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Preferential investment liberalization under bilateral investment treaties: How to ensure compliance with WTO law?

by
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In the 1990s, the United States (US) – followed by Canada, Japan and, more recently, the European Union (EU) and China – started negotiating a new type of bilateral investment treaty (BIT) with third countries. This new type of BIT does not only comprise post-establishment treatment and investment protection provisions like traditional BITs, but also contains substantive investment liberalization commitments. It grants foreign investors national and most-favored-nation (MFN) treatment at the pre-establishment stage. So whereas traditional BITs merely create a secure business environment for established foreign investors in a host economy, this new type of BIT also seeks to reduce market entry barriers and to liberalize investment flows arguably on a preferential basis.[1] In this regard, the new type of BITs resembles preferential trade agreements. About 4% of all BITs contain substantive investment liberalization commitments.[2]

BITs with such commitments raise an important legal question, which policy-makers have mostly ignored. World Trade Organization (WTO) law imposes obligations on WTO members that intend to engage in preferential economic integration. Does WTO law – and, more specifically, the General Agreement on Trade in Services (GATS) – circumscribe the ability of WTO members bilaterally to liberalize investment flows under BITs?

The GATS does indeed seem to have a bearing on WTO members engaging in the bilateral liberalization of investment flows under BITs.[3] The GATS recognizes the "establishment of a commercial presence abroad" as one of four modes of services trade. The establishment of such a presence is roughly identical to foreign direct investment in service sectors. Most international services trade is carried out through the establishment of a commercial presence, i.e., investment in the target market. In 2012, 72% of the world's outward FDI stock was in services.[4] BITs with substantive investment liberalization commitments are therefore agreements that liberalize the statistically most significant mode of services trade.

The GATS contains rules on when and how WTO members may bilaterally liberalize services trade. GATS Article II states that members doing that must a priori afford the same market access rights to all other WTO members. The GATS provides only for two exceptions to this MFN treatment obligation. First, GATS Article II.2 stipulates that WTO members do not need to multilateralize market access commitments granted under bilateral agreements if the members have exempted the relevant sectors and activities from the MFN obligation in their GATS schedules. Second, they do not need to grant market access commitments afforded under bilateral agreements to other members if these agreements fulfil certain economic integration criteria. GATS Article V inter alia states that such agreements should not exclude any mode of supply from liberalization efforts from the outset, have substantial sectoral coverage and match or go beyond countries' GATS commitments.

Most, if not all, BITs with substantive investment liberalization commitments seem to fall short of the conditions for a preferential liberalization of service-related investments laid out in the GATS. Hence, substantive service-related liberalization commitments granted under such BITs should, in principle, be multilateralized. For one thing, such commitments granted under BITs often seem to exceed countries' reservations tabled in their schedules under GATS Article II.2; only 17 WTO members have inscribed general BIT-related reservations into their schedules.[5] Secondly, BITs seem hardly compatible with GATS Article V. BITs by design only liberalize one of four modes of services trade. Moreover, many BITs contain substantial reservations. The US, for example, typically includes vast carve-outs for her states into her BITs.

Few policy-makers seem to be aware that service-related investment liberalization commitments granted under BITs are likely to be subject to the MFN obligation enshrined in GATS Article II. One can hardly imagine, for instance, that the US and the EU put themselves through arduous negotiations on investment liberalization with China, knowing that any hard-fought service-related market access commitments are likely to be instantaneously multilateralized.

So what can policy-makers do to ensure preferential investment liberalization in compliance with WTO law? First, they could exclude service-related liberalization commitments from their BITs in order to avoid the applicability of the GATS. However, this approach is not desirable. Second, they might only focus on reaching for additional market access in service sectors excluded from the MFN treatment obligation under their GATS schedules. Third, they might step up their liberalization efforts to comply with the requirements of GATS Article V. Countries would have to ensure broad sectoral coverage across all modes of supply. The consequent complexity of such investment negotiations, however, would make it more reasonable to directly engage in full-fledged preferential trade agreements negotiations.

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[1] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, 2nd ed. (Oxford: OUP, 2012), p. 89.

[2] Rudolf Adlung and Martin Molinuevo, "Bilateralism in services trade: Is there fire behind the (BIT-)smoke?" WTO Working Paper ERSD-2008-01, January 16, 2008, available at http://www.wto.org/english/res_e/reser_e/ersd200801_e.pdf.

[3] *Id*.

[4] UNCTAD, *World Investment Report 2014* (Geneva: UNCTAD, 2014), annex tables.

[5] Rudolf Adlung, "Multilateral investment disciplines: Don't forget the GATS!," *Columbia FDI Perspectives*, No.117, March 17, 2014, available at http://ccsi.columbia.edu/files/2013/10/No-117-Adlung-FINAL.pdf.

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