Preliminary analysis of new provisions applicable to all services*

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Introduction

This text appears to be US proposals for the 'New and Enhanced Disciplines' Part of the Trade In Services Agreement (TISA) core text². Other TISA countries have then indicated whether they agree or disagree with them. The proposal seems to be intended to apply to all services³ and it is being considered whether it will apply to certain financial services⁴.

This initial analysis indicates some of the possible implications of this proposal for the ability to regulate (companies from any country in a number of the proposals) in developed and developing countries as well as for development policies. Further in-depth analysis by experts in the relevant sectors and areas of law is required to more comprehensively understand the potential impacts.

These proposals are more extreme than the USA's model bilateral investment treaty (BIT) and its recent free trade agreement (FTA) investment chapter. Therefore even for TISA countries which already have US BITs⁵/FTAs⁶ (eg Australia, Canada, Chile, Colombia, Costa Rica, Israel, Japan, Korea, Mexico, New Zealand, Panama, Peru, Turkey)^a, accepting these TISA proposals would go further than their existing USFTAs/BITs. Even if the TISA rules were the same as those in their USFTAs/BITs, agreeing to it in TISA would a) extend these obligations to companies from more countries (the rest of the TISA countries) and b) the US is likely to seek additional liberalisation in TISA (eg removal of scheduled exceptions etc in existing USFTAs/BITs).

Furthermore, the proposals in this text restrict the ability of developing countries to use the development paths taken by many of the developed TISA countries. Some experts call this developed

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^a Assuming they have these provisions because the US has a strong template and not counting some European Union (EU) countries which have US BITs

countries 'kicking away the ladder' after they have climbed up, to prevent developing countries from developing the same way.

To fully understand the implications of this proposal, it needs to be read with all the other proposed TISA provisions. Since these have not all been made public, this preliminary analysis looks at these proposals in conjunction with the latest versions of the TISA core text and financial services annex proposals which were available.⁷

This analysis generally does not consider the combined effect of these TISA provisions with other existing trade and investment rules/those being negotiated. For example, although these TISA proposals still allow TISA countries to require foreign companies to do research and development in their country, for TISA countries in the Regional Comprehensive Economic Partnership (RCEP)^b, this will be restricted if the Japanese proposal in the ongoing RCEP negotiations (to restrict the ability to require local research and development on a negative list basis)⁸ is accepted.

Local presence

This proposed text⁹ would prevent a TISA country (eg Pakistan) from requiring a service company from another TISA country (eg the USA) to have an local office/branch/company/subsidiary^c etc as a condition of supplying a service to Pakistan (eg via the internet, or Pakistan's citizens going to the USA to consume the service eg study/do banking/as tourists etc), unless Pakistan has a scheduled exception that allows it to impose that condition. If the service supplier is a human being, eg an architect from the USA going to Pakistan, the proposal is that the person cannot be required to be resident/domiciled in Pakistan to provide those services (eg architecture), unless there is a scheduled exception. This 'negative list' liberalisation (where local presence cannot be required in any sector except those listed) has a number of implications including that:

- TISA countries will need to think carefully about all the laws, regulations and policies in all the
 current service sectors that can be affected by a lack of local presence (eg employment, taxation,
 financial regulation, fraud, consumer protection etc, see below) and make sure each sector etc is
 excluded.
- No new local presence requirements can be imposed in any sector unless it has been listed in the TISA country's schedule.

Presumably these scheduled sectors which are exempted from the local presence requirement will have to be negotiated and all TISA countries will have to agree to every other TISA country's proposed exception.

As the United Nations Conference on Trade And Development (UNCTAD) notes: 'In some countries, a specific requirement, arising out of the particular nature of some services, is the local presence requirement. This is a kind of duty of establishment which requires a firm to place the business itself within a locally registered and licensed corporate entity.' 10

To generate employment

'local presence requirements may be introduced to ensure more developmental benefits for the host country, for example, in terms of creating new jobs. A number of Canadian and United States FTAs, in their services chapters, prohibit signatories from requiring a service provider of the party to establish or maintain a representative office or any form of enterprise in the territory of the other party as a condition of providing services in the territory of that latter party.'

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^b Australia, Japan, Korea and New Zealand

^c Definition of 'commercial presence' and 'juridical person' in Article I-2 of the 1 July 2015 TISA core text, https://wikileaks.org/tisa/. These are based on the definitions in the World Trade Organization's General Agreement on Trade in Services (GATS) Article XXVIII. These include subsidiaries according to a WTO Dispute Panel interpreting these provisions, Report of the Panel re USA's complaint, https://www.wto.org/english/tratop e/dispute/cases e/ds27 e.htm.

An example of a country requiring local presence is 'Samsung Electronics invested in Viet Nam to produce television sets, monitors and other home appliances to service the local market because Viet Nam requires foreign companies to establish production facilities in Viet Nam in order to sell their products to the Vietnamese market' 12

Some implications for the ability to effectively regulate the financial sector

As the World Trade Organization (WTO) Secretariat notes: 13

- 'The dramatic increase in the use of Internet in the last decade has led to a new organizational form in banking: the Internet-only or virtual bank. These banks do not have a branch network, but a limited physical presence, for example, an administrative office or facilities such as ATMs.'
- Challenges for regulators include 'The changing financial landscape has brought with it new risks and challenges for financial institutions' management, and for regulation and supervision. The major ones stem from increased supply of services across-border resulting from drastically lower transaction costs and the greater ease and speed of financial activities (Nsouli and Schaechter, 2002). Although these risks are not new, cross-border financial services can increase some of them, such as strategic, operational, reputational, and legal risks. . . Legal and regulatory risks arising from the supply of financial services electronically is another area of concern for financial services in general. Financial institutions can potentially expand the geographical scope of their services faster through electronic means than through traditional means (including establishment abroad). While some of these uncertainties pre-date the development of the Internet and affect traditional cross-border financial services, the use of the electronic delivery channel facilitates the offering of services on a cross-border basis and thus increases these challenges. . . For example, in some jurisdictions, banking supervisors may not have the authority to impose local licensing requirements on banks that provide cross-border e-banking services to local residents. . . The recent case of Icesave provides a dramatic example of the risks that may arise to consumers in host countries from the operations of foreign banks through a combination of delivery channels – Internet and branch form in this case.'

According to UNCTAD, local presence requirements 'can be the case, for example, with respect to financial services, where, the need for prudential supervision is difficult to achieve without the physical presence of the related assets of the businesses in the markets they serve. A further reason concerns the regulatory authorities' ability to recover assets of suppliers, should the need to do so arise. As an alternative to local establishment, a country may allow foreign suppliers of services to operate in its markets as long as they provide a suitably large deposit to cover their potential liabilities with an institution within the host country, as determined by the host country government or a regulatory authority.' 14 Similarly, in the context of financial services, Philip Wood QC noted that 'regulators cannot enforce their regulatory orders against foreigners unless the have a local presence or deposit caution money within the jurisdiction. However this option to require a deposit would not be permitted under TISA for reinsurance if the Swiss proposal on prohibiting local collateral requirements in the TISA financial services annex is accepted. 16 Therefore if this proposal on local presence and the Swiss proposal prohibiting local collateral requirements are both accepted without relevant exceptions, then in the example above, a US reinsurance company could provide reinsurance services in Pakistan without having a subsidiary, or branch, or any collateral held in Pakistan. If a claim on the reinsurance was then made in Pakistan (eg due to a natural disaster such as an earthquake) and the US reinsurance company did not or could not pay out (eg due to the size of the disaster), there would be no collateral/branches/subsidiaries' assets to seize in Pakistan. Reinsurance companies have failed in the past.¹⁷

As noted above, this proposal could also apply to financial services, even though:

• The WTO Secretariat notes that regulatory approaches in banking include the 'Basel Concordat': 'However, practical problems arise when trying to enforce the Concordat principles to situations

where a bank engages in cross-border e-banking activities and does not have a local physical presence.'18

- TISA is being negotiated as countries are still recovering from the global financial crisis, where some of the problems in this financial crisis were due to lack of sufficient local presence (see IceSave operating through branches instead of subsidiaries, discussed below)
- Some TISA countries such as New Zealand have been trying to get banks from other TISA countries to incorporate as subsidiaries instead of branches.^d
- financial regulators are currently moving towards requiring foreign firms to operate through even stronger forms of local presence (eg subsidiaries which must have local capital in the country they are operating in etc rather than branches). For example:
 - a 2010 International Monetary Fund (IMF) paper advised that 'in the absence of well-defined cross-border burden sharing arrangements, economies with large banking systems can help defray crisis risks through:
 - Effective regulation and supervision. This can be achieved through a more hands -on approach and/or more stringent regulatory ratios. Subsidiarization of foreign operations may also help in these types of economies by lowering fiscal and foreign currency risks, although other considerations are important for this choice. . .
 - O The choice between foreign subsidiaries and branches largely reflected bank business decisions rather than lender of last resort considerations. These different ownership structures mattered for the potential fiscal liabilities of home countries over the crisis. Subsidiaries are independently capitalized and under the host country supervision, while home regulators are typically responsible for branches (particularly in Europe). 19
 - a 2014 IMF paper on Cross-Border Bank Resolution:
 - suggests that effective cross-border resolution 'might include the establishment of self-sufficient subsidiaries and/or restrictions on intra-group flows, with a view to ensuring that entities in the group can operate—and be resolved—on a stand-alone basis. . .
 - o From the perspective of financial stability, a branch structure unequivocally puts responsibility for soundness on the parent institution, while a subsidiary structure can limit losses at the host level, should the parent come under stress (given local capital and liquidity requirements). . .
 - O Subsidiarization ex ante is likely to be a superior strategy to ring-fencing ex post. . .
 - Where small hosts cannot ensure their capacity to achieve these outcomes through ex ante agreements on cooperative resolution strategies and burden sharing, measures

^d Steps were 'taken to try and get Westpac, in particular, to establish a New Zealand incorporated subsidiary, which was seen as being of particular importance because, as a branch, there was a concern that Australian depositors might be given priority in terms of the repayment of New Zealand deposits (reflecting the priority given under the Australian Banking Act).' http://www.nzfc.ac.nz/archives/2013/papers/updated/57.pdf

e Eg 'Recent moves towards greater reliance on subsidiarisation in several jurisdictions indicate that major national regulators are not convinced of being able to count on a favourable outcome for the single point of entry (SPE) approach [involving branches]. . . The IMF, while acknowledging the cost advantages of cross-border branching for some categories of banking group (in particular for those with primarily wholesale operations), has nonetheless drawn attention to the advantages of the subsidiary structure for the purpose of crisis management and resolution during banking crises (J. Fiechter, I. Otker-Robe, A. Ilyina, M. Hau, A. Santos, and J. Surti, Subsidiaries or Branches: Does One Size Fit All?, IMF Staff Discussion Note, 7 March 2011: chapter II). . . [countries have an] increasingly favourable view of subsidiarisation as the appropriate corporate form for cross-border banks, since this choice can be protective of a country's interests owing to the way in which the losses of an insolvent cross-border banking group are assumed in the jurisdictions in which loss-making entities are legally incorporated'

ensuring local operations are resolvable through structural requirements, such as requiring local capital and liquidity via subsidiarization or asset maintenance requirements for branches, may be appropriate. ²⁰

- When UK regulators accepted IceSave accounts through Landsbanki bank as a branch²¹ they then had great difficulty in getting British deposits (by ordinary people and local governments) back when Landsbanki closed down in the current financial crisis. Even so, since there were branches with some assets in the UK, when the British government used anti-terrorism laws to freeze assets in Landsbanki branches in Britain, that amounted to about 4billion euros. Under this TISA proposal, since TISA governments could not even require branches (unless there is an exception), even this amount would not be available if a bank collapses.
- 'By contrast, Swiss banks' U.S. broker-dealers used for investment banking operations had to be independently capitalized subsidiaries, helping to cushion the blow to Swiss taxpayers when the crisis hit. . . The contrasting outcomes of resolutions of Icelandic bank subsidiaries versus branches suggest subsidiarization can lower fiscal risks for countries with large banking systems.'²³

While TISA is likely to have a prudential defence:²⁴

- a) it is not clear the USA will allow it to apply to these proposed rules, see exceptions below and
- b) the prudential defence has been heavily criticised, ²⁵ so may not be effective.

Some implications for other types of regulation

As noted in an analysis of an earlier TISA leak: 'Local presence is often a key element in assessing the applicability of domestic laws and protections to foreign companies. In the absence of a local presence obligation e-commerce companies could, therefore, insulate themselves from domestic laws (for better or worse). Cross-border duties and taxation of electronic services has also proven a controversial topic, with some claiming that digital service providers situated abroad attempt to bypass domestic tax structures applicable to competing services.'²⁶

Lack of local presence could also have implications for employment law²⁷ and other aspects of government regulation. This is because for laws to be effective, they need to be enforceable. 'And in general a nation can only enforce its laws against: (i) persons with a presence or assets in the nation's territory; (ii) persons over whom the nation can obtain personal jurisdiction and enforce a default judgment against abroad; or (iii) persons whom the nation can successfully extradite.'²⁸ Since not all TISA countries have extradition treaties with all other countries and even where there are extradition treaties, they only apply to extraditable offences (which may only be criminal offences and even then may not include fraud, ²⁹ let alone civil fraud etc where cases are brought by the consumer who suffered the damage³⁰), option (iii) is unlikely to be sufficient. There are also restrictions on obtaining personal jurisdiction as the article written in the context of cyberspace ecommerce notes.³¹ Therefore restrictions on local presence can significantly reduce the ability of host governments to effectively regulate companies providing services.

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^f For more information about the IceSave crisis, see for example https://www.mfa.is/tasks/icesave/q--a/, https://www.imf.org/external/np/pp/eng/2014/060214.pdf and https://www.imf.org/external/pubs/ft/scr/2012/cr1291.pdf

Local management and boards of directors

This proposal³² would prevent:

- 1) TISA governments from requiring senior managers of a company/branch etc^g in its country to be citizens of the host country (where the service is being supplied)^h, unless there is a scheduled exception. Ie this proposal appears to apply to companies from any country (including the host country or non-TISA countries).
- 2) a TISA country (eg Finland) from requiring the majority of the board of directors (or any of its committees) of a company from another TISA country (eg Panama) which is located in Finland to be citizens of or resident in Finlandⁱ, unless it does not materially restrict the ability of Panamanians to exercise control of the company. This only applies to companies from another TISA country. However it seems that no exceptions can be scheduled to this by a TISA country (eg for affirmative action by nationality, or sensitive sectors such as media, or newly privatised entities).

This proposal by the US and Australia is basically the same as the current US Model Bilateral Investment Treaty (BIT)³³ which is reflected in the investment chapter of US free trade agreements (FTAs) such as the Trans-Pacific Partnership Agreement (TPP)³⁴. However, it is more extreme than the obligation in the US BIT or TPP in two ways:

- 1) the nationality of senior management provision in TISA would apply to companies from all countries, whereas in the BIT/TPP it only applies to companies from countries in the BIT/TPP^k.
- 2) it seems that TISA countries are prohibited from scheduling any exceptions to the directors provision, unlike in the BIT/TPP where countries could schedule exceptions (eg Australia's below).

A lack of local senior managers and directors can make it more difficult to hold them liable if the company breaks the law (eg they may not even be present in the host country). In combination with the restrictions on local presence (above), this can make it even more difficult to effectively regulate foreign service companies.

Some examples from history

'during their early stages of development, now-developed countries systematically discriminated between domestic and foreign investors in their industrial policy. They have used a range of instruments aimed at foreign investors to build up national industry. These included: limits on foreign ownership; performance requirements on exports, technology transfer or local procurement; insistence on joint ventures with local firms; and barriers to 'brownfield investments' through mergers and acquisitions.' 35

Some US examples

For example, when the USA was a net importer of capital (even though inward FDI stock into the USA was a smaller proportion of GDP than in developing countries today), there was a lot of concern about foreign investment, including 'absentee management' and foreign domination of the economy.³⁶ For example an 1835 article noted 'We have no horror of FOREIGN CAPITAL—if subjected to American management'. 37 'In order to ensure that foreign investment did not lead to loss of national control in the key sectors of the economy, much federal and state legislation was enacted in the US

g Definition of 'commercial presence' in Article I-2 of the TISA core text 24/4/2015 version from https://wikileaks.org/tisa/
h Or any other specified country

i Or any other specified country

^j Because the proposed text has the 'Subject to any conditions and qualifications set out in its Schedule' only in paragraph 1 re senior managers and a tribunal may assume that if scheduled exceptions were intended to apply to paragraph 2 (re directors), it would have said so (eg the way it is set out in Articles X.3 and X.4 of this

Due to their definitions of 'covered investment' in Articles 1 and 9.1 of those treaties respectively.

since its independence until the mid-twentieth century, when it became the world's top economic nation.' 38

This included the 1864 National Bank Act which required that the directors of national (as opposed to state) banks had to be Americans –this lasted even after the introduction of the Federal Reserve System in 1913.³⁹ This meant that '"foreign individuals and foreign financial institutions could buy shares in U.S. national banks if they were prepared to have American citizens as their representatives on the board of directors". And therefore "[t]hat they could not directly control the banks served as a deterrent to investment". ⁴⁰ This could be seen as a way of deliberately discouraging foreign investment in sectors where the US was developing its own industry (a form of infant industry protection), the way the New York state government discouraged foreign finance firms in its 1886 and 1914 etc laws⁴¹. Chang's 'historical survey shows that, only when domestic industry has reached a certain level of sophistication, complexity, and competitiveness do the benefits of non-discrimination and liberalisation appear to outweigh the costs. As a result, countries generally move towards a greater degree of non-discrimination and liberalisation as they develop. In that sense, non-discrimination is better seen as an outcome of development, not a cause.' ⁴²

In TISA, the USA is proposing restrictions on host countries being able to require senior managers be citizens of the host country. Yet when it was a capital importer, the USA had the opposite law: its 1885 contract labour law prohibited the import of foreign workers, ie the USA required senior managers (and all other staff) be Americans, which increased the chances of skills being passed to locals. ⁴³

Examples from some other countries

In Finland (a TISA country via the EU⁴⁴), from 1895 to the mid 1980s the majority of the members on the board of directors of limited liability companies had to be Finnish.⁴⁵ Finland also passed a law prohibiting foreigners from being the general manager of a firm.⁴⁶

In Japan (another TISA country), a 1967 law specified that 'the Japanese representation on the board of directors must be greater than the proportion of Japanese ownership in the venture'. 47

After analysing the policies used by Japan, Korea and Taiwan (all TISA countries), the article concluded that 'Like the US in the nineteenth century, the three largest East Asian 'miracle' economies have tried to use foreign capital under national management as much as they can, and consequently have used extensive controls on foreign investment in terms of ownership, entry, and performance requirement, throughout their developmental period.'48

The article goes on to argue that regulation of foreign investment does not have a significant impact on whether foreign investors come in and that even with these regulations the USA was the fastest growing economy in the world in that period. 49

Some examples of risks for sensitive sectors

A case study by Law Professor Kelsey⁵⁰ shows some of the possible risks of allowing company directors from foreign countries in sensitive sectors. A US information services company with board members which included former defence department and intelligence agency officials was able to form a joint venture (INTESA) with Venezuela's state owned oil company which controlled the entire data processing of Venezuela's state owned oil and gas company (PDVSA). PDVSA provided half the Venezuelan government's income. 'Moves by the Chávez government to reclaim control over PDVSA and its revenues prompted a prolonged period of 'oil sabotage' from late 2002. The management's strategy was to shut down a large part of the industry and force Chávez out of office by removing his access to oil revenue. INTESA closed off its systems so that all data had to be processed manually. . . "Although oil still flowed, without the capacity to manage the complex computer systems, PDVSA was unable to sell oil, resulting in the loss of billions of dollars of revenue for the nation". ⁵¹ Furthermore, 'The Chávez government alleges that through INTESA information about its deposits, production and capacity that was classified as confidential, and of paramount importance to national security, found its way into the hands of the major companies. ⁵²

For example in the TPP, Malaysia ensured that in sensitive sectors, such as nuclear power generation, it could require local senior managers and directors.⁵³

In New Zealand, a TISA country, ⁵⁴ the local incorporation policy was 'designed to ensure that larger and systemically significant banks had local boards of directors, which should be more responsive to New Zealand needs than the directors of a foreign bank operating a New Zealand branch'. ⁵⁵

Australia, a TISA country, was careful to ensure an exception in the TPP so that it could require the Chairperson and a majority of directors of Telstra (the privatised telecommunications company) to be Australian citizens. ⁵⁶ However even if TISA does allow exceptions to be scheduled to the proposed rule on directors, if additional companies are privatised in the future and public sensitivities require the senior managers and/or directors to be citizens, this would not be possible, unless a broad exception for privatised companies is agreed by all TISA countries.

TISA countries which want to continue to have these kinds of laws and policies (or introduce them) would need exceptions for them if this proposal is accepted. However, which sectors are sensitive and so need local directors and/or managers can change over time (eg as political sensitivities change and/or foreign ownership in a sector increases due to liberalisation under TISA or other FTAs/at the World Trade Organization (WTO) and so sensitivity about foreign control of a particular sector increases). Unless TISA allows TISA countries to unilaterally add exceptions to their schedule, additional exceptions for these changed sensitivities will not be possible¹.

An example of implications for affirmative action policies/laws

In Malaysia, socio-economic imbalances between ethnic groups led to a racial riot in 1969.⁵⁷ To address this situation, the Malaysian government launched the New Economic Policy (NEP) in 1971⁵⁸ to help the economically disadvantaged ethnic Malays (Bumiputeras). In 1991, Bumiputeras were still under-represented at the supervisory and managerial levels.⁵⁹ Government owned companies and privatised projects were required to employ qualified Bumiputeras.⁶⁰ The NEP and its successors have increased Bumiputera (ethnic Malay) representation in management, but it can still be improved⁶¹ (most Bumiputra managers are in government or state owned companies⁶²). As of 2005, the 'share of Bumiputera employed in the senior officials and managers category remained low at 37.1 per cent'⁶³ (despite 67% of the population being Bumiputera in 2010⁶⁴) and Bumiputeras were still poorer than Chinese or Indian Malaysians⁶⁵. Malaysia obtained exceptions in the TPP so that it could require that all distributive trade companies with foreign equity shall appoint Bumiputera directors and managers that reflect the racial composition of Malaysia.⁶⁶ Unless equivalent exceptions (eg in the schedule) are obtained for current/future affirmative action, these types of affirmative action policies by TISA countries would no longer be possible.

Local content

The US is proposing on a negative list basis to restrict local content requirements imposed on companies or human beings **from any country** which supplies services in a TISA country^m.⁶⁷ Although all the TISA countries are already WTO members,⁶⁸ this goes beyond the WTO's rules in the Agreement on Trade-Related Investment Measures (TRIMS) in a number of ways including because:

• It does not have the transition period that least developed countries (LDCs) at the WTO still have for TRIMS⁶⁹ (in case any LDCs join TISA). For example under WTO rules, an LDC can still require that a hotel (whether operated by a foreign or local company) buy its food, towels and

¹ The leaked TISA core text (24/4/2015 version from https://wikileaks.org/tisa/) does not even have a mechanism to negotiate changes to a country's services schedule the way the WTO's services rules have: Article XXI, https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm (although it has proven to be difficult to use).

^m Definition of 'service supplier' and 'person' in Article I-2 TISA core text released 1 July 2015, https://wikileaks.org/tisa/

sheets from local companies; but this would not be possible under this TISA provision for any LDCs which join TISA, unless an exception is agreed.

- It does not allow for developing countries to have another transition period for TRIMS (which is being negotiated at the WTO⁷⁰).
- It appears to reduce the general exceptions to TRIMS and remove the TRIMS exceptions for developing countries, see exceptions below.
- It also restricts any requirement (or as a condition of getting an advantage such as a taxbreak or subsidy) on services suppliers to buy locally made electronically transmitted content. This may prevent TISA countries from requiring (or giving incentives to) television stations to broadcast locally made programs for a certain number of hours per day, unless a scheduled exception is agreed. These kinds of local content requirements in television (TV), radio, cinemas and in advertising are used by a number of TISA countries (such as Australia) to ensure that local culture and languages are reflected in these media instead of US TV programs which are often cheaper due to the large audience in the USA covering the costs of production.

Paragraph 3 only makes it clear that the rules above still allow TISA countries to **incentivise** (eg via taxbreaks or subsidies) production locally, training/employment of workers, local research and development. It does not say that the rules above still allow TISA countries to **require** production locally, training/employment of workers, local research and development.

Local technology

If accepted, this US proposal⁷¹ would prevent (on a negative list basis) TISA host country governments (eg Mauritius) from requiring a service supplier **from any country** to:

- a) transfer technology to a human being or company in Mauritius.
- b) buy, use or give a preference to Mauritian technology (or not buy/use foreign technology)

This goes beyond the WTO's TRIMS rules and is very similar to the US Model BIT⁷² and TPP⁷³.

In 1989, of 31 developing countries studied, 11 had technology transfer requirements.⁷⁴

An example of a technology transfer requirement is in Taiwan where 'In some cases, the government gave approval for investment on the condition that the TNC help its domestic suppliers to upgrade their technology'. ⁷⁵

Local content rules had been a way of obtaining technology transfer in the past. A famous example is the Singer Sewing Machine Company which was allowed into Taiwan in 1964 on condition that Singer must buy 80% of the parts for the sewing machines from Taiwanese companies within one year. To achieve this, the company offered training seminars, provided standard blueprints to its parts producers, supplied them with tools and fixtures, and gave technical assistance and by 1967 Singer's exports used all locally made parts except needles for its straight stitch model. Since requiring local products as inputs is no longer allowed for WTO member countries (except LDCs, see above), countries may instead wish to require technology transfer directly (something which is still allowed by TRIMS), but this would be restricted by this TISA provision if it is accepted.

The second proposal restricting requirements to buy/use local technology seems to be aimed at policies such as China's which was seen as an indirect local content requirement. China developed its own WLAN standard and for devices sold in China to gain access to public networks in the country, they must support this standard which is owned and controlled by a group of China-based chipset manufacturers. Therefore 'the U.S. government, and industry saw this as a ploy to force companies to purchase chips from domestic Chinese manufacturers.' Direct requirements for locally made products as inputs are already prohibited for WTO member countries (except LDCs) and this TISA

ⁿ Since producers of TV programs often make advertisements as well and cross-subsidise their production of dramas, comedies, documentaries etc from the revenue they make from making commercials.

Operation of 'person' in Article I-2 TISA core text released 1 July 2015, https://wikileaks.org/tisa/

proposal would restrict TISA countries from following China's example and circumventing this by requiring the use of local technology instead.

The proposal includes exceptions to both these rules for compulsory licences (eg if a government orders a compulsory licence of a patented medicine so that generic companies could make it while paying a royalty to the patent owner) and technology transfers required by a court etc because a company has been found to be anticompetitive.⁸⁰

Scheduling of localization commitments

This Article is where exceptions for each TISA country to the rules above can be scheduled.⁸¹ As noted above, they will presumably have to be negotiated, so if a TISA country asks for 100 exceptions, it may only get some of them.

Two types of exceptions are proposed here:

- if the exception (eg for finance regulations) is listed in Section B, this can only be for laws, regulations, rules etc^p that are already in place on the date the TISA takes effect, or if they are promptly renewed. Ie this is a standstill.
 - o Furthermore, any change to these measures that reduce the scope of this exception cannot be reversed (a ratchet). Eg if Finland listed an existing law that required 70% of a board of directors to be Finnish and it later decided to reduce this requirement to 50% to encourage foreign investment, if a new Finnish government is elected that wanted to raise the requirement to 60% or even back to 70% Finnish directors, it could not do this under exceptions listed in Section B.
- If the exception (eg for television broadcasters) is listed in Section A, then new measures can be implemented, even if they were not in effect when the TISA took effect. Eg if Norway listed television broadcasting in Section A of TISA and at the time TISA starts operating it has no law requiring Norwegian programs for a certain period each day, it could still implement a law later that requires Norwegian programs to be shown on TV for X hours per day. Since Section A exceptions allow more flexibility than Section B, it is likely that it will be even harder to get all the other TISA countries to agree to the exceptions a TISA country proposes here.

In the US Model BIT⁸² or USFTAs such as the TPP⁸³:

- the exceptions (non-conforming measures) to equivalent rules are automatic for existing local government measures (without listing them in the schedule). Whereas if TISA countries want to exempt even their existing local government measures from these proposed rules, under the USA's TISA proposals, these all have to be negotiated and scheduled.
- There is an exception to the equivalent rules on the nationality of senior managers and directors for 'subsidies or grants provided by a Party, including government supported loans, guarantees and insurance'. This exception is not in the USA's TISA proposal.

Exceptions

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This Article⁸⁴ proposes some general exceptions to the rules above that would apply to all TISA countries.

Paragraph 2 ensures that if two private companies voluntarily decide they want to have local content, local technology or technology transfer requirements as part of their dealings, they can. Eg if a Mauritian hotel company forms a joint venture with an American hotel chain to open a hotel in Mauritius, the Mauritian company may specify as part of the deal that the towels and sheets used in

^p The definition of 'measure' in Article I-2 of the TISA core text of 24/4/2015 at https://wikileaks.org/tisa/ says measures can be in any form.

^q It is not in Article X.6 of this proposal either (which is where the government procurement exception is located).

this hotel must be bought from Mauritian suppliers. However this cannot be a Mauritian government requirement unless an exception has been agreed.

Paragraph 3 is an environmental exception. However:

- It only applies to half of the obligations in this proposal (local content and local technology).
- To use this exception, the measure cannot be:
 - o a disguised restriction on trade in services. This requirement is in the chapeau of the WTO environment exception for goods and services.
 - o and they cannot be applied in an arbitrary or unjustifiable manner. A narrower version of this test is in the chapeau of the WTO environment exception for goods and services (which has been copied into the TISA core text⁸⁵). In the WTO rules, to use the exception, the measure cannot be: applied in a manner which would constitute a means of arbitrary or unjustifiable **discrimination between countries where the same/like conditions prevail**. WTO cases have already shown that this is difficult to pass, see below. The TISA version proposed would be even tougher because any arbitrary/unjustifiable application at all (not just discrimination between countries with the same/similar conditions) would mean this exception cannot be used.

At the WTO, out of 9 attempts to pass the chapeau above to use this exception, 8 failed.⁸⁶ Ie it is difficult to pass even the easier WTO chapeau tests. Therefore it is likely to be very difficult to successfully use this environmental exception.

The proposal also includes exceptions to these rules for government procurement and essential security interests^r.

Since the proposal includes the equivalent of the security and environment exceptions from the TISA core text, ⁸⁷ it seems these are intended to be the only exceptions to these rules (even though the core text exceptions and prudential defence say they apply to the whole of TISA). This means that:

- the human and animal health^s and tax etc other exceptions which are in the general exceptions in the TISA core text would not apply to the rules above and
- even in the areas where the local content rules are the same as at the WTO, this TISA proposal does not have the health, balance of payments and other exceptions that are in the WTO's TRIMS rules⁸⁸ restricting local content requirements. And
- any prudential defence (eg in TISA's financial services annex) would not apply to these rules and
- it has fewer exceptions than even the US Model BIT⁸⁹ which has exceptions to the equivalent restrictions (on technology transfer and requirements to use local technology) for measures 'necessary to protect human, animal, or plant life or health'.

Conclusions

If accepted, these TISA proposals would restrict the ability of:

- Developed and developing countries to effectively regulate, including in ways widely recommended as governments learn the lessons from the current financial crisis.
- Developing countries in TISA to use a number of development policies that developed countries in TISA used, despite Dr Ha-Joon Chang, a well-known economic historian noting that 'In short, when they were net recipients of foreign investment, all of today's developed countries imposed

^r This is self-judging, ie it is up to the TISA country concerned to decide what it thinks is necessary for its own essential security interests.

^s Although compulsory licences (eg for health reasons) are allowed to the local technology proposal above, if a government wanted to act for health reasons that did not involve compulsory licensing, it could not override these proposed rules.

strict regulation on foreign investment. . . history clearly shows the importance of the policy space for developing countries (of yesterday and today) to use a wide range of measures to regulate foreign investment. '90

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<sup>1</sup> Part III
<sup>2</sup> TISA core text available at https://wikileaks.org/tisa/.
 Title of the proposal
 Last line of the proposal
 http://investmentpolicyhub.unctad.org/IIA/CountryBits/223#iiaInnerMenu
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 Article X.1
10 http://unctad.org/en/Docs/iteiit20052_en.pdf
11 http://unctad.org/en/Docs/wir2004ch6_en.pdf
http://unctad.org/en/Docs/iteteb20069_en.pdf
<sup>13</sup> WTO document S/FIN/W/74 from https://docs.wto.org/dol2fe/Pages/FE Search/FE S S001.aspx
14 http://unctad.org/en/Docs/iteiit20052_en.pdf
<sup>15</sup> Conflict of Laws and International Finance (The Law and Practice of International Finance, Vol. 6) (v. 6)Jul
31, 2007 by Philip R. Wood
<sup>16</sup> Article X.7 in the 15 April 2015 version, https://wikileaks.org/tisa/.
<sup>17</sup> Eg see http://www.bis.org/publ/qtrpdf/r qt1212e.pdf.
18 WTO document S/FIN/W/74 from https://docs.wto.org/dol2fe/Pages/FE Search/FE S S001.aspx
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<sup>24</sup> Eg see Article X.16 of the 15/4/2015 financial services annex, <a href="https://wikileaks.org/tisa/">https://wikileaks.org/tisa/</a>
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32 Article X.2
<sup>33</sup> Article 9, http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf
<sup>34</sup> Article 9.11 of Chapter 9, https://www.mfat.govt.nz/en/about-us/who-we-are/treaty-making-process/trans-
pacific-partnership-tpp/text-of-the-trans-pacific-partnership

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⁴⁹ http://law.wisc.edu/gls/documents/foreign_investment1.pdf

⁵⁰ 'Serving Whose Interests? The political economy of trade in services agreements', Routledge-Cavendish,

^{51 &#}x27;Serving Whose Interests? The political economy of trade in services agreements', Routledge-Cavendish,

⁵² 'Serving Whose Interests? The political economy of trade in services agreements', Routledge-Cavendish,

⁵³ Annex II https://www.mfat.govt.nz/en/about-us/who-we-are/treaty-making-process/trans-pacific-partnershiptpp/text-of-the-trans-pacific-partnership-annexes/

⁵⁶ Annex I, https://www.mfat.govt.nz/en/about-us/who-we-are/treaty-making-process/trans-pacific-partnershiptpp/text-of-the-trans-pacific-partnership-annexes/

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⁶⁹ Annex F of WTO document WT/MIN(05)/DEC from

⁷⁰ WTO document G/L/589 from https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S001.aspx

⁷¹ Article X.4

⁷² Article 8.1f) and h) http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf.

⁷³ Article 9.10.1f) and h) of the investment chapter, https://www.mfat.govt.nz/en/about-us/who-we-are/treatymaking-process/trans-pacific-partnership-tpp/text-of-the-trans-pacific-partnership

⁴ http://unctad.org/en/Docs/iteiia20037 en.pdf

⁷⁵ http://law.wisc.edu/gls/documents/foreign_investment1.pdf

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Paragraph 2

⁸¹ X.5

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84 X.6

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⁸⁶ http://www.citizen.org/documents/general-exception.pdf

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