National Treatment in Emerging Market Investment Treaties

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ABSTRACT:

This article considers the national treatment standard in international investment agreements as implemented by emerging market countries. It briefly explains the nature and purpose of the standard and how it has been examined by international investment tribunals. Specific examples of national treatment provisions in emerging market international investment treaties as well as WTO instruments are discussed, focusing the scope and limitations to this standard commonly provided in treaty practice. The associated issue of performance requirements is then considered. The article concludes that whereas the national treatment standard is found in most but not all emerging market investment treaties, it is often limited by scope or application, although a trend towards greater liberalization is noted.

I Introduction

Foreign direct investment to developing countries comprised 45 per cent of the world's total foreign direct investment ('FDI') flows in 2011, a rise of 11 per cent over the previous year.[1] This considerable increase was lead by large economies such Brazil, India, China and Russia as well as upcoming giants such as Indonesia, Mexico and Turkey.[2] Such countries are often described as "emerging markets" because they have high rates of economic growth, typically well beyond those enjoyed by developed countries, rising GDPs and a burgeoning middle class. Taken together these factors represent an attractive target for foreign firms seeking new

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[1] UNCTAD, World Investment Report 2012 at xi <http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf>

[2] The Economist: 'Emerging Markets, Dream On?' The Economist, 21 June 2012 < http://www.economist.com/node/21559336?zid=295&ah=0bca374e65f2354d553956ea65f756e0> (accessed January 2013)

consumers and an increasingly educated yet low-cost labour pool. Emerging market countries, as with their developed country counterparts, continued in 2011 to demonstrate a positive trend of liberalization in their policies towards FDI.[3] The role played by international investment agreements ('IIA')s in FDI flows remains controversial,[4] but there is some evidence to suggest one of the chief regulatory means by which FDI flows to emerging markets have been enhanced is through the conclusion of such agreements,[5] of which there now more than 3000 are in existence.[6] These instruments, which are now regularly concluded between two developing countries rather than a developed and a developing country as in the 20th Century paradigm, protect foreign investments from certain harmful regulatory actions by host states. These include actions such as expropriation without compensation and discrimination on the basis of nationality. This latter risk can be mitigated through the use of national treatment provisions in IIAs.

National treatment has been identified by United National Conference on Trade and Development ('UNCTAD') as the "single most important standard of treatment enshrined in international investment agreements."[7] Simply put, the national treatment clause in an IIA requires that the host state make no negative differentiation between foreign and national investors when applying its rules and regulations. This ensures that foreign investors enjoy the same level of treatment as nationals, allowing them to compete on an equal footing. The national treatment standard is linked to the notion of state responsibility for injury to aliens seen in public

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[3] UNCTAD, above note 1 at xi
[4] See e.g. Eric Neumayer and Laura Spess, "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries" in Karl Sauvant and Lisa Sachs eds. *The Effect of Treaties on Foreign Direct Investment* (Oxford University Press, 2009)
[5] UNCTAD, above note 1 at xx
[6] Ibid at xx
[7] UNCTAD, National Treatment, UNCTAD Series on Issues in International Investment Agreements (New York and Geneva, United Nations, 1999) at 1

international law and found in Charter of Economic Rights and Duties of States.[8] It grew in prominence throughout the late 20th Century as developing country host states began to exceed the minimum standards understood by customary international law, rendering the treatment of foreign investors relative to local investors a vital instrument for safeguarding the expectation of high-risk commercial projects overseas.[9] While it eradicates discrimination against foreign investors on the basis of the nationality of ownership of an investment and in so doing should encourage FDI, the national treatment standard is a double-edged sword because it harbours the potential for deep encroachment on national sovereignty. Precluding favouritism towards local firms can undermine a host country's capacity to govern not simply its own economy, but possibly many aspects of domestic social policy that may be affected by the presence of foreign firms, such as national security, culture and even indigenous rights.

This article will examine the use of the national treatment standard by emerging market countries in their IIAs, including investment-related instruments administered through the World Trade Organization ('WTO'). It will begin by very briefly outlining the nature of the national treatment standard in international investment law and will then turn to some examples of how these clauses have been used by emerging markets in their investment treaties, examining first the scope of the clause and then common ways in which it is limited. The article will then consider the closely related issue of performance requirements which typically discriminate against foreign firms in a manner that could engage national treatment obligations. It must be acknowledged from the outset that generalizations about the treaty practice of emerging market countries must be approached with caution for two principal reasons. First, there is an enormous

[8] United Nations, A/Res/29/3281, Art 2(2)c (12 December 1974)

[9] Nicholas DiMascio and Joost Pauwelyn, "Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin" 102 American Journal of International Law 48 (2008) at 67

variation in economic size and developmental status among countries that could fit within the category "emerging" with China and India being perhaps the two most conspicuous outliers. As such it is difficult to infer much less identify consistent policy objectives towards FDI. Secondly and perhaps more importantly, the contents of IIAs pursued by developing countries, especially historically, has more often been dictated by the powerful developed partner country, rather than indicative of a strategic approach by the relevant developing state to the national treatment standard or investment treaties generally.

II The National Treatment Standard In International Investment Law

The application of the national treatment standard in international investment law requires a comparison between treatment accorded to foreign investors and domestic investors by host states. In order for this comparison to be legally meaningful the relevant investors must be in similar or "like" circumstances. Some older IIAs had used the phrase "situations" instead of "circumstances" although it is not clear that there is a difference between the two concepts.[10] Whether or not foreign and domestic investors can be seen to be in "like" circumstances will depend on the nature of the investment and the investors. The way in which this analysis is conducted by investment tribunals which interpret international investment instruments remains controversial. More specifically, it is unclear whether the standard requires that foreign and domestic investors are in exactly the same business or simply the same industry or sector. Clearly a large multinational corporation is very different from a small local operator, suggesting

[10] Rudolph Dozler and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) at 179

that differential treatment between such entities should not be viewed as discrimination.[11] The size of a business entity often signifies its capacity to engage in abusive market practices, such as predatory pricing, which may be viewed as a justification for discrimination irrespective of nationality. However discrimination based upon an investor's size, while not necessarily intending to disadvantage foreign investors, may result in a national treatment violation because in many developing countries, although less so the big emerging markets, large investors will most likely be exclusively foreign. It appears that de facto discrimination should be sufficient to find a national treatment violation.[12]

Crucially the test for "likeness" for national treatment purposes in the investment context is different than that of the trade context, as seen in the WTO's General Agreement on Tariffs and Trade ('GATT') in particular, where a comparison between "like products" is specified.[13] The unique nature of the national treatment test in international investment law was illustrated by a the arbitration tribunal in the *Methanex v USA* decision under the investment provisions in the North American Free Trade Agreement ('NAFTA'). That tribunal held that the foreign investor did not receive less favourable treatment than a similarly placed domestic investor in that instance. This was because although the relevant law did discriminate against the production of different types of chemicals (ethanol and methanol) the regulation did not discriminate between methanol producers themselves.[14] Commentators have accordingly cautioned against the reliance on WTO jurisprudence to inform the analysis of national treatment obligations in international investment law.[15] Still, it has been argued that the finding of a national treatment violation with respect to a trade-oriented measure under WTO law by a panel or the Appellate

[11] M Sornarajah, *The International Law on Foreign Investment* (3d ed, Cambridge University Press, 2010) at 203
[12] Felman v Mexico, ICSID Case No. Arb (AF)/99/1, award 16 December 2002
[13] Art III.
[14] Methanex Corporation v United States, Award, 44 ILM (2005) 1345 (3 August 2005)
[15] Dolzer and Schreuer above note 10 at 184-185 and Sornarajah above note 11 at 203

Body could potentially strengthen an investor's claim that the same measure undermined its national treatment entitlement under an IIA.[16] Clearly the conceptual link between the national treatment standards in the trade and investment contexts remains controversial however a full discussion of this issue is outside the scope of this article.

When bringing a claim based upon a national treatment violation in the investment context, the claimant must show prima facie evidence that it has been treated in a different and less favourable manner than an equivalent domestic investor, at which point the burden shifts to the respondent state to disprove this allegation.[17] The precise procedure for evaluating a national treatment claim will depend upon the specific wording of the relevant IIA, with a relatively clear process now evident for such claims under NAFTA, as developed through jurisprudence.[18] In that regard, NAFTA jurisprudence also shown that it is sufficient for the investor to show that there was less favourable treatment accorded to it than to domestic investors in like circumstances; the investor does not have to show that the discrimination is motivated by nationality.[19] This view is supported by commentators who argue that the relevant test for the breach of the national treatment standard under international investment law is whether the alleged discrimination is effectively based upon nationality rather than some other policy reason.[20] Investment tribunals have traditionally ruled that there is no need to find a

[16] Arwel Davies, "Scoping the Boundary Between the Trade Law and Investment Law Regimes: When Does a Measure Relate to Investment" 15:3 Journal of International Economic Law 793 (2012) at 794
[17] Felman v Mexico above note 12
[18] See Peter Muchlinski, *Multinational Enterprises and the Law* (Second Edition, Oxford University Press, 2007) at 622-623
[19] Feldman v Mexico above note 12 at 181
[20] DiMascio and Pauwelyn above note 9 at 76

discriminatory intent in order for a regulation to violate a national treatment commitment, although such an intention can be indicative of a violation.[21]

As noted in the introduction, the purpose of national treatment, either in the investment or trade contexts, is clear. The standard seeks to ensure that there is a degree of competitive equality between foreign and national investors or traders. Under international investment law this objective manifests itself as the protection of individual investors from targeted attacks by host states. In ensuring fairness, national treatment eliminates distortions caused by unevenly applied laws, achieving economic efficiency by allowing the best producers to supply consumers based on the quality and price of their goods and services, which is achieved either by selling to new markets or lowering production costs abroad. The national treatment standard is thought to facilitate FDI by assuring foreign investors that their substantial resource commitments in other countries are relatively safe from arbitrary state action, mitigating the chilling effect of inconsistent and unpredictable state interference. As UNCTAD summarizes cogently, "the ongoing internationalization of investment and production concludes that access to foreign markets under non-discrimination conditions is necessary for the effective functioning of an increasingly integrated world economy."[22]

A high level of standardization of national treatment clauses in IIAs has resulted in a generally simple use and interpretation of the standard in practice, certainly with respect to other more ambiguous standards such as fair and equitable treatment.[23] This comparative clarity does not mean that the national treatment clause in IIAs is without controversy. In addition to difficulties in its application in arbitration arising from the comparison at the root of the highly

[21] E.g. Siemens v Argentina, ICSID Case No. ARB/02/8 (6 February 2008) at par 320
[22] UNCTAD, above note 2 at 2
[23] Dolzer and Schreuer above note 10 at 179

fact specific "like circumstances" test noted above[24], the phrasing of the clause itself can take a number of different forms in IIAs. It is this second issue that forms the basis of this article, not a discussion of how the standard has been assessed by specific investment arbitration tribunals which operate in the absence of *stare decisis*.

As a consequence of significant inequalities in economic and technological power among nations, some degree of differentiation between foreign and domestic firms may be necessary for the very purpose of attaining some level of operative equality. This may be particularly so because there is often no way for developing host states to promote their domestic industries either at home or abroad in order to achieve more full economic development.[25] Accordingly there are a number of emerging market IIAs which contain no promises of national treatment at all.[26] This strategy allows host states to grant preferential treatment to their own firms so that they can withstand foreign competition.

The national treatment standard is understood not to grant foreign investors protection that is *greater* than that available to similarly placed domestic investors. Clearly in some politically unstable countries local businesses may suffer at the hands of their own governments, regularly facing expropriations or excessively burdensome regulations. Thus some minimum international standard of treatment of aliens, drawn from customary international law rather than treaty, is be required to safeguard investors' property, a concept distinct and in many ways oppositional to formal national treatment.[27] The reality that national law as applied to local citizens could actually be less protective of foreign investors than the general rules of

[24] E.g. Feldman v Mexico above note 12 (where like circumstances was held to refer to the same business) and Occidental v Ecuador, Award, 12 ICSID Reports 59 (1 July 2004) (where like circumstances was held to refer to local producers in general).
[25] Surya P Subedi, *International Investment Law: Reconciling Policy and Principle* (2nd ed, Hart, 2012) at 71-72
[26] E.g. Indonesia-Romania (signed 26 June 1997)
[27] Subedi, above note 25 at 72

international law is seen in the commonly used words "no less favourable", acknowledging that other rules may be more favourable than those found in domestic law. In this sense, positive differentiation remains possible and will even be obligatory where the general standards of international law are higher than those applying to domestic entities.[28] Denial of this entitlement to "better than national treatment" was a central component of the Calvo Doctrine which theorized that foreigners should receive formally identical treatment to nationals, notably by using the host state's dispute settlement mechanisms rather than international ones, just as any domestic investor would do.[29] The practical effect of the national treatment standard embracing an international minimum standard is that in some respects foreign investors are effectively placed in a position superior to that of their domestic equivalents. Again this is seen most notably where IIAs grant foreign investors access to remedies through international investment tribunals. This can be advantageous because such systems are often less expensive, confidential and not plagued by corruption. Bypassing local courts is problematic also because it could transgress the constitution of some host states, particularly in treaties where there is no requirement of prior exhaustion of local remedies.[30]

In addition to its status as a stand-alone obligation, national treatment's prohibition of discrimination against foreigners in international investment law can also be found implicitly in the guarantees against expropriation which are common to IIAs. In order for an expropriation to be considered lawful it must not be discriminatory, meaning that it must not be performed against foreign investors simply because of they are foreign.[31] Moreover, a standard of compensation for expropriation reflecting compensation available to locals under national laws

[28] Dolzer and Schreuer above note 10 at 178
[29] K Lipstein, "The Place of the Calvo Clause in International Law" (1945) 25 British Yearbook of International Law 130
[30] Santiago Montt, *State Liability in Investment Treaty Arbitration* (Hart, 2009) at 366
[31] Dolzer and Schreuer above note 10 at 91

(another re-iteration of the Calvo Doctrine) is similarly an embodiment of the national treatment standard. This type of compensation, as distinct from the more common Hull Formula of "prompt, adequate and effective" compensation, was historically asserted by developing states,[32] and can still be seen in some Latin American IIAs.[33]

III National Treatment Guarantees in Emerging Market IIAs

As noted above, national treatment is a treaty made standard that does not exist in customary international law on its own. It is a standard defined by reference to the treaty in which it appears which in turn dictates how the national laws relating to relevant economic activities must be written and applied.[34] Most legal commentary on national treatment in international investment law tends to concentrate on a discussion of the jurisprudence developed in relation to NAFTA,[35] quite possibly because there is now a significant body of publicly available case law decided by tribunals constituted under this instrument. Focussing instead on the text of IIAs concluded by emerging markets and not on investor-state arbitration awards, this article will now consider treaty practice among emerging markets with respect to the scope of application of the national treatment standard.

i) Pre or Post Establishment

[32] See e.g. Asif Qureshi and Andreas Ziegler, *International Economic Law* (3rd ed, Sweet and Maxwell, 2011) at 511

[33] E.g. Brazil-Cuba Art 4.2 iii) (signed 26 June 1997) which references compensation according to the law of the contracting party that is making compensation.

[34] Muchlinski above note 18 at 625

[35] E.g. DiMascio and Pauwelyn above note 9

One of the most controversial aspects of the national treatment guarantee in IIAs is the question of what stage in the investment process it applies. In most emerging market IIAs, national treatment normally only extends to the post-establishment stage of an investment, meaning after the foreign investor has entered a host country and begun its operations there. Limiting the standard in this critical manner allows more economically vulnerable host states to dictate which forms of foreign economic activity it is willing to permit within its borders, according to its own economic and social requirements; a crucial manifestation of national sovereignty. Pre-establishment national treatment guarantees are rare, although they can be seen in NAFTA (encompassing the emerging market Mexico), US and Canadian Model bilateral investment treaties ('BIT')s as well as BITs concluded between these countries and emerging countries,[36] likely because these large developed states did not fear competition from emerging market firms. Some regional trade agreements ('RTA')s that include investment provisions signed by emerging markets contain pre-establishment national treatment,[37] possibly because the economic power of these Member states perceived as more equal. The more common appearance of pre-establishment national treatment in IIAs has been described as a "revolution" because it represents a fundamental form of international economic integration.[38] This extreme form of liberalization may become more popular among the emerging world as these firms seek to engage more aggressively in outward FDI. Generally speaking there has been an increased emphasis on granting national treatment at both the pre-establishment and post-establishment phase of the investment, a phenomenon that has been linked to economic globalization.[39] This

[36] E.g. Canada-South Africa Art III.1 b) (signed 27 November 1995)
[37] E.g. Japan-Singapore RTA Art 73 (signed 13 January 2002)
[38] UNCTAD, above note 7 at 3-4
[39] Sornarajah above note 11 at 335, who also asserts that the appearance of pre-establishment national treatment is the consequence of the acceptance of neo-liberal views, at 336.

may indicate growing parity between the developed and developing world in terms of their capacity to export capital.

The scope of application of the national treatment standard is typically expressed in IIAs under the heading Treatment of Investment. It is not customary for treaties to state explicitly that the national treatment standard is extended only to the post-establishment phase of investment. The scope of application of the national treatment standard may also be controlled by the definition of investment or investor as specified under the IIA, with the various protections applying only to those activities that fit within the definition so proscribed. As will be discussed further below, countries often exclude specific sectors from national treatment coverage, which may explain why pre-establishment national treatment has begun to appear at all in IIAs. It is important to note that there has yet to be an investment arbitration award that has considered a state's violation of a pre-establishment national treatment guarantee. It is difficult to imagine on what basis the compensation for such a treaty breach would be, given that the injured investor would have no record of operation in the host state, rendering any claim of lost profits highly speculative.

A standard example of a national treatment clause employed by an emerging market that covers only post-establishment is that of South Africa's BIT with Canada which states that each party shall permit the establishment of an investment on conditions no less favourable than that granted to its own investors or prospective investors in like circumstances.[40] South Africa's BIT with Turkey similarly grants national treatment only to investments "once established."[41] India's BIT with Turkey uses the same language,[42] as does the BIT between Turkey and Indonesia.[43] A

[40] Art II (3) a) (signed 27 November 1995)
[41] Art II 3 (signed 23 June 2000)
[42] Art II.2 (signed 17 September 1998)

classic post-establishment restriction on national treatment can be seen in Vietnam's BIT with Chile which contains a national treatment obligation, limiting protections to investments "made in its territory"[44] with the past tense "made" indicating that the investment has already been established. Likewise the BIT between the Philippines and the Czech Republic includes a protocol that limits national treatment (lacking in the main text of the treaty) explicitly to the post-establishment stage with the words "...investors and investments once admitted…"[45] Other Philippine instruments use the phrase "investors or investments once established"[46] or "admitted investments."[47]

One of the most common restrictions on the scope of national treatment can be seen in China's few modern BITs which contain a national treatment clause but only "in accordance with the laws and regulations of the other Contracting Party."[48] Similarly Mexico's BIT with Switzerland promises to admit investors in accordance with the party's laws and regulations.[49] Malaysia's BIT with Korea expressly limits the national treatment guarantee (which is unusually found in the same clause as the fair and equitable treatment provision) by stating that investments in financial services will only enjoy national treatment protection in accordance with the relevant laws and regulations of each contracting party,[50] indicating that host states are free to discriminate against foreign investors in these sectors on the basis of national laws. These types of provisions, seen in a wide range of emerging as well as developed country IIAs, allow the host

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[43] Art II.2 (undated)
[44] Art IV(2) (signed 16 September 1999)
[45] (signed 5 April 1995)
[46] Philippines-Turkey, Art III (2) (signed 22 February 1999)
[47] Philippines-Finland, Art 3(2) (signed 25 March 1998)
[48] E.g. China-Czech Republic Art 3.2 and 1.1 (signed 8 December 2005)
[49] Arts 4(2) and 3(2) (undated)
[50] Art 3(1) (signed 11 April 1988)

state to screen foreign investments through their own national laws, including those relating to crime and national security as well as those governing certain sectors or the economy generally.

The India-Sweden BIT states that the obligation to admit foreign investments is subject not only to its laws and regulations, but also to its "general policy in the field of foreign investment"[51] which appears to grant host states greater latitude to restrict entry, even if this power is not contained in official legislation. Similar language is seen in Malaysia's BIT with Germany, which specifies that national treatment will be extended "unless stipulations made in the document of admission provide otherwise"[52] effectively granting host states the complete discretion to abandon the treaty's national treatment standard as required.

While uncommon, pre-establishment national treatment can be found in some emerging market IIAs. Singapore's RTA with India contains a pre-establishment national treatment guarantee, although it has sectoral restrictions.[53] Vietnam's BIT with Japan also extends national treatment to the pre-establishment stage, specifically including the word "establishment and acquisition" in the treaty's relevant clause.[54] Peru extends national treatment to all stages of investment in some of its IIAs.[55] Ecuador has concluded IIAs that does not limit national treatment to investments that have already been established,[56] suggesting that a right of establishment may exist. Mexico has extended pre-establishment national treatment in the investment chapter of NAFTA with some reservations.[57]

[51] Art 3(1)
[52] Art 3 (signed 22 December 1996)
[53] Art 6.3(1)
[54] Art 2.1 (signed 14 November 2003)
[55] Peru-Czech Republic, Art 3.1 (signed 16 March 1994). Peru's BIT with the Netherlands uses unusual phrasing, extending national treatment but only with respect to the full protection and security standard: Art 3.2 (undated)
[56] Ecuador-Netherlands Art 3.2 (undated)
[57] Art 1102 (signed 17 December 1992)

One way of restricting the intrusiveness of a pre-establishment national treatment obligation is to make it hortatory only. In this regard the national treatment clause in Russia's BIT with Canada, covering both pre- and post-establishment, is phrased as a "best efforts" obligation; national treatment will be granted "to the extent possible and in accordance with [each contracting party's] laws and regulations."[58] Argentina's BIT with Canada contains the same language.[59] It is difficult to envision how such a provision could be challenged without some evidence of bad faith.

The ASEAN Comprehensive Investment Treaty, which is based on regional liberalization among the key emerging markets of Indonesia, Malaysia, the Philippines, Thailand, Vietnam and others contains a national treatment provision that embraces the pre-establishment stage for investors from Member States.[60] In order to limit the risks of excessive foreign competition in sensitive areas ASEAN allows Members to submit reservation lists, excluding certain industries from the benefit of this provision.[61] As suggested above, these countries may have been willing to extend pre-establishment national treatment to each other because they were not apprehensive about the invasion of superior foreign firms as a consequence of their relatively equal economic positions.

The WTO's General Agreement on Trade in Services ('GATS'), binding more than 150 Member states and now including all of the large emerging markets, covers foreign direct investment through its Mode 3 "commercial presence" mode of supply of services.[62] GATS extends pre-establishment national treatment, structured as a right of entry to foreign investors,

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[58] Art III(4)
[59] Art IV (signed 5 November 1991)
[60] Art 5 (signed 6 February 2009)
[61] Art 9
[62] Art I.2 c)

but only in those sectors that Members have included in their schedules and subject to any restrictions.[63] This "positive list" approach to investment liberalization is different than that of NAFTA, for example, which uses a "negative list" (national treatment in all sectors except those which are specifically excluded) and which is specified in the OECD Liberalization Codes which may be seen as useful guides for emerging markets. It is thought that the negative list format, in which the default is pre-establishment national treatment is more conducive to achieving investment liberalization, but developing countries have tended to favour the GATS positive list approach because it is more gradual, requiring further negotiation and as such is less intrusive. The negative list technique, seen in the ASEAN Comprehensive Investment Treaty, requires that the country be able to assess its capacity to absorb FDI as well as the ability of its domestic firms to withstand foreign competition in particular sectors *ex ante*.[64]

The WTO's plurilateral Agreement on Government Procurement ('GPA'), which currently has only 14 signatories, including the emerging markets Israel, Singapore and Chinese Tapei, contains a national treatment guarantee that is relevant to international investment. Article III:2 of the GPA states that signatories "shall not treat a locally-established supplier of a governmental service less favourably than another locally-established supplier on the basis of their degree of foreign ownership or affiliation." This provision ensures that host states do not unfairly prejudice foreign firms seeking to supply goods or services to governments, again allowing the most efficient provider to obtain the tender or contract on the basis of their competitiveness, not their foreign character. The GPA is structured in a positive-list manner that allows signatories to list which sectors or industries in which they are willing to extend commitments under the agreement, often by reference to specific agencies within the central and

[63] Art XVII
[64] Muchlinksi, above note 18 at 254

sub-central government. Most emerging market signatories, such as Israel[65], typically do not include commitments in industries relating to national security.

Finally and perhaps most significantly from the perspective of distinguishing emerging market IIA practice from that of developing countries some Asian emerging markets, such as Indonesia[66] and Singapore[67] typically do not grant national treatment at all in their IIAs. National treatment is also lacking entirely from some Philippine,[68] and earlier Chinese[69] IIAs. This approach clearly reflects a high level of caution with regards to foreign capital. Granting national treatment protection to foreign investors was difficult for some emerging markets such as China given the dominance of state-owned enterprises in its economy. On the other hand Russia, which has an economy that is also dominated by state-owned enterprises, has specifically included the favourable treatment accorded to its state owned enterprises in the definition of national treatment in some IIAs.[70] This approach may reflect Russia's desire to attract foreign capital to exploit fully its natural resources. While excluding national treatment entirely could discourage many foreign investors, this strategy clearly allows host states to retain maximum control over their own economies and to extend preferential treatment to their own firms, allowing them to withstand competition from often more advanced foreign entrants and to grant preferential treatment to specific industries or firms.

ii) Exceptions to National Treatment

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[65] Israel, Annex 1 (WT/Let/513) 3 February 2006
[66] E.g. BITs with Thailand (signed 17 February 1998) and Sweden (signed 17 September 1992)
[67] E.g. BITs with Mongolia (signed 24 July 1995) and Peru (signed 27 February 2003)
[68] E.g. Philippines-UK (signed 3 December 1980)
[69] E.g. China-Cambodia (signed 19 July 1996)
[70] E.g. Russia-US Art 1.1 h) (signed 17 June 1992)

States may structure IIAs to grant them the power to deny national treatment at any stage of investment. In order for foreign investors to understand precisely how they will be regulated by host states it is usually further necessary to examine domestic legislation governing the foreign investment process. Of course these regulations must conform to obligations made in international instruments. Most IIAs contain lists of the types of matters that are excluded from the coverage of the instrument's protection, allowing the host country to enact discriminatory laws in fields because of justifications linked to health, public order or the environment.[71] It should be clarified that it is not the aim of this article to consider exceptions to IIA commitments generally but rather to consider those limitations expressly placed on national treatment obligations as seen in emerging market IIA practice.

Including a list of exceptions to national treatment, and other treaty guarantees, is a relatively recent phenomenon in international investment law, thought to have been derived from the first US Model BIT.[72] Even in the absence of specific limitations in the text of an IIA it is widely accepted that some differentiation between domestic and foreign investors is acceptable if rational grounds are demonstrated.[73] The precise nature of these justifications has been a source of agitation for a number of investment tribunals.[74] In the special context of emerging markets, the developmental status of the host state may also influence the perceived legitimacy of any such justifications in line with the principle of special and differential treatment seen in public international law.[75] The extent to which developmental status can legitimately apply to the large

[71] Many IIAs specifically adopt the language of the General Exceptions contained in the GATS Art XIV, e.g. Jordan-Singapore Art 18 (signed 16 May 2004).
[72] Subedi, above note 25 at 181
[73] Dolzer and Schreuer above note 10 at 181
[74] E.g. SD Myers v Canada, First Partial Award, 40 ILM (2001) 1408 (13 November 2000) at [250] where the protection of public interest was discussed and Thunderbird v Mexico, Award 26 January 2006 at [263] where conduct illegal under national law justified a departure from the national treatment standard.
[75] Seen for example in the preamble to the WTO Agreement (signed 15 April 1994)

emerging markets itself remains contentious. The applicability of this logic to the large emerging markets like China, India, Russia and Brazil is particularly questionable.

Russian IIAs provide a number of express exceptions to national treatment. Its BIT with Cyprus specifies that parties reserve the right to make limited exceptions to national treatment guarantees in accordance with their own legislation, allowing maximum policy flexibility.[76] Russia's BIT with Egypt specifies that each contract party has the right to determine the branches of the economy and spheres of activity in which activity by foreign investors is excluded or restricted.[77] A similar limitation appears in the Russian BIT with Japan, which includes the additional requirement that these restricted spheres of activity must be notified to the other party.[78] Investments that do not maintain a significant commercial presence in the host are specifically excluded from national treatment protections in some Russian IIAs,[79] preventing foreign investors from using Russian as an artificial home state to take advantage of Russian IIAs with other countries where the investor might have operations but no treaty. Russia's BIT with Germany permits discrimination against foreign investors taken on the grounds of "law, order and security, morality or public health."[80] These broad exceptions to national treatment are also found in the BIT with Sweden, which additionally makes reference to unspecified "limited exceptions" to national treatment that may be maintained by contracting parties.[81]

Singapore's BIT with Jordan specifies that parties may maintain limitations to national treatment in relation to any sectors or matters to be covered by later annexes.[82] Likewise

[76] E.g. Russia-Cyprus Art 3.3
[77] Russia-Egypt Art 3.3 (signed 23 September 1997)
[78] Protocol Art 5(2)-5(4) (signed 13 November 1998)
[79] E.g. Russia-US Art I.3 (signed 17 June 1992)
[80] Protocol Art (2) c (signed 13 June 1989)
[81] Art 3 (3) (signed 19 April 1995)
[82] Art 5(2) (signed 16 May 2004)

Vietnam's BIT with Japan includes an Annex that lists forms of economic activity that are excluded from national treatment, with each country listing its own exclusions, with Vietnam's exclusions tending to focus on services industries.[83] As noted above this negative list strategy allows states room to control inward investment in sectors that may not be able to withstand full competition.

Brazilian IIAs contain numerous exceptions to national treatment guarantees. For example, in the BIT with Chile, Brazil grants preferential treatment to Brazilian companies in the supply of governmental services. It also prohibits foreign companies from investing in health care services. Furthermore Brazil only permits investors that are native Brazilians or who have been naturalized for more than ten years the capacity to own companies which engage in broadcasting of sounds and images.[84] This limit reflects Brazil's trepidation concerning its indigenous culture on a predominately Spanish speaking continent. Perhaps illustrating a more general Latin American resistance to foreign cultural influences, Chile's RTA with Canada also exempts cultural industries from all protections contained in the instrument.[85]

Some IIAs exclude subsidies or grants provided by a host state from the scope of national treatment.[86] China's BIT with Guyana permits parties to grant special privileges to their own nationals in order to stimulate the growth or creation of local industries, provided that these do not impair the activities of foreign investors.[87]Subsidies are used in order to provide assistance to struggling sectors or industries or to encourage the development of impoverished groups or

[83] Annex II (signed 13 November 2003)
[84] Protocol (1) (undated)
[85] Annex O-06 (signed 5 December 1996). This restriction could equally reflect Canada's desire to protect French language and culture in the province of Quebec.
[86] E.g. NAFTA art 1108(8)
[87] Art 4.6 (signed 27 March 2003)

regions. While subsidies are viewed by most economists as economically inefficient,[88] some forms of subsidy are less damaging to international trade and investment than others, with those linked to export performance being the most harmful. As such retaining some degree of discretion with respect to subsidies may be seen as a key economic tool for emerging markets.

Discrimination against foreign investors is often justified by host states on the basis that foreign investment represents a risk to national security. Indeed, Russia's BIT with Thailand specifically permits parties to introduce exceptions to national treatment for the purpose of "national security and public order."[89]Although such provisions typically do not occur expressly in conjunction with the national treatment guarantee in IIAs, national security exemptions may be seen as a derogations from the national treatment guarantee in as much as they are often phrased so as to permit host states to depart from all obligations contained in a treaty: "nothing in this agreement shall be construed to prevent a Party from taking any action which it considers to be in its essential security interest."[90] The concern for national security is especially common in industries related to vital infrastructure such as telecommunications, finance and transportation because of the fear that foreign influences could de-stabilize a country's critical infrastructure. National security exceptions in IIAs are a special category of restriction because they are often phrased using the above indicated "self-judging" language. This allows the host state to determine when it considers its national security to be under threat. International tribunals may therefore not question this determination.

[88] See e.g. Michael Trebilcock, *Understanding Trade Law* (Edward Elgar, 2011) at 87
[89] Art 3.3 (signed in October 2003)
[90] E.g. India-Switzerland Art 11.2 (signed 4 September 1997)

Under GATS, national treatment is extended to services and services suppliers in scheduled sectors, subject to "any condition and qualification set out therein..."[91] Thus, as noted above WTO Members may prescribe limits to their national treatment commitments affecting foreign direct investment under Mode 3 commercial presence (or any mode for that matter) either horizontally across sectors, or vertically (all modes) within one sector. Nationality or residency requirements, differential capital requirements and special operational limits applying to foreign firms are typical examples of standard national treatment limitations to GATS.[92] Additional commitments that have not been made the subject of scheduling, such as those relating to qualifications, standards, or licensing, are left to negotiation between WTO Members.[93] Although they are not expressly linked to national treatment, the GATS contains general exceptions for measures necessary to protect public morals, public order, health as well as the prevention of fraud. These would permit the departure from a national treatment commitment that had been extended by a Member under the agreement.[94] Like the general exceptions under the GATS, the GPA also contains an exemption for laws relating to public morals, health and the protection of intellectual property, provided that such laws are not enacted in a manner that is a disguised restriction on international trade.[95]

Perhaps the most controversial of all departures from the national treatment standard in international investment law are those relating to ethnicity. South Africa and Malaysia in particular have programs that grant preferential treatment to specific ethnic groups in order to attempt to redress historic discrimination inflicted upon indigenous minorities. Such ethnic

[91] Art XVII (1)
[92] Panagiotis Delimatsis, *International Trade In Services and Domestic Regulations* (Oxford University Press, 2007) at 77
[93] Art XVIII
[94] Art XIV
[95] Art XXIII.2

groups are often assured a certain percentage of ownership of various investment projects, most notably those in the natural resources sector.[96] These laws are difficult to reconcile with national treatment because they clearly disadvantage foreign investors, although they could also arguably disadvantage local investors that do not fit within the relevant ethnic group. Malaysian and South African IIAs do not make explicit reference to these policies in their IIAs, however it may be possible to fit these forms of positive discrimination within general public policy exceptions to national treatment found in IIAs such as those referring to public order.

IV National Treatment and Performance Requirements

Performance requirements are conditions placed upon foreign investors by host sates so that they are permitted to enter and establish themselves in host states and carry on business there. These requirements are aimed at ensuring that the foreign investors engage in commercial activity that is economically advantageous to the host state. Common examples include the obligation to use locally sourced goods, to export a certain percentage of their production, to hire local personnel or that the foreign investor operates through a locally incorporated venture, a requirement popular in Asia. While the prohibition of these measures in IIAs typically do not refer to non-discrimination directly, the national treatment standard appearing elsewhere in the instrument may support the claim that performance requirements like these should not be imposed on foreign investors. This is because requirements such as the purchase or use of local goods would not normally be imposed upon local investors, a clear indication of discrimination based upon

[96] Sornarajah above note 11 at 344

nationality.[97] Accordingly a ban on performance requirements is seen in a number of emerging market IIAs, such as Russia's BIT with the United States[98] and Chile's RTA with Canada.[99]

In one sense performance requirements could undo the advantage of equality achieved through national treatment, distorting markets in favour of inefficient local investors by requiring the foreign investor to use expensive local goods or hire unskilled local employees. Whether performance requirements actually achieve economic advantage for host states is a source of controversy, as it typically viewed that, as a form of subsidization, it is ultimately self defeating. However recent studies have shown that linking performance requirements to tax incentives has been able to manipulate foreign direct investment in a manner that has led to beneficial spillovers in the form of technology transfer.[100] Performance requirements are additionally controversial because they were traditionally employed by the major industrial powers during their growth stage in the 20th Century. In this sense, by depriving developing countries of the use of performance standards, IIAs are denying these countries one of the key historic tools of economic growth.[101]

The dismantling of performance requirements through national treatment could equally undermine the welfare-enhancing potential of these requirements, negating protections afforded to weaker or nascent industries or firms.[102] Accordingly some performance requirements may be specifically excluded from the national treatment standard in the text of the IIA. Strictly speaking the inclusion of a ban on performance requirements in an IIA could be viewed as superfluous

[97] Ibid at 202
[98] Art II.5 (signed 17 June 1992)
[99] Art G-06.1
[100] Ronald B Davies and Christopher J Ellis, "Competition in Taxes and Performance Requirements for Foreign Direct Investment" 51:6 European Economic Review 1423 (2007)
[101] M Sornarajah, "India, China and Foreign Investment" in M Sornarajah and Jiangyu Wang eds. China*, India and the International Economic Order* (Cambridge University Press, 2010) at 150
[102] Sornarajah, above note 11 at 339

where there is a national treatment clause in the treaty. While it would be possible to exempt performance requirements from the scope of national treatment, no IIAs appear to have done this. States that impose performance requirements in their national legislation do so on the basis that their treaties extend protection only to investments which are made in accordance with the laws and regulations of the host state, precluding coverage under the national treatment standard.[103]

Mindful of the damaging effect of performance requirements on the international flow of goods, the WTO Agreement on Trade-Related Investment Measures ('TRIMs') prohibits the use of certain performance requirements in conjunction with goods, re-iterating the GATT national treatment standard. WTO Members may not apply a trade-related investment measure that is inconsistent with the GATT obligation not to discriminate against a good on the basis of its nationality of origin as well as through the imposition of quantitative restrictions.[104] This requirement is subject to the exceptions contained in the GATT, which would include the General Exceptions of Article XX as well as national security and balance of payments.[105] The TRIMS Agreement contains an illustrative list of trade-related investment measures that are so prohibited, effectively listing forbidden performance requirements linked to goods manufacturing. These include the requirement that enterprises use domestic goods,[106] or export a certain amount or value of produced goods.[107] Several large emerging markets were required to abandon their regime of imposing performance requirements as a condition of their entry into the WTO, including China and most recently Russia. TRIMS obligations are specifically re-iterated

[103] Ibid at 342
[104] Art 2.1 and 2.2
[105] Art 3
[106] Annex 1.a)
[107] Annex 1.b)

in a number of emerging market IIAs.[108] China and India had resisted the inclusion of performance requirements in their IIAs because of the importance of the use of local goods to their manufacturing-focused economies.

With regards to the above mentioned link between performance requirements and incentives extended by host states to attract foreign direct investment, it should be noted that the TRIMS Agreement only bans performance requirements as a condition for the entry of continued presence of a foreign enterprise, but not as a condition for the receiving of investment incentives, such as favourable tax treatment. Thus WTO Members are able to employ incentivization to attract foreign direct investment, even where this is conditional upon the imposition of trade-based investment measures. Such investment incentives would also not violate national treatment guarantees in IIAs because the treatment to the foreign investor would in such instances be better than that accorded to the equivalent domestic investor.

Some south-east Asian countries such as Thailand and Malaysia removed or weakened some of their performance requirements following the Asian financial crisis of the late 1990s. India has also removed many of its performance requirements as part of an initiative to attract more FDI in the early 21st Century. Many of the performance requirements that are still implemented by emerging market countries tend to be in place where the host state has a stronger position relative to foreign investors, especially where the host state can offer either inexpensive natural resources or a well-developed market.[109] As such, performance requirements appear to be more readily implemented as an economic policy tool when a country is sufficiently attractive to

[108] E.g. ASEAN Comprehensive Investment Treaty Art 7 (signed 26 February 2009)
[109] UNCTAD: Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries (UNCTAD, 2003) at 19

foreign investors that entry and establishment can be made contingent upon activities that are in the exclusive interest of the host country and may impinge upon the foreign investor's freedom.

V Conclusion

National treatment is one of the foundational principles of international investment law, as it is with many other branches of international economic law, notably international trade and is a key component of the IIA strategy of emerging markets. The prevention of discrimination against foreign investors on the basis of their foreign character helps achieve regulatory competitive equality among investors, ensuring that foreign investors enjoy the same opportunity as similarly placed local investors. This allows the most efficient suppliers to supply markets in host states and to take advantage of their lower cost resources to supply markets more efficiently elsewhere. By ensuring that foreign investors are not treated unfavourably with respect to domestic investors through national treatment guarantees in IIAs, the level of FDI to emerging markets should increase, as the risks linked to discrimination, such as excessive regulation or expropriation, are accordingly diminished. Clauses guaranteeing national treatment in emerging market IIAs, including through the prohibition of performance standards, may be one of the reasons that developing countries that have concluded IIAs with developed countries have been shown to receive greater FDI inflows.[110] Increased FDI flows to the developing world have also been linked to liberalization policies adopted by host states in their national screening and admission legislation.[111]

[110] Neumayer and Spess, above note 4 at 248
[111] UNCTAD, above note 1 at xxi

National treatment guarantees in IIAs remain controversial. In addition to uncertainty with respect to the assessment of such provisions by investment tribunals, such clauses are rightly viewed as infringements on host state economic sovereignty. By requiring host states to treat similarly placed foreign investors no worse than local investors, host states are denied a crucial means of controlling the inward flow of capital to suit their own economic needs. This strategy is particularly important for emerging markets which seek economic development and which may be acutely vulnerable to foreign competition because of lower levels of skill and technology. Blanket national treatment requirements may be unfair to countries in a less advanced stage of development precisely for this reason, especially since developed countries implemented discriminatory policies toward foreign entrants at an earlier stage of their own development.

Mindful of the perils of making generalizations about emerging market country treaty practice, the national treatment standard in modern emerging market IIAs tends to be limited, typically extending only to the post-establishment stage, a strategy similar to most European developed countries, although a departure from North American practice and from the GATS positive list approach. National treatment is usually refined through exceptions, such requirements of conformity with host state laws or by reference to national security concerns. In that regard emerging market practice is not unlike that of developed countries. Interestingly a number of Asian countries have concluded IIAs that do not offer national treatment protection whatsoever, most likely reflecting nervousness about vulnerable local firms or industries. Specifically excluding a broad range of sectors from post-establishment national treatment is rare in modern emerging market IIAs, demonstrating their eagerness to attract FDI through a generally applicable guarantee of non-discrimination. Based on the reciprocal nature of these agreements, this move towards greater liberalization and protection may signify equally that emerging markets now seek to ensure that their own investors enjoy the advantages of national treatment in foreign markets.