPLE OF NON-DISCRIMINATION

2. The principle of non-discrimination aims to ensure that when governments apply policies to manage their international commercial transactions, the policies will be applied without regard to the origin, and in some instances the destination, of any particular transaction. Typically, this means without regard to the nationality of the goods, of the services and the service suppliers, or of the investors involved. It is synonymous with the idea of "equal treatment for all" under a common set of treaty rules. Equal treatment, in the sense of "identical" treatment, may not be practicable or lead to the desired result in all cases, so non-discrimination is often translated operationally in commercial treaties to mean effective equality of opportunity to compete on equivalent terms and conditions.

3. A number of advantages are associated with including a general principle of non-discrimination in commercial treaties:

- In a market economy, leaving commercial transactions to be concluded on the basis of price competition, without reference to their origin or destination, is generally believed to lead to a better allocation of resources for all parties concerned. It allows a country to benefit from the comparative advantage of each of its trading partners, and it allows them to benefit from the comparative advantage that they each enjoy. There is no systematic gain to be had in economic terms from favouring transactions with one particular trading partner over another simply on the grounds of nationality.

- As commercial restrictions are liberalized, the benefits are extended automatically to every participant in the treaty. In this sense, the principle of non-discrimination acts like a multiplier, opening up new market access opportunities to all of a country's commercial partners and spreading the benefits of liberalization.

- Legal security and confidence in sharing in the benefits of a unified, rules-based commercial treaty are increased, particularly for participants with less individual commercial or political influence than others.

- Transaction and administration costs are reduced (at customs, for example), and there is an economy of rule-making, when the same policy measures are applicable to all commercial transactions instead of being differentiated by origin or destination.

- For the private sector, the guarantee of non-discrimination translates into greater transparency, stability and predictability of government policies, and therefore into lower risk for their commercial activities.

[2] References to the discussions in the Working Group on this topic are to be found in the following Reports: WT/WGTI/M/4, paras. 44-49 and 57-74; M/5 paras. 27-33, 36-41and 63-64; M/6 paras. 41-51, 59-63 and 79; M/7 paras. 40-46; M/8 paras. 47-49 and 84-88; M/9 paras. 36-37 and 44: M/10 para. 9; M/11 paras. 39 and 45-48; M/12 paras. 15-22, 54 and 63; M/14 paras. 5, 26-35, 64, and 76; and M/15 paras. 44, 49 and 52. References to this topic in Members' communications can be found in: WT/WGTI/W/19, W/22, W/28, W/29, W/30, W/33, W/34, W/36, W/37, W/42, W/51, W/54, W/68, W/71, W/75, W/79, W/84, W/89, and W/104.

- Applying the rule of non-discrimination through international treaty law is often perceived by foreigners as offering a better guarantee than applying it solely through national legislation, which can be changed unilaterally.

4. Notwithstanding the advantages that are associated with the full application of the principle of non-discrimination, all commercial treaties allow for exceptions, qualifications, or limitations to their rules of non-discrimination. These provide governments with flexibility to accommodate various domestic policy needs – particularly to offer protection to domestic producers and investors, and to pursue other public interest objectives that cannot be realized without practising some degree of discriminatory treatment.

5. Many treaties provide systemic exceptions to the rule of non-discrimination, which carve out particular activities, sectors, or measures entirely from the scope of its application. The GATS, for example, exempts government procurement services from the scope of its MFN and national treatment obligations, and the GATT excludes the payment of subsidies exclusively to domestic producers from its National Treatment obligation. International investment agreements can contain similar exemptions – for matters such as taxation and government procurement, for specific sectors or industries, and for certain measures such as subsidies.

6. Most treaties contain general exceptions to the rule of non-discrimination that are permanently available for any eligible treaty participant to use, subject to specific conditions. Two standard categories of general exceptions apply in the GATT, the GATS, and international investment agreements. One covers exceptions for governments to regulate in the public interest, in areas such as the protection of national security and of public health, order and morals. The other covers exceptions for regional trade and economic integration agreements that allow parties to treat trade with each other better than they treat trade with the rest of the world.

7. Some treaties (the GATS and most international investment agreements, but not the GATT) allow each participant to choose and register individually country-specific exceptions to the rule of non-discrimination with regard to particular industries and/or measures. Country-specific exceptions to the national treatment obligation can be of particular importance in providing countries with flexibility to pursue their economic development policies and objectives. They are also used to provide flexibility in other areas of economic policy-making – examples given in the Working Group include education, training, employment and environmental protection.

8. Country-specific exceptions can be applied in two different ways: as exceptions to a general rule, or as commitments to a conditional rule.

- The first approach starts from the presumption that the principle of non-discrimination applies across-the-board, as a general rule. It then allows each participant to compile its own "negative" list of exemptions in the form of industries and/or measures where it will not apply the principle of non-discrimination (the so-called "top-down" approach). This approach is used widely in bilateral investment treaties.

- The second approach starts without any presumption about the application of the principle of non-discrimination, and then allows each participant to compile and register its own "positive" list of commitments in the form of industries and/or measures where it will apply the principle of non-discrimination (the so-called "bottom-up" approach). This approach is used in the GATS for scheduling market-access commitments and national treatment obligations, with related conditions and qualifications on the scope of their application.

In theory, these two approaches will converge at the same point. However, the "bottom-up" approach is viewed by many developing countries as the more flexible of the two, which best provides them

with a means of protecting fragile sectors of their economies against open competition from foreign products and producers. It allows them to lock in some of their commercial policies on a non-discriminatory basis, and to remove remaining discriminatory measures progressively over time, as circumstances permit.

9. Most treaties allow also for *ad hoc* exceptions to the principle of non-discrimination, to address any special needs of participants that arise on a case-by-case basis. Typically this is achieved through the granting of waivers from the rule of non-discrimination on a time-limited basis, subject to the approval of the other parties concerned.

III. STANDARDS OF MOST-FAVOURED-NATION TREATMENT AND NATIONAL TREATMENT IN THE GATT AND THE GATS

10. The two standards used in the GATT and the GATS for applying the principle of non-discrimination are most-favoured-nation (MFN) treatment and national treatment. They are both standards of relative treatment that a country should meet when applying its commercial policy measures. This means that they do not set a specific standard of non-discriminatory treatment, but instead establish the standard by reference to existing practice. MFN treatment aims to ensure that foreign products and producers receive equal treatment relative to that given to other foreign products and producers. National treatment aims to ensure that foreign products and producers do not receive less favourable treatment than that given to domestic products and producers.

11. One reason for using two different standards of non-discriminatory treatment, and for separating them operationally in this way, is to provide flexibility for countries to protect their domestic producers against foreign competition. Applying the MFN standard does not interfere with a country's ability to impose measures that give a competitive advantage to domestic producers over their foreign competitors. However, the national treatment standard, in its strictest sense, aims to ensure that inside the border the protection of domestic products and producers ceases, so that foreign products and producers are given an equal opportunity to compete for a share of the domestic market.

12. This is reflected most clearly in the GATT. Border measures, such as import tariffs, can be applied under the GATT to protect domestic producers against foreign competition. The MFN rule requires that the measures are applied equally to all imports, regardless of their origin. Once goods have crossed the border, however, the GATT's national treatment rule states that internal laws and regulations " … should not be applied to imported or domestic products so as to afford protection to domestic production". This differentiation of the roles of MFN and national treatment in the GATT is facilitated by the ease with which imports of goods can be checked by customs authorities at a country's border, and appropriate border measures can be imposed to protect domestic producers.

13. Trade in services does not lend itself so easily to a line being drawn between treatment at the border and treatment inside the border. In part, this is because some imports of services cannot be checked physically and taxed or regulated as they cross the border. More importantly in practice, and for the purpose of this Note, foreign services are often delivered directly into the domestic market through the establishment by a foreign service provider of a "commercial presence" in the territory of the country concerned. As a result, the services produced never actually cross the border; competition between foreign and domestic suppliers takes place directly in the local market place.

14. In the case of the GATS, therefore, in seeking to establish a workable rule of non-discrimination on the one hand, in combination with allowing a country flexibility to support its domestic producers on the other, account is taken of the fact that part of the job of protecting them is shifted inside the border onto the differential application of domestic laws and regulations in favour of domestic service suppliers. As a result, the GATS national treatment obligation is not cast in the same way – as an unconditional obligation – as it is in the GATT. The GATS allows Members to select the services sectors in which national treatment will apply, and to attach conditions and qualifications to

their national treatment obligations in respect of the measures they use, so as to be able to continue to offer preferential treatment to domestic service suppliers. At the same time, the importance of continuing to apply the MFN standard inside the border tends to take on more practical significance in the GATS than in the GATT – hence the reason why the GATS MFN standard is a general and unconditional obligation. Foreign service suppliers need to be able to count on the fact that they will not face differential treatment *vis-à-vis* each other in the host country market, even though they may not be treated as favourably under internal laws and regulations as their domestic competitors.

A. LEGAL FORMULATIONS OF MFN TREATMENT

15. The MFN rule obliges a government, when applying its commercial policies, to treat all WTO Members "equally" in the conduct of its commerce with them. If it negotiates improvements in the treatment it offers to one of its trading partners – so that this country becomes the most-favoured-nation – the MFN rule obliges it to extend the same improvements to all other WTO Members on a non-discriminatory basis.

16. Article I of the GATT, and Article II of the GATS, contain the MFN obligations for trade in goods and trade in services, respectively, and in most respects they are very similar.

17. The most-favoured-nation can be *any country with which a WTO Member trades*; it does not have to be another WTO Member. WTO Members therefore benefit from any trade advantages enjoyed by a third country that is not itself a WTO Member.[3]

18. The notion of *equal treatment* is addressed in the GATT as follows: " … any advantage, favour, privilege or immunity …" is to be " … accorded immediately and unconditionally to … all other contracting parties …". In most cases, providing the "same" treatment to goods from different sources is a practical proposition, since import duties and other trade taxes are the most usual border measures applied to trade in goods and these can be expressed in comparable, quantitative terms. In the case of trade in services, it is typically regulations, rather than taxes, which are the most important policy measures involved. The GATS MFN obligation requires that "treatment no less favourable" be accorded to services and service suppliers from different sources. This term underscores the qualitative notion of "equal treatment" used in the GATS, covering both *de jure* and *de facto* discrimination.

19. The MFN obligation applies under the GATT to *like* goods, and under the GATS to *like* services and *like* service suppliers. If products from different foreign suppliers are considered to be "like", they must be treated in the same way (or at least no less favourably) at a Member's border. If they are not "like", they can be treated differently. This allows a government to differentiate the trade policies it applies to different industries and sectors of its economy, protecting some against foreign competition more than others. In its most straightforward sense in the GATT, two products are "like" when they are classified under the same heading in a country's tariff schedule. The concept has acquired a broader meaning in practice, however, to include in certain circumstances the regulatory purpose of a measure (it must not have a protectionist intent) as well as the end-uses of products, which may be considered "like" if they are close substitutes and therefore directly competitive with each other. The concept of "like" in the context of the GATS MFN obligation has not been clarified beyond its literal meaning; it is not defined in the Agreement.

20. The MFN obligation is *unconditional* in both the GATT and the GATS. This means that when a WTO Member changes its trade policy (lowers a trade barrier, for example), it must apply the

[3] At the time the GATT was drafted, some GATT contracting parties were offering to third countries special trade preferences that they wished to preserve and not extend to other GATT members. It was necessary, therefore, to specifically exclude these preferences from the coverage of GATT Article I:1; the exclusions are listed in paragraphs 2 to 4 of that Article.

change automatically to all other WTO Members without requiring anything from them in return. Prior to taking a decision to change its trade policy, a Member may in fact try to negotiate reciprocal concessions from one or more of its trading partners. Once it has decided to make the change, however, the change must be applied to all WTO Members regardless of whether they were involved in the reciprocal bargaining process.[4]

B. LEGAL FORMULATIONS OF NATIONAL TREATMENT

21. The national treatment rule obliges a government, when applying its commercial policies, to treat foreign products and producers "equally" to the way it treats its own domestic products and producers. If the government changes the laws or regulations that affect the way that commercial transactions take place in its internal market, the changes must apply to all transactions, regardless of whether they involve foreign or domestic products or producers.

22. Article III of the GATT and Article XVII of the GATS contain the core national treatment obligations for trade in goods and trade in services, respectively. While there are similarities between the two, there are also differences. The most important is that national treatment is a rule of general application under the GATT, but in the case of the GATS it is a specific commitment related to the market access that a Member is prepared to grant. This is discussed further below.

23. The formulation used to define the notion of equal treatment in both the GATT and the GATS is "treatment no less favourable" than that accorded to domestic goods, services, and service suppliers. As noted above in the context of MFN treatment under the GATS, this allows a qualitative notion of "equal treatment" to be applied to the use of domestic regulations, where *de jure* equal treatment may still lead to *de facto* unequal treatment. In the GATS, the meaning of the term "less favourable" in the context of national treatment is defined further, as treatment "which modifies the conditions of competition in favour of [domestic] services or service suppliers". A similar interpretation has been given by some dispute settlement panels to the meaning of the phrase in the GATT national treatment rule.

24. The national treatment standard applies under the GATT to *like* goods, and under the GATS to *like* services and *like* service suppliers. By and large, the term "like" carries the same meaning as in the case of the MFN standard, but in the case of National Treatment it focuses, above all, on the competitive relationship in the marketplace that exists between different products, whether they are physically similar or not. With regard specifically to taxation, the interpretative note to GATT Article III:2 introduces the concept of "a directly competitive or substitutable product" for use in the context of deciding whether a tax might breach the condition that it not be applied so as to afford protection to domestic production.

C. EXCEPTIONS TO THE RULE OF NON-DISCRIMINATION

25. Both the GATT and the GATS allow systemic, general, and *ad hoc* exceptions to the rule of non-discrimination. The GATS allows, in addition, country-specific exceptions to its national treatment obligation, and one-time exceptions to its MFN obligation.

26. With regard to systemic exceptions, government procurement activities are exempted from having to meet both the MFN and the national treatment obligation in the GATS (Article XIII), and

[4] It is worth recalling that, from 1979 to 1994, the Tokyo Round "Code" Agreements were applied, by and large, on a *conditional* MFN basis; the MFN rule applied among signatories of the Codes, but signatories were not obliged to apply MFN treatment in areas of trade policy-making covered by the Codes to other GATT contracting parties. Conditional MFN treatment continues to apply in the plurilateral agreements on Government Procurement and Trade in Civil Aircraft.

from having to meet the national treatment obligation in the GATT (Article III:8(a)).[5] Also, under the GATT (Article III:8(b)) the national treatment obligation does not prevent the payment of subsidies exclusively to domestic producers.[6]

27. With regard to general exceptions, subject to specified conditions, both the GATT and the GATS exempt from the application of MFN and national treatment a range of public policy objectives.[7] These include the protection of national security and of public health, order and morals. In the case of MFN treatment, both the GATT and the GATS exempt preferential treatment granted to some foreign products and producers but not to others under regional trade agreements.[8] The GATT also contains a general exception to MFN treatment to allow developed countries to implement the Generalized System of Preferences, and apply lower tariffs on imports from developing and least-developed countries than the tariffs they apply on imports from other developed countries.[9] By facilitating and promoting the trade of developing and least-developed countries in this way, the expectation is that the progressive development of these countries' economies will benefit not just themselves but also their developed country trading partners, as their domestic markets expand and their demand for imports increases.

28. *Ad hoc* exceptions to the rules of MFN and national treatment in the GATT and the GATS can be granted through the WTO waiver provisions.[10]

29. Country-specific exceptions constitute the most extensive group of exceptions to the rule of non-discrimination under the GATS. They are not available under the GATT. In the GATS, they are used in particular to address the fact that protection of domestic service suppliers from foreign competition cannot necessarily be achieved at the border. Flexibility is therefore needed under the national treatment rule so as to be able to apply inside-the-border measures for this purpose

30. The MFN rule is a general obligation in the GATS, that applies unconditionally to all services and service suppliers, not just those that are included in a Member's Schedule of Concessions. However, country-specific exceptions were provided for in the GATS (Article II:2) at the time of its entry into force, so as to allow Members to offer better market access to some foreign services and foreign service suppliers than to others. Members were able to register their own exemptions from MFN treatment, and maintain them for a time that should not, in principle, exceed ten years.

31. The GATS national treatment rule is classified not as a general obligation but as a specific commitment that is related to the market access commitments that a Member grants. It need apply only in the services sectors inscribed as market access commitments in a Member's Schedule, and it is subject to any conditions and qualifications set out in that Schedule. Where a Member does not make

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[5] In the GATT, there is no explicit exemption from the MFN obligation for government procurement activities, but an exemption can be implied by the provisions of GATT Article I:1 and Article XVII:2.

[6] The GATS does not contain any similar exemption for subsidies. However, in practice a Member applying national treatment in a particular sector and wishing to offer subsidies exclusively to domestic service suppliers could include a condition to that effect in its Schedule of Concessions and achieve a similar end result through a country-specific exception, although not necessarily one that is as it is permanent as under the GATT.

[7] The conditions include the requirement that any discrimination involved should not be "arbitrary or unjustifiable". GATT Article XX and GATS Articles XIV and XIV*bis* list eligible regulatory purposes that the measures can serve.

[8] GATT Article XXIV and GATS Article V. In the case of the GATT (but not the GATS), general exceptions to the rule of non-discrimination are also permitted under specific circumstances in the application of restrictions to safeguard the balance-of-payments (Article XIV). This provision was needed during the period of currency inconvertibility, but it has not been invoked since 1961.

[9] The exception is contained in the 1979 CONTRACTING PARTIES Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, known usually as the "Enabling Clause" (L/4903).

[10] Article IX:3 of the Marrakesh Agreement Establishing the World Trade Organization.

a market access commitment in a particular services sector, it does not have to undertake a National Treatment obligation in that sector either.[11] At the same time, the GATS sets the expectation that the general level of specific commitments undertaken by Members will increase over time, through progressive liberalization under successive rounds of negotiations.

32. With regard to methods of scheduling country-specific exceptions and commitments to the rule of non-discrimination (described above in paragraph 8), the GATS allows each Member to select its commitments to national treatment by scheduling (bottom-up) a "positive" list of service sectors to which it will apply national treatment, coupled as necessary with conditions and qualifications on the application of national treatment to measures used in these sectors. At the time of entry into force of the GATS, temporary exemptions from the general MFN obligation could be taken top-down, by compiling a "negative" list of measures to which a Member would not apply MFN treatment.

IV. THE NON-DISCRIMINATION PRINCIPLE IN INTERNATIONAL INVESTMENT AGREEMENTS

33. The aims and advantages of applying the principle of non-discrimination in international investment agreements (IIAs) – bilateral, regional or multilateral – are much the same as those associated with applying it in trade agreements: it helps to produce a better international allocation of resources, in this case not only capital but also technology and other assets associated with foreign investment; it acts as a catalyst to spread the benefits of liberalization; it provides predictability of treatment for all participants under a unified, rules-based system; it reduces transaction and administration costs; it offers foreign investors a more transparent, stable and predictable policy environment; and it reinforces confidence in a host country's national legislation.

34. The challenge facing negotiators of IIAs is similar to that facing trade negotiators: to find a workable balance between the benefits of applying the principle of non-discrimination on the one hand, while retaining flexibility to support domestic investors and producers and to attain certain other domestic policy objectives on the other.

A. STANDARDS OF TREATMENT

35. As in the case of trade agreements, MFN treatment and national treatment are the two standards most commonly used in IIAs for applying the principle of non-discrimination. IIAs that contain MFN and national treatment obligations also allow for exceptions to them – from a menu that can include country-specific exceptions, as well as systemic and general exceptions – so as to provide host countries with policy flexibility for development purposes, for regional integration agreements, to regulate in the public interest, and so on. They are described below, along with other detailed aspects of the application of MFN and national treatment in the context of IIAs.

36. Some IIAs contain other standards of treatment, based on customary international law, that have a bearing on the application of the principle of non-discrimination. These are generally less familiar from the point of view of trade agreements.

37. The most important of them is the standard of fair and equitable treatment, which is often coupled with a standard of full protection and security. It is often used in combination with MFN and national treatment, or in combination with MFN treatment alone.[12] A typical formulation is:

[11] More precisely, a GATS schedule shows under each mode of supply whether a Member intends to grant full market access and/or national treatment, no market access and/or national treatment, or conditioned market access and/or national treatment.

[12] The "fair and equitable treatment" standard is used, generally in conjunction with MFN and national treatment, for example in the Model bilateral investment agreements of Chile, China, France, Germany, Switzerland, the United Kingdom and the United States, and in regional agreements such as the NAFTA and

Each Party shall at all times accord to covered investments and investors fair and equitable treatment and full protection and security in its territory.

38. UNCTAD notes that the use of the standard of "fair and equitable treatment" in bilateral investment treaties dates from 1967, and it has assumed prominence in IIAs in recent years.[13] It serves two main purposes: to act as a yardstick by which relations between foreign investors and host country governments can be assessed, and as a signal from host countries of their willingness to accommodate foreign investment on terms that take into account the interests of the foreign investor.[14]

39. Fair and equitable treatment has its roots in customary international law. It is generally considered to cover the principle of non-discrimination, along with other legal principles related to the treatment of foreign investors, but in a more abstract sense than the standards of MFN and national treatment. In particular, it is an absolute standard, which may be measured in terms of the plain meaning of the term, but more usually has come to be regarded as a minimum international standard of treatment.[15] It therefore has to be interpreted on a case-by-case basis in the light of the particular circumstances in which it is used. UNCTAD suggests that a challenge in this area of international law is to identify what common elements the standard might contain.[16] In contrast, MFN and national treatment are measured relative to the yardstick of the actual treatment provided to other foreign or domestic investors or investments, which gives these standards a more precise and predictable quality.

40. Fair and equitable treatment is not necessarily a lower standard of treatment than MFN or national treatment. In some circumstances, it may be preferred to national treatment by a foreign investor where the standard of treatment of national investors in a host country falls below minimum international norms. Also, other legal principles contained within it, such as prompt and effective compensation in case of expropriation or harm to investment, have a particular value of their own. In the context of applying the principle of non-discrimination, however, in most instances the role of the fair and equitable treatment standard in an IIA would appear to be one of backing up the more specific standards of MFN and national treatment, or in some cases of substituting for them, particularly in the context of applying the principle to the pre-establishment stage of an investment.

41. Some IIAs combine the standard of fair and equitable treatment with a specific non-discrimination standard, couched in terms of the avoidance of arbitrary, unreasonable and discriminatory measures.[17] A typical formulation is:

Neither Party shall impair by arbitrary, unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of covered investments in its territory.

UNCTAD suggests that this represents a minimum international standard of treatment, but that discrimination based purely on the nationality of an investor does not violate it as such – there may be valid reasons why a country may wish to give preferential treatment to investors of a particular

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COMESA. (UNCTAD, International Investment Instruments: A Compendium, Volume III, pp. 75, 107, 143-195), as well as in the bilateral investment agreements of Canada (WT/WGTI/W/19), the EC member States (WT/WGTI/W/30), Korea (WT/WGTI/W/42), and Turkey (WT(WGTI/W/51). UNCTAD cites a number of IIAs (which it characterizes as "unusual") in which the standard of fair and equitable treatment substitutes for national treatment. One example is the ASEAN Agreement for the Protection and Promotion of Investments. (UNCTAD, National Treatment, Series on Issues in International Investment Agreements, 1999, pp. 15-16).

[13] UNCTAD, Bilateral Investment Treaties in the mid-1990s, 1998, pp. 53-55.

[14] For a full discussion, see UNCTAD, Fair and Equitable Treatment, Series on Issues in International Investment Agreements, 1999.

[15] See OECD, "Council Resolution of 12 October 1967 on the Draft Convention on the Protection of Foreign Property", *International Legal Materials*, (1968) Vol. 7, p. 117.

[16] UNCTAD, *Ibid*, p. 5.

[17] UNCTAD, Bilateral Investment Treaties in the Mid-1990s (1998), p. 55.

nationality. Consequently, the addition of MFN treatment in an IIA can substantially improve the situation for foreign investors that would otherwise prevail under customary international law.[18]

42. Finally, many bilateral investment treaties contain a specific investment protection provision guaranteeing foreign investors non-discriminatory treatment with respect to indemnification or compensation for non-commercial losses, as a result, for example, of armed conflict or civil strife or similar circumstances, and in some instances of natural disasters too.[19]

B. MFN TREATMENT AND NATIONAL TREATMENT

43. Including the MFN treatment and national treatment standards in IIAs tends to raise more complex issues than including them in trade agreements. One reason is that the entry of foreign investment into a host country – its admission and establishment, which corresponds to market access in trade agreements – is in most cases a more delicate issue, particularly politically, than is the entry of goods and services for circulation on the domestic market. Consequently, the application of the rule of non-discrimination to the pre-establishment stage of foreign investment is sensitive.[20] Even when non-discrimination is restricted to the post-establishment stage of an investment, the application of the full national treatment obligation limits a host country's ability to protect its domestic investors against foreign competition through the differential application of laws and regulations. Also, the activities of foreign investors in a host country can be diverse – typically covering at the post-establishment stage alone the operation, maintenance, use, sale or liquidation of an investment – so that the potential range of policies and measures that is subject to the principle of non-discrimination, and the national treatment obligation in particular, is correspondingly broad.

44. Of the two standards, MFN treatment is generally the less controversial, since it does not impinge as directly as does national treatment on a host country's ability to provide support and protection to domestic investment and business interests.[21] What counts most for a host country government is likely to be flexibility to differentiate between national investments and foreign investments, rather than among foreign investments. Nonetheless, a host country may wish to exercise selective controls over which foreign investments to admit, and on what terms they are to be admitted, particularly in light of its policies to promote national investments. It may, for example, use screening policies on a case-by-case basis to select which foreign investments it considers to be compatible with its domestic industrial policy. It may also wish to continue to offer certain foreign investors, but not others, investment incentives and other benefits after they have established locally and begun production. In such instances, the host country would not be willing to offer full MFN treatment at the pre-establishment or post-establishment stage of investment.[22]

45. Whether or not to apply national treatment to the entry of foreign investment is a particularly sensitive issue for many host countries. According to UNCTAD, until relatively recently national treatment in IIAs was seen to be relevant almost exclusively to the post-establishment treatment of

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[18] UNCTAD, Most-Favoured-Nation Treatment, Series on Issues in International Investment Agreements, 1999, p. 35.

[19] WT/WGTI/W/19, Communication from Canada. This is a common element of Japan's bilateral investment agreements (WT/WGTI/W/34).

[20] For a discussion of this, see UNCTAD, Admission and Establishment, Series on Issues in International Investment Agreements, 1999.

[21] UNCTAD concludes that "the MFN principle is itself flexible in the sense that it allows in-built exceptions that could accommodate development concerns of host countries". UNCTAD, Most-Favoured-Nation Treatment, Series on Issues in International Investment Agreements, 1999, p. 3.

[22] UNCTAD notes that in the case of investment incentive schemes, the MFN obligation would only apply to general incentive programmes designed for an industry or sector as a whole. It would not oblige a host country to extend the benefits of so-called "one-off deals", in which a special benefit is provided to a particular foreign investor, to all other foreign investors. UNCTAD, Most-Favoured-Nation Treatment, Series on Issues in International Investment Agreements, 1999, p. 30.

investment; extending it to the pre-establishment stage of investment in some recent IIAs, notably the bilateral investment treaties of Canada and the United States, as well as regional agreements such as the NAFTA, is a "revolution" for many countries.[23] When applied in full, it places foreign investors on an equal footing with national investors, and removes to a very large extent the means that a host-country government has of supporting and protecting its own national investors.[24] At the pre-establishment stage of investment, for example, full national treatment would prevent a host-country government from reserving certain sectors or industries exclusively for national investors, or attaching special conditions to foreign investment (even on an MFN-basis) that are not applicable to national investment. At the post-establishment stage, it would prevent a host country government from subsidizing or providing other benefits exclusively to national investments, or from exercising stricter regulatory control over foreign investments than over national investments, in areas such as environmental or employment policy. As a result, the type and extent of exceptions and conditions attached to the rule of national treatment, that may be required in order to retain an appropriate degree of host country discretion in investment matters, become all important.

46. The practical implication of these considerations is that the application of the rule of non-discrimination in IIAs ranges from a strict and comprehensive formulation in some, to a much looser and narrower formulation in others. Under a comprehensive formulation, an IIA requires a host country to accord to a foreign investor no less favourable treatment, under all applicable laws and regulations, than it accords to other foreign investors (MFN treatment) and to national investors (national treatment), in like circumstances, with respect to the establishment and acquisition (pre-establishment treatment), and the operation, maintenance, use, sale or liquidation (post-establishment treatment) of covered investments.[25] For the time being, very few IIAs approach this level of ambition. Most deal with post-establishment treatment only, focusing on investment protection rather than on market access, and most contain exceptions that limit the scope of application of the rule of non-discrimination, particularly the national treatment obligation, in some cases considerably.

1. "Pre-establishment" and "post-establishment" treatment

47. A crucial distinction exists in most IIAs in the application of MFN and national treatment between the "pre-establishment" and the "post-establishment" stages of investment.

48. Two main approaches are used in IIAs with regard to the pre-establishment (admission and establishment) treatment of foreign investment.

49. One approach is for foreign investments to be admitted in accordance with the domestic laws and regulations of the host country, coupled in many instances with a requirement that each party shall create favourable conditions for investors of other parties to make investments in its territory. This is the formula used in the majority of bilateral investment treaties. An example is:

> *Each Contracting Party shall promote investments by investors of the other Contracting Party and admit such investments in accordance with its laws and regulations. It shall accord such investments fair and equitable treatment, and shall not impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments.*[26]

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[23] UNCTAD, National Treatment, Series on Issues in International Investment Agreements, 1999, p. 4.

[24] UNCTAD notes: " ... no country has so far seen itself in a position to grant national treatment without qualifications, especially when it comes to the establishment of an investment." *Ibid*, p. 1.

[25] An example is the Model bilateral investment treaty of the United States, whose language on non-discrimination is reproduced in paragraph 52 of this Note.

[26] This, or similar language, is contained in the Model bilateral investment treaties of Chile, China, France, Germany, Switzerland, and the United Kingdom. (UNCTAD, International Investment Instruments: A

These treaties do not limit a party's ability to regulate or restrict the entry of foreign investment, and MFN and national treatment do not apply to the pre-establishment stage of an investment. Generally, however, these treaties do apply MFN and national treatment at the "post-establishment" stage of an investment, after its admission to the host country.[27]

50. Limiting the application of MFN and national treatment to the post-establishment stage of an investment can be achieved in several ways. The most usual is for an IIA to make it clear that these obligations apply only to investments that have already been admitted and established in the territory of the host country. A typical example is:

> *A Contracting Party shall accord investments of the investors of one Contracting Party in its territory a treatment which is no less favourable than that accorded to investments made by its own investors or by investors of any third country, whichever is the most favourable*.[28]

51. The second approach to the admission and establishment of foreign investment is to apply MFN treatment alone, or MFN and national treatment, to the pre-establishment as well as to the post-establishment stage of investment. MFN and national treatment are applied at the pre-establishment stage of an investment in most bilateral investment treaties of the United States and the recent ones of Canada, as well as in some regional integration agreements that contain investment provisions, such as NAFTA and MERCOSUR. Naturally, in all cases the benefits of MFN and national treatment apply only to investors and/or investments of parties to these agreements, not to third countries. Although this approach is far less common in IIAs for the time being, UNCTAD notes a movement recently towards the wider application of MFN treatment at the pre-establishment stage of an investment, and suggests that non-discrimination at this market access stage is becoming an increasingly important issue for host countries that want to attract more foreign direct investment (FDI).[29]

52. Application of MFN and national treatment in an IIA to the pre-establishment as well as to the post-establishment stage of an investment is typically achieved by listing admission and establishment as falling within the scope of activities to which the obligations apply. For example, the United States model bilateral investment treaty states:

> *With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favourable than that it accords, in like situations, to investment in its territory of its own nationals or companies (hereinafter "national treatment") or to investments in its territory of nationals or companies of a third country (hereinafter "most-favoured-nation treatment"), whichever is most favourable (hereinafter "national and most-favoured-nation treatment")*.[30]

Compendium, (1996-2001), Volume III, pp. 143-193). Most of the BITs concluded by the EC member States follow this pattern (WT/WGTI/W30). In some instances, MFN treatment, but not national treatment, is required at the pre-establishment stage of investment. This is a common element of Japan's bilateral investment agreements (WT/WGTI/W/34).

[27] This is a standard feature, for example, of the Model bilateral investment treaties of Chile, France, Germany, Switzerland, and the United Kingdom (UNCTAD, *Ibid*), as well as all of the BITs concluded by the EC member States (WT/WGTI/W30) and India's Bilateral Agreements for the Promotion and Protection of Investments (WT/WGTI/W/71).

[28] WT/WGTI/W/75, Communication from Japan.

[29] UNCTAD, Most-Favoured-Nation Treatment, UNCTAD Series on Issues in International Investment Agreements, 1999, p. 15.

[30] WT/WGTI/W/29, Communication from the United States. The NAFTA uses a similar formulation.

2. Exceptions

53. All IIAs provide for exceptions to the principle of non-discrimination. These are important in determining the scope of application of MFN and national treatment. Exceptions to the national treatment obligation are generally more numerous in IIAs than are exceptions to MFN treatment.

54. Many IIAs contain systemic exceptions that exclude particular activities, sectors or measures from application of the rule of non-discrimination, and the range of potential exclusions is much greater than in the case of trade agreements. In some cases, these are based on reciprocity considerations. For example, all IIAs dealing with taxation matters exempt them from the MFN obligation, to avoid undermining the purpose of separate, reciprocal, bilateral treaties on the avoidance of double taxation.[31] Other examples where separate reciprocal arrangements can take precedence over IIAs are agriculture, fisheries, and maritime, air and road transportation.[32] Some IIAs exclude matters falling under the GATT/WTO.[33] Some exclude the protection of intellectual property rights, in recognition of separate obligations a treaty's parties may have under other international intellectual property rights agreements.[34] Some IIAs exclude government procurement activities from the rule of non-discrimination, some exclude sectors controlled by state-owned enterprises, some exclude cultural industries, and some exclude subsidies.[35]

55. Most IIAs provide general exceptions to the rule of non-discrimination that are permanently available for any eligible treaty participant to invoke. Typically, these cover much the same policy areas as trade agreements – measures a host country applies in pursuit of the public interest in areas such as public health, order and morals, although the protection of national security is not generally covered in bilateral investment treaties. They cover also measures applied pursuant to regional trade and economic integration agreements.[36]

56. Many IIAs allow for country-specific exceptions. In contrast to the bottom-up, "positive" list approach used in the GATS, most IIAs provide for exceptions and reservations to their MFN and national treatment obligations through a top-down, "negative" list approach. Where an IIA covers pre-establishment as well as post-establishment treatment of an investment, the "negative" list of exceptions is generally longer than when post-establishment treatment only is involved.[37] It should be

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[31] UNCTAD, Most-Favoured-Nation Treatment, UNCTAD Series on Issues in International Investment Agreements, 1999, p. 18. Examples have been given of the bilateral investment treaties of the EC member States (WT/WGTI/W/30), India (WT/WGTI/W/71), and Korea (WT/WGTI/W/42).

[32] UNCTAD, Most-Favoured-Nation Treatment, UNCTAD Series on Issues in International Investment Agreements, 1999, pp. 7-8.

[33] For example, the bilateral investment treaty between Canada and Trinidad and Tobago (1995) exempts from MFN treatment advantages accorded to third countries under any bilateral agreement "negotiated within the framework of the GATT or its successor organization and liberalizing trade in services". The bilateral investment treaty between the United States and Jamaica (1994) exempts from MFN treatment advantages accorded to nationals or companies of any third country by virtue of "that Party's binding obligations under any multilateral international agreement under the framework of the General Agreement on Tariffs and Trade".

[34] In most US bilateral investment treaties, for example, MFN and national treatment obligations do not apply to procedures provided for in multilateral agreements concluded under the auspices of WIPO relating to the acquisition or maintenance of intellectual property rights. The bilateral investment treaty between Hong Kong, China and Japan (1997) states that, notwithstanding the inclusion of intellectual property in the definition of investment, nothing in the agreement shall be construed so as to derogate from the rights and obligations of the parties under international agreements relating to intellectual property rights.

[35] E.g., NAFTA excludes government procurement, cultural industries, and subsidies. On the other hand, some recent bilateral investment treaties include specific obligations on parties to apply MFN treatment in respect of investment incentives, or include provisions aimed at avoiding practices that subject foreign investment to certain restrictive and possibly distortive conditions. (WT/WGTI/W/77).

[36] The example of the Mexico/Costa Rica Free Trade Agreement is cited in WT/WGTI/W/68.

[37] UNCTAD notes, for example, that in the case of the bilateral investment treaty between the United States and Jamaica, the United States lists 17 exceptions to MFN treatment and 13 exceptions to national

recalled in this regard that most IIAs apply only to the post-establishment stage of an investment. In IIAs where national treatment is provided at both the pre-establishment and the post-establishment stages of an investment, a schedule of specific reservations is generally annexed to the agreement. This schedule usually takes a "negative" list approach, under which the State undertakes to grant national treatment in all investment stages and with respect to all laws, regulations and sectors, with the exception of the reservations expressly included in the schedule.[38] For example, the US Model bilateral investment treaty provides the right for each party to adopt or maintain exceptions falling within one of the sectors or matters listed in the annex to the agreement.[39] MERCOSUR follows a similar pattern with respect to investments by its member States, subject to the right of each of them to maintain exceptional limitations for a transitional period, which must be detailed in an annex to the Protocol.[40]

3. MFN treatment, national treatment, or the better of the two

57. MFN treatment and national treatment are separate but closely related standards of treatment. Situations can arise in which the two standards conflict, particularly when they are used together in different IIAs whose detailed terms and conditions vary.[41]

58. The following is an example. Host country A concludes a bilateral investment treaty with country B, under which investors from country B are entitled to a special investment incentive that is not available to national investors in country A. Country A has an existing bilateral investment treaty with country C that entitles its investors to post-establishment MFN and national treatment but not to any special investment incentive. It follows, then, that investors from country C can claim entitlement to the investment incentive under the MFN standard, but not under the national treatment standard. In interpreting the bilateral investment treaty between country A and country C, which standard should prevail?

59. Some IIAs do not specify which standard should prevail in the event of a conflict between the two. Examples are the Model bilateral investment treaties of Germany, Portugal, and the United Kingdom.[42] Others specify that the standard that is the more, or the most, favourable to the foreign investor and/or investment applies. Examples are the model bilateral investment treaties of Canada, Chile, many of the EC member States, Korea, Switzerland, Turkey, and the United States, as well as in the NAFTA.[43] In the example given above, this would mean that the MFN standard would prevail, since it would offer foreign investors from country C "better" treatment than national treatment. All foreign investors would be entitled to the same preferential treatment given to foreign investors from country B. The formula can be applied to the pre-establishment and the post-establishment stage of investment. An example from the United States Model bilateral investment treaty was cited in paragraph 52.

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treatment, while Jamaica lists four exceptions and one exception, respectively. UNCTAD, National Treatment, UNCTAD Series on Issues in International Investment Agreements, 1999, p. 53, fn. 18.

[38] WT/WGTI/W/68, Communication from Costa Rica.

[39] US Model investment treaty, Article II(2).

[40] See UNCTAD, International Investment Instruments: A Compendium, (1996-2000) Volume II, p. 520 for listed exceptions.

[41] This would not seem to be as relevant to a multilateral investment agreement, since the MFN and national treatment standards would both be measured from the same point of departure for all participants alike. However, it could be relevant if a multilateral investment agreement needed to operate in parallel with obligations of some of the parties concerned under existing bilateral investment agreements.

[42] UNCTAD, International Investment Instruments: A Compendium, (1996-2000) Volume III, pp. 169 and 187, and UNCTAD, Bilateral Investment Treaties in the Mid-1990s, (1998) p. 268.

[43] UNCTAD, *Ibid*, (1996-2000), pp. 145, 161, 179, and 197, and WT/WGTI/W/19, W/28, W/29, W/30, W/42 and W/51.

60. Evidently, using the formulation in an IIA that the better of MFN and national treatment will apply can lead to all foreign investors being treated better than national investors. More probably, however, an IIA will contain exceptions or limitations to national treatment, with the result that foreign investors will be treated better than their domestic counterparts in certain respects, but not as well in others.

4. "Investment" or "investor"

61. As in the case of trade agreements, the principle of non-discrimination needs an objective basis upon which it can be applied in an IIA, that makes it clear precisely what is to receive MFN and national treatment. In the case of the GATT, that basis is products, and in the case of the GATS it is services and service providers. Some IIAs take the "investment" as the objective basis, some take the "investor", and some apply to both.

62. In most cases, the explanation for the difference in wording between IIAs on this issue relates to the definitions used in a particular IIA. As noted in WT/WGTI/W/108, some IIAs use and define only the term "investment", some use and define both "investment" and "investor"; the same approach is carried over to specify the scope of an IIA's non-discrimination provisions. For example, the bilateral investment treaties of the United States grant MFN and national treatment only to "investment", but at the same time they do not contain reference to, nor define, the term "investor". In contrast, the NAFTA and the Model investment treaty of Switzerland use and define also the term "investor", and they entitle both foreign investors and their investments to MFN and national treatment.[44]

63. It has been stated in the Working Group that the choice between "investment", "investor" and "investment and investor" can have substantive implications that go beyond the simple definitional issue, in certain contexts at least. At the pre-establishment stage of investment, it has been suggested that it may be necessary to clarify whether the host country undertakes to grant MFN and national treatment to potential investors who have not yet established an investment but intend to do so.[45] As regards the post-establishment stage of investment, one Member has noted that its practice is to apply national treatment to foreign investments, but not to foreign investors.[46]

5. "Equal" treatment

64. Most IIAs use the term "treatment no less favourable" to establish the basis of comparison between foreign investments for applying the MFN standard, and between foreign and national investments for applying the national treatment standard.[47] The rationale for this was explained earlier in this Note in relation to the GATT and the GATS (see paragraphs 18 and 23). A standard of "identical" treatment can be applied when there are clear and objective (usually quantitative) grounds for measuring it, as is the case, for example, of *ad valorem* tariffs under the GATT MFN obligation. However, this standard is more difficult to apply to laws, regulations and other measures that involve a qualitative comparison of the treatment proffered and, often, also administrative discretion in their application. In the main, it is these measures, rather than quantitative measures, that affect the treatment of investment in a host country.

65. The standard of "treatment no less favourable" is therefore typically used in IIAs, with the aim of creating effective opportunities for foreign investment to compete with domestic investment on

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[44] UNCTAD, International Investment Instruments: A Compendium, (1996-2000) Vol III, pp. 73 and 177.

[45] WT/WGTI/W/68, Communication from Costa Rica.

[46] WT/WGTI/W/71, Communication from India.

[47] This is the formulation used in the Model investment agreements of Chile, France, Germany, the Netherlands, Portugal, Switzerland, the United Kingdom and the United States, as well as in the NAFTA. UNCTAD, International Investment Instruments: A Compendium, (1996-2000) Vol III, pp. 73 and 143-193.

equivalent terms and conditions. This means that justifiable differences can exist in the treatment accorded, as long as the overall competitive opportunities of foreign investments in the host country market are maintained.

66. The formulation of "treatment no less favourable" implies that foreign investors may be treated more favourably than national investors in the context of the application of national treatment. For some host countries, that may indeed be the intention – to offer positive discrimination in favour of foreign investors in order to attract foreign investment. To the extent that this is not the intended consequence, however, some IIAs specifically exclude that possibility. For example, according to a 1992 World Bank survey of 51 investment codes adopted by developing countries, many have favoured a definition of national treatment that excludes the possibility of granting more favourable treatment to foreign investors, through a test of treatment similar or equal to that given to local investors.[48]

6. "Like" circumstances

67. Since MFN and national treatment are relative standards of treatment, that are to be measured against the treatment given to existing producers and investors, some IIAs follow the practice of the GATT and the GATS in specifying that they apply only between investments that are in "like" or "similar" circumstances.[49] This indicates that investors do not have to be treated equally irrespective of their activities in a host country. Different treatment is justified if investors are in different objective circumstances, such as operating in different sectors of activity. For example, it would not necessarily breach MFN or national treatment in an IIA if a host country limited subsidies to investors in high technology industries, but not others, or if it set a threshold relating to the size of the workforce employed as a condition for both national and foreign investors to receive a subsidy. Only if investors of a particular nationality, or foreign investors as a group, found themselves systematically excluded, or if the purpose of a measure were found to be deliberately protectionist, would there be grounds for considering *de facto* discrimination.

68. Including the term "in like circumstances" in an IIA raises the question of what relevant criteria should be used to determine which circumstances are "like", and which are different. One view is that this can encourage creative thinking on the part of host countries to define "different" circumstances, and that it is preferable not to use the term at all. This leaves open the scope for comparison of the treatment offered to investors, *vis-à-vis* other foreign investors and national investors.

V. DISCUSSIONS IN THE WORKING GROUP

69. It has been noted in the Working Group that MFN and national treatment are core provisions of most IIAs, and that their application can vary according to a number of factors. These are, in particular: whether an IIA applies to the post-establishment treatment of investment only, or to pre-establishment treatment and admission of investment too; appropriate means of striking a proper balance between applying the rule of non-discrimination on the one hand, and maintaining policy flexibility to address vital economic, development, and public interest objectives on the other; and appropriate forms of exceptions and limitations attached to non-discrimination provisions, particularly to national treatment. In addition, a number of comments have been made on more detailed aspects of the formulation of the rule of non-discrimination.

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[48] World Bank, Legal Framework for the Treatment of Foreign Investment, Volume 1: Survey of Existing Instruments, (Washington, 1992).

[49] The term is used in bilateral investment treaties of the United States, in the Canada-Chile Free Trade Agreement, and in the NAFTA.

70. Although the principle of non-discrimination and the standards of MFN and national treatment have become common features of IIAs, some have suggested that the different ways in which they are applied operationally in separate IIAs decreases their value considerably. That is particularly the case for the numerous bilateral investment treaties that exist today. Notwithstanding the MFN commitments incorporated into most of them, they have created a fragmented web of different legal standards of treatment for investors from different countries. This is detrimental both to the ease and efficiency with which governments can administer the agreements, and to the transparency, stability and predictability of investment conditions that private investors are seeking. This makes it desirable to take a multilateral approach and to establish a common standard of non-discrimination applicable to all.

71. Some others have doubted that the diversity of bilateral investment treaties undermines the value of their respective non-discrimination provisions in any significant way, and suggested, in any event, that from a developing country's point of view the flexibility of these agreements outweigh any disadvantages they may have in this respect.

A. PRE- AND POST-ESTABLISHMENT TREATMENT

72. A prominent theme of discussion, particularly with regard to national treatment, has been whether the principle of non-discrimination should apply only to the post-establishment stage of investment, which is common practice in most IIAs, particularly bilateral investment treaties, or at the pre-establishment stage too, which for the time being is not.

73. It has been noted that under customary international law there is no "right to invest" or "right of admission" for foreign investors, and there are very few protections for foreign investment once established. Any legal rights and obligations in this field are the result of international legal instruments that States choose to accept. The related concept of the "right of establishment" has been created in foreign investment law, but this typically occurs only in the context of deep economic integration agreements, such as an economic union; it is not a standard feature of IIAs.

74. In this regard, it has been suggested that MFN and national treatment are the most common and practical forms of pre-establishment obligations undertaken in IIAs. They do not involve a right of establishment, but rather a requirement to eliminate measures that discriminate against foreign investors. They can be made subject to exceptions, relating to matters such as screening procedures, national security, public order, privatization, balance-of-payments considerations, and performance requirements. They can also be tied to specific ("negative" or "positive" list) commitments on market access. In this way it has been suggested that a modulated legal framework for regulating the admission and establishment of foreign investment can be created, combining the discipline of non-discrimination with flexibility for host countries to apply domestic policies according to their needs.

75. One view has been that developing countries need to be able to apply national treatment in particular, and MFN treatment too, flexibly at both the post-establishment and the pre-establishment stages of investment. Incorporating a development dimension into an international investment agreement implied that there should be no automatic right to invest or establish a foreign investment. This would ensure that host countries retained the ability to screen foreign investments, and allow in only those that would best suit their industrial policies and developmental needs and not stifle domestic investment and development. Most bilateral investment treaties provide for that, by excluding pre-establishment treatment from application of MFN and national treatment, and by attaching whatever limitations or qualifications developing countries deem necessary to their MFN and national treatment obligations at the post-establishment stage of investment. At the pre-establishment stage, they provided an assurance of investment protection in accordance with the domestic laws of host countries by applying international standards such as "fair and equitable treatment". Bilateral investment treaties therefore offered a framework within which countries could

act autonomously to create an enabling environment for foreign investment. While creating legal security for foreign investors, they did not affect the ability of a host country to regulate FDI and to use other policies to pursue national development objectives.

76. Another view has been that in order to protect an investment adequately, an investment agreement must address the three stages of an investment – its entry, its operation after establishment, and its liquidation – and MFN and national treatment should apply to investors and/or their investments at all three stages. Applying the principle of non-discrimination to the post-establishment stage only is not sufficient. Entry is the stage at which governments can deny market access altogether, demand government or local participation in the ownership or control of the investment, or set conditions such as performance requirements. Conditions attached to entry into a host country often remain in force throughout the life of an investment, either because the applicable policies remain in force or because once such conditions have been set, it is often impractical or too costly for a foreign investor subsequently to restructure the investment. This means that discrimination applied at the pre-establishment stage can prevent a foreign investor from competing on equal terms with domestic investors throughout the life of an investment, and this prospect can preclude an investment from taking place altogether. In this regard, the application of the principle of non-discrimination at the pre-establishment stage of an investment is a critical market access issue, and market access is a key ingredient of an investment treaty. A commitment not to discriminate at the post-establishment stage is meaningless if the investment is prevented altogether from happening or so handicapped by restrictions and conditions applied during establishment that it is at a competitive disadvantage *vis-à-vis* competing domestic investors.

B. BALANCING DISCIPLINE WITH FLEXIBILITY

77. A second prominent theme of discussion has been the need for IIAs to strike an appropriate balance between discipline and flexibility in the application of the principle of non-discrimination: discipline to provide legal security for foreign investors on the one hand, and flexibility for host countries to regulate the activities of foreign investors and to be able to pursue their development and other domestic policy objectives on the other.

78. One view has been that flexibility to accommodate development and other domestic policy objectives in an investment agreement is not synonymous with discrimination. Appropriate standards of non-discrimination, coupled as appropriate with exceptions and limitations, can be found that allow for the necessary degree of policy flexibility for host countries.

79. In this respect, some have felt that a differentiation may need to be made between MFN and national treatment. They have suggested that there is no evident reason to discriminate among investments or investors on the grounds of their nationality, so that MFN treatment should be a core principle of general application in IIAs. Host countries have better policy instruments at their disposal to attract the kind of high quality foreign investment that they want other than differentiating between investors on the grounds of their nationality. With regard to national treatment, on the other hand, there can be scope to vary its application so as to allow host countries to use their development policies flexibly, as well as policies in other areas such as education, training, employment and environmental protection. However, this should be done on the basis of objective and transparent criteria that reflect differences in circumstances between foreign investors and domestic investors, particularly those in developing countries.

80. In this context, some have pointed to the national treatment exceptions and limitations that are allowed under the GATS as examples of how a suitable balance between discipline and flexibility can be struck. One comment in this regard has been that modalities for scheduling market access in an investment agreement would have important bearings on the application of the principle of non-discrimination, particularly the application of the rule of national treatment.

81. Another view has been to question whether a proper balance between discipline and flexibility can ever be found in a multilateral framework on investment, and whether the national treatment principle, in particular, is readily transferable from trade to the case of foreign investment. Granting MFN and national treatment to foreign investors prevents developing countries from pursuing policies that they deem appropriate in areas such as industrialization and the transfer of technology.

82. Doubts have been expressed about the GATS offering the necessary degree of flexibility to serve as a model for a possible investment agreement. Even with the use of MFN exemptions and national treatment exceptions and limitations, it was felt that developing countries would not be able to secure the level of protection for their domestic investors that they needed. One concern expressed in this regard has been whether developing countries would have the scope to adjust national treatment commitments they make in particular sectors if they find subsequently that these are not compatible with their development needs. It has been suggested that in the case of a possible multilateral investment agreement it would be necessary to consider creating permanent carve-outs from national treatment for specific sectors and policies.

83. One view has been that the contours of any set of rights and obligations on investment should depend on whether the objective was the promotion, treatment and protection of investment, its liberalization, or both. Broadly speaking, a host country needed to ensure the effective promotion, fair treatment and full protection of FDI, while a home country would need to respect the policies and rules of the host country and actively assist in the realization of its objectives or, at the very least, not undermine such objectives. The crux of the matter was how multilateral rules could take into account the development dimension in a more meaningful manner than through preambular references and transition periods. The development dimension should be manifest in each of the elements that comprised any set of multilateral rules on investment.

C. EXCEPTIONS

84. It has been noted that the principle of non-discrimination, whether applied at the post-establishment stage of investment only, or at the pre-establishment stage too, is always subject in IIAs to horizontal or sectoral exceptions that allow participants to pursue essential domestic policies, such as development policies, and to safeguard important interests, such as national security and public order.

85. In that context, there has been reference in particular to the qualification of national treatment in the GATS on a country-by-country basis through the "positive" list approach to scheduling service industries to which the National Treatment standard applies. One view is that this weakens the standard significantly. Another is that it is needed to provide flexibility to host countries, particularly developing countries.

86. A key consideration for some is that whether a "positive" or a "negative" list approach is used, there should be transparency and predictability of any limitations to national treatment.

D. DEFINITIONAL ISSUES

87. It has been noted that the scope of application of MFN and national Treatment in an IIA depends crucially on the definitions used.

88. One view has been that when applying MFN and national treatment, foreign and domestic investors need to be in "like" circumstances. For example, two firms with the same manufacturing facilities and the same product, but located in different regions, might be held to different air pollution control standards because of differences in levels of air pollution between these regions. These two investors would not be in like circumstances for the purpose of air pollution controls. Some have felt

that the concept of like circumstances could be useful to ensure a degree of flexibility in the application of national treatment in particular, but that it would need to be defined precisely if it were to be incorporated in a multilateral investment agreement.

E. OTHER AREAS FOR FURTHER ANALYSIS

89. A number of other areas for further analysis have been proposed in the Working Group:

- interaction between the non-discrimination provisions of existing IIAs, particularly their MFN provisions;
- application of the principle of non-discrimination in the case of investment laws and regulations at sub-federal levels of government;
- whether the existence of a common competition policy should be a prerequisite for the existence of a right of establishment in an IIA;
- whether MFN and national treatment should be applied as conditional or unconditional principles of non-discrimination;
- criteria to define potential investors if national treatment were to be accorded to foreign investors at the pre-establishment stage of an investment;
- the compatibility of the MFN principle with screening procedures used by some host countries to evaluate the costs and benefits of particular foreign investments;
- handling investment incentives under the rules of MFN and national treatment.

VI. EXAMPLES OF THE APPLICATION OF THE PRINCIPLE OF NON-DISCRIMINATION IN REGIONAL AND MULTILATERAL INVESTMENT AGREEMENTS AND ARRANGEMENTS

90. The 1987 *Agreement Among the Governments of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore and the Kingdom of Thailand for the Promotion and Protection of Investments* requires each contracting party to encourage and create favourable conditions in its territory for investments from the other contracting parties, in a manner consistent with its national objectives. General treatment standards require contracting parties to accord fair and equitable treatment and full protection and security to investments from other contracting parties, to observe any obligation arising from particular commitments entered into with regard to specific investments of nationals or companies of the other contracting parties, and to refrain from impairing by unjustified or discriminatory measures the management, maintenance, use, enjoyment, extension, disposition or liquidation of investments from other contracting parties. The Agreement requires that MFN treatment be accorded to investments made by investors of other contracting parties, but national treatment is a subject for bilateral negotiations between contracting parties.

91. Under the 1992 *North American Free Trade Agreement* (NAFTA) each Party is required to accord the better of MFN and national treatment to investors of another Party, and to investments of investors of another Party, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. This obligation is qualified by the Parties' ability to lodge (top-down) country-specific reservations listed in annexes to the Agreement and is subject to certain exceptions with respect to government procurement, subsidies and intellectual

property.[50] Minimum standards of treatment require each Party to accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security, and non-discriminatory treatment with respect to measures a Party adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.

92. The 1994 *Colonia Protocol on Reciprocal Promotion and Protection of Investments within MERCOSUR* covers investments of investors of one MERCOSUR Member State in the territory of another. It provides that each contracting party shall accord MFN and national treatment in respect of the admission of investments of investors of another contracting party. An Annex to the Protocol identifies for each contracting party specific sectors in which it may maintain limited, temporary exceptions to this obligation, requires contracting parties to make all efforts to eliminate these exceptions as soon as possible, and provides for periodic consultations to monitor the process of their elimination. With respect to the treatment of investment once admitted, the Protocol requires the contracting parties to accord fair and equitable treatment and full legal protection, to refrain from impairing the management, maintenance, use, enjoyment or disposal of investments through unjustified or discriminatory measures, and to accord MFN and national treatment.[51] It prohibits nationalization or expropriation of covered investments, except for public purposes and then only on a non-discriminatory basis. It also requires that national treatment and MFN treatment be accorded to covered investments in relation to measures taken with respect to indemnification or compensation for losses suffered owing to war, other armed conflict or internal disorder.

93. In 1994, MERCOSUR Member States adopted a *Protocol on Promotion and Protection of Investments from States not Parties to MERCOSUR*. The Parties to this Protocol undertake not to accord to investments of investors of third countries more favourable treatment than that provided for in the Protocol. Each Party is required to promote investments from third countries and to admit them in conformity with its domestic laws and regulations. In respect of the treatment of established investments, the Protocol lays down general standards of treatment which are similar to those contained in the Colonia Protocol, except that the Parties can decide whether or not to accord national treatment and MFN treatment to established investments of investors of third countries. Parties to the Protocol may not extend to investors of third countries treatment, preferences or privileges accorded under regional trade and integration agreements or agreements in the field of taxation.

94. The 1995 *Treaty on Free Trade between Colombia, Mexico and Venezuela* requires Parties to accord MFN and national treatment to investors of another Party and their investments, subject to an exception for treatment accorded pursuant to bilateral agreements for the avoidance of double taxation, and to the right of each Party to impose special formalities in connection with the establishment of an investment. The Treaty envisages the conclusion of an additional Protocol containing lists of sectors and subsectors in which each Party may maintain or adopt measures not conforming to these national treatment and MFN treatment obligations.

95. The 1994 *Energy Charter Treaty* requires each contracting party to encourage and create stable, equitable, favourable and transparent conditions for investors of other contracting parties to

[50] Article 1108 allows for such country-specific reservations with regard to: (1) existing non-conforming measures maintained by a Party at the federal, state or local level, as set out in that Party's Schedule to the Agreement; (2) any measure that a Party maintains or adopts with respect to specified sectors, subsectors or activities, as set out in its Schedule to Annex II; and (3) treatment accorded by a Party pursuant to specified agreements or with respect to sectors, as set out in its Schedule. With respect to intellectual property, the MFN and National Treatment obligations do not apply to any measure that is an exception to, or derogation from, the obligations under the National Treatment article of the NAFTA Chapter on intellectual property, as specifically provided for in that article.

[51] With regard to the MFN and National Treatment obligations, the Annex contains a reservation by Brazil relating to government procurement.

make investments in its area; to accord fair and equitable treatment and the most constant protection and security to investments of investors of other contracting parties; to refrain from impairing by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of such investments; to accord treatment which shall be no less favourable than that required by international law, including treaty obligations; and to observe any obligation it has entered into with an investor or an investment of an investor of any other contracting party. With regard to MFN and national treatment, the Treaty distinguishes between the treatment of established investments and the admission of investments. Regarding the treatment of established investments, it requires contracting parties to accord the better of MFN and national treatment to investments of investors of other contracting parties and their related activities, including management, maintenance, use, enjoyment or disposal. This obligation does not apply to intellectual property, nor to grants and other forms of financial assistance and contracts for energy technology. Regarding the admission of investments of investors of other contracting parties, it provides that contracting parties "shall endeavour" to accord the better of MFN and national treatment to investors of other contracting parties. Negotiations were concluded in 1997 on a Supplementary Treaty containing a legally binding non-discrimination obligation covering the pre-establishment stage, defined as establishing new investments, acquiring all or part of existing investments, or moving into different fields of investment activity. It provides for two types of exceptions from the non-discrimination principle: it grandfathers existing restrictions which are registered by individual Member countries, and it provides for a listed country to reserve for its own nationals all or some of the state's share of assets which are being privatized.

96. The 1994 *APEC Non-Binding Investment Principles* contain principles of a general nature that Member economies will extend MFN treatment to investors from any economy with respect to the establishment, expansion and operation of their investments, and accord national treatment to foreign investors in relation to the establishment, expansion, operation and protection of foreign investment, with exceptions as provided for in domestic laws, regulations and policies. Member economies will not expropriate foreign investments or take measures that have a similar effect except for public purposes, and then only on a non-discriminatory basis in accordance with the laws of each Member and principles of international law.

97. The 1976 OECD National Treatment Instrument is one of four components of the OECD *Declaration on International Investment and Multinational Enterprises*.[52] The Declaration is not legally binding, and it does not deal with the right of Member countries to regulate the entry of foreign investments or the conditions of establishment of foreign enterprises, so that it covers the treatment of investment only after its admission. The National Treatment Instrument provides that Member countries, consistent with their needs to maintain public order, to protect their essential security interests and to fulfil commitments relating to international peace and security, should accord to enterprises operating in their territories, and owned or controlled directly or indirectly by nationals of another member country, treatment consistent with international law and no less favourable than that accorded in like situations to domestic enterprises. Exceptions to this national treatment commitment are notified to the OECD for transparency purposes.

[52] WT/WGTI/W/40, Communication from the OECD.