

**COMMUNICATION FROM MEXICO**

The following communication, dated 3 July 2002, has been received from the Permanent Mission of Mexico.

**NON-DISCRIMINATION**

*The Mexican Delegation submits this paper with the aim of contributing to the debate on Non-Discrimination that will be taking place in the Working Group on the Relationship between Trade and Investment (WGTI), in accordance with Paragraph 22 of the Doha Ministerial Declaration. In this regard, Mexico reserves the right to expand or modify its position as the study of the issue progresses.*

**I. INTRODUCTION**

1. The principle of non-discrimination is one of the mainstays of the multilateral trading system, and therefore, central to virtually all international trade and investment agreements. This standard establishes that a country should not differentiate between its trading partners, nor between its own and foreign products, services or nationals.

2. Non-discrimination is mainly expressed in two core provisions: *most-favoured-nation treatment* and *national treatment*.

**II. MOST-FAVOURED-NATION (MFN) TREATMENT**

**A. DEFINITION, OBJECTIVE AND SCOPE**

3. Traditionally, the MFN clause has been linked to trade agreements. In fact, it was not until the 1950s that such a provision became a common expression in international investment agreements.

4. In general, most-favoured-nation treatment implies that a host country must extend to investors from a foreign country treatment no less favourable than that which it accords to investors from any other foreign country in like cases. That is to say, the MFN clause prevents a country from discriminating among its different trading partners. If the benefits it gives to one country are improved, it will have to give the same "best" treatment to all its other trading partners so that they all remain "most favoured".<sup>1</sup>

<sup>1</sup> *Trading into the Future* (Second Edition). World Trade Organization, 1999. p. 5. Even if the phrase "most favoured" sounds like a contradiction, as it suggests some kind of special treatment for one particular country, in the international parlance it actually means treating everyone equally. However, the MFN status

5. In this regard, MFN treatment encourages equality of opportunities between investors from different foreign countries by preventing distortions which could be generated by discrimination based on nationality considerations. Furthermore, MFN treatment sets certain limitations upon signing countries of an international agreement with regard to their investment policies by preventing them from favouring investors of one particular foreign nation over those of another foreign country.

6. Despite the existence of several types of MFN clauses<sup>2</sup>, it is evident that in the investment field the trend is toward similar basic structures. However, this does not mean that the language used in such clauses is identical. Many MFN provisions include specific terminology such that, even if it does not change the basic thrust of such discipline (avoid discrimination between foreign investors operating in a territory), it could have some impact on their scope and implementation:

- (a) Some clauses include certain qualifying words such as "**in like circumstances**"<sup>3</sup> or "**in like situations**".<sup>4</sup> These qualifying phrases allow the granting of some kind of differential treatment of investors in different objective situations, since it could be difficult to grant an "identical" treatment.
- (b) Likewise, other variations concern **the object of treatment** – that is to say whether the MFN treatment applies only to investors or to investments, or both. Undoubtedly, this is a question that would need to be clarified by the WGTI.
- (c) Another element addresses the **activities that are covered** by MFN treatment – i.e. whether provisions apply to the pre-establishment or post-establishment phase of investments. In the framework of GATS, the MFN principle applies to "any measure covered by the agreement".

## B. STAGES OF ADMISSION OF AN INVESTMENT

7. A key difference among MFN clauses that deserves special attention is their application to the pre- or post-establishment of investments.

8. On the one hand, MFN treatment has traditionally been applied to the post-establishment phase. It means that there is an obligation to apply MFN only after an investment has been made. This type of scheme can usually be found in BITs as well as in some multilateral arrangements such as the OECD National Treatment Instrument. Certainty of non-discriminatory treatment after an investment has been admitted in accordance with the domestic laws and regulations of a Party is a fundamental element for foreign investors in terms of competition and costs.

9. On the other hand, commitments on admission and establishment are less common, even though there has certainly been an increase in the use of that approach, ensuring that investors feel they are still protected even if their investment-related activities undergo some kind of modification or expansion during the time of their investment. MFN in the pre-establishment phase prevents a host

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strangely enough did not always mean equal treatment. In the early years of international agreements, being included among a country's "most-favoured" trading partners was similar to being in an exclusive club because only a few countries enjoyed that privilege. Today, that MFN club is no longer exclusive since such principle ensures that each country treats its trading partners equally.

<sup>2</sup> Unilateral or reciprocal, conditional or unconditional, limited or unlimited.

<sup>3</sup> Used in agreements such as NAFTA.

<sup>4</sup> Used in US BITs and in OECD instruments.

country from according preferential access to certain foreign enterprises without extending the same commercial opportunities to others.<sup>5</sup>

### C. EXCEPTIONS

10. MFN treatment can be a flexible principle if it is allowed to include exceptions that meet the development concerns of host countries. Such exceptions can encompass, *inter alia*, general exceptions necessary to maintain public order, health or moral and national security, as well as specific exceptions by which the Parties keep the right to take an MFN reservation with regard to any measure, sector or activity provided that the exception is listed in the country-specific schedule.

### D. PROBLEMS ARISING FROM THE MFN TREATMENT

#### 1. "Free Rider"

11. Implicit in MFN treatment is the potential problem of "*free riders*". A third country could claim, via MFN, any additional benefit that one of its trading partners extended to another country, without undertaking any additional obligations itself – i.e. without reciprocity. The concern about this more and more frequent phenomenon is the unfair asymmetrical situations that it creates.

#### 2. Identity

12. Another difficulty that arises in the implementation of MFN treatment involves determining corporate nationality. Given the current integrated nature of country international production systems, it is more and more difficult to know whether a foreign affiliate is entitled to the same treatment as its parent company.

13. Moreover, with the emergence of this process of internationalization, it has even become difficult to determine the nationality of a parent company. This situation could lead to other types of conflicts related to triangulation, whereby the investor who owns a national firm of a contracting party can indirectly benefit from the provisions of an agreement.

### III. NATIONAL TREATMENT (NT)

14. National treatment is not only one of the main general standards used in international instruments to secure a certain level of treatment for foreign investment in host countries, but also one of the spheres of convergence among the different existing agreements. This principle seeks to grant foreign investors treatment comparable to that granted to national investors operating in the host country.

15. National treatment is a relative, not an absolute, standard. It implies a standard of comparison between the treatment accorded to foreign investors and the treatment accorded to domestic ones. Consequently, its content is determined on the basis of the treatment that a country grants to its nationals and not on the basis of *a priori* absolute principles of treatment. In this regard, implicit in the function of national treatment is an obligation to make a comparison between the individuals and the circumstances, taking into account the relevant characteristics of the one and the other.

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<sup>5</sup> MFN treatment applied to the pre-establishment stage is commonly found in BITs signed by the United States, in NAFTA, in the APEC Non-Binding Investment Principles and in the OECD Code of Liberalization of Capital Movements.

## A. MAIN ELEMENTS TO BE CONSIDERED.

16. In principle, it could be thought that provisions on NT follow the same pattern. Nevertheless, there are some aspects that not only make each provision unique but that have implications for the process of economic development of the countries as well.

### 1. Scope and application

- **Beneficiaries.** This matter raises the question of who will be subject to NT: the investor, the investment or both. Some theories consider that the term investment already includes the investor because of their inevitable link.
- **Scope.** The application of NT in the field of investment goes beyond that in trade. The activities that foreign investors can carry out in the host country are larger in number<sup>6</sup>, not to mention the wide variety of operations that can be involved in the creation and management of an enterprise. Hence, a larger set of economic transactions can be subject to NT under investment agreements than under trade agreements.
- **Stages of admission of an investment.** One of the main characteristics that make an NT clause unique is its application in the different phases of an investment; i.e. whether NT only protects foreign investment after it has been admitted in accordance with the laws and regulations of the host country, or whether it also applies to the entry of the foreign investment.

17. At first, it was thought that NT was only relevant to the treatment accorded to foreign investors after they establishment. However, more recently, some countries have signed international investment agreements containing NT clauses applicable to the pre-establishment stage of investment in order to secure market access to foreign investors on "equal" terms as domestic investors.

18. A modality that deserves special consideration is the GATS hybrid model. The GATS is based on the "progressive liberalization" concept; hence, its NT obligation, contained in Article XVII, is not a general obligation applicable to trade in services in all sectors and for all members, but applies only to the sectors listed in each of the Member's schedule of specific commitments.

19. Furthermore, each Member State has the possibility of deciding the level of national treatment that will be granted to each listed sector by pointing out specific limitations in the same schedules.

20. Likewise, the GATS considers the application of a "formally identical" or "formally different" treatment. It suggests that, under this agreement, any form of discrimination – *de jure* or *de facto* – is prohibited.

### 2. Exceptions

21. Exceptions are an important factor in the practical determination of the impact that the NT provision will have under an investment agreement.

22. For many countries, the recent trend to apply NT to the pre-establishment stage of investments has been a revolution since the admission of an investment has traditionally been a right reserved by States using sovereignty as an argument, and heightened by the significance of NT for development. This trend has triggered a discussion on the type and extension of NT exceptions that

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<sup>6</sup> i.a. trade in products, trade in components, know-how and technology, local production and distribution and the provision of services.

countries should establish in order to keep a certain discretion with respect to some investment-related measures that are of particular importance for these countries.

23. Experience in recent years shows a broad range of exceptions to national treatment: (i) general exceptions<sup>7</sup>; (ii) subject-specific exceptions<sup>8</sup>; (iii) industry-specific exceptions<sup>9</sup>; and (iv) reciprocity clauses.

24. These limitations can be presented under two modalities: a general right to national treatment subject to a "negative list" containing those areas or industries which are exempted from such a provision, or a "positive list" in which no a priori right to national treatment exists, and in which such treatment is only extended to those industries and areas specifically included in country schedules.

### **3. Substantive content**

25. The substantive content of the NT standard involves two issues in particular: the factual situation to which the principle will apply, and the definition of NT itself.

26. With respect to the first issue, NT clauses usually contain a variety of qualifying terms that delineate the implementation of such a provision. Some of these terms are: "identical situations", "same circumstances", "like circumstances", "like cases" or "like situations". In some cases, the NT principle is defined by an illustrative list of economic activities as happens in the case of GATS.

27. Regarding the definition of NT, there is a series of possibilities that can cover, *inter alia*, a strict formulation of equality of treatment as well as terminology that allows a comparison to be made between the treatment offered to nationals and foreigners. Under this approach, concepts such as "same treatment", "treatment as favourable as" or "treatment no less favourable than" can be found.

### **4. "De jure" and "de facto" national treatment**

28. The element to be considered here for the formulation of a NT clause is whether it covers not only "de jure" NT, that is to say, the treatment given to foreign investors in accordance to the domestic laws and regulations but also "de facto" NT which refers to measures that in practice may lead foreign investors to disadvantageous situations as a result of regulations and practices that, although not discriminatory against them *per se*, nevertheless can have a detrimental effect on their ability to operate because of their condition of being "foreign".

## **IV. THE GATS FORMULA IN THE NON-DISCRIMINATORY REGULATION OF INVESTMENTS**

29. One of the constant demands during the pre-Doha WGTI discussions centred on the necessity of striking the right balance between regulation and flexibility in applying the principle of non-discrimination. That is to say, Member States - mainly developing countries - are seeking a formula that, on the one hand, provides foreign investors with legal security and certainty and, on the other hand, provides host countries with adequate flexibility to both regulate the activities of foreign investors carried out in their territories and pursue their development and other domestic policy objectives.

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<sup>7</sup> Based on considerations of public health, order and morals and national security.

<sup>8</sup> i.a. taxation, intellectual property rights, prudential measures in financial services, temporary macroeconomic safeguards, incentives, public procurement, special formalities in connection with establishment and cultural industries.

<sup>9</sup> By which the Parties reserve the right to treat domestic and foreign investors in certain types of activities or industries differently under their laws and regulations for reasons of national economic and social policy.

30. In this regard, Mexico considers that the approach adopted in the General Agreement on Trade in Services (GATS) can provide some inspiration to satisfy both demands since it reflects a pragmatic and realistic model which takes into account the different realities, and reflects a global balance in concessions.

31. Therefore, **most-favoured-nation treatment** could be conceived as a basic standard of general application to which all members and the whole range of existing operations would abide by. As in the case with GATS, a member could have the right to maintain a measure incompatible with the general principle of MNF if it had been listed as an exception.

32. Besides the possibility of listing reservations to MFN treatment, it is essential to include a provision similar to that contained in GATS Article V (economic integration) with the aim of avoiding the "*free rider*" phenomenon.

33. With respect to the **national treatment** principle, the hybrid approach adopted by GATS could be the most convenient in terms of flexibility for WTO Member States. An approach based on sector by sector positive commitments would allow governments to retain control of FDI entering their economies without discriminating between investors by reason of nationality. This approach is even more relevant given that NT is much more difficult to reflect in a multilateral framework than MFN treatment. On this matter, each member could grant foreign investors and their investments treatment no less favourable than the treatment granted to its own investors and investments in the sectors listed in its schedule of specific commitments and subject to the conditions and limitations set out therein.

34. However, following the GATS, the Working Group would have to pay special attention on certain aspects related to the design of schedules of specific commitments that some practitioners and observers have identified in GATS as issues that introduce elements of opacity and interpretative ambiguity into the agreement. One of these aspects concerns the existing overlap between the NT principle and the *Market Access* provision contained in GATS Article XVI.<sup>10</sup>

35. GATS Schedules of specific commitments set out the limitations and conditions on the sector-specific commitments that countries have voluntarily made with regard to market access and national treatment. This bifurcation between market access limitations and discriminatory measures may raise some confusion about the true nature of a Member's scheduled commitments. The reason can be summed up as follows: GATS Article XX.1<sup>11</sup> sets out the parameters for scheduling commitments. Its provisions not only deal with those measures exclusively pertaining to Article XVI (market access) or Article XVII (NT), but embraces those restrictive measures falling within the scope of both provisions as well. That is to say, it also encompasses discriminatory market access limitations.

36. In this case, GATS Article XX:2 states that relevant non-conforming measures should only be inscribed in the market access column of the schedule and would be understood to provide a condition or qualification to NT as well. Thus, the market access column contains not only *non-discriminatory* market access limitations but also *discriminatory* market access limitations. The technical problem here is that nowhere is it indicated whether the measures listed are of a discriminatory nature or not.

37. Certainly, this overlap between Articles XVI and XVII already represents a problem regarding the scope of the national treatment obligation. But, in addition, this technical difficulty becomes broader when the member State undertakes to provide national treatment and not full market access. In this case, there is no way of knowing whether any unscheduled improvements in market

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<sup>10</sup> Low Patrick & Mattoo Aaditya, "Is there a better way? Alternative approaches to liberalization under GATS". *GATS 2000: New directions in services trade liberalization*. (Brookings Institution Press & Center for Business and Government: 2000) p. 450.

<sup>11</sup> "Schedules of Specific Commitments".

access would have to respect full national treatment. This problem is most acute in commercial presence since, in mode 3, market access is in practice a two-stage process: one set of measures will define the terms of entry for a foreign investor, and another will establish the conditions for post-entry activity.

38. One more question that will have to be clarified, given this technical problem, is whether in the formulation of multilateral investment rules the Working Group should only support the regulation of NT non-conforming measures – and not other kinds of non-discriminatory measures (quantitative) – particularly because the provision of market access is not an element considered in Paragraph 22 of the Doha Ministerial Declaration. In this regard, the Mexican Delegation considers that the Working Group should focus on discriminatory measures based on nationality considerations only, as most existing bilateral and regional investment instruments do.

39. Likewise, the WGTI could find language that would cover *de facto* discrimination as well as *de jure* discrimination for both principles (NT and MFN treatment).

40. Finally, an important issue, regarding the principle of non-discrimination, is the inclusion of the term "*in like circumstances*". As it has been mentioned, NT and MFN treatment are relative parameters. It has also been noted that Governments could have legitimate reasons for granting foreign and domestic investors and investments different treatment in specific circumstances. The fact that a measure applied by a government could have different effects on an investment or on an investor of another Party does not mean that the measure is incompatible with NT or MFN treatment. In this regard, the aim of the term "*in like circumstances*" is to consider all relevant circumstances in decision-making – including those concerning foreign investors and their investments – with respect to which investor or investment (whether domestic or from a third country) should be properly compared.

41. It has been pointed out that the provisions of an eventual multilateral framework on investment should be as transparent as possible. In this respect, the term "*in like circumstances*" would only clarify and specify the scope of its provisions. In short, the referred language would be useful to avoid distortions of the concepts of NT and MFN treatment.

42. Besides, as mentioned in the Note by the Secretariat, this term is commonly used in international law with regard to the application of NT and MFN treatment. In the investment field, it is used as a derivation of similar terms already used in trade agreements, including multilateral ones (e.g., "*like products*" GATT 1994 Article III; "*like services and service providers*" GATS Articles II and XVII). The term is also included in a variety of BIT models of many countries (e.g., United States, Netherlands and Canada BIT models).

43. To sum up, the term "*in like circumstances*" would ensure that comparisons carried out between investors and their investments take into account only the relevant characteristics for such a comparison and not the nationality of the Parties concerned.

44. The objective of the term would be to:

- (i) consider all relevant circumstances (including those concerning the foreign investor and its investment) in deciding which investor or investments (domestic or third country) would be compared, and
- (ii) exclude all features that are considered irrelevant to carry out the comparison.

**V. OTHER STANDARDS OF TREATMENT**

45. The Note by the Secretariat (WT/WGTI/W/118) points out that some investment agreements contain standards that could have a bearing on the application of the principle of non-discrimination. The Note mentions the principle of "fair and equitable treatment" as one of those standards. It also indicates that investment agreements which use such a provision often do so in combination with other principles defined by international customary law such as the standard of full protection and security. We believe those concepts are merely a reference to the customary international law minimum standard of treatment of aliens. Therefore, the same concepts do not require treatment in addition – or beyond – that which is required by the customary international law minimum standard of treatment of aliens.

46. In this stage of the discussions, Mexico considers that the Working Group should focus on the standards of NT and MFN treatment for the context of non-discrimination.

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