THE BASICS OF TRADE AGREEMENTS, INTERNATIONAL INVESTMENT AGREEMENTS AND DISPUTE SETTLEMENT CLAUSES

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SESSION 1

Outline

- The sources of law
- Special features
- Commonalities and differences between trade and investment
- Dispute settlement – enforcing trader and investor rights
- Key substantive provisions
- Procedural issues
- Future trends
- Sources of data and statistics
- Questions & Answers (Q&A)

The Importance of Trade in Services in the Global Economy

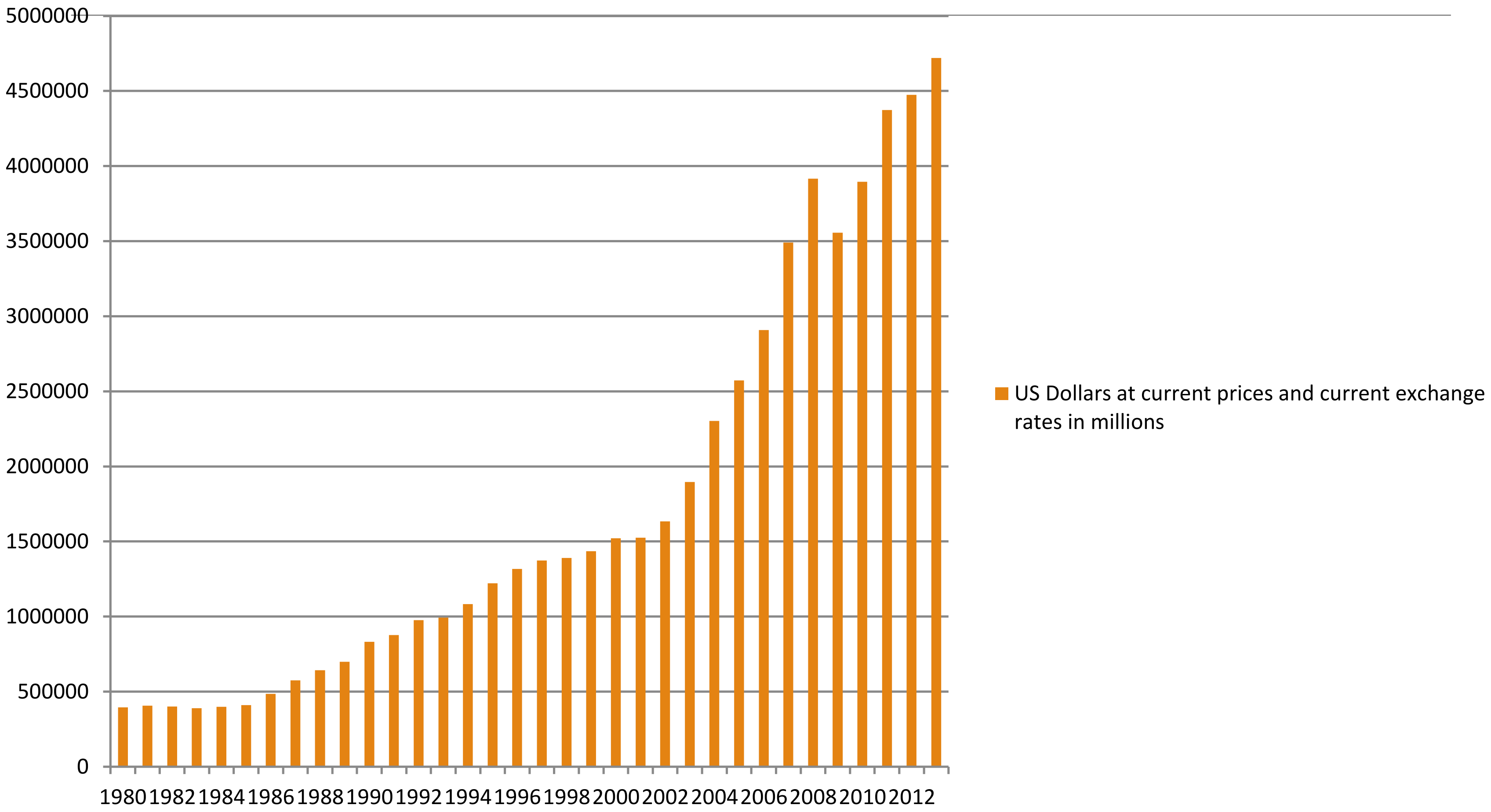
Trade in Services is an important part of economic activity

- Services represent more than 45% of world trade
- Over the past two decades, trade in services has grown more quickly than trade in goods
- Service have only recently been multilateralised, barriers remain high

Services are diversified and complex, as are their regulation

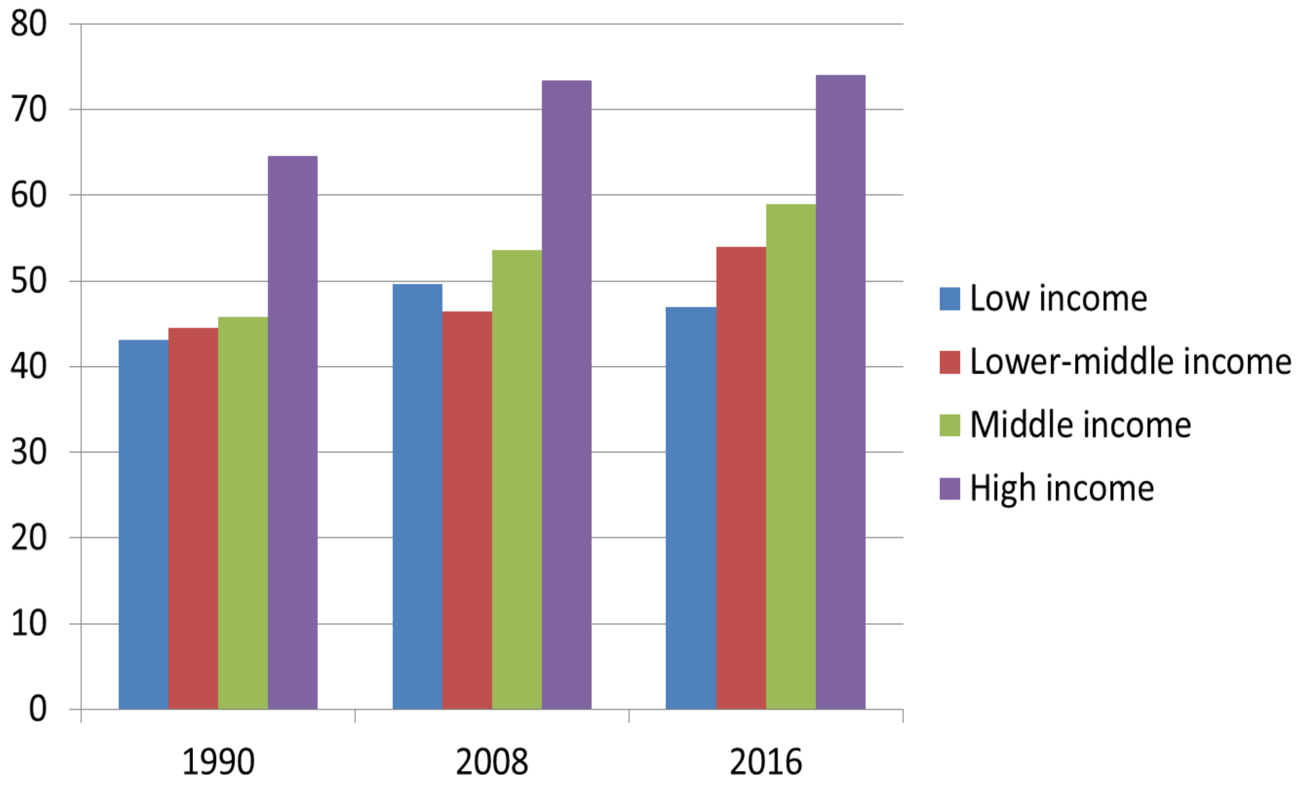
- i.e. banks to hospitals to telecommunications to lawyers to ferries…
- Goods are primarily regulated at the border; barriers similar in every country
- Regulation of services seen more as ‘domestic’, and even necessary for public policy reasons i.e. health, safety, financial system
- Services are regulated at the point of delivery or consumption, with the source, nature and content of regulation varying widely by country and service

Rise of services

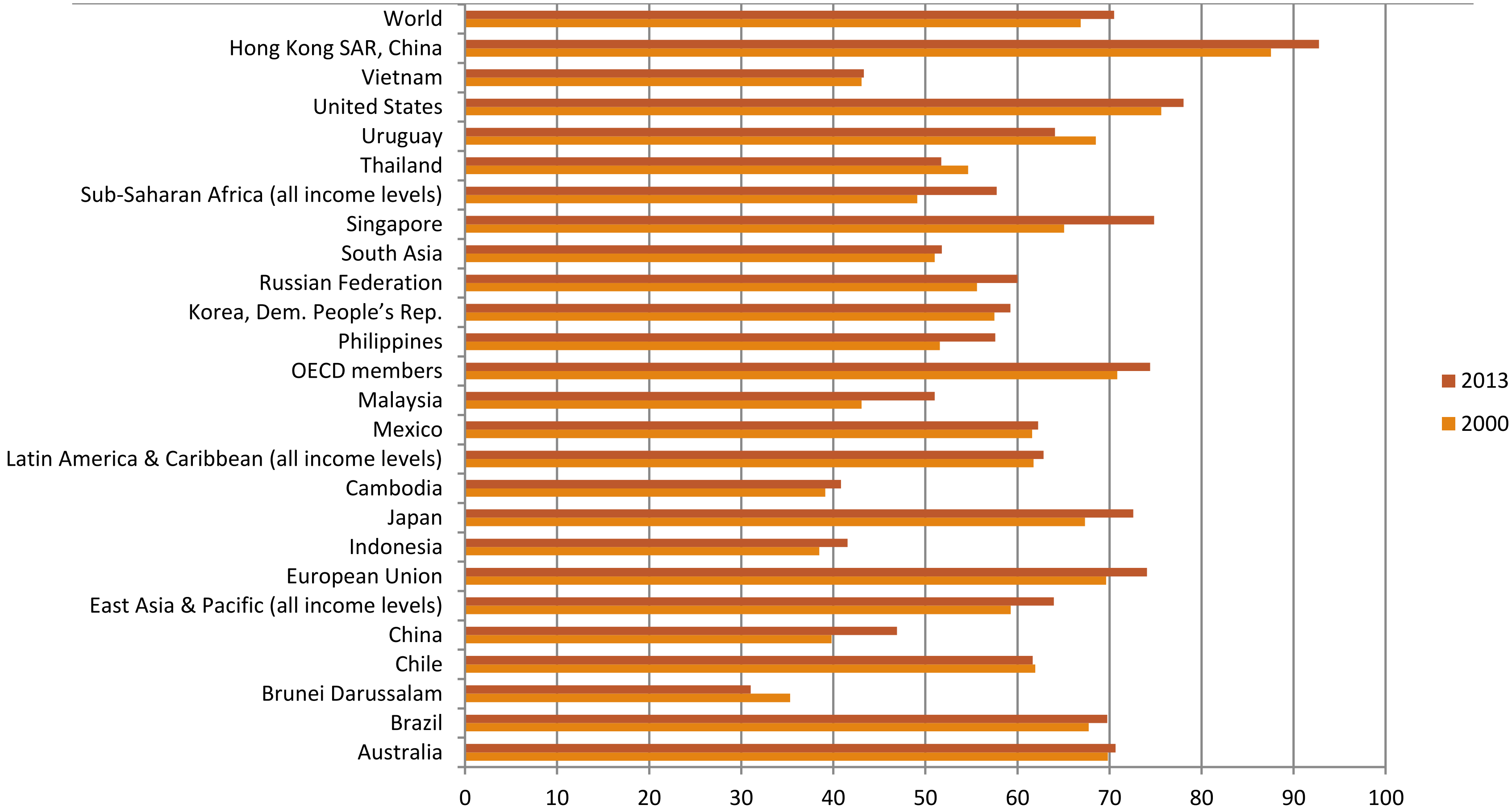


Source: UNCTADstat, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx

Services to GDP (ratio)



Importance of services…



Source: World Bank Data, http://data.worldbank.org/indicator/NV.SRV.TETC.ZS

WTO Members share in world commercial services trade, 2016

A9. Leading exporters and importers in world trade in commercial services (excluding intra-EU (28) trade), 2016

(Billion dollars and percentage)

Rank	Exporters	Value	Share	Annual percentage change	Rank	Importers	Value	Share	Annual percentage change
1	Extra-EU (28) exports	917	24.9	0	1	Extra-EU (28) imports	772	21.1	2
2	United States of America	733	19.9	0	2	United States of America	482	13.2	3
3	China	207	5.6	-4	3	China	450	12.3	4
4	Japan	169	4.6	7	4	Japan	183	5.0	3
5	India	161	4.4	4	5	Singapore	155	4.2	1
6	Singapore	149	4.1	1	6	India	133	3.6	8
7	Switzerland	112	3.1	1	7	Korea, Republic of	109	3.0	-2
8	Hong Kong, China	98	2.7	-6	8	Canada	96	2.6	-2
9	Korea, Republic of	92	2.5	-5	9	Switzerland	95	2.6	1
10	Canada	80	2.2	1	10	United Arab Emirates	82	2.2	3
11	Thailand	66	1.8	8	11	Hong Kong, China	74	2.0	0
12	United Arab Emirates	63	1.7	8	12	Russian Federation	73	2.0	-16
13	Australia	53	1.4	9	13	Brazil	61	1.7	-11
14	Russian Federation	50	1.4	-2	14	Australia	55	1.5	-2
15	Chinese Taipei	41	1.1	1	15	Chinese Taipei	52	1.4	2
16	Israel	39	1.1	10	16	Saudi Arabia, Kingdom of	51	1.4	-8
17	Turkey	37	1.0	-20	17	Norway	47	1.3	-1
18	Norway	36	1.0	-11	18	Thailand	42	1.1	-1
19	Malaysia	34	0.9	-2	19	Malaysia	39	1.1	-2
20	Brazil	33	0.9	-1	20	Indonesia	31	0.8	-1

Source: International Trade Statistics 2017, https://www.wto.org/english/res_e/statis_e/wts2017_e/wts2017

The Six Key Drivers of Services

1. Technological change
   - Innovation allows countries to:
     - Integrate into the global division of labour (in services);
     - Exploit newfound sources of comparative advantage; and
     - Leapfrog entire stages of infrastructural development

i.e. ICT – dramatic cost reductions in information processing; increased tradability of services transactions

The Six Key Drivers of Services

2. Production Fragmentation

- Intensification of competitive pressures have altered manufacturing process
  - i.e. role of logistics in manufacturing efficiency
- Key service functions are now outsourced, including cross-border
- Design, accounting, professional services, after-sales services, human resources, etc
- Result is rise in services as percentage of economy

The Six Key Drivers of Services

3. FDI Growth

- FDI growth has in recent years acceded domestic growth and trade
- Important vector of globalisation
- FDI related to services
  - 1950s: rise of the MNC. Service suppliers followed the manufacture
  - 1990s: service sectors pursuing endogenous internationalisation strategies (facilitated by international rules and privatisation movement)

The Six Key Drivers of Services

4. Human capital

- Services usually mean contact and proximity between supplier and consumer
- World's richest countries are all service economies
- Services sector embraces low and high skilled jobs
- Services liberalisation and growth usually entail a rise in high skilled jobs – and higher wages – international market for service suppliers (linked to migration and movement of labour)
- To sustain growth, countries must pay attention to human capital -- education and training

The Six Key Drivers of Services

5. Changes in demand

- Services are highly income elastic
- Rising income leads to demand for better healthcare, education, environment and increased travel and entertainment
- Globalisation increasingly leads to convergence of consumer tastes (ie demand) and emergence of global brands, advertisers, retailers, etc (which mean distributors and logistics)

6. Ideology

- Government intervention gave way to privitisation of investment and pro-competitive regulatory regimes in key service sectors
- This allowed for the internationalisation of services
- Concern is that a structural reversal will occur

Key drivers of service growth

- Infrastructural services (‘producer services’) are critical determinants of economic efficiency and growth
  - ie energy, telecommunications, finance and transport
- Increasingly ‘servicification’ is occurring with the importance of services in other sectors rising
  - Ie agriculture, mining, manufacturing …

Services Agreements

1. Liberalization

2. Scheduling

3. Dispute settlement

Basic Principles of Services Liberalisation (1)

Following the conclusion of the Uruguay Round in 1994 resulting in the first ever multilateral services trade agreement, the General Agreement on Trade in Services (GATS), it is generally accepted that the key obligations governing liberalisation of international trade in services shall include the following:

- ***Transparency***: Countries must notify each other of all relevant measures affecting services trade, including prompt publication, maintenance of enquiry points, and fair judicial review.
- ***Most-Favoured-Nation (MFN)****:* Countries must grant each other the most-favourable treatment accorded to any of their trading partners.
- ***Non-Discrimination***: Countries must treat services and services suppliers from one country no less favourably than those from other countries.

SOURCE: ASEAN (2015) ASEAN INTEGRATION IN SERVICES

Basic Principles of Services Liberalisation (2)

- ***Market Access**:* In terms of access to the market of a country, services and services suppliers of any other countries must be accorded the same treatment specified in its schedule of commitments.
- ***National Treatment**:* Services and services suppliers of a country must be permitted access to the market of another Country on the same terms as those accorded to domestic services or services providers.
- ***Progressive Liberalisation**:* Countries shall enter into successive rounds of negotiations, with a view to achieving a progressively higher level of liberalisation.

SOURCE: ASEAN (2015) ASEAN INTEGRATION IN SERVICES

Overview of Scheduling Techniques (1)

Positive-list approach

The positive list approach is the listing of sectors, sub-sectors and (in trade in services) individual modes of supply in which countries voluntarily undertake liberalization commitments. The selective nature of liberalization under this approach entails that <u>an agreement's core obligations apply only to the activities listed in a country's schedule and solely on the terms described therein</u>. So commitments do not apply unless the sector and/or specific sub-sector is inscribed in the schedule.

Examples: AFAS, ASEAN-Australia-New Zealand-FTA (AANZFTA, 2009), Pakistan-China (2009), Korea-India (2009)

Overview of Scheduling Techniques (2)

Negative-list approach

For the negative-list approach countries agree on a set of general obligations and then list all individual measures to which such obligations either do not apply or which qualify their obligations. It means that <u>everything is liberalized unless otherwise specified in the list/schedule</u>. Such approach is useful for producing a detailed inventory of all non-conforming measures contracting parties maintain.

Examples: Canada-Peru (2008), Australia-Chile (2008), US-Oman (2006), Japan –Mexico (2004), CETA, CPTPP

Overview of Scheduling Techniques (3)

Hybrid approach

A hybrid approach is any variation of either approach above.

For example, in the Comprehensive Economic Partnership Agreement between Japan and India both countries opted for scheduling all reservations to their services chapters in a positive-list approach, and all reservations to their investment chapters in a negative-list approach.

Another hybrid approach can be found in the China-Australia FTA (ChAFTA, Annex III) where Australia opted overall for a negative-list approach for scheduling all its non-conforming measures whereas China chose a positive-list approach.

Dispute settlement

State-to-State: applies only between State parties to the Agreement. (like the DSU in the WTO, the ASEAN DSB)

International Investment Agreements

International Investment agreements (IIAs)
- Bilateral Investment Treaties (BITs)
- Chapters of free trade agreements (FTAs)

Approximately 3000 IIAs currently in force, more than half (1,480) involve a country from the Asia-Pacific

The majority of BITs focus on investor promotion and protection
- Non-discrimination clauses
- Provisions against expropriation
- Fair and equitable treatment for foreign investors/investments
- Prohibition on performance requirements
- Liberalisation of sectors
- Compensation for violations

Benefits of IIAs

(May) encourage and lead to additional foreign investment

Create beneficial conditions for investors by liberalizing, facilitating, promoting and protecting cross-border FDI.

Contain commitments to a business-supportive and investment-friendly environment

Move towards providing domestic as well as foreign investors similar protection provisions, which increases the attractiveness of doing business.

Typical IIA focuses on

1. Definitions and scope
   eg What is an investment? Who is an investor?
2. Transparency and other measures
3. Admission or pre-establishment
4. Four pillars of protection:
   - Standards of treatment
   - Expropriation
   - Transfers
   - Settlement of disputes
5. Liberalisation through MA, NT and MFN
6. Exceptions

Dispute Settlement

State-to-State: applies only between State parties to the Agreement. (like the DSU in the WTO, the ASEAN DSB)

Investor-to-State: allows private investors to submit claims against a host State to international arbitration

(eg. NAFTA and BITs)

Most IIAs contain both types of mechanisms

ISDS

Consultations and negotiations (time-period)

Most IIAs do not require exhaustion of local remedies

In some, resort to local courts precludes subsequent submission to international arbitration: the fork in the road.

Direct resort to international arbitration (institutional or *ad hoc*)

- ICSID Convention
- Ad hoc arbitration following UNCITRAL Arbitration Rules

ISDS

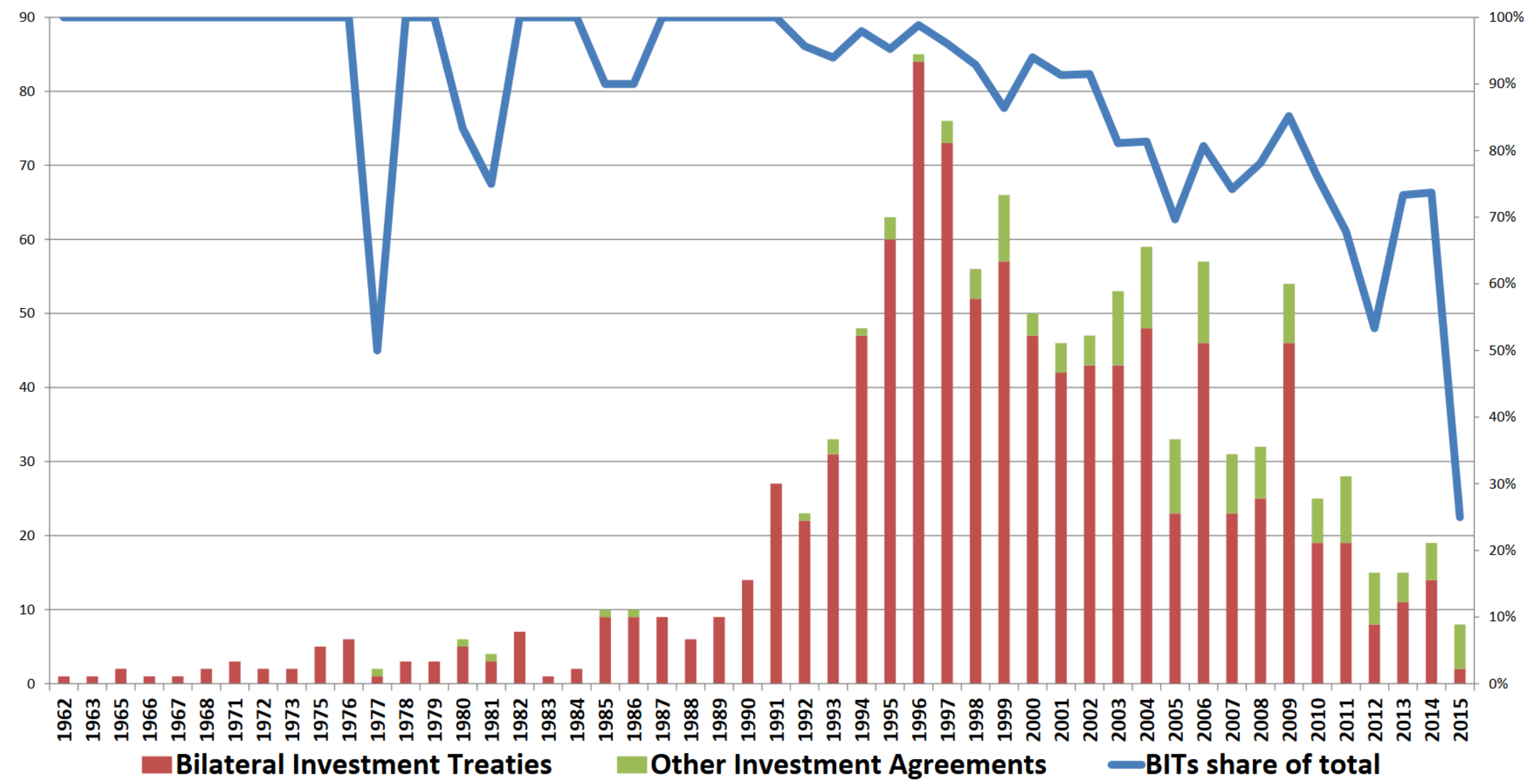
Constitution of tribunal (as per arbitral rules)

Applicable law: IIA's provisions; law of the host-State; investment contract, rules of international law.

ICSID Convention (Article 42): absent agreement between parties, the tribunal shall apply the law of the host State and the applicable rules of international law.

Arbitral awards: final and binding, but require exequatur (except in the case of ICSID awards)

ICSID Members shall recognize and enforce the awards in their territory as if they were final judgements of a State court



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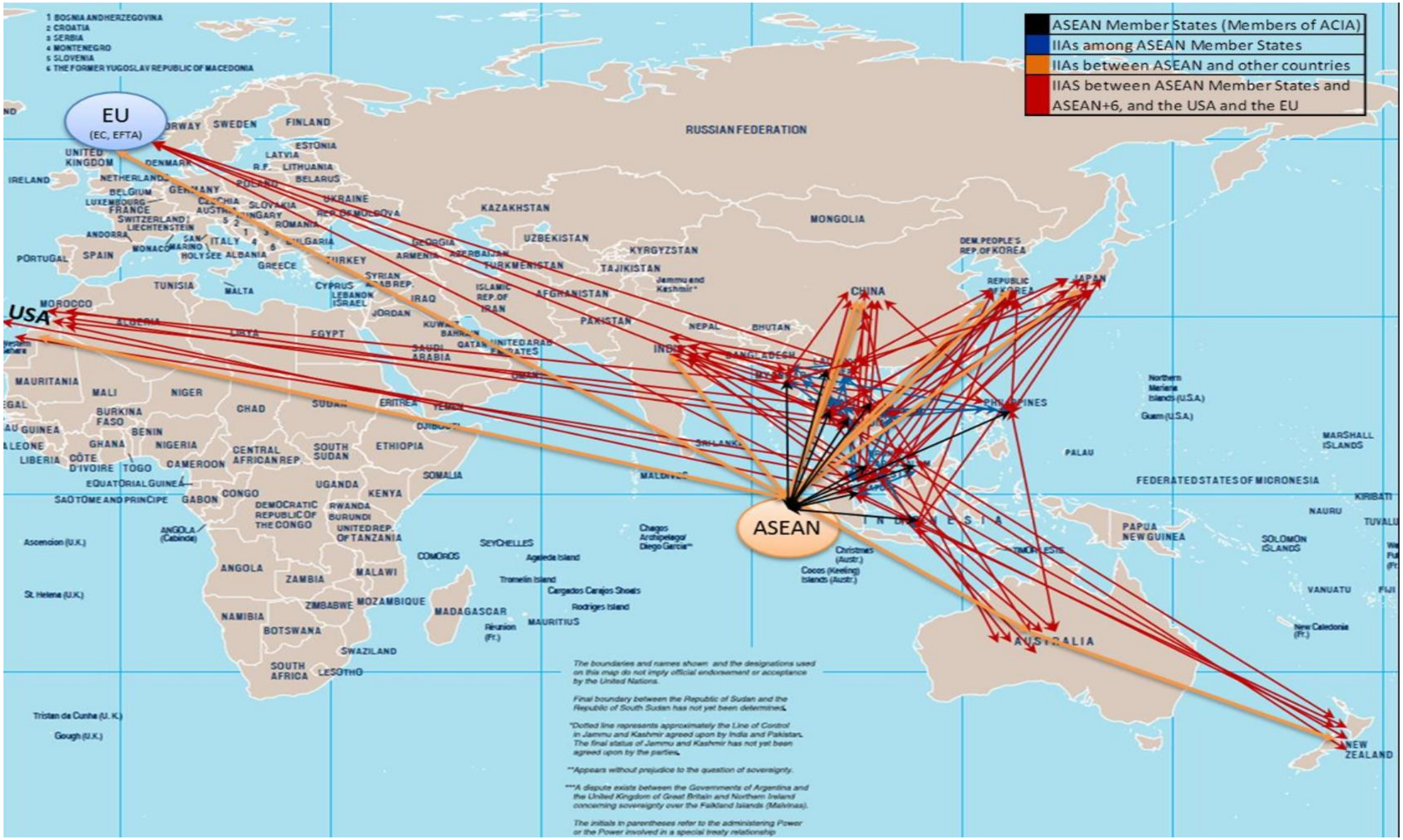
Bilateral Investment Treaties
Other Investment Agreements
BITs share of total


ASEAN Member States (Members of ACIA)
IIAs among ASEAN Member States
IIAs between ASEAN and other countries
IIAS between ASEAN Member States and ASEAN+6, and the USA and the EU
EU
(EC, EFTA)
USA
ASEAN
1 BOSNIA ANDHERZEGOVINA
2 CROATIA
3 SERBIA
4 MONTENEGRO
5 SLOVENIA
6 THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA
RUSSIAN FEDERATION
KAZAKHSTAN
MONGOLIA
CHINA
JAPAN
REPUBLIC OF KOREA
DEM.PEOPLE'S REP.OF KOREA
INDIA
PHILIPPINES
AUSTRALIA
NEW ZEALAND
The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations.
Final boundary between the Republic of Sudan and the Republic of South Sudan has not yet been determined.
*Dotted line represents approximately the Line of Control in Jammu and Kashmir agreed upon by India and Pakistan. The final status of Jammu and Kashmir has not yet been agreed upon by the parties.
**Appears without prejudice to the question of sovereignty.
***A dispute exists between the Governments of Argentina and the United Kingdom of Great Britain and Northern Ireland concerning sovereignty over the Falkland Islands (Malvinas).
The initials in parentheses refer to the administering Power or the Power involved in a special treaty relationship

Why negotiate agreements for the liberalization of Trade in Services

Trends in services negotiations

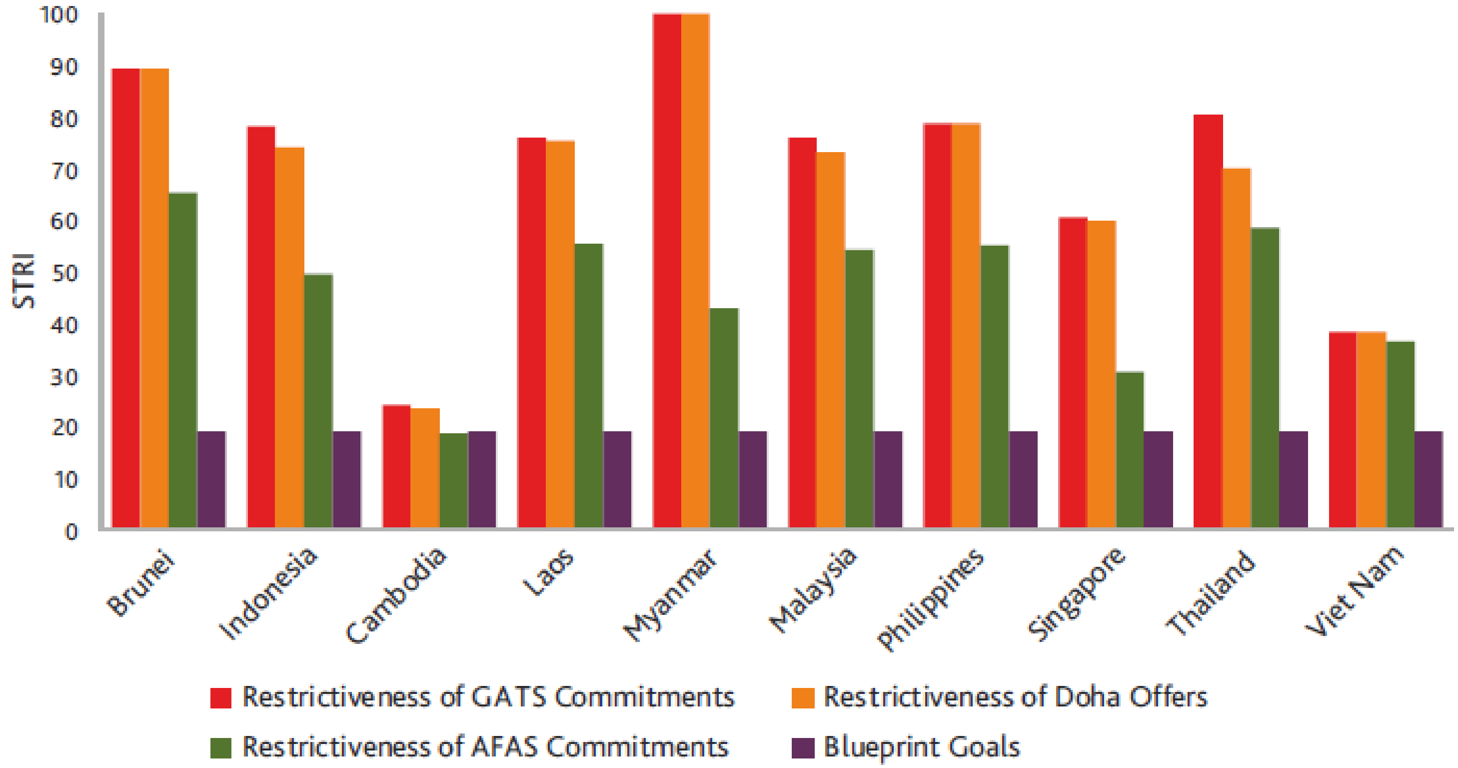
Services offer scope for large welfare gains

Uruguay Round/GATS remains incomplete, with deeper rules than commitments and several 'leftover' issues

Multilateral negotiations yet to yield meaningful results, while FTAs contain deeper commitments and unilateral reforms have been substantial

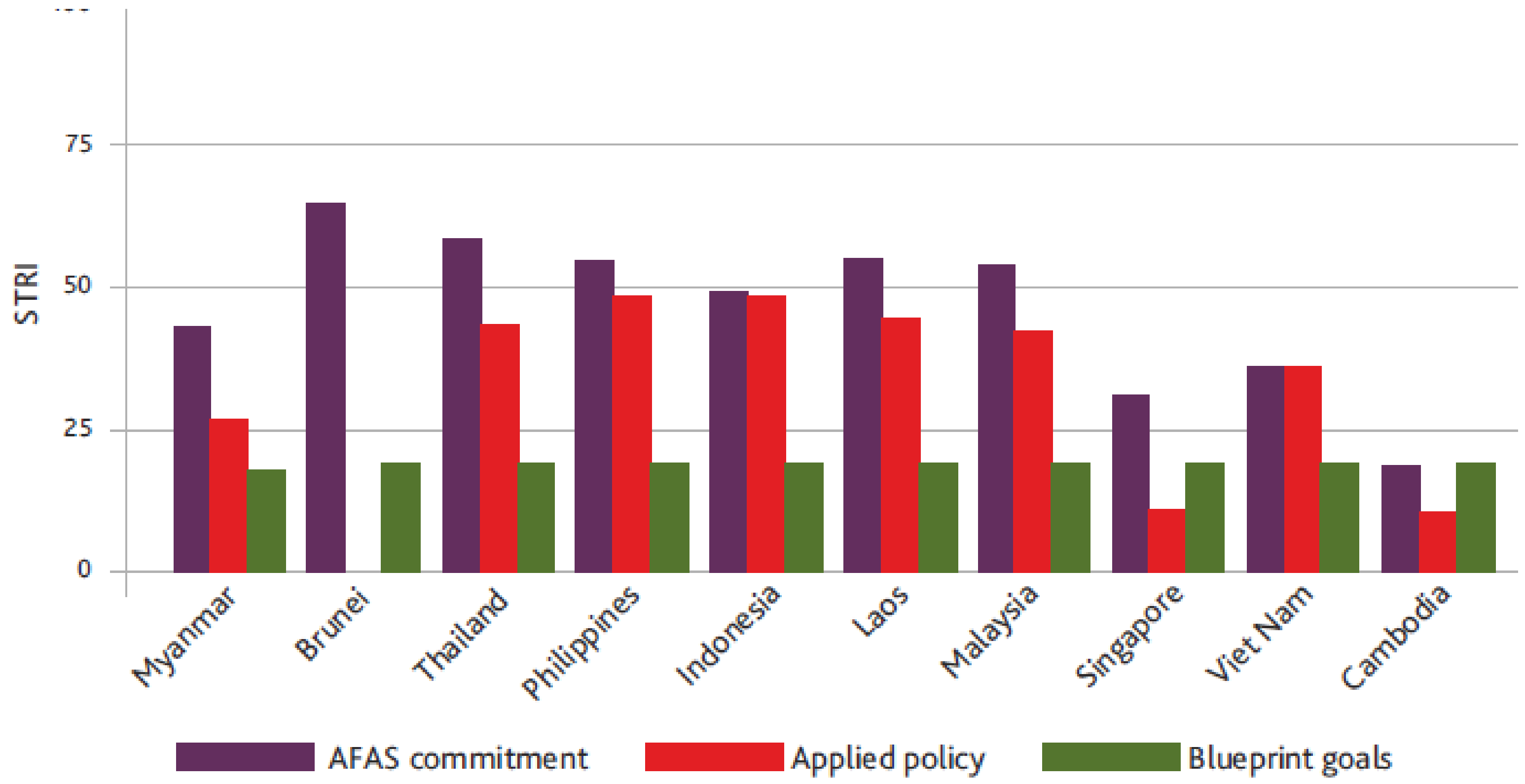
The 'newness' of trade in services has meant a precautionary approach to negotiations, with stakeholders seeking regulatory protection

Restrictiveness of GATS commitments, Doha Round offers, AFAS commitments, and Blueprint 2015 goals for ASEAN, 2012 (by STRI)



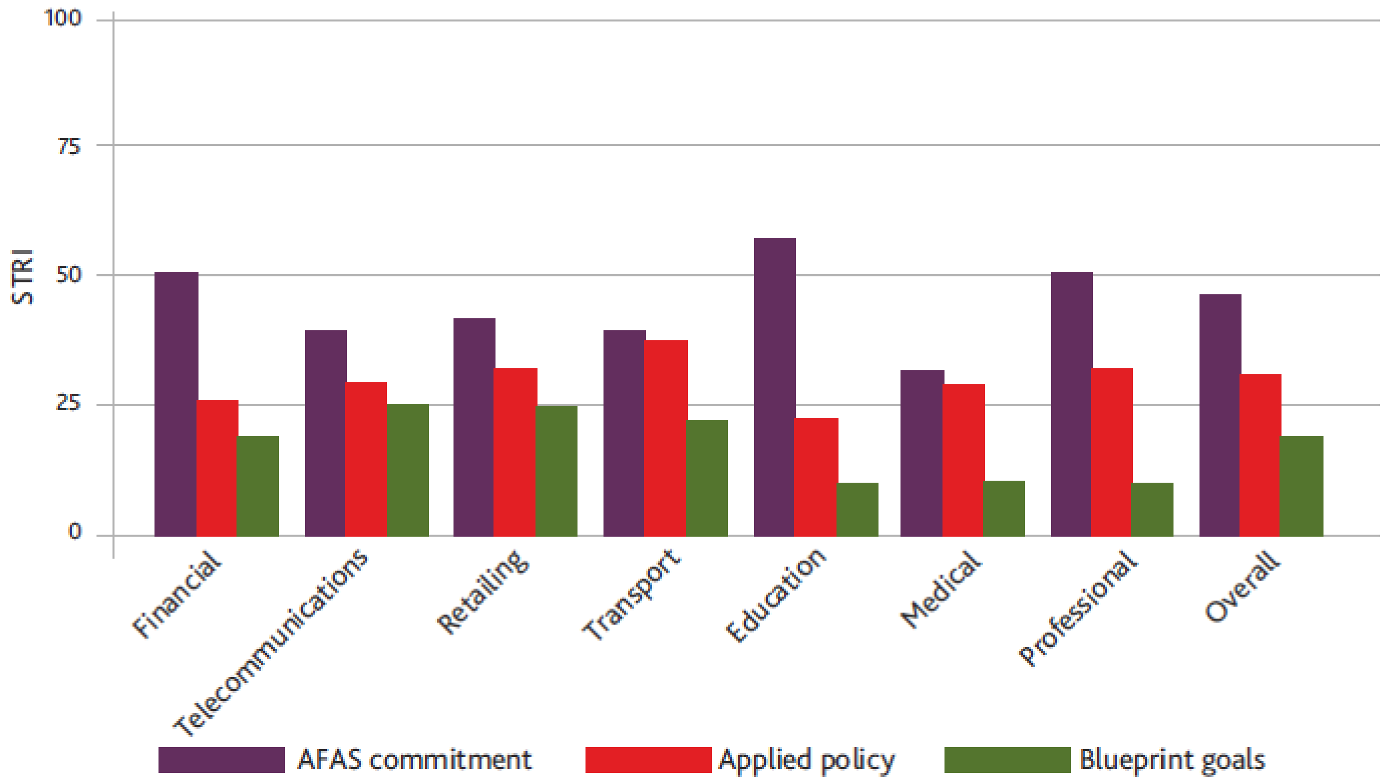
Note: The figures indicate the restrictiveness of the commitments measured in STRI, which covers seven major services sectors (financial, distribution, telecommunications, transportation, higher education, health services, and professional services), with 100 equalling the highest level of restrictiveness.
Source: Gootiiz & Mattoo (2015)

Restrictiveness of AFAS commitments, applied policy, and 2015 Blueprint goals for ASEAN members, 2012 (by STRI)



Note: The figures indicate the restrictiveness of the commitments measured in STRI, which covers seven major services sectors (financial, distribution, telecommunications, transportation, higher education, health services, and professional services), with 100 equalling the highest level of restrictiveness. Applied policy information for Brunei is missing.
Source: Gootiiz and Mattoo (2015)

Restrictiveness of AFAS commitments, applied policy, and Blueprint 2015 goals by industry for ASEAN members, 2012 (by STRI)



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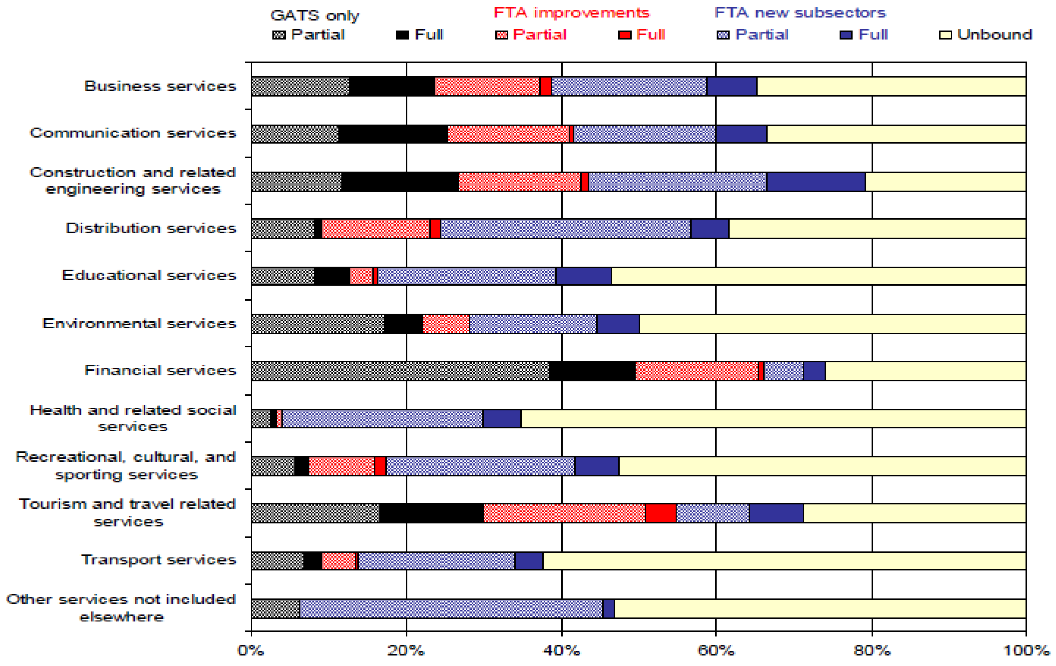
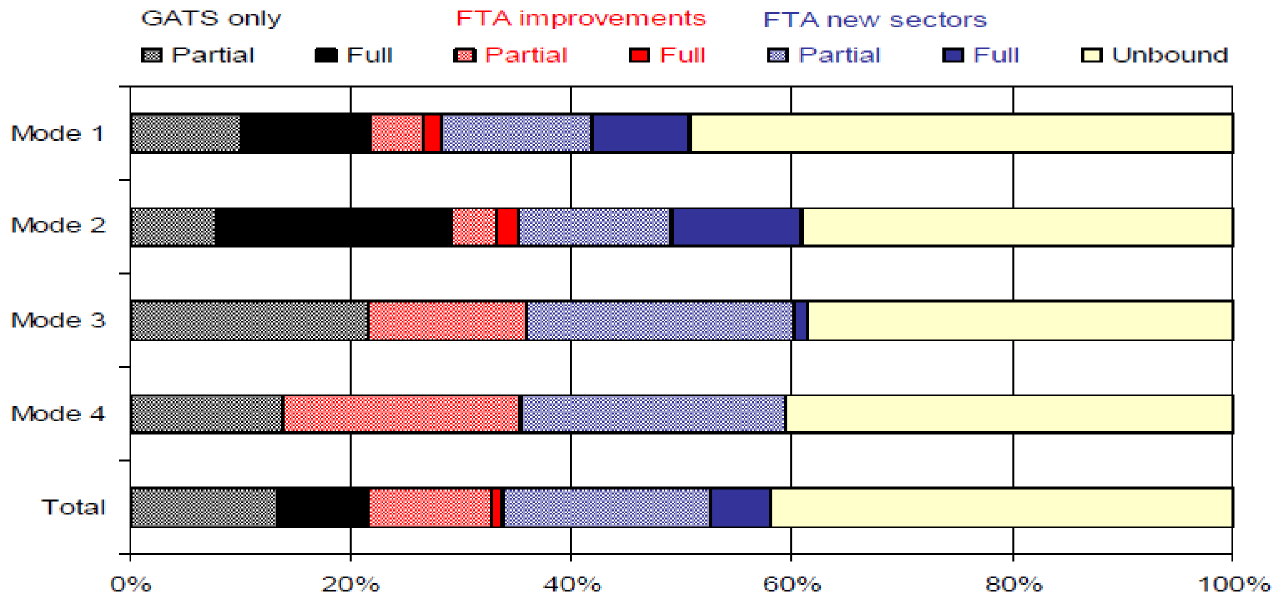
Source: Gootiiz and Mattoo (2015)

GATS+ in Asian FTAs – by sector



Source: Fink and Molinuevo (2007)

GATS+ in Asian FTAs – by Mode



Source: Fink and Molinuevo (2007).

Services Commitments are Incomplete

- Large economic gains could be made from reducing quota-type restrictions to improve competition and competitiveness
  - Increased transparency (ie less administrative discretion in licensing decisions)
  - Less distortion of competition
  - Quantitative restrictions are less economically efficient than tariffs for goods

Why Negotiate

Unilateral action and policy reforms helpful, but negotiations can support domestic reform

- Reciprocity-based bargaining can help overcome domestic opposition to reform
- Unilateral reform cannot address barriers in other markets
- Binding commitments strengthen credibility, improve investment climate and are more difficult (and costly) to reverse
- Can pre-commit to future reform adding urgency and promoting orderly adjustments
- Commitments regarding transparency and regulatory principles complement the removal of barriers

Why Negotiate

Negotiations secure better access to *imports* of services – improve overall economic performance

- High(er) quality services
- Improved performance and competitiveness of domestic firm
- International best practices (ie domestic regulation)
- Better skills and technologies
- Access to distribution networks
- Investment capital, which may be otherwise difficult to secure

Core benefits of negotiations

Better economic performance

Enhanced credibility

Deeper regulatory cooperation

Factors in negotiating services

- Intangible
- Non-storable
- Intermediates
- Behind the border protection
- Highly regulated
- Diverse

Negotiating Issue	Goods	Services
Modes of Supply	Cross-border; limited investment coverage; no need for factor mobility	Inherent need for factor mobility, reliance on modes of supply
Quality of data, measurement and modelling	Comprehensive, disaggregated and robust	Partial, aggregated and weak; Problematic for emergency safeguards
National treatment	General obligation; no exceptions	A la carte in scheduled sectors and modes; limitations and right to not schedule
Most-favoured nation	General obligation; no exceptions	One-time exception upon entry into force; weak sunset clause
Quantitative restriction	Per se prohibited	Allowed, subject to listing
Diversity	Common rule to all sectors	Co-existence of horizontal and sector-specific disciplines

Financial Services - GATS

- Financial services rules can be found in four main documents:
  - GATS framework agreement, which contains obligations applicable to all services and all modes of supply;
  - WTO Members' Schedules of Commitments, which contain their specific market access and national treatment commitments in the financial services sector, divided by services subsector, and by mode of supply;
  - Annex on Financial Services ('the Annex'), containing additional provisions relating solely to financial services, the most important of which relate to services supplied in the exercise of governmental authority prudential regulation, mutual recognition, and dispute settlement; and
  - Understanding on Commitments in Financial Services ('the Understanding') which sets out a standard set of MA and NT commitments, as well as additional obligations which WTO Members may undertake, on a voluntary basis, in the financial services sector

Financial services are defined in GATS Annex on Financial Services as "… any service of a financial nature offered by a financial service supplier of a Member".

Financial services include insurance and insurance related services, banking, financial trading, asset management, brokerages, settlement and clearing services, provision of financial information and advisory services

Financial service suppliers do not include state-owned or -controlled entities

Financial institutions refer to the financial service providers (FSPs) and the regulatory agencies that enforce the rule governing what FSPs may do and how they do it.

Domestic financial reform: eg deregulation of domestic financial services (privatizing state-owned banks; freeing interest rates to be market-determined; and removal of restrictions on intra-sectoral activities (ie banks offering insurance) and increasing efficiencies.

Policy coherence dictates that as trade policy reforms liberalise cross-border supply of services and market entry for foreign FSPs, a loosening of restrictions on at least some forms of capital flows will also be required.

Users of financial services are households, firms and governments

- Households save, invest and finance purchases through personal loans from banks and other financial services providers (FSPs)
- Corporations use the services of banks in the form of secured and unsecured loans and revolving credit facilities or through the sale of debt obligations
- Governments also borrow from banks and issue securities.

Two main types of FSP

- **Financial intermediaries** – eg deposit-taking intermediaries (commercial banks, savings institutions), and nonbank financial intermediaries (NBFIs) such as insurance, finance, credit, leasing and investment companies; and
- **Direct finance institutions –** in capital markets such as brokerages and securities firms that facilitate transactions undertaken directly between the providers and users of funds, such as underwriting and selling bonds and equities.
  - These firms may operate in both the primary (original issue) and secondary (resale) markets for these securities.

Mode	Example 1	Example 2
Mode 1: Cross-border supply	A bank established in the City of London accepts deposits via telephone or internet banking from a client in the Republic of Korea.	A Singaporean firm sells commercial aviation insurance to a French airline company located in France.
Mode 2: Consumption abroad	A Spanish company opens a bank account in Colombia for transactions occurring in Colombia.	A Swiss company takes out accident insurance from a Singaporean firm for its work in Singapore.
Mode 3: Commercial presence	A London bank establishes a branch in Korea to lend funds in Korea.	An American insurance company establishes a German subsidiary to provide reinsurance services in Germany.
Mode 4: Temporary presence of persons	The management of a Korean branch is staffed by British citizens from the bank's London headquarters.	A German portfolio manager travels to Canada to provide counsel and advice to a 'high-net-worth' Canadian client.

Commitments

Financial services contain the usual obligations

- Transparency
- Most-Favoured Nation (subject to exclusion list)
- National Treatment
- Market Access (with the six prescribed limitations)

GATS commitments in financial services are particularly weak (eg significant policy space)

- See also Para 2(a) of the Annex on Financial Services (eg prudential exception)

Macroeconomic policy essentially untouched

- Exchange rates, monetary policy, etc…

Commitments

GATS commitments do not oblige a Member to allow international capital mobility

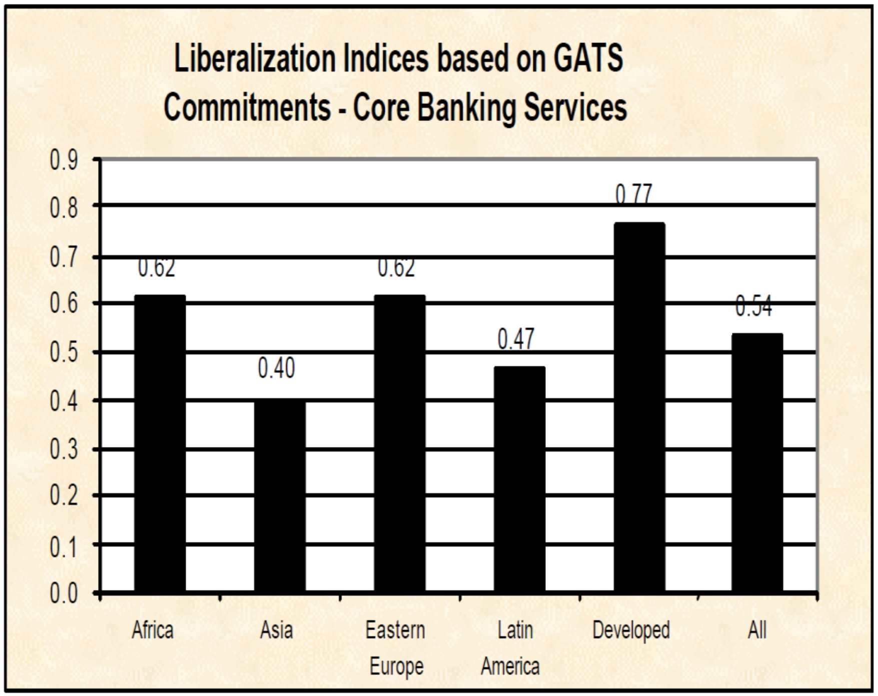
- But if a Member undertakes a market access commitment in relation to the cross-border supply of a service and if the cross-border movement of capital is an essential part of the service itself, it is committed to allow such movement of capital
- If a Member undertakes a market access commitment in relation to the supply of a service through commercial presence, it is committed to allow related inflows of capital
- Members do not have any obligations with respect to capital flows related to consumption abroad or to capital outflows related to commercial presence
- Restrictions on current or capital transactions in the event of serious balance-of-payments and external financial difficulties or the threat thereof (Article XII) is permitted

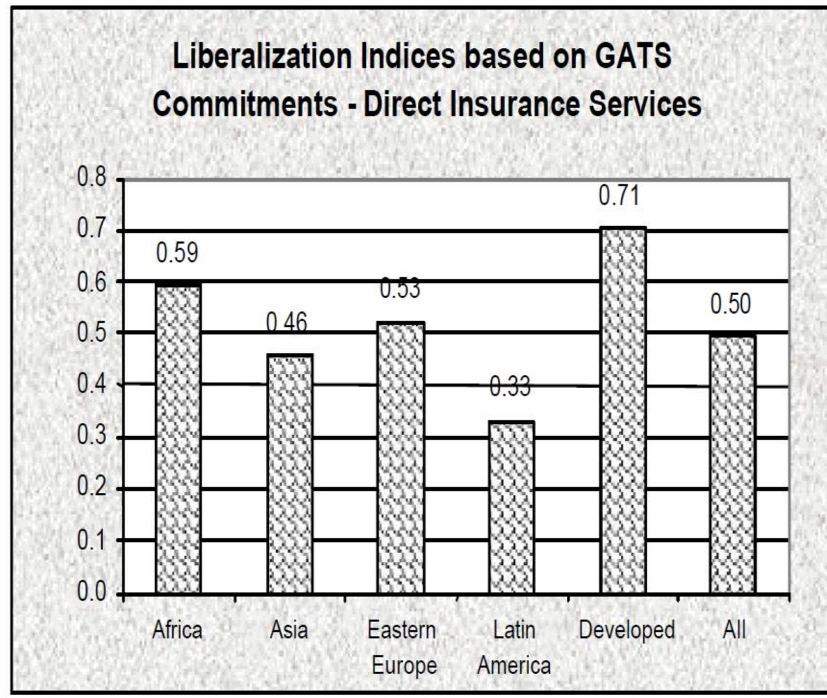
Benefits (and Risks) of Liberalisation

Economic impacts of trade policy reform

- Increased domestic competition
- Domestic reform
- Increased regulatory transparency
- More robust domestic financial system capable of dealing with shocks
- Supplies of new skills, products and technologies
- Better access to capital
- Increased risks and uncertainties

Reform not led by trade agreements, but unilateral measures (to attract foreign investment)





Newer, but not that different

Financial Services Agreement (1997)

- Three approaches: Bound status quo, less than status quo and commitment for future reform
- Grandfathering in existing market entrants (foreign equity, legal form and general)

Negotiations today build on this framework, regardless of architecture

How to prepare for negotiations?

Where to find data on trade in services?

At the national level, undertake a ***REGULATORY AUDIT*** (laws, regulations, sector strategies etc.) & review statistics

At the international and regional level, many sources are available:

- World Trade Organization (WTO)
- World Bank Group
- United Nations Conference on Trade and Development (UNCTAD)
- Organisation for Economic Co-operation and Development (OECD)
- ASEAN

Where to find data and information on trade in services?

Trade in services data – just a click away!

World Trade Organization (WTO)

- Statistics on trade in commercial services
- Regional Trade Agreements Information System: https://rtais.wto.org/
- **I-TIP database**: https://i-tip.wto.org/services/
- Trade Policy Review: Thailand 2016
- WTO website includes among others guide to GATS, commitments, MFN exemptions etc.
- Training provided by WTO Secretariat staff, plus https://ecampus.wto.org/ for government officials (only).

Where to find data and information on trade in services?

Trade in services data – just a click away!

World Bank

- World Development Indicators (WDI)
- Services Trade Restrictions Database (STRI)
- Export Value Added Database (EVAD)
- WBG reports (selection!):
  - Trade in Services Negotiations : A Guide for Developing Countries
  - Cambodia Services Trade : Performance and Regulatory Framework Assessment
  - Services Negotiations in Southeast Asia (2018)

Where to find data and information on trade in services?

Trade in services data – just a click away!

UNCTAD

- UNCTAD STAT
  - Trade in goods and services (e.g. Maritime Profile)
  - Foreign direct investment
- World Investment Report (WIR)
- Investment Policy Hub
  - International Investment Agreements (keeping track!)
  - Mapping of IIA content

Where to find data and information on trade in services?

Trade in services data – just a click away!

Organisation for Economic Cooperation and Development (OECD)

- **Services Trade Restrictiveness Index** (STRI) provides an up-to-date snapshot of services trade barriers in 22 sectors across 44 countries, representing over 80% of global services trade. (*watch video*)
  - Sector Notes for Services Trade Restrictiveness Index
- **FDI Regulatory Restrictiveness Index** is not specific to services, but includes services sectors. It measures how restricted a particular sector is. The database includes regularly updated information but is only available for a small subset of countries (the OECD and associate countries).

Where to find data and information on trade in services?

Trade in services data – just a click away!

ASEAN

- **Trade in Services** data:
  - Trade in Services, by Reporting Countries and Major Service Categories (in million US$)
  - Trade in Services, Intra-ASEAN, by Major Service Category, (in million US$)
  - Visitor Arrivals (tourism)
  - Flows of Inward Foreign Direct Investment (FDI)
- ASEAN Services Report 2017 The Evolving Landscape
- ASEAN Investment Report 2017 (more later)


QUESTIONS?