



Investment & Services - Implications of the MFN Rule at the Regional / Bilateral Level

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Introduction

At first glance, it may seem unusual to incorporate a non-discriminatory Most Favoured Nation obligation in a bilateral or regional trade and/or investment agreement that is by its very nature intended to be preferential and non-MFN. There are, however, some very good reasons to include such a clause in a PTA and that's why the MFN obligation is very commonly found in such agreements. As you know, it is a common, but not a universal approach. The objective of our discussion in this session is to look at the implications of the MFN rule, how it might operate in practice and some of the risks or potential inconsistencies posed by an MFN obligation in a PTA.

In my introductory remarks, I intend to discuss the issue in general terms and then focus in on how the MFN provision might operate in the context of some actual preferential trade agreements.

Non-Discrimination in a PTA - MFN and National Treatment

It is very common for both Investment and Trade in Services chapters to incorporate non-discrimination obligations on the parties. Usually, we can find both national treatment and MFN clauses in these chapters. The language in the investment chapter tends to be more detailed than that in the services chapter because the Parties generally feel compelled to spell-out the scope of the obligation. The MFN obligation in respect of investment usually specifies that it applies both to investors and to covered investments. The obligation is to provide treatment no less favourable than that accorded to investors and investments of non-Parties with respect to establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

On occasion, we can find a supplementary clause in a PTA that obligates Parties to accord to investments or investors of the other Party the better of national treatment or MFN. This is the case, for example, in the NAFTA investment chapter. This seems curious. How could

treatment provided to foreigners be better than that accorded to nationals? Here we can imagine a situation where a country, in an effort to attract foreign direct investment, might offer incentives and/or other forms of special treatment that actually discriminate in favour of foreign enterprises. I believe this has been the case in at least some sectors in China, for example. So a clever PTA negotiator should probably include this additional obligation just to be sure of always getting the best possible treatment for the party's investors.

In much the same way as the WTO GATT and GATS treats non-discrimination obligations, PTAs routinely specify that the MFN obligation is not an absolute obligation. The MFN obligation is subject to reservations and exclusions. In so-called "top-down" (NAFTA style) PTAs where all investment and services trade are covered unless specifically excluded in a schedule of non-conforming measures, the MFN obligation does not apply to the non-conforming measures listed. Sometimes the MFN obligation is also qualified as not applying to certain special sectoral agreements undertaken by the Parties.

Naturally, the basic purpose of including an MFN obligation in the services and/or investment chapters of a PTA is to ensure that a party's investors and services providers should never be disadvantaged in relation to those of a non-Party in the event that the other party to the PTA negotiates a different and better regime for investment and services with some non-Party.

How Should the MFN Rule Operate in Practice?

How should the MFN rule operate in practice? Now I am going to take a look at a few specific agreements with MFN provisions. I'll be referring to the North American Free Trade Agreement (NAFTA), the Closer Economic Relations Agreement between Australia and New Zealand, the Australia - United States Free Trade Agreement, the Thailand-Australia FTA, the Singapore-Australia FTA and the Japanese-Australian "Nara" Agreement.

If we start with NAFTA, we find strong MFN commitments in both Chapters 11 (investment) and 12 (trade in services). The commitment is qualified by reference to non-conforming measures and listed sectoral and other agreements. For example, in the Annex on non-conforming measures, the United States exempts from the MFN obligation its agreement with Canada concerning airworthiness certification.

In Annex IV, the United States takes an exception to MFN for "all bilateral and multilateral international agreements in force or signed prior to the date of entry into force of NAFTA". This is a very significant exception given that the United States is a country with a large number of bilateral investment treaties and other agreements, some of which might possibly be more generous than NAFTA's Chapter 11. The U.S. also exempts from MFN treatment aviation, fisheries, maritime and telecommunications transport services agreements.

Now, Australia has an FTA with the United States that has some very significant commitments and obligations on both services and investment. In their schedules in Annex I to the Agreement, both countries list their non-conforming measures not subject to the MFN obligation and in Annex II they list other measures where they reserve the right to deny MFN treatment. American exceptions to MFN in the agreement with Australia parallel those listed in NAFTA. Australia uses its Annex I non-conforming measures schedule to both cover the existence of the country's Foreign Investment Review Board and also to describe the more favourable treatment under FIRB negotiated by the Americans in the course of the FTA.

Without doubt, the United States is the country currently guaranteed by Australia to receive the most favourable treatment under the FIRB by virtue of the FTA.

Singapore's FTA with Australia has chapters on both investment and trade in services. Both chapters contain obligations on the parties with respect to national treatment. For reasons undoubtedly known to the negotiators, however, there is no MFN obligation in the bilateral agreement. Thailand also has an FTA with Australia and in Article 910:1 of the TAFTA, the two countries have agreed that "Each Party shall accord to investors of the other Party treatment no less favourable than it accords, in like circumstances, to investors of any non-Party."

Does this mean that Thai investors in Australia can use the MFN clause in the TAFTA to claim treatment no less favourable than that accorded to American investors by virtue of the Australian-American agreement? Singaporeans seem to be out of luck because they have no MFN clause in the SAFTA but the Thais may have a claim on better treatment under Australia's FIRB. If that is not the case, then what is the value of the MFN provision in the agreement?

What about the Japanese? Japan and Australia have yet to negotiate an FTA, but evidently an agreement that has been around for some time now - the "Nara Agreement" contains a general MFN clause which Japan has argued entitles its investors to treatment along the same lines as the Americans.

It is possible that it might be argued that the phrase "in like circumstances" somehow acts to disqualify the potential Thai claim on the same investment treatment given to Americans. This phrase, however, appears in virtually all the MFN provisions I have encountered in FTAs. It would seem that if it could be interpreted to shut out claims like we are discussing then the MFN clause would have very little value in terms of extending favourable treatment for a Party's investors arising out of deals with third parties.

Curiously, New Zealand and Australia did not include investment provisions in the CER Agreement that has now been on the books for more than two decades. Both governments review incoming foreign investment proposals. In recent years the two governments have started to discuss the possibility of providing for some kind of liberalised treatment of each others' investors. Given the very close relations between the two economies, it would not be out of the question to imagine that Canberra and Wellington might agree to exempt each other's investors from screening. If that were to happen, would the TAFTA and Australia-US FTA MFN clauses entitle Thais and Americans to equal treatment?

One of the issues I have been asked to address in my comments today is whether there are any systemic risks or potential inconsistencies arising out of the incorporation of MFN clauses in PTAs. One such risk might arise in the context of dispute settlement under a PTA.

When the United States and Australia were negotiating their bilateral agreement an issue that they needed to face was whether or not to incorporate the possibility of investor-state dispute settlement. Washington and Canberra decided not to include investor-state dispute settlement, although they reserved their rights to come back to this issue later. Earlier, Australia agreed to include investor-state dispute settlement in its FTA with Singapore and the United States, Canada and Mexico incorporated investor-state dispute settlement in NAFTA.

Now, it seems to me that an Australian firm with an investment-related problem in the United States might come to the conclusion that it is being treated less favourably than a Canadian

firm that has the right to directly challenge Washington. Would the MFN clause in the investment chapter of the Australian-American FTA be capable of being interpreted to require the United States government to allow itself to be directly challenged by the aggrieved Australian firm even if such a challenge is not provided for in the bilateral FTA? The argument could also operate in the opposite direction by virtue of the SAFTA.

Now, when I first started writing my remarks for today, I confess I did not know the answer to this question. However, through a bit of subsequent research, I came across a dispute brought before the ICSID in 2000 that goes by the name *Maffezini v. Kingdom of Spain* that seems to provide the answer.

The case concerned a claim by an Argentine investor brought against Spain to the ICSID in which Mr. Maffezini argued that the MFN clause in the Argentine-Spain BIT entitled him to invoke the same treatment as that provided under the more favourable Chile-Spain BIT. In this case, the ICSID tribunal decided:

“Notwithstanding the fact that the basic treaty containing the clause does not refer expressly to dispute settlement as covered by the most favoured nation clause, the Tribunal considers that there are good reasons to conclude that today dispute settlement arrangements are inextricably related to the protection of foreign investors...”

And that:

“if a third party treaty contains provisions for the settlement of disputes that are more favourable to the protection of the investor’s rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favoured nation clause as they are fully compatible with the *ejusdem generis* principle...”

By the way, in this case, the ICSID tribunal expressly rejected Spain’s claim that, under the principle of *ejusdem generis*, the most favoured nation clause can only operate in respect to substantive matters or material aspects of the treatment granted to investors and not to procedural or jurisdictional questions.

So that would seem to settle it, right? Not quite. In the final draft text of the US-CAFTA agreement, the parties included an interpretative footnote on the scope of application on the MFN treatment clause in the Investment Chapter of the agreement that reads:

“The Parties note the recent decision of the arbitral tribunal in *Maffezini v. Kingdom of Spain* which found an unusually broad most-favoured-nation clause in an Argentine-Spain agreement to encompass international dispute resolution procedures. ... By contrast, the Most-Favoured-Nation Treatment Article of this Agreement is expressly limited to matters “with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.” The Parties share the understanding that this clause does not encompass international dispute resolution mechanisms...”

Well, that’s about all I have to say on the subject for the moment. It seems to me that the MFN Clause in investment and services chapters of FTAs can certainly serve as a guarantee that one’s firms will not lose out in the face of subsequent more generous deals with non-parties. It also seems like the MFN clause could be interpreted in ways that are problematic for the parties to an agreement.