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REPORT (2001) OF THE WORKING GROUP ON THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT TO THE GENERAL COUNCIL

Addendum

Note by the Secretariat

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A. INTRODUCTION

1. At its meeting on 5 October, when the Working Group on the Relationship between Trade and Investment adopted its annual report (2001) to the General Council, several delegations regretted that the Secretariat's draft report had not followed the pattern of previous years by summarizing the Group's discussions. This Addendum is intended to rectify that. It has been prepared by the Secretariat on its own responsibility, at the request of the Chairman, and it supplements the information contained in WT/WGTI/5.

2. At its meeting held on 9-11 and 18 December 1998, the General Council took the following decision with respect to the continuation of the work of the Working Group:

"The General Council decides that the Working Group on the Relationship between Trade and Investment shall continue the educational work that it has been undertaking on the basis of the mandate contained in paragraph 20 of the Singapore Ministerial Declaration. The work of the Working Group, which shall be reviewed by the General Council, shall continue to be based on issues raised by Members with respect to the subjects identified in the Checklist of Issues Suggested for Study. It is understood that this decision is without prejudice to any future decision that might be taken by the General Council, including in the context of its existing work programme."¹

B. PROCEDURAL INFORMATION ON THE GROUP'S ACTIVITIES

(a) Sources and materials used in the Group's work

3. The work of the Working Group in 2001 has been based on written contributions, and on oral statements, questions and answers by Members in the Group. This material has been supplemented by information received from observer intergovernmental organizations. A tabular summary of written contributions provided to the Group in 2001 is attached as Annex 3 to WT/WGTI/5.

(b) Meetings held in 2001

4. The Working Group held three formal meetings under the Chairmanship of Ambassador Demiralp (Turkey) in 2001, on 7 and 8 March, 13 and 14 June, and 5 October. Minutes of the meetings are contained in documents WT/WGTI/M/14, 15, and 16, respectively.² The dates of these meetings were determined in the light of the instruction in paragraph 22 of the Singapore Ministerial Declaration that careful attention be given to coordinating meetings of the Working Groups established under paragraphs 20 and 21 with those of relevant UNCTAD bodies. At its meetings in March and June, the Working Group considered all Items of the Checklist of Issues Suggested for Study. At its meeting in October, the Working Group adopted its report to the General Council.³

(c) Cooperation with other intergovernmental organizations

5. The Singapore Ministerial Declaration (paragraph 20) encouraged the Working Group to undertake its work in cooperation with UNCTAD and other appropriate intergovernmental fora in

¹ WT/GC/M/32, p. 52. The text of paragraph 20 of the Singapore Ministerial Declaration is reproduced in Annex 1. The Checklist of Issues Suggested for Study is reproduced in Annex 2 of WT/WGTI/5.

² Annex 3 of WT/WGTI/5 contains a tabular summary of contributions received in the Working Group on the Relationship between Trade and Investment in 2001.

³ Reports for previous years are contained in WT/WTGI/1/Rev.1 (1997), WT/WTGI/2 (1998), WT/WTGI/3 (1999) and WT/WTGI/4 (2000).

order to make the best use of available resources and to ensure that the development dimension is taken fully into account. In this regard, the IMF and the World Bank attended the Working Group's meetings in an observer capacity, pursuant to the cooperation agreements concluded between the WTO and these organizations. UNCTAD, OECD and UNIDO also attended the meetings as observers, on the basis of an invitation from the Working Group. In the course of the Group's meetings, these organizations have kept the Group updated on their relevant activities and contributed to the debate. The Working Group is highly appreciative of the valuable contributions to its work made by the observers.

C. SUBSTANTIVE WORK DONE IN THE GROUP IN 2001

6. This part of the report provides an overview of the substantive work done in the Working Group, pursuant to the mandate given in paragraph 20 of the Singapore Ministerial Declaration and to the General Council's decision adopted in December 1998. By its very nature, such an overview cannot reflect everything that was said and capture all nuances, such as can be found in the detailed records of the meetings of the Working Group and in Members' written contributions.

I. IMPLICATIONS OF THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT FOR DEVELOPMENT AND ECONOMIC GROWTH

7. The Group continued its discussion of a written contribution by India (W/86)⁴, which provided an assessment of the work carried out to date in the Working Group and identified subjects requiring further attention. It also discussed two Notes by the Secretariat (W/95 and W/103) on the relationship between foreign direct investment (FDI) and the balance-of-payments. Statements were made by Japan, Hungary, Mexico, Brazil, Canada, India, Korea, the United States, the European Communities, Switzerland, Egypt, Norway, Argentina, Costa Rica, Malaysia, Chile, and Kenya.

(a) Comments on India's written contribution (W/86)

8. Discussion focused on some of the perceived pros and cons of bilateral investment treaties and of possible multilateral rules on investment, particularly the extent to which they allowed host countries to exercise flexibility in applying certain conditions to FDI, and the extent to which they might be expected to lead to increased FDI flows.

9. One view expressed was that bilateral investment treaties provided adequate transparency, stability and predictability of host countries' investment regimes. They permitted host countries to liberalize their investment regimes autonomously, and while doing so to maintain flexibility in the policies they adopted towards FDI. It was acknowledged that FDI played an important role in economic development, but it was felt that the benefits of FDI could be augmented by attaching to it conditions, such as export performance and technology transfer requirements. Bilateral investment treaties allowed this to be done. In contrast to the extensive experience that had been gained with bilateral investment treaties, there was no experience of multilateral investment rules but there was concern that they would limit the policy flexibility of host countries. In this context, one question raised was whether it was envisaged that permanent carve-outs from multilateral investment rules would be available for particular sectors or policy disciplines, such as national treatment; permanent carve-outs were to be distinguished from the kind of exceptions provided for under the GATS, which over time were likely to be diluted. Furthermore, there was no basis to believe that multilateral investment rules would lead to an increase in FDI flows to developing countries, since a host country's attractiveness to foreign investors was related to many factors other than its investment

⁴ Documents issued in the series WT/WGTI/W/- are referred to in this report as "W/-". Documents issued in the series WT/WGTI/M/- are referred to as "M/-".

regime. In sum, it was stated that the arguments advanced in favour of multilateral investment rules were not compelling.⁵

10. Another view expressed was that the value-added of multilateral investment rules in the WTO should be seen primarily in light of the role they could play in increasing the attractiveness of the investment climate in host countries by providing legal certainty for foreign investors. In this regard it was felt that they could contribute to increasing flows of FDI, but it was acknowledged there could be no guarantee of this given that FDI flows were dependent on such a wide range of economic and other factors. It was felt that multilateral investment rules were not incompatible with the maintenance of domestic flexibility to regulate and pursue development policies, and they could usefully act as a counterweight to pressure for unsuitable policy change from special interest groups. Both the GATT and the GATS demonstrated that policy flexibility could be accommodated in multilateral rules, *inter alia* through the negotiation of exceptions, consistently with the maintenance of important basic principles such as non-discrimination.⁶

11. In this context, reference was made to an earlier written contribution which set out reasons why multilateral investment rules need not be incompatible with the achievement of domestic policy objectives.⁷

12. While there was general agreement in the Group that bilateral investment treaties could serve valuable purposes, some felt that when numerous and not mutually compatible, they could become costly to administer, create untransparent and discriminatory treatment of investors, and fail to create a legally consistent and integrated international investment environment, particularly between the pre-establishment and post-establishment phases of investment. Some others contested this view of the weaknesses of bilateral investment treaties.⁸

13. With regard to the relationship between FDI and the transfer of technology to host countries, one view expressed was that this, and the role performance requirements could play in this regard, required further analysis. Another view was that the relationship in question was complex and dependent on many factors, including the ability of host countries to absorb and use imported technology and the degree of competition in the domestic industry, but experience had demonstrated that the imposition of technology transfer requirements was not an effective policy instrument.⁹

(b) *The relationship between FDI and the balance-of-payments (W/95 and W/103)*

14. There was support for the view expressed in the Secretariat Note that it was difficult to draw general conclusions on the impact of FDI on the balance-of-payments. One reason was that many factors could affect a host country's balance-of-payments situation, and FDI would not necessarily be the most important. Another was that it was felt important to take into account all of the direct and indirect, and static and dynamic, effects of FDI on the balance-of-payments, and this made it difficult to draw firm conclusions on the overall impact. Many factors and policies, including regional trade and investment affiliations, affected a host economy's ability to benefit from FDI. In this regard, attention was drawn to several written contributions that had described national experiences.¹⁰

15. There was support for the view that the existence of a competitive trade and investment environment in the host country was a key determinant of the effects of FDI on the balance-of-

⁵ M/14, paras. 22, 29 and 32.

⁶ M/14, paras. 23, 27-28, 30, 31, 33-34 and 37.

⁷ M/14, para. 76, and W/84.

⁸ M/14, paras. 27-29, 32, 34, 36-38. See also M/15, para. 61.

⁹ M/14, paras. 24-25 and 36.

¹⁰ M/14, paras. 3-4, 7-9, 11 and 15, and M/15, para. 8.

payments, and attention was drawn in this regard to the shift that had taken place in the trade and investment policies of many host countries from an emphasis on import-substitution in the 1960s and 1970s to a more export-oriented stance recently.¹¹

16. One view was that notwithstanding whether the overall effect was positive or negative, important policy implications stemmed from the balance-of-payments effects of various aspects of FDI. For example, if it was accepted that increased exports were a key aspect of the positive contribution that FDI could make to a host country's balance-of-payments, it should be appropriate to apply export performance requirements to enhance that contribution. Equally, policies to channel FDI into specific sectors or industries could enhance its positive balance-of-payments effects. One reaction to this was that it was important to view the balance-of-payments effects of FDI holistically, not partially, and that national experience and empirical studies suggested certain policies, such as local content requirements, could have perverse, secondary balance-of-payments effects. Another reaction was that it was difficult *a priori* to draw conclusions on which sectors or industries might be more or less import-intensive or export-oriented than others.¹²

17. With regard to merger and acquisition (M&A) activity, there was support for the view that its effects on the balance-of-payments of a host country involved much the same considerations as greenfield investment. However, one view was that M&A activity in developing countries was likely to produce quantitatively and qualitatively different results from greenfield investment, in respect of its balance-of-payments and other effects, and this needed to be studied further.¹³

18. There was general agreement that FDI usually provided a more stable, less volatile source of foreign financing than other forms of foreign capital inflows, and reference was made in this regard to a number of national experiences. Nonetheless, concern was expressed about the heavy concentration of FDI in relatively few host countries worldwide.¹⁴

19. The Secretariat Note was felt to be useful in helping clarify differences between FDI and portfolio investment, and between various forms of portfolio investment. One view was that foreign portfolio investment had no place in WTO work on the subject of trade and investment, in part because of its inherently more volatile nature than FDI and its potentially destabilizing effects on a host country's balance-of-payments and macroeconomic management. Another view was that bilateral investment treaties typically covered portfolio investment as well as FDI, and that it could not be claimed that certain categories of portfolio investment were inherently more unstable than FDI. FDI and portfolio investment flows were largely complementary and both could be economically beneficial for host countries.¹⁵

20. It was noted that only a very small proportion of bilateral and regional investment treaties incorporated balance-of-payments safeguard provisions. One view was that some nonetheless did incorporate such provisions, showing that balance-of-payments concerns could be accommodated in international investment agreements. Another view was that bilateral investment treaties did not need to incorporate balance-of-payments provisions because they did not impose restrictions on the right to regulate the inflow of FDI, so that balance-of-payments concerns of host countries were minimal.¹⁶

¹¹ M/14, para. 6.

¹² M/14, paras. 5, 10 and 13.

¹³ M/15, paras. 4-7 and 9.

¹⁴ M/14, para. 16.

¹⁵ M/15, paras. 11-13.

¹⁶ M/15, para. 14.

II. THE ECONOMIC RELATIONSHIP BETWEEN TRADE AND INVESTMENT

21. New written contributions were made by Canada (W/97 and W/98) and India (W/105). The Group also exchanged views on the issue of investment incentives. Statements were made by Canada, Korea, Switzerland, Singapore, India, the European Communities, Argentina, Australia, Hong Kong China, the United States, Mexico, Japan, Hungary, Poland, Brazil, Norway, and Malaysia.

(a) *Comments on Canada's written contributions (W/97 and W/98)*

22. The results of the industry survey on the impediments facing Canadian investors abroad, and the research findings on the nature and effects of FDI, both outward and inward, for Canada, were noted with appreciation.¹⁷

(b) *Comments on India's written contribution (W/105)*

23. India's contribution highlighted the need to differentiate between different kinds of foreign investment as regards their contribution to economic development, and in particular the transfer of technology to developing countries. It concluded that effective transfer of technology could not be achieved only through reliance on market forces, and that developing countries had to preserve the right to regulate FDI.¹⁸

24. One view, drawing also from the Group's early discussion on technology transfer, was that although FDI was not a sufficient condition to ensure technology transfer to developing countries, it was an important vehicle for making such transfers. Many factors and policies prevailing in the host country could affect the willingness of investors to transfer technology, and the nature of the technology transferred. However, applying performance requirements on foreign investors was not considered to be an optimal approach, and it was felt that they could prove counterproductive in certain circumstances.¹⁹

25. Another view was that the potential usefulness of performance requirements could not be dismissed out of hand. Case-by-case-study was necessary to consider their potential costs and benefits.²⁰

(c) *Investment incentives*

26. The Group continued the discussion of investment incentives that had begun during its meetings in 2000.

27. A statement was made on the perceived benefits of investment incentives.²¹ One reaction was that recent studies suggested investment incentives had rather more positive than negative effects, and did not seriously distort investment flows between regions. Another reaction was that while competition among host countries to attract FDI could induce governments to strengthen economic fundamentals, improve infrastructure and reduce the restrictive and discriminatory elements of their investment regimes, such competition could also have unforeseen and negative effects. It was suggested that rather than using investment incentives to correct for poor economic fundamentals, a better policy response would be to correct problems at their source. It was suggested also that the use of investment incentives by richer nations could disadvantage poorer countries' ability to attract FDI, that they could have a distortionary impact on the allocation of capital, that they could discriminate against

¹⁷ M/14, paras. 41-44, and M/15, paras. 24-27.

¹⁸ M/15, para. 16.

¹⁹ M/15, paras. 19-22.

²⁰ M/15, paras. 19 and 23.

²¹ Circulated subsequently in W/99.

small firms and domestic investors, that they could distort competition generally, and that they could encourage rent-seeking behaviour.²²

28. It was stated that further examination was needed of the conditions under which investment incentives could have undesirable effects, and a proposal was reiterated for a Secretariat study on the applicability of the Agreement on Subsidies and Countervailing Measures (ASCM) to investment incentives. There was some support for this proposal, as part of an exercise by the Group to identify whether and how investment incentives might cause trade and investment-distorting effects and what kind of multilateral disciplines might address them. There was also some resistance.²³

29. There was a discussion of whether international disciplines might be needed to correct the trade and investment-distorting effects of investment incentives.²⁴

III. STOCKTAKING AND ANALYSIS OF EXISTING INTERNATIONAL INSTRUMENTS AND ACTIVITIES REGARDING TRADE AND INVESTMENT

30. Statements were made by the European Communities, Japan, Malaysia, Pakistan, Norway, Switzerland, Mexico, India and Hong Kong China, and by UNCTAD and the OECD.

(a) *Bilateral, regional, plurilateral and multilateral agreements and initiatives; implications for trade and investment flows of existing international instruments*

31. The Group was informed of recent regional seminars covering trade and investment that had taken place, in the Philippines (November 2000), Chile (November 2000), South Africa (January 2001), and Malaysia (March 2001).²⁵

32. There was discussion of a presentation by the OECD at an earlier meeting of the Group of its study on Policy Competition for FDI, which provided a critical assessment of the use of investment incentives.²⁶ One view was that the OECD study demonstrated the negative effects that investment incentives could have, and there were suggestions that ways should be found to enhance the transparency of the use of investment incentives, at national and regional levels. Another view was that the study did not take sufficient account of the particular needs and concerns of developing countries.²⁷

33. Statements were made by UNCTAD and the OECD on their recent work on investment.²⁸

IV. ITEM IV OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY

34. New written contributions were made by Korea (W/96), the European Communities (W/102), and Japan (W/104). Statements were made by Korea, Switzerland, Hungary, the European Communities, India, Brazil, Chile, the United States, Japan, Malaysia, Hong Kong China, Canada, Egypt, Australia, Norway, Indonesia, Costa Rica, Cuba, and Ecuador.

²² M/14, paras. 47-50, 53, 55-56.

²³ M/14, paras. 45, 51, 53 and 55.

²⁴ M/14, paras. 46, 48, 50, and 54.

²⁵ M/14, paras. 59-60, and M/15, paras. 30-31.

²⁶ W/100.

²⁷ M/15, paras. 32, 34 and 35.

²⁸ Circulated in W/100, W/101, and W/106.

(a) Comments on Korea's written contribution (W/96)

35. Korea's contribution to the study process in the Group suggested that the GATS could serve as a benchmark in formulating multilateral rules on investment in the WTO, in view of its flexibility, the importance it gave to development considerations, and its coverage of many of the main elements of investment rules. However, it would be necessary to address certain issues that were not covered in the GATS, such as expropriation and compensation, and performance requirements. It would be necessary also to consider a number of more technical issues, such as whether services should be covered by new investment rules or whether the rules should apply only to non-service sectors, how the concept of "commercial presence" in the GATS related to broader definitions of investment, how market-access commitments might best be framed, and how many of the GATS provisions might be applied in a multilateral investment framework.²⁹

36. One view was that the GATS was a useful and realistic model for thinking through the design of multilateral investment rules, particularly its "bottom-up" approach to pre-establishment commitments, the flexible way national treatment commitments were dealt with, and its in-built flexibility for regulatory and development policies. However, one feeling was that it would be necessary to go beyond the GATS in respect of certain subjects, such as investment incentives and performance requirements. Another was that further consideration was needed of whether the principles applicable to trade in services could be applied to investment.³⁰

37. Another view was that while the advantages of the GATS were to be acknowledged, it was both premature to think of the GATS as a starting-point for negotiating multilateral rules on investment in the WTO, and worrying if the implication was that the GATS represented the lowest level of ambition of the proponents of negotiations. These worries were compounded by comments about the need to go beyond the GATS in respect of issues such as performance requirements and investment incentives.³¹

(b) Comments on the European Communities' written contribution (W/102)

38. The European Communities' contribution aimed to encourage discussion of the possible role of the WTO in providing technical assistance in the field of FDI, taking into account the activities of other relevant organisations such as the World Bank and the UN, to assist developing countries to improve their capacity to attract, absorb and benefit from FDI and to participate in negotiations on international investment rules and to transpose the results into domestic laws and regulations.³²

39. There was support for the view that technical assistance could play a useful role in assisting developing countries to improve their ability to attract, absorb and benefit from FDI, although some thought its potential was limited. Some said it was premature to speak about assistance for negotiations. Emphasis was placed on the importance of technical assistance being demand-driven, and on the need for the WTO to coordinate its technical assistance activities with those of other organisations so as to avoid duplication and overlap.³³

²⁹ M/14, para. 64. See also M/15, para. 62.

³⁰ M/14, paras. 65-67, 69-70 and 72. See also M/15, para. 63.

³¹ M/14, paras. 68 and 74, M/15, para. 60.

³² M/15, para. 39.

³³ M/15, paras. 40-41.

(c) *Comments on Japan's written contribution (W/104)*

40. Japan's contribution reviewed various ways in which international investment agreements could provide flexibility for host countries to pursue their development objectives, and how rights and obligations of investors might be addressed.

41. There was support for the need to provide for an appropriate balance in international investment agreements between disciplines to ensure predictability for foreign investors on the one hand, and flexibility for host countries to pursue their development objectives on the other.³⁴

42. One view was that while this balance might be struck through bilateral investment agreements, developing countries could not contemplate the creation of multilateral investment rules until it had been demonstrated how such a balance could be satisfactorily achieved. In that regard, preambular treaty language was ineffective. Furthermore, time-limited exceptions for development purposes were insufficient to meet developing countries' needs for policy flexibility; consideration needed to be given to permanent carve-outs from disciplines. In addition, it was felt that while multilateral investment rules would limit developing countries' flexibility to pursue their development objectives, they would neither guarantee increased flows of FDI nor create commitments on the part of foreign investors, in areas such as the transfer of technology.³⁵

43. Another view was that a GATS-type approach to designing multilateral investment rules could provide considerable flexibility for development purposes, going beyond the instrument of time-limited exceptions. However, flexibility to accommodate development objectives should not be interpreted so broadly as to allow for discrimination between foreign investors of different nationalities.³⁶

44. On the question of the definition of investment, it was stated that short-term capital flows often played a complementary role to FDI and these could also benefit from being made subject to international rules.³⁷ In this context, additional comments were also made on an earlier written contribution.³⁸

45. There was a brief exchange of views on the issue of transparency.³⁹ In this context, additional comments were also made on an earlier written contribution, in particular on the need to consider both the benefits and the costs of introducing new international initiatives to increase transparency in this area and the need to consider carefully what kind of information it was most valuable to provide.⁴⁰

46. On the issue of non-discrimination, one view was that while it was inappropriate to allow for discrimination at the pre-establishment phase, the principle of national treatment could be applied more flexibly to take account of development concerns. Flexibility could also be provided through a GATS-type "positive list" approach to scheduling commitments, qualified where necessary by conditions and restrictions on non-discrimination disciplines. Another view was that bilateral investment treaties provided a more appropriate level of flexibility, since most did not contain national treatment provisions and they did not affect a host country's ability to use policy instruments such as screening, performance requirements, and investment incentives.⁴¹

³⁴ M/15, paras. 45 and 49.

³⁵ M/15, paras. 46, 48 and 50.

³⁶ M/15, paras. 47 and 49.

³⁷ M/15, para. 51.

³⁸ M/14, para. 80, and W/92.

³⁹ M/15, para. 52.

⁴⁰ M/14, paras. 77-79, and W/90.

⁴¹ M/15, para. 53.

47. On the issue of performance requirements, one view was that these were important policy instruments for developing countries to pursue their development objectives and to promote domestic industry. The difficulties some Members had experienced in implementing the TRIMs Agreement was cited as evidence of the value they attached to performance requirements in this regard. Another view doubted that performance requirements were effective policy instruments, but it was noted that at least some existing international agreements did provide flexibility for their use, while ensuring that they were applied in a transparent and predictable manner. In this context, there was also some discussion of the TRIMs Agreement.⁴²

48. It was stated that it would not be appropriate to include provisions in the WTO that would allow for investor-state dispute settlement. More generally, it was stated that dispute settlement under WTO investment rules would benefit only home countries.⁴³

49. Concerning the issue of flexible treatment of developing countries in the implementation of investment agreements, one view was that the GATS provided a range of means for achieving this, in particular through its approach to scheduling commitments. Another was that many WTO Agreements provided flexibility through transition periods and technical assistance. However, a point made in this respect was that the effectiveness of these provisions needed to be reviewed. Another view was that in an international investment agreement permanent exemptions would need to be extended broadly to cover screening, channelling of investment, and performance requirements.⁴⁴

50. With regard to investor obligations, it was stated that these could most properly be addressed through transparent and predictable legislation in host countries.⁴⁵

⁴² M/15, paras. 54-56.

⁴³ M/15, para. 57.

⁴⁴ M/15, para. 58.

⁴⁵ M/15, para. 59.