Unclassified **DAFFE/MAI/EG3(96)10**

Organisation for Economic Co-operation and Development
Organisation de Coopération et de Développement Economiques

30 August 1996

Negotiating Group on the Multilateral Agreement on Investment (MAI)

Expert Group No.3 on "Special Topics"

INVESTMENT INCENTIVES

(Note by the Chairman)

This document was issued during the MAI negotiations which took place between 1995 and 1998.
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INVESTMENT INCENTIVES

Note by the Chairman

I. General considerations

1. The Expert Group considered that as a high standard agreement, the MAI should **cover Investment Incentives (IIs) and try to develop disciplines on them**. IIs are an important aspect of the treatment accorded to foreign investors and their investments. IIs can also have distorting effects on cross border investment flows and lead to costly competitive bidding among governments to attract foreign investment. **Opinions varied, however, as to the possible nature and scope of MAI provisions in this area.**

2. The discussion confirmed that IIs are both a politically sensitive and technically difficult subject. IIs can take various forms and cannot be easily defined**. The nature and size of economic distortions they can create may vary.** Existing international agreements such as the 1994 GATT Agreement on Subsidies and Countervailing Measures and the WTO TRIMs Agreement contain important disciplines on the trade effects of IIs, but it is not entirely clear whether, or to what extent, they adequately address "investment" related problems of IIs. IIs are also related to other subjects discussed under the MAI, including performance requirements and taxation.

3. In light of these considerations, the Expert Group examined two broad sets of issues namely a) the application of the National treatment, MFN treatment and Transparency to the field of IIs and b) the desirability and feasibility of including in the MAI specific disciplines on those IIs which may cause the greatest distorting effects on the international allocation of foreign investment.

II. Application of the Treatment obligations of the MAI

i) National Treatment and MFN Treatment

4. A majority of delegations considered that the obligations of National Treatment and MFN treatment should apply to all types of IIs (with due regard to the treatment of taxation issues under the MAI under consideration in the Expert Group n°2). **They also considered MFN treatment should apply where National Treatment is not provided. One delegation indicated, however, that these obligations should be limited to IIs that do not distort trade. Another delegation indicated it remained opposed to MAI disciplines in the area of IIs.**

5. Those delegations which were in favour of MAI disciplines considered, however, that non-conforming measures could be covered by country specific reservations in accordance with the procedures defined by Drafting Group N°2 [DAFFE/MAI/96(16)]. **One delegation held the view that the**

Contracting Parties should have the right to lodge such reservations when new IIs programmes are created.

6. The application of these core obligations of the MAI should not present difficulties when the conditions for acceding to IIs programmes are clearly defined in domestic legislation or other legal texts. Some delegations noted, however, that it may not always be easy to make such a determination if responsible authorities are given some discretion in implementing these programmes. While this problem may not be confined to IIs, it is of particular significance in this case because of the subjective nature of the assessment of the merits of an investment proposal. **Other delegations noted, however, that this should not prevent the application of MAI obligations.**

7. **Delegations also discussed the situation of IIs tailored** to a particular investment project, often referred to as "one-off" or occasional IIs. A number of delegations expressed doubts as to the applicability, in the absence of any appropriate point of comparison, of the National Treatment and MFN provisions since these are comparative terms. This type of IIs may amount to a major limitation to these obligations, particularly in view of the growing importance of these schemes in OECD countries in recent years.

8. Other delegations considered that this did not constitute a compelling reason for explicitly excluding occasional or one-off IIs from the coverage of the MAI. They argued, on the contrary, in favour of strong and comprehensive obligations on transparency and dispute settlement to prevent a weak interpretation and application of the National Treatment and MFN treatment obligations.

9. It would be desirable to reflect further on this problem.

ii) Transparency

10. A majority of delegations considered it unnecessary to develop specific disciplines on transparency in addition to those already envisaged under the transparency article of the MAI [DAFFE/MAI(96)16, section A.II.2]. If, as proposed, IIs are made subject, in principle, to the National treatment and MFN provisions, the Contracting Parties would be obliged "to promptly publish, or otherwise make publicly available, its laws, regulations, procedures and policies[1]" on IIs insofar as they "may affect the operation of the Agreement". They would be obliged to promptly respond to specific questions and provide, upon request, information to other Contracting Parties on matters raised by the IIs[2]. Some delegations also referred to the administrative burden already imposed by the transparency obligations of other international agreements, notably the 1994 GATT Agreement on Subsidies and Countervailing Measures. **Another delegation felt this was not an overriding argument and, moreover, stated that transparency should be achieved at all levels of government, including sub-federal entities.**

11. A few delegations questioned, however, whether this article would be sufficient with respect to IIs. It was not clear, in their view, whether the language would capture all modalities of implementation of

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1 ... and administrative rulings and judicial decisions of general application as well as international agreements which may affect the operation of the Agreement. Where a Contracting Party establishes policies which are not expressed in laws or regulations or by other means listed in this paragraph but which may affect the operation of the Agreement, that Contracting Party shall promptly publish them or otherwise make them publicly available.

2 Contracting Parties would not be required to disclose confidential business information, however.

IIs or, more importantly, the discretionary decisions of responsible authorities **and the actual amount of aid disbursed**. Additional provisions could provide, as in the Energy Charter, that one-off IIs programmes be reported to the implementing authorities of the MAI in order to be scrutinised. **Transparency would appear to be a minimum obligation for this type of II. A few delegations felt that** individual foreign companies may also be given the right to have answers provided concerning specific questions they may have on IIs. **As regards transparency in the disbursement of IIs, one delegation argued that this was not only a highly sensitive issue, but a very difficult obligation to implement.**

12. The Expert Group agreed that these issues need further consideration.

III. Additional disciplines

i) Positive discrimination

13. It was acknowledged that the National Treatment and MFN obligations would not prevent Contracting Parties to offer, in their respective territories, "more favourable" IIs to foreign investors than to national investors. A large number of delegations felt, however, that it would not be wise to **prohibit** positive discrimination in favour of foreign investors in respect of IIs. This could create confusion over the meaning of the National Treatment obligation under the MAI and raise the question of why positive discrimination is not prohibited in other fields. Such an obligation would certainly create difficulties for those countries which actively engage in foreign investment promotion; moreover, it could discourage non-OECD countries from adhering to the MAI.

14. Other delegations argued, however, that it should be possible to incorporate this obligation into the MAI. This approach would have the advantage, **if applied across the board,** of not requiring a general definition of IIs. IIs programmes could gain in fairness and acceptability at the national or local levels. It would render the grant of an II more costly to governments since both domestic and foreign investors would be entitled to the same benefits. **It would be compatible with a high standard MAI. One delegation suggested that positive discrimination could be forbidden for some incentives (such as subsidies).**

15. **It was agreed that further work was necessary to determine the merits of this approach**.

ii) Specific limitations on the use of IIs

16. **A large majority of** delegations considered that it would be very difficult, if not impossible, within the time table set for the MAI negotiations to devise any specific limitations on the use of IIs beyond National Treatment, Most Favoured Nation and Transparency. A number of considerations were in support of this position.

17. The problems created by IIs have not yet, in their view, been adequately defined. There is not sufficient information about the nature, scope and economic effects of IIs. IIs may take a variety of forms, some specific (grants, subsidies, tax advantages...) as well as more general forms (infrastructure or R&D facilities, differences in regulatory requirements). **These forms may very over time and between countries.** They can be provided by different levels of government (state, local, municipalities). They may be based on a variety of considerations (job creation, regional development...). Individual tax and

non-tax incentives are also often interchangeable. Extensive ground work would, therefore, appear necessary to determine priorities for additional disciplines in this area.

18. Caution was also recommended over duplicating or re-opening disciplines agreed in other fora. It was noted, in particular, that the GATT Subsidies Agreement contains provisions on certain types of "trade" distorting investment incentives. It would be desirable to assess to what extent these disciplines cover "investment" distorting IIs and, in particular, those which cause the greatest distortions to international investment.

19. **Some delegations indicated that** the MAI should not aim at consolidating these disciplines, but rather at addressing possible gaps in the treatment of investment distorting IIs. This too could require extensive analytical work.

20. At a more general level, it was underlined that quantitative or qualitative limitations on IIs would conceptually represent a new approach from that embodied in the National Treatment and MFN provisions. While the purpose of the latter is to confer rights to foreign investors, the imposition of constraints on the use of IIs would inevitably take away certain benefits from foreign investors. **Several** delegations indicated they were not prepared to consider this approach since it could also reduce their ability to attract those foreign investments that could benefit their economy. Other delegations questioned the rationale of disciplining IIs of MAI Parties in the absence of similar disciplines on non-MAI Parties. This would entails the risk of negatively affecting the competitive position of the former in relation to the latter.

21. A few delegations expressed unease, however, over the prospect of not tackling at all the problem of distortionary IIs during the MAI negotiations. **A few delegations** considered that it should be possible to draw on work done elsewhere, notably in the GATT and the OECD, to draft specific provisions on both tax and non-tax IIs. Article 1 of the 1994 Agreement on Subsidies and Countervailing Measures could provide a basis for defining such IIs. It would also be desirable that the MAI focus on IIs that are specific to an enterprise, industry, or locality. Article 2 of the GATT Agreement could also provide a useful starting point for defining such a specific requirement. With regard to the disciplines that could be envisaged, one delegation suggested that stand-still and roll-back could constitute effective means for reducing the global distortion of investments caused by IIs. It invited the Expert Group to examine the suggestions made in its Note DAFFE/MAI/EG3/RD(96)1.

22. Another delegation suggested that Article 10 of the Energy Charter on Investment Promotion and Protection could provide an alternative option for including provisions on IIs in the MAI. A best endeavour clause could encourage MAI Parties to practice restraint in the allocation of IIs and to inform the Parties Group of the specific modalities of any existing or new IIs programmes. This article could also specify a programme for further work on IIs after the coming into force of the MAI. This approach would be less ambitious than the GATT approach, but it would present the advantage of securing more time for both necessary analytical work as well as the basis of the potential elaboration of provisions on the basis of the analysis.

23. Delegations were less attracted by the approach in the OECD Instrument on International Incentives and Disincentives although they did not want to discard it completely for now. **One delegation suggested, nevertheless, that non-binding guidelines might be the best approach for the use of certain IIs.** Some Delegations thought it might be worthwhile to study the merits of the procedures of the OECD Arrangement on Guidelines for Officially Supported Credits.

24. Delegations remained unconvinced by the need for special consultation procedures for IIs, although final judgement would need to await the decisions taken on the coverage of the MAI. The presumption was that as with other agreements, consultations would be the first procedural step of the dispute settlement mechanism of the MAI. Consultations could also be part of the Parties Group's functions. It should be possible to revisit the adequacy of the provisions on dispute settlement and the role of the Parties Group when their configuration is better known. One delegation questioned whether the dispute settlement mechanism of the MAI could apply to investment distorting IIs or to IIs granted illegally. These questions would also deserve further attention.

25. The Expert Group concluded that further work was required to assess the merits of various options, **notably that of identifying a possible built-in agenda item for the MAI after its entry into force.**

26. A background note [DAFFE/MAI/EG3(**96)14**] was prepared to take stock of the provisions in existing international agreements which apply to IIs and review analytical work already done in this area.This note was reviewed by the Expert Group at its September 1996 meeting.

27. On the basis of the discussion, the Expert Group concluded that the most appropriate way to proceed would be to *...(to be completed in light of September's meeting).*