



Negotiating Group on the Multilateral Agreement on Investment (MAI)

**DEPARTURES FROM STANDSTILL: GATS, NAFTA
AND POSSIBLE SOLUTIONS FOR THE MAI**

(Note by the Chairman)

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1. The "standstill" principle, i.e. not to adopt any new non-conforming measures is a key feature of the MAI. At the same time, we have recognised that limited exceptions to standstill may be justified to preserve flexibility for future departures from MAI disciplines for specific purposes, such as domestic sensitivities or the role of other international agreements.

2. My earlier note [DAFFE/MAI(98)5] set out a list of principles which could apply to solutions permitting departures from standstill under the MAI. The Annex to that Note lists eight areas - (i) National Security; (ii) Public Order; (iii) REIO; (iv) Culture; (v) Subsidies; (vi) Issues arising from international agreements; (vii) Aboriginal/Minority Preferences, and (viii) Social Services - where departures from standstill are an issue. Privatisation and demonopolisation may also be relevant in this context.

3. In my view, a comprehensive approach to departures from standstill should:

- avoid large carveouts wherever possible;
- draw exceptions tightly around needs by sector/activity;
- recognise elements common to many or all countries;
- recognise country-specific elements: on certain issues: some countries are ready to commit to standstill, while others wish to retain flexibility;
- contribute to the overall balance of rights and obligations under the MAI;
- achieve maximum transparency;
- ensure the protection of existing investments.

4. The present note seeks to advance the discussion on these issues. To that end, Annex I presents a succinct analysis of approaches under GATS and NAFTA, where parties already had to deal with most of the concerns listed in paragraph 2 above. It might be helpful to be aware of their choices and solutions when considering how we should deal with these issues in the MAI.

5. Annex II deals with air transport as a highly regulated services sector, while Annex III deals with Aboriginal/Minority preferences. Both these Annexes take account of GATS and NAFTA experience and propose illustrative texts for consideration in the MAI.

6. The approach in these draft Annexes could also serve as inspiration for further Annexes in other areas. For instance, the fisheries sector could be treated in a way comparable to the air transport sector. In other areas, such as maritime transport or culture, a mixed approach between common rules in an Annex and country-specific exceptions, such as proposed for Aboriginal Preferences, could be considered.

Questions:

1. Do Delegates agree with the approach proposed in Annex II on Air Transport?

2. Do delegates agree with the approach proposed in Annex III on Aboriginal/Minority preferences?

ANNEX I

ANALYSIS OF APPROACHES UNDER GATS AND NAFTA

This Annex first summarises the general approach in GATS and NAFTA regarding the standstill principle. It then presents the choices made in GATS and NAFTA with regard to the eight issues listed in the Annex DAF/MAI(98)5 as possible exceptions allowing future departures from standstill: (i) National Security; (ii) Public Order; (iii) REIO; (iv) Culture; (v) Subsidies; (vi) Issues arising from international agreements; (vii) Aboriginal/Minority preferences and (viii) Social services.

GATS AND NAFTA: THE GENERAL APPROACH TO STANDSTILL

The GATS provides, to a large extent, for standstill at the parties' discretion. Due to the "bottom-up approach", future departures from standstill regarding Market Access and National Treatment are prohibited only in accordance with commitments inscribed in a party's schedule.¹ New restrictive measures are allowed for any sector, subsector or mode of delivery not bound in a country's schedule. Future departures from MFN are permitted for sectors and measures inscribed in a country's list of MFN exemptions.

Only the approach contained in the GATS Understanding on Financial Services includes a general standstill obligation for countries scheduling in accordance with this approach. This is possible because, contrary to the GATS in general, the Understanding is based on a top-down, rather than a bottom-up approach.

NAFTA's standstill obligations are in principle further-reaching than those of the GATS, since NAFTA applies the "top-down approach", i.e. any restrictive measures not listed as exceptions/reservations are prohibited. Reservations for existing measures are inscribed in NAFTA's Annex I and subject to standstill.

With regard to investment and services, however, NAFTA enabled parties to inscribe reservations for future measures in a closed list attached as Annex II to the Agreement. Reservations for future measures in Annex II may concern all sectors - including financial services - and any of NAFTA's principal obligations:

- National Treatment
- MFN
- Local Presence
- Performance Requirements
- Senior Management

However, future measures are not exempt from the NAFTA's obligations regarding investor protection (i.e. transfers, expropriations etc.).

There is a separate Annex IV for certain MFN exceptions. In fact, Annex IV only lists MFN exceptions with regard to existing (all) or future (some sectors only) bilateral or multilateral agreements. Any other exceptions to MFN and/or other obligations regarding future measures are included in NAFTA's Annex II.

1. Even for sectors inscribed in a country's schedule of specific commitments, the standstill obligation is not absolute: Article XXI GATS allows for withdrawal of any commitment, while giving to the other parties an entitlement for compensation.

GATS AND NAFTA: APPROACHES REGARDING SPECIFIC ISSUES

(i) National Security

GATS: Article XIV bis contains a general exception regarding national security similar to the draft Article in the MAI Consolidated Text, with the notable exception of the subparagraph on nuclear weapons, which is considerably wider in the GATS. The question of maintaining investment protection even in circumstances affecting national security, as stipulated in the Consolidated Text, is not at issue under the GATS, which does not provide for investment protection.

NAFTA : Article 2102 has the same wording as the draft in the Consolidated Text, with the latter being somewhat more restrictive regarding application of the National security exception to the supply of military establishments.

(ii) Public Order

GATS: Article XIV contains a general exception for public order. Considerably wider than the draft paragraph in the MAI consolidated text, it exempts (a) measures necessary to protect public morals or to maintain public order; (b) measures necessary to protect human, animal or plant life, or health; (c) measures necessary to secure compliance with laws or regulations not inconsistent with the Agreement.

NAFTA: The general provisions covering certain public-order related issues in Article 2101 do not apply to the NAFTA Investment Chapter. A specific paragraph in the Investment Chapter reserves parties' rights to take measures for the purposes of law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health and child care, as long as these measures are consistent with the provisions of NAFTA. It is noteworthy that consumer protection measures are covered as an exception with regard to cross-border services, but not with regard to investment.

(iii) REIO

GATS: Article V on Economic Integration allows for preferential liberalisation measures amongst parties to economic integration agreements, provided such measures do not, with respect to third parties, raise the overall level of barriers within a given sector or subsector. Subsidiaries of third-country enterprises established within REIO territory are entitled to REIO treatment. The GATS also includes notification, examination and recommendation procedures applicable to REIOs.

NAFTA: Contains no REIO clause.

(iv) Culture

GATS: The GATS does not include a general exception regarding culture. Because of the Agreement's "bottom-up" approach, parties wishing to remain free to adopt future measures protecting their cultural identity:

- did not inscribe any of the culturally sensitive sectors, such as audio-visual services, in their schedules of commitments, and
- included MFN exemptions regarding these sectors into their individual MFN exemption lists (some countries have only inscribed MFN exemptions regarding existing and future co-production agreements).

As a result, measures regarding audio-visual services in the countries concerned are neither subject to standstill nor to MFN. At the same time, it remained possible for other GATS parties to offer broad standstill and MFN commitments on audio-visual services in exchange for commitments in other sectors. Transparency requirements apply to all parties.

NAFTA: NAFTA Article 2106, in conjunction with Annex 2106, spells out a general exception for cultural industries. It is subject to the same terms and conditions as the cultural exception in the Canada - United States Free Trade Agreement. It therefore includes the possibility of retaliation for the other party where new restrictive measures are applied for cultural reasons.

NAFTA Article 2107 contains a closed list of sectors which are considered "cultural industries" (books, films and video tapes, audio or video music recordings, music CDs, and broadcasting).

(v) Subsidies

GATS: There is no general exception for subsidies. Article XV GATS provides, however, for future negotiations to "...avoid [the] trade-distortive effects.." of subsidies. Future measures restricting National Treatment remain possible for sectors which have not been inscribed into a country's schedule, or where a horizontal commitment has been limited accordingly. Non-application of the MFN principle requires in addition a corresponding entry in a country's MFN exemption list.

NAFTA: The Investment Chapter in Article 1108 excludes subsidies from the obligations regarding National Treatment, MFN and Senior Management. In accordance with Article 1106(3), a reduced set of obligations regarding Performance Requirements apply to the granting of "...an advantage in connection with an investment...".The interdiction of performance requirements is further relaxed in the particular case of export promotion and foreign aid programs.

(vi) Aboriginal/Minority Preferences

GATS: No general exception. No entries in schedules regarding horizontal commitments. No entries in individual MFN exemption lists. This may be due to the definition of National treatment under the GATS.

NAFTA: All three NAFTA countries have lodged reservations for existing and future measures in Annex II, regarding National Treatment and other obligations. It should be noted that NAFTA Article 1102(3) defines National Treatment for the Investment Chapter, with respect to a state or province, as "treatment no less favourable than the most favourable treatment accorded, in like circumstances, by the state or province to investors, and to investments of investors, of the Party of which it forms a part".

(vii) Social Services

GATS: The NAFTA countries, Australia and New Zealand have excluded standstill for social services by not inscribing this sector in their schedule of specific commitments. No MFN exemptions have been listed. Other countries have not excluded the Social Services sector as a whole, but maintain public monopolies. It should be noted that a number of services in this sector are usually provided directly by governments, on a non-competitive, non-commercial basis. Such government services are excluded from the coverage of the GATS in accordance with Article 1(3)(b).

NAFTA: All NAFTA parties have lodged identical reservations in Annex II regarding National Treatment, Local Presence and Senior management (only Canada also regarding MFN) for existing and future measures concerning social (including health) services for a public purpose.

(viii) Issues arising from international agreements

(a) Government Procurement

GATS: Article XIII of the GATS contains a general exception, with regard to Government Procurement, from the MFN, Market Access and National Treatment obligations. Paragraph II of this Article refers to the multilateral negotiations on government procurement in services.

NAFTA: Chapter 10 on government procurement applies to the procurement of both goods and services. It provides for National Treatment and MFN for foreign suppliers from other NAFTA countries, with regard to the tendering and selection process. The provisions of Chapter 10 replace those of the Investment Chapter on National Treatment, MFN, Senior Management, as far as Government Procurement is concerned (cf Article 1108). Some elements of the Chapter's obligations regarding Performance Requirements remain, however, applicable..

(b) Fisheries

GATS: Not applicable, except for services incidental to fishing. Canada has lodged an MFN exemption regarding preferential bilateral relations in this sector.

NAFTA: There are no specific provisions on fisheries. Chapter 11 fully covers investment in the fisheries sector. All NAFTA countries have, however, taken an exception to MFN in Annex IV regarding existing and future bilateral and multilateral agreements in the fisheries sector. There are no other reservations covering future measures with regard to fishing.

(c) Air Transport

GATS: The GATS Annex on Air Transport Services has two main features: It confirms explicitly that GATS obligations shall not reduce or affect a party's obligations under existing bilateral or multilateral agreements. And it carves out of the GATS' coverage air transport traffic rights (including criteria for the designation of airlines, such as ownership and control) and directly related services.(6)

Nevertheless, the United States and the European Community, for instance, have lodged an MFN exemption regarding bilateral agreements relating to (i) computer reservation systems, and (ii) the selling and marketing of air transport services.

NAFTA: NAFTA does not feature a specific Annex on air transport. All parties have taken, however, an exception to MFN in Annex IV regarding existing and future bilateral and multilateral agreements in the aviation sector. Moreover, Chapter 12 excludes cross-border provision of all air services, whether domestic or international (except air speciality and aircraft repair) from NAFTA coverage. Finally, Annex II contains a reservation by Canada, with regard to NT, MFN and Senior Management, covering future measures on investment in air speciality services. All NAFTA countries have included their existing rules on the "genuine link" in Annex I (standstill).

(d) Maritime Transport

GATS: Negotiations on Maritime Transport regarding international shipping, auxiliary services and access to port facilities have not been concluded yet under the GATS. Any commitments that may have been made are legally not subject to standstill and application of the MFN principle has been limited. At the moment, there is no general reference to existing or future bilateral and multilateral agreements on maritime matters.

NAFTA: No specific Annex on Maritime Transport has been included. All NAFTA countries, however, have taken an exception to MFN in Annex IV regarding existing and future bilateral and multilateral agreements on maritime matters. In addition, Annex II contains the following reservations to National Treatment, MFN and other obligations, with regard to future measures: (i) Canada, with respect to maritime cabotage, and a specific MFN denial (as compared with Mexico) for US investors; (ii) United States, with respect to any maritime transport services, except vessel construction and landside aspects of port activities. Only Canada appears to have listed, in Annex I, its existing conditions concerning the "genuine link" required to fly the Canadian flag

e) Telecommunications

GATS: Negotiations on basic telecommunications services were finalised only about a year ago. Many limitations to commitments concern cross-border services rather than investment. A number of countries still maintain full or partial monopolies in the basic telecommunications sector.

Furthermore, the GATS features a specific Annex on access and use of public telecommunications transport networks and services. It provides for foreign suppliers' access to such networks and services (except with regard to cable or broadcast distribution of radio or television programming) and defines the conditions and restrictions which may be imposed. A specific paragraph recognises the role of specialised international organisations and agreements.

NAFTA: A special chapter deals with investment and services in certain areas of the telecommunications sector (mainly public networks and value-added services). It does not apply to broadcast or cable distribution of radio and TV programs.

All three NAFTA countries have taken an exception to MFN in Annex IV for existing and future bilateral and multilateral agreements in the field of telecommunications transport. In addition, Annex II contains the following reservations to National Treatment, MFN etc. for future measures: (i) Canada, on telecommunications transport, (ii) Mexico on telecommunications transport, as well as on certain other telecom services, (iii) United States on telecommunications transport and cable television.

ANNEX II

AIR TRANSPORT

1. Activities in the Air Transport sector are to a large extent governed by a network of multilateral and bilateral agreements. While the MAI is intended to apply fully to investment in the Air Transport sector, it is not its role to call into question the balance of rights and obligations established under existing or future multilateral and bilateral treaties. The attached draft Annex on Air Transport to the MAI seeks to reconcile these objectives. It proposes a generic solution¹, given that the issue of bilateral/multilateral agreements on air transport arises for virtually all MAI countries.

2. Drawing on the Annex on Air Transport Services to the GATS, Article 1 excludes all measures concerning air traffic rights from the coverage of the MAI's principal obligations, i.e. National Treatment, MFN, Performance requirements and Senior Management and Board of Directors. This applies independently from the framework within which such measures are taken, whether unilaterally or, as will mostly be the case, through international agreements.

3. Measures concerning air traffic rights could probably be seen as less relevant to the MAI than to the GATS. Indeed, such measures will in most cases affect the cross-border provision of services, rather than investment. However, it has been pointed out by some delegations that under the MAI definition of investment, in certain circumstances, air traffic rights could possibly be considered as one of an airline's assets. The wording of Article 1, while excluding the MAI's main obligations, maintains investor protection for existing air traffic rights to the extent that they constitute an asset.

4. The definition of "air traffic rights" in Article 1 reproduces the text appearing in the GATS Annex on Air Transport, with the notable exception of "criteria for the designation of airlines, including such criteria as number, ownership or control".

5. While it may, strictly speaking, not be necessary from a legal point of view, Article 2 sends a signal by reaffirming the MAI parties' determination to keep investment in air transport within the coverage of the Agreement. In this respect, it should be noted that the obligations regarding foreign direct investment, contained in the OECD Code of Liberalisation, already apply to ownership and control of airlines.

4. Article 3 of the draft Annex is inspired by the GATS Annex on Air Transport, but also by Annex IV to NAFTA. In order to preserve MAI countries' ability to maintain existing and conclude future bilateral or multilateral agreements without having to extend preferential treatment to other MAI parties, Article 3 excludes such agreements from the MFN obligation. At the same time, other MAI obligations will continue to apply. Therefore, future agreements may not impose new restrictions on third countries.

1. cf para 6 of the Aide-Memoire of the Meeting of the Technical Group on country-specific exceptions held on 21-23 January 1998 [DAFFE/MAI/EX(98)18].

5. This approach is also inspired by the fact that many OECD countries, including the EU and the United States, have scheduled MFN exemptions under the GATS for existing and future bilaterals regarding air transport (applicable to areas other than air traffic rights, such as computer reservation systems). The general exception proposed in Article 3 would obviate the need for open-ended specific country exceptions regarding existing and future bilaterals which some countries have included in their list of proposed exceptions to the MAI.

ILLUSTRATIVE TEXT OF AN ANNEX ON AIR TRANSPORT

Article 1

Air Traffic Rights

1. Obligations under this Agreement regarding National Treatment, MFN, Performance Requirements and Senior Management and Board of Directors shall not apply to the granting of air traffic rights.
2. "Air Traffic Rights" mean the right for scheduled and non-scheduled services to operate and/or to carry passengers, cargo and mail for remuneration or hire from, to, within or over the territory of a Member, including points to be served, routes to be operated, types of traffic to be carried, capacity to be provided, tariffs to be charged and their conditions.
3. No Contracting Party may, under any measure adopted after the date of entry into force of this agreement and authorised under paragraph 1 of this Article, require an investor of another contracting Party, by reason of its nationality, to sell or otherwise dispose of an investment at the time the measure becomes effective.¹

Article 2

Ownership of Airlines

Nothing in the provisions of Article 1 shall be construed as affecting Parties' obligations regarding ownership, control and management of airlines, or any other enterprises providing air transport services.

Article 3

Other International Agreements

1. This Agreement shall not affect parties' rights and obligations under existing bilateral and multilateral agreements.
2. Article X [on MFN] shall not apply to treatment accorded under existing and future international agreements in the air transport sector.

1. This text draws on NAFTA Article 1108(4), reproduced in the Consolidated Text DAF/MAI(98)7, p.89.

ANNEX III

ABORIGINAL/MINORITY PREFERENCES

1. A number of MAI countries have proposed open-ended exceptions or specific Annexes to cover measures according preferential treatment to some of their nationals, usually in the framework of specific policies in favour of aboriginal people and/or disadvantaged minorities.
2. At issue is not the question of whether the MAI should allow existing and future measures in favour of aboriginals and minorities - the principle is largely accepted -, but rather the question of how this needs to be reflected in the MAI. The answer depends on the definition of National Treatment. Would MAI National Treatment oblige parties to accord foreign investors treatment no less favourable than the best treatment available, even if such treatment is reserved to ethnic and other minorities, or is it sufficient to accord treatment no less favourable than that accorded to national investors in general? Only in the first case, an exception - either country-specific or general - would be required.
3. This issue is closely linked to the question of definition of national treatment in federal States: Does the concept of National Treatment require in-state treatment for foreign investors, or is it sufficient to accord treatment no less favourable than that accorded to out-of-state nationals? The question has been raised in MAI negotiations¹ (1), but not yet settled.
4. NAFTA Article 1102(3) defines National Treatment with respect to a state or province as "treatment no less favourable than the most favourable treatment accorded, in like circumstances, by the state or province to investors, and to investments of investors, of the Party of which it forms a part". All three NAFTA countries have lodged reservations for existing and future measures regarding preferential treatment for aboriginals in Annex II to NAFTA.
5. The GATS, on the other hand, does not contain an explicit definition comparable to Article 1102(3) NAFTA. Perhaps for that reason, none of the three NAFTA countries has deemed it necessary to inscribe a limitation regarding existing and future measures in favour of aboriginals into their GATS schedules.
6. MAI negotiators should consider the following options:
 - (i) In the current Consolidated Text, National Treatment remains defined as treatment no less favourable than the treatment accorded to a Party's own investors. It does not require "treatment no less favourable than the most favourable treatment", for instance treatment accorded to in-state-residents or to ethnic minorities. Neither a general exception nor open-ended country-specific exceptions would be required for preferential treatment of aboriginals. If parties deemed it necessary, this could, however, be clarified through an interpretative note.
 - (ii) National treatment could be defined, as in the NAFTA precedent and in accordance with the proposal by one delegation, by comparison with the best treatment available to national investors, which includes in-state treatment and preferential treatment for minorities. Countries wishing to maintain freedom with regard to preferential treatment for aboriginals and/or other minorities would have to lodge open-ended exceptions, and/or obtain consensus for a specific Annex or a general exception clause.

1. see proposal by one delegation in the Consolidated Text DAF/MAI(98)7, p.118

7. If agreement were reached on the second option, i.e. that the National Treatment definition should cover the "best treatment available", negotiators will need to consider the technical options for allowing departures from standstill regarding aboriginal/minority preferences, in accordance with the guiding principles set out in the present Note, as well as in paragraph 10 of the Chairman's note on exceptions [DAFFE/MAI(98)5].

8. Attached to this note is the draft text of an Annex to the MAI which illustrates one possible solution. The approach in this Annex is based on a mixture of general exception and country-specific approach. It spells out an authorisation to lodge open-ended country-specific exceptions intended to protect aboriginals or other minorities. Such exceptions would remain subject to review, notification and transparency requirements, and be taken into account when establishing the balance of commitments. Investor protection provisions would apply; the draft article 2 in the Annex referring to future measures is based on Article 1108(4) NAFTA.

ILLUSTRATIVE TEXT OF AN ANNEX ON ABORIGINAL/MINORITY PREFERENCES

Article 1

Parties may schedule in Annex ... of the Agreement exceptions to the obligations regarding National Treatment, MFN, Performance Requirements and Senior Management and Board of Directors for measures they wish to adopt or maintain in order to protect aboriginals or disadvantaged minorities.

Article 2

Parties may not, under any measure adopted after the entry into force of this Agreement and listed in Annex... pursuant to Article 1, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective.