

International Agreements Covering Foreign Investment in Services: Patterns and Linkages

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I. INTRODUCTION

With the growth of the service industry in the last 30 years, it is not surprising that the number of international agreements purporting to liberalize and promote trade and investment in the service sector has increased dramatically.¹ In particular, the multilateral trade disciplines embodied in the General Agreement on Trade in Services (GATS) expressly apply to both international trade and foreign investment in services. Article I:2(c) of GATS defines trade in services *inter alia* as both the supply of a service from the territory of one member into the territory of any other member (i.e., ‘cross-border supply’) and the supply of a service by a service supplier of one member through commercial presence in the territory of any other member (so called ‘commercial presence’).

More than 2300 bilateral investment treaties (BITs) are aimed at promoting and protecting all kinds of foreign investment, including investment in the service sector. There exist several hundred regional integration agreements, including free trade agreements (FTAs) with specific chapters covering investment in services and/or trade in services (e.g. NAFTA, ASEAN Framework

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¹ For purpose of understanding the global legal framework dealing with international supply of services (including both cross-border trade and foreign direct investment), one cannot but include, next to FTAs and CUs, BITs. Contrary to Art. XXIV GATT, Art. V GATS (providing for the ‘regional economic integration’ exception) does not limit its scope exclusively to FTAs and CUs but applies more generally to any ‘agreement liberalizing trade in services’. Thus, for purposes of this chapter, we will consider BITs, FTAs, and CUs as the relevant regional economic integration (or trade) agreements. See UNCTAD, *The REIO Exception in MFN Treatment Clauses* (2004).

Agreement) and customs unions (CUs) which also include provisions relating to services. The result of this almost frenetic treaty-making activity is a complex and multilayered network of international rules regulating the transnational movement of services and service providers.²

This chapter considers the issue of coordination, or lack of coordination, between the many international agreements covering investment in services. In particular, it focuses on the question of whether bilateral and regional economic integration agreements are consistent with the multilateral disciplines embodied in the GATS. The chapter briefly introduces the legal disciplines in international agreements dealing with investment in services, highlighting the, at times stark, differences in the levels of liberalization and protection of investment flows in services among the complex network of such agreements (section II). The chapter then focuses on the linkages between bilateral and regional economic integration agreements, on the one hand, and the multilateral disciplines within the WTO, on the other. First, we posit that BITs and FTAs, by providing more favourable treatment to certain categories of investors, violate the Most-Favoured-Nation (MFN) obligation enshrined in Article II GATS (section III). Secondly, we also posit that such violation cannot be justified on the basis of the 'Economic Integration' exception of Article V GATS (section IV).

II. INTERNATIONAL DISCIPLINES REGULATING FOREIGN INVESTMENT IN SERVICES

The disciplines contained in international agreements dealing with foreign investment in the services field differ quite substantially. This is evidenced even by a simple overview of the three main features of such disciplines: (a) investment liberalization provisions; (b) investment protection provisions; and (c) dispute settlement provisions.

A. Investment liberalization provisions

In line with the traditional approach to trade liberalization (developed in the field of trade in goods),³ liberalization provisions covering trade/investment in services under the GATS (a) require the elimination of an exhaustive list of

² While simultaneity of production and consumption is an essential attribute of services, there exist several ways in which services may be provided across countries: (a) from the territory of one Member into the territory of any other Member (cross-border supply); (b) in the territory of one Member to the service consumer of any other Member (consumption abroad); (c) by a service supplier of one Member, through commercial presence in the territory of any other Member (commercial presence); (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member (presence of natural persons). (Art. I:2 GATS).

³ Although the focus of trade liberalization has at least historically been on reducing border measures (or market access restrictions), provisions dealing with internal measures have come under the overarching liberalization agenda.

specific 'market access' restrictions (Article XVI)⁴ and (b) subject all other measures affecting trade in services to the National Treatment principle (Article XVII).

Accordingly, the investment liberalization effects of Articles XVI and XVII GATS are potentially quite broad. First of all, most of the market access restrictions listed in (and prohibited by) Article XVI:2 focus on freeing up investment flows. Secondly, the national treatment obligation covers potentially any governmental measures 'affecting' *inter alia* investment in services, thus including measures that restrict investment entry or admission to the host state (even if not included under the exhaustive list of market access restrictions in Article XVI).⁵

In the investment field, on the other hand, the traditional emphasis of international rule-making has been on the provision of disciplines addressing post-entry concerns of foreign investors.⁶ International disciplines have thus focused on protecting foreign investors after entry in the host state, usually through establishing some basic treatment guarantees.⁷ Only recently have international investment agreements included provisions aimed at liberalizing investment flows through the reduction of entry barriers (liberalization *stricto sensu*). This has occurred principally by extending national treatment guarantees beyond the post-entry phase to cover also entry or admission restrictions.⁸ While a broad national treatment obligation does not recognize *per se* a right of establishment to foreign investors (as that contained in Article 43 of the EC Treaty, for example), it has the potential of recognizing a *de facto* right of entry, as long as a service sector is open to domestic operators.⁹

B. Investment protection provisions

Investment protection disciplines encompass basic treatment guarantees against discriminatory, unfair and expropriatory conduct by host states *vis-à-vis* foreign investments or investors (once they have been admitted in the

⁴ The market access restrictions listed in Art. XVI:2 GATS include *inter alia*: limitations on the number of service suppliers; limitations on the total value of service transactions or assets; limitations on the total number of service operations; measures which restrict or require specific types of legal entity or joint venture; and limitations on the participation of foreign capital.

⁵ WTO Appellate Body Report, *EC—Bananas III*, WT/DS27/AB/R, adopted 25 September 1997, para. 220. However, the liberalization effects of Arts XVI and XVII GATS are greatly curtailed (at least for the time being) since GATS subjects these two provisions to members' specific commitments.

⁶ UNCTAD, *World Investment Report 2004—The Shift towards Services* (2004), at 224. See M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: CUP, 2004), 97 ff.

⁷ These agreements contain mere hortatory language aimed at promoting foreign investment as in Art. 2 of the 1999 BIT between UK and Lebanon.

⁸ See for example Art. 1102 of NAFTA, Art. 3 of the 2004 Canada Model BIT and Art. 2 of the 2002 BIT between Korea and Japan.

⁹ Nevertheless, even BITs and FTAs that include investment liberalization provisions usually provide for the possibility of Contracting Parties to complement such provisions with a number of limitations and reservations.

territory of the host state). In particular, these disciplines include the national treatment and MFN treatment obligations (prohibiting discrimination on the basis of the nationality of the investment or investor), fair and equitable treatment, and full protection and security obligations, the obligation to compensate foreign investors for expropriation (under certain circumstances), transparency requirements, transfer of funds obligations, and the requirement to observe any general or specific obligation entered into with the foreign investor (the so called ‘umbrella clause’).¹⁰

International agreements that take an investment-based approach (providing for a single, uniform discipline for all investment sectors, whether in goods or services) will usually contain all the standard investment protection provisions mentioned in the previous paragraph.¹¹ On the other hand, international agreements that take the service-based approach (where investment in services is covered by the disciplines regulating more broadly trade in services) tend to be less far-reaching in terms of investment protection guarantees, focusing only on non-discrimination obligations (such as national and MFN treatment), transparency requirements, and certain disciplines on domestic regulation requiring host states to conform to ‘necessity’ and/or ‘least-restrictive measure’ tests. The GATS and certain FTAs, such as the 2003 EFTA–Chile FTA,¹² follow this approach.

The point that should be made here is perhaps an obvious one: the protections offered to foreign investors in the service sector (even more so than in the goods sector) differ, sometimes dramatically, from agreement to agreement. More importantly, even BITs or FTAs that are signed by the same country differ depending on the contracting party or parties with whom those agreements are signed, as well as the time in which these agreements are drafted.¹³ Differences may also stem from more subtle differences in the wording of investment protection provisions as well as in the manner in which they are interpreted by arbitral panels.¹⁴

¹⁰ See generally Sornarajah, above at n 6 and P. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell Publishers, 1999).

¹¹ Most (if not all) BITs and certain FTAs (such as NAFTA or the 2000 New Zealand–Singapore FTA) follow this approach. See the 1996 Canada–Chile FTA which contains a chapter on Investment (covering also investment in services) and a chapter on cross-border trade in services.

¹² The 2003 EFTA–Chile FTA contains a chapter on Trade in Services (covering also investment in services) which includes only GATS-type protection provisions. See Arts 22–42.

¹³ The 2001 China–Jordan BIT grants foreign investments *inter alia* full protection and security and fair and equitable treatment (Art. 3), national and MFN treatment (Art. 4) and expropriation guarantees (Art. 5). On the other hand, the older, but still in effect, 1988 China–New Zealand BIT grants foreign investments *inter alia* fair and equitable treatment (Art. 3, para. 2), MFN treatment (Art. 4) and expropriation guarantees (Art. 6) but it does not include full protection and security or national treatment.

¹⁴ Compare, for example, the FET obligations in the 1999 BIT between Australia and India and in the 2005 FTA between Australia and the US.

C. Dispute settlement provisions

International agreements concerning investment generally contain mechanisms with which disputes arising between states (State–State) and/or between a foreign investor and a host state (investor–State) may be resolved. State–State dispute settlement mechanisms usually provide that any dispute between states concerning the interpretation or application of the treaty (which cannot be resolved through negotiations or consultations) shall at the request of either party be submitted to an arbitral tribunal. Investor–State dispute settlement mechanisms generally grant foreign investors the option of submitting a dispute arising between the investor and the host country to international arbitration.

Several differences may be noted with regard to dispute settlement provisions. Agreements taking the investment-based approach, such as BITs and most recent FTAs, usually contain mechanisms for both State–State and investor–State dispute settlement (e.g. NAFTA Chapter Twenty, Section B and Chapter Eleven, Section B). On the other hand, agreements that follow the services-based approach, such as the GATS and certain FTAs (such as the 2003 Chile–EFTA FTA), only provide for State–State dispute settlement.

Furthermore, as highlighted in a recent UNCTAD study,¹⁵ several differences exist in both State–State and investor–State dispute settlement mechanisms concerning: (a) the scope of the subject matter that can be referred to dispute settlement, (b) the rules governing the procedural aspects of arbitration proceedings, (c) the relationship between international arbitration and recourse to domestic tribunals, (d) the applicable rules for the settlement of disputes, and (e) the effect and enforcement of arbitral awards.

III. COMPATIBILITY OF BITS AND FTAS WITH THE MFN OBLIGATION IN GATS?

The argument advanced in this section is that potentially a large number (if not all) BITs and many FTAs violate the general MFN provision of the GATS (Article II) by failing to accord immediately and unconditionally to service suppliers of any other member treatment no less favourable than that accorded to like service suppliers of any other country.¹⁶

We consider the following hypothetical example: Country A, a WTO Member, by signing a BIT or an FTA with Country B (whether a WTO Member or not) may be found to violate the MFN principle of Article II GATS *vis-à-vis* WTO Member C if Country A provides, through the BIT or FTA more

¹⁵ UNCTAD, *Key Terms and Concepts in IIAs: A Glossary* (2005), at 43 ff.

¹⁶ For an examination of the linkages (in the opposite direction) between WTO law and BITs, see G. Verhoosel, 'The Use of Investor–State Arbitration under Bilateral Investment Treaties to Seek Relief for Breaches of WTO Law' (2003) 6 JIEL, 493.

favourable treatment to the investors of Country B compared to the treatment it affords to like investors (or service suppliers) of WTO Member C (as well as any other WTO Members).

This argument is premised on two (undisputed) assumptions. First, no country maintains equivalent BITs or FTAs with all its partners; on the contrary, as evidenced in section II above, the liberalization and protection commitments offered by BITs and FTAs differ extensively from agreement to agreement, even among those agreements concluded by the same country. Secondly, and in any event, no WTO Member maintains BITs or FTAs with all other WTO Members.

The MFN provision in GATS sets out three conditions to its application. In other words, in order to determine the consistency of a member's conduct with the MFN obligation in Article II GATS, a dispute settlement panel will need to address: (a) whether the measure at issue is a 'measure covered' by the GATS; (b) whether the services or service suppliers concerned are 'like' services or service suppliers; and (c) whether the member accords 'less favourable treatment' to the services or service suppliers of another member.

A. Measure covered

A measure is covered by the GATS if it is a 'measure by a Member' and is 'affecting trade in services'.

The GATS takes a broad definition of what may be a measure by a member. Article I:3 states that measures by members will include 'any measure taken by central, regional or local governments and authorities, as well as non-governmental bodies in the exercise of powers delegated [by those governments and authorities]'. Moreover, Article XXVIII (a) defines 'measure' as 'any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form'.

BITs and FTAs are formally international agreements, which at a minimum need to be ratified to become binding in the international plane (usually through an act of the Government which may be accompanied by consent of Parliament) and some will subsequently be incorporated into the domestic legal system either directly or through *ad hoc* legislation. The question may be raised whether the mere signature or ratification of these agreements are deemed to be 'measures' for purposes of Article II GATS. The definition of a 'measure' in Article XXVIII (a) is quite broad—including any measure by a member whatever its form—and is thus apparently broad enough to include even measures of a pure international nature. This broad reading is in line with the objective of the MFN provision, which is to guarantee the equality of opportunities between service and service providers of different countries.¹⁷

¹⁷ P. van den Bossche, *The Law and Policy of the World Trade Organization—Text, Cases and Materials* (Cambridge: CUP, 2005), 319.

Whether the measure potentially upsetting this equality is of an international or national nature should not make a difference for purposes of determining the scope of the MFN provision in Article II GATS. Accordingly, not only laws, regulations, administrative actions applying, or taken pursuant to, a BIT or FTA, but also the mere signature or ratification of such a treaty or agreement, will be considered as measures by a member for purposes of Article II GATS.¹⁸

Similarly broad is the definition of a 'measure affecting trade in services'. As noted above, 'trade in services' is defined as including any of the four modes of supply listed in Article I:2 of GATS. Mode 3, commonly referred to as 'commercial presence', clearly covers foreign investment with regard to services ('the supply of a service by a service supplier of one Member, through commercial presence in the territory of any other Member'). Article XXVIII of GATS defines 'commercial presence' as 'any type of business or professional establishment, including through (a) the constitution, acquisition or maintenance of a juridical person, or (b) the creation or maintenance of a branch or a representative office, within the territory of a Member for purpose of supplying a service'.

Secondly, WTO jurisprudence has interpreted broadly the term 'affecting'. A measure affects trade in service (including service FDI) when the measure 'modifies the conditions of competition in supply of a service'.¹⁹ In its Report on *EC—Bananas III*, the Appellate Body noted that the use of the term 'affecting' indicates that the GATS has 'a broad scope of application' wider in scope than such terms as 'regulating' or 'governing'.²⁰ Furthermore, in order to determine whether a measure 'affects' trade in services, there is no need to determine actual effects, rather it is enough to demonstrate a potential effect on trade. Though within the context of determining the meaning of 'affecting'

¹⁸ The recent WTO Appellate Body Report in *Mexico—Soft Drinks* interpreted the terms 'laws and regulations' in Art. XX(d) GATT as referring only 'to rules that form part of the domestic legal system of a WTO Member'. This general statement should not, however, modify our conclusion for two reasons. First, the term 'measure' in Art. II GATS is broader than the terms 'laws and regulations' in Art. XX(d) (or in Arts I and III GATT). Second, the central issue raised before the Appellate Body in *Mexico—Soft Drinks* was limited to whether the terms 'to secure compliance with laws or regulations' in Art. XX(d) of the GATT encompass WTO-inconsistent measures applied by a WTO Member to secure compliance with *another* WTO Member's obligations under an international agreement. The Appellate Body excluded that 'laws and regulations' in Art. XX(d) included 'obligations of *another* WTO Member under an international agreement'. WTO Appellate Body Report, *Mexico—Soft Drinks*, WT/DS308/AB/R, adopted 24 March 2006, paras 68–9.

¹⁹ See WTO Panel Report, *EC—Bananas III (US)*, WT/DS27/R/USA, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, at para. 7.281 and GATT Panel Report, *Italy—Agricultural Machinery*, adopted 23 October 1958, BISD 7S/60.

²⁰ WTO Appellate Body Report, *EC—Bananas III*, above at n 5, at para. 220. See W. Zdouc, 'WTO Dispute Settlement Practice Relating to the General Agreement on Trade in Services' in F. Ortino and E.-U. Petersmann (eds), *WTO Dispute Settlement System: 1995–2003* (London: Kluwer, 2004), Ch 21 and A. Mattoo, 'MFN and the GATS', in T. Cottier et al. (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor: University of Michigan Press, 2000), 53.

in Article III:4 GATT, in *Canada—Autos*, the Panel held that a measure can be considered to be a measure affecting the internal sale of imported products even if it is *not* ‘shown to have an impact under current circumstances on decisions of private firms’ to buy imported products.²¹ Accordingly, in determining the coverage of the MFN provision in GATS, it is sufficient to show that a governmental measure has the potential to affect (i.e., to have an effect on) trade in service (including investment in services).

As mentioned in section II above, BITs and FTAs provide for a variety of investment liberalization and protection provisions which are aimed at promoting foreign investment including investment in the service sectors. In order for such investment provisions to be considered ‘measures affecting trade in services’ within the meaning of Article I:1 GATS, it is not required that they have an ‘actual’ effect on investment in services or that this effect be a ‘positive’ one (i.e., that they encourage foreign investment). It is simply sufficient that investment provisions in international agreements have the potential to modify the conditions of competition between investments or investors in services from any WTO Member.

B. Like services or service suppliers

The second element of the three-tier test of consistency concerning the MFN obligation of Article II GATS deals with the relationship between the service suppliers (including service investors)²² at issue. The non-discrimination obligation embodied in the MFN clause only applies between ‘like’ service investors. Accordingly, it is necessary to answer the following question: Are service investors of non-BIT/FTA origin (i.e., not covered by a BIT or FTA) *like* service investors of BIT/FTA origin (i.e., covered by a BIT or FTA)? In the example that we have given above (i.e., WTO Member A has concluded a BIT or FTA with Country B but not with WTO Member C), the relevant legal question here is the following: Are service investors (e.g. banks or engineering companies) from Country B *like* service investors from WTO Member C?

The GATS does not contain a definition of the term ‘like’ service providers. The issue of likeness under Article II GATS has only been addressed twice in GATS/WTO jurisprudence, albeit very briefly. In *EC—Bananas III* and *Canada—Autos*, a relevant statement by both Panels was that ‘to the extent that entities provide like services, they are like service suppliers’.²³ Looking at the extensive jurisprudence on the issue of the likeness of products under

²¹ WTO Panel Report, *Canada—Autos*, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, as modified by the Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R, paras 10.80 and 10.84. See GATT Panel Report, *Italy—Agricultural Machinery*, above at n 19, at para. 12.

²² Art. XXVIII(g) defines a ‘service supplier’ as ‘any person who supplies a service’, including natural and legal persons as well as service suppliers providing their services through forms of commercial presence, such as a branch or a representative office (see footnote 12).

²³ WTO Panel Report, *EC—Bananas III*, above at n 19, at para. 7.322 and WTO Panel Report, *Canada—Autos*, above at n 21, at para. 10.248.

GATT;²⁴ it may be said that the likeness test in the GATS should be based *inter alia* on the following factors: (a) service's end-uses in a given market; (b) consumer habits and preferences regarding the service or the service supplier; (c) characteristics of the service or the service supplier; and (d) classification and description of the service in the UN CPC system.²⁵

However, the issue of likeness does not raise problems when the governmental measure under review is a measure that expressly differentiates between (service) investors and investments *on the basis of the nationality* of the investor (i.e., it is a formally discriminatory measure). Since a formally discriminatory measure presupposes by definition that the regulated service investors and investments are, for purposes of that same measure, identical (that is, identical except for their different nationality), an examination of the service investors' relationship is not (or at least should not be) a relevant issue in the case at issue.²⁶

In our hypothetical example, it is the BIT or FTA itself that uses nationality as the discriminating criterion: it is only nationals of WTO Member A and Country B that can avail themselves of the investment protections of the BIT or FTA between countries A and B. Accordingly, any investors from WTO Member C (whether a financial service provider or an engineering firm) will be potentially 'like' investors from Country B that are covered by the investment protections provided for in the BIT or FTA between countries A and B.

C. 'Less favourable treatment'

The third and final element of the MFN test under Article II GATS focuses on the obligation to accord to services and service providers of members no less favourable treatment than the treatment they accord to like services and service providers of any other country.²⁷

Looking at WTO jurisprudence, the Appellate Body in *EC—Bananas III* took the view that 'treatment no less favourable' in Article II:1 of the GATS should be taken to include both *de jure* and *de facto* discrimination.²⁸

Further insights may be had from WTO jurisprudence interpreting the term 'less favourable treatment' in the field of trade in goods. From the early GATT practice, the phrase 'no less favourable' has been described as an expression of the underlying principle of *effective* equality of treatment between imported products, under the most favoured national standard. Accordingly, a measure

²⁴ WTO Appellate Body Report, *EC—Asbestos*, WT/DS135/AB/R, adopted 5 April 2001, at para. 101.

²⁵ A. Mattoo, 'National Treatment in the GATS—Corner Stone or Pandora's Box' (1997) 31 *JWT* 107, at 128, Zdouc, above at n 20 and van den Bossche, above at n 17, at 323–24.

²⁶ F. Ortino, *Basic Legal Instruments for the Liberalisation of Trade: A Comparative Analysis of EC and WTO Law* (Oxford, Hart 2004), 124 ff.

²⁷ The MFN obligation in GATS thus extends also to the treatment afforded to services and service providers of non WTO Member ('of any other country').

²⁸ WTO Appellate Body Report, *EC—Bananas III*, above at n 5, at paras 231–34.

affords less favourable treatment if it *adversely* modifies the conditions of competition between imports from two different countries. As mentioned above, in order to establish whether the ‘no less favourable standard’ has been met, panels need to determine whether the particular measure at issue has the *potential* to lead to the application to imported products of treatment less favourable, and not whether it had actually done so. Both non-discrimination norms in WTO law are there to protect *expectations* on the competitive relationship between products.²⁹

Affording service providers (or investors) from Country B, for example, an *additional* dispute settlement option (in the form of international arbitration), which is not available (or as favourable as that afforded) to service providers from WTO Member C may represent a breach of the MFN obligation as it may upset the equality of competitive opportunities between providers of Country B and WTO Member C.³⁰ Similar arguments may be raised with regard to the investment protection and liberalization provisions in BITs and FTAs, whereby investors from Country B would enjoy *higher* market access or post-entry guarantees (due to the BIT or FTA) compared to those accorded to investors from WTO Member C.

IV. AVAILABILITY OF THE ‘ECONOMIC INTEGRATION’ EXCEPTION OF ARTICLE V GATS?

Using the above hypothetical example, this section posits that Country A may not be able to resist a claim of a GATS violation by having recourse to the ‘Economic Integration’ exception provided for by Article V GATS since BITs lack ‘substantial sectoral coverage’ and FTAs do not always provide for the ‘elimination of substantially all discrimination’ in the sense of Article XVII GATS, as required, respectively, by subparagraphs (a) and (b) of Article V:1 GATS.

Aside from the exemptions to MFN that Article II:2 GATS allows WTO Members to maintain (for a limited period of time, and if listed in their Schedules of Commitments),³¹ Article V GATS on ‘Economic Integration’ provides for the only permitted departure from MFN treatment under the

²⁹ See GATT Panel Report, *Italy—Agricultural Machinery*, above at n 19, at paras 11–2 and GATT Panel Report, *US—Section 337*, adopted 7 November 1989, BISD 36S/345, at paras 5.10–5.13.

³⁰ Although it dealt *in casu* with the National Treatment obligation in Art. III GATT, the GATT Panel Report in *US—Section 337* found that the United States provided ‘less favourable treatment’ to imports *vis-à-vis* domestic products in light of the fact that Section 337 of the Tariff Act of 1930 allowed holders of US intellectual property rights to obtain *expedited relief* from the International Trade Commission against imports which infringe upon these rights, while patents infringement by domestic products were subject to *normal domestic judicial proceedings*.

³¹ These exemptions could be taken only at the time the negotiations were concluded. Most of them are subject to a ten-year expiration period since the entry in to force of the GATS (i.e., they should have expired in January 2005).

GATS. Modeled on Article XXIV GATT, Article V GATS provides for an exception to the MFN obligation in order to permit WTO Members to be party to or enter into an agreement liberalizing trade in services between or among the parties to such an agreement. Article V GATS, however, sets out the necessary requirements for such an economic integration exception to come into operation. It provides that the economic integration agreement:

- (a) has substantial sectoral coverage,³² and
- (b) provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII, between or among the parties, in the sectors covered under subparagraph (a), through:
 - (i) elimination of existing discriminatory measures, and/or
 - (ii) prohibition of new or more discriminatory measures, either at entry into force of that agreement or on the basis of a reasonable time frame, except for measures permitted under Articles XI, XII, XIV and XIV *bis*.

A. 'Substantial sectoral coverage'

With regard to the 'substantial sectoral coverage' requirement, footnote 1 to Article V specifies that 'this condition is understood in terms of numbers of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply'.

Both the meaning of Article V GATS in this regard and the concept of how substantial sectoral coverage should be measured are not very clear.³³ It would appear that the 'substantial sectoral coverage' requirement is there to prevent members from using the Article V exception for economic agreements that are limited to one specific mode of supply, such as cross-border services (mode 1) or foreign direct investment (mode 3). As noted by the WTO Secretariat, the requirement in Article V:1(a) 'is designed to prevent the conclusion of regional agreements with limited coverage, for example covering one or few sectors, or exchanging preferential treatment in limited domains such as foreign direct investment'.³⁴

The three relevant factors mentioned in footnote 1 (numbers of sectors, volume of trade affected and modes of supply) seem to apply cumulatively. In other words, the failure to cover a high number of service sectors or the exclusion of one or more modes of supply would mean that the international agreement lack substantial sectoral coverage for purposes of Article V:1(a).

³² See below sub-section A on 'substantial sectoral coverage'.

³³ S.M. Stephenson, 'GATS and Regional Integration', in P. Sauvé and R. Stern (eds), *GATS 2000: New Directions in Services Trade Liberalization* (Washington DC: Brookings, 2000), 514–15.

³⁴ See WTO Secretariat document, available at www.wto.org/english/thewto_e/whatis_e/eol/e/wto06/wto6_17.htm (visited 10 April 2006).

Accordingly, while determining the sectoral coverage of an economic integration agreement is generally a very difficult exercise,³⁵ it may not be so in the case of a BIT because of its evident lack of 'substantial sectoral coverage'. It should be emphasized in this regard that BITs generally limit their scope of application expressly to investors and investment of one party in the territory of the other party.³⁶ In other words, in GATS terminology, BITs cover principally 'commercial presence'. Thus, having regard to the 'modes of supply' factor, a BIT that only covers investment in services (i.e., commercial presence) but not cross-border trade in services (or consumption abroad) may not be said to have substantial sectoral coverage.

This conclusion is supported also by the additional requirement in footnote 1 specifying that the relevant agreement should not provide for the *a priori* exclusion of any mode of supply. Even if one were to interpret footnote 1 as requiring an *express* exclusion of any mode of supply, it appears that the provision in the BIT that limits the scope of application *ratione materiae* to foreign investment (in service) would be enough to fail the requirement of 'substantial sectoral coverage' of Article V:1(a) GATS.

A related issue is whether, for purposes of the 'substantial sectoral coverage' test, a BIT (covering investment in services) may be analysed in conjunction with an FTA (covering the cross-border trade in services, consumption abroad and presence of natural persons) which has been concluded between the same parties. If the combined effect of the two international agreements is to *substantially* cover service sectors, volume of trade affected and modes of supply, it may be argued that these two agreements would meet the requirement of Article V:1(a), even if taken individually they would fail such test. This conclusion is reinforced by the provision in Article V:2 GATS which states that 'In evaluating whether the conditions under paragraph 1(b) are met, consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned'.

³⁵ Stephenson, above at n 33, at 515. The author in particular notes the difficulty of measurement of the volume of trade in services because of the severe limitations on the availability of accurate data on services trade and the aggregate nature of the categories reported in statistical publications.

³⁶ Art. 2 on 'Scope and Coverage' of the 2004 US Model BIT provides that the treaty 'applies to measures adopted or maintained by a Party relating to: (a) investors of the other Party; (b) covered investments; and (c) with respect to Arts 8, 12, and 13, all investments in the territory of the Party'. The US Model BIT defines 'investor of a Party' and 'covered investment' as follows: *investor of a Party* means a Party or state enterprise thereof, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party; *covered investment* means, with respect to a Party, an investment in its territory of an investor of the other Party in existence as of the date of entry into force of this Treaty or established, acquired, or expanded thereafter.

B. 'Elimination of substantially all discrimination'

Even if the BIT or FTA in question is found to meet the 'substantial sectoral coverage' test, the international agreement would still need to comply with the non-discrimination requirement of Article V:1(b).

For purposes of determining the availability of the MFN exception of Article V GATS, the agreement in question needs to provide for the absence or elimination of substantially all discrimination, in the sense of Article XVII GATS, between or among the parties in the sectors covered by the agreement (except as permitted *inter alia* by general public policy exceptions and balance of payments safeguards). Albeit that GATS Article V:1(b) requirement is not as strict as the parallel requirement of Article XXIV:8 GATT,³⁷ it is nevertheless quite broad given the scope of application of the National Treatment provision in Article XVII GATS. As noted above, the National Treatment provision in GATS covers potentially any governmental measures 'affecting' *inter alia* investment in services, including both measures that restrict investment entry or admission to the host state (pre-establishing phase) and measures that apply to the post-establishment phase of foreign investment.

This broad interpretation has been followed in *Canada—Autos*, where the Panel considered that, with respect to an import duty exemption available to only a limited number of firms, Canada could not claim an exemption from its MFN obligation under Article II by invoking Article V:1 GATS. The Panel noted that the Canadian measures at issue did not grant more favourable treatment to all services and service suppliers of members of NAFTA (i.e., only a small number of manufacturers/wholesalers of the United States and of Mexico enjoyed more favourable treatment).³⁸

Although some recent BITs and FTAs provide for broad national treatment obligations with regard to investment (including both pre and post-establishment investment measures), the majority of BITs and a number of FTAs still tend to limit the scope of their national treatment obligations to post-establishment, only. Focusing on this point, these latter agreements may fail the broad non-discrimination requirement of Article V:1(b) GATS.³⁹

However, Article V:1(b) does not require the elimination of all discrimination, but only the elimination of *substantially* all discrimination. As noted by the Appellate Body in *Turkey—Textiles* with regard to the similar provision in Article XXIV:8 GATT, 'substantially all' is not the same as 'all', and is something considerably more than merely 'some'.⁴⁰ Furthermore, while recognizing

³⁷ See J.H. Mathis, 'Regional Trade Agreements and Domestic Regulation: What Reach for "Other Restrictive Regulations of Commerce"', in this volume, at XXX.

³⁸ WTO Panel Report, *Canada—Autos*, above at n 21, at para. 10.271.

³⁹ A more complex issue is whether the national treatment provisions in BITs and FTAs (even if applicable to both pre and post-establishment) need to be formulated or (at least) interpreted as provided for in Art. XVII GATS.

⁴⁰ WTO Appellate Body Report, *Turkey—Textiles*, WT/DS34/AB/R, adopted 19 November 1999, at para. 48.

that the terms of Article XXIV:8(a) offer 'some flexibility' to the constituent members of a RTA when liberalizing their internal trade (as members may maintain in their internal trade certain restrictive regulations of commerce permitted under Articles XI through XV and under Article XX GATT), the Appellate Body cautioned that the degree of 'flexibility' is limited by the requirement that 'duties and other restrictive regulations of commerce' be eliminated with respect to 'substantially all' internal trade.⁴¹

It is difficult to determine whether a BIT or FTA limiting its national treatment obligation only to post-establishment measures will satisfy the 'elimination of substantially all discrimination' requirement of Article V:1(b) GATS. This determination cannot but involve a case-by-case analysis, where particular attention will have to be paid to any exclusion or exemption of the scope of application of the national treatment obligation provided for in the BIT or FTA (for example, through exclusions included in an annex to the agreement or through conditions imposed on a member's positive list of commitments). Furthermore, with regard to FTAs, determining whether the agreement provides for the elimination of substantially all discrimination will necessarily imply an analysis of all modes of supply (and not just the 'commercial presence' mode of supply). In other words, it may be that by maintaining certain discriminatory measures to the pre-establishment phase, an FTA will nevertheless meet the requirement of Article V:2(b) GATS if overall the agreement eliminates all discrimination in relation with the other three modes of supply ('cross border', consumption abroad', 'presence of natural persons').

V. BRIEF CONCLUSIONS

As the process of integration of the global market place continues, efforts to steer such process at the international level through treaty-making (whether of a bilateral, regional or multilateral nature) should at a minimum seek to achieve a certain level of coordination, and in particular consistency with such fundamental instruments as GATS. The current legal framework relating to liberalization of the international provision of services does not appear to achieve that objective. It may be inevitable that inconsistencies will occur between so many bilateral and regional international agreements, which are negotiated by different people in different countries with different policy aims, but government trade officials, academics and international organizations need to consider carefully how better to coordinate BITs and FTAs with obligations under GATS, if the whole system is not to tie itself in knots.

⁴¹ *Ibid.* In the context of Art. XXIV:8(a)(ii), the Appellate Body agreed with the Panel that the ordinary meaning of the term 'substantially' appears to provide for both qualitative and quantitative components: *ibid.*, at para. 49 citing the WTO Panel Report, *Turkey—Textiles*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, at para. 9.148.