International negotiations on Foreign Direct Investment: Prospects for Latin America and the Caribbean

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This document has been prepared in compliance with Project 3.2.2. “International Negotiations on foreign direct investment in Latin America and the Caribbean”, of the Permanent Secretariat’s Work Programme for 2004.

The objective of this paper is to inform Member States about the current status of international negotiations regarding Foreign Direct Investment (FDI), both in the multilateral framework of the WTO and at a hemisphere level with the FTAA. In this frame of mind, the background and recent evolution of both negotiations were analyzed, and the main issues that might affect the development interests of countries in the region in each relevant case have been highlighted.

The paper concludes with a list of elements that bear an interest for the ongoing participation of SELA Member States in these negotiations.

The staff involved in preparing this paper belongs entirely to the Permanent Secretariat.
I. INTRODUCTION

Latin American and Caribbean countries have actively participated in international negotiations geared at creating a multilateral implementation framework with an incidence on Foreign Direct Investment (FDI) as a way to foster and protect foreign investment flows while preserving the economic, social and technological development interests of receiving countries. After the failure of the Organisation for Economic Cooperation and Development (OECD) negotiations, and with those of the World Trade Organisation (WTO) Doha Round put on hold, these negotiations have been confined to the hazy domain of the Free Trade Area for the Americas (FTAA).

And yet, it is worth wondering, why is it necessary to negotiate general rules of multilateral FDI implementation when there already is a vast network of bilateral (BITs) and regional free trade agreements (FTAs) on investment, as well as rules in force within the WTO, regulating FDI flows in some measure or another?

Debates on this topic have highlighted the relationship existing between investment agreements and investment currents, or between investment agreements and trade flows, which is more complex than the relationship between trade standards and trade exchange. In the same debates, some claim that a multilateral framework for WTO investments would not constitute any guarantee for stronger investment currents.

Nevertheless, admitting that foreign investment may contribute to greatly fulfill the growth expectations of developing and least advanced countries, a multilateral implementation regulation on FDI would be significantly important to the international economy and to the insertion of least developed countries into it, as long as the contents of such agreement are compatible with the necessary discretionality in the creation and implementation of public policies to foster development in countries receiving FDI. Even if there were no multilateral standards on FDI at all, investment would undoubtedly continue, but the existence of well conceived standards in the multilateral sphere might help create a framework to go beyond allowing investments and boosting investment currents to facilitate transparency and prevision, thus increasing economic efficiency and the possibilities to forward the priorities of growth and development in countries receiving FDI.

The possibility of negotiating in a multilateral plane with virtually all the main trade partners enhances the negotiation power of these nations and also represents an opportunity to set up agreements with a greater diversity of countries making and receiving FDI.

On a different frame of mind, a multilateral agreement would be useful to minimise conflicts between standards from different bilateral or multilateral agreements. It would act as a driver for internal policies in countries by providing greater judicial security. In addition, it would create a framework of international rules and commitments supported by a dispute settlement system with a multilateral scope that would, in turn, guarantee policy continuity and thus greater stability in the general environment of investment and business.

The following pages are an overview of the legal regime currently applied to FDI in different countries in the region and the evolution of multilateral negotiations on the
subject, both in the WTO and in the FTAA, to draw some conclusions and suggestions that might be of interest to Member States of the SELA.

II. POLICIES ON FDI IN LATIN AMERICA AND THE CARIBBEAN

In the mid 1980s, countries in the region began to sign international agreements featuring standards for the protection and promotion of FDI. Even if moderate, these standards showed a much higher degree of opening and liberalisation than they did in previous decades when policies restricting FDI predominated. The fundamental instrument in this opening policy has been the figure of Bilateral Investment Treaties (BITs), massively and swiftly adopted by countries in the region with developed countries during the 1990s. According to the UNCTAD (2003), up until 2002, countries in Latin America and the Caribbean had signed 413 agreements of this type, most of them subscribed during the decade of the nineties. This was, as history shows, a universal trend, as 75% of the 2,181 BITs existing in the world were signed during that same decade.\(^1\)

In other words, bilateral investment agreements, as a model to attract, protect and foster FDI, seem to have become some sort of window of opportunities in the immense scenario of multilateral interdependence generated and fed by the globalisation process. Nevertheless, the impact caused by BITs is not very clear yet, as many countries have unilaterally changed their FDI regulation structures, the actual effects of which are hard to ascertain as their negotiation implies joint commitments instead of unilateral ones.

A more detailed analysis of the characteristics of the policies currently in force in Latin American and Caribbean countries in connection with FDI, however, shows that although these policies are similar when it comes to improving the general environment for FDI, granting stronger protection to foreign investors and motoring an important convergence of standards and disciplines, they tend to leave aside old mechanisms of industrial and technological encouragement policies and, furthermore, they generally fail to include either performance requisites or incentives set by governments to attract, steer or influence investment towards specific development goals.

In fact, there is a strong tendency to use bilateral investment treaties as the second best solution in lack of a universal agreement on foreign investment and as an important instrument of negotiation to attract FDI, but in very few cases has this solution been successfully oriented,\(^2\) at some level or another, towards economic and social development objectives. BITs are used rather as a tool to generate an increase in economic and trade cooperation between the parties involved, and to enhance relations and the business climate between them by assuring legal protection to FDI in the receiving country.

This might be due to the fact that even if BITs are formally symmetrical – that is, non preferential – in the sense that they establish rights and obligations that are supposedly identical for both parties, in practice, however, they are actually quite asymmetrical, for they deal almost exclusively with the treatment that foreign investors are supposed to get from the receiving country and they do not set up any obligations to be fulfilled by the investing country or the investors. Therefore, these instruments are ruled by international

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2 The treaties subscribed by CARICOM are, in that case, the exception.
public law which imposes certain obligations on the signatories as to the treatment to be given to foreign investment and they include mechanisms for dispute settlement aimed at having such obligations fulfilled, but they are politically neutral and hardly apt to incorporate the development objectives that the FDI receiving country might have in mind.³

This implicit nature of bilateral investment treaties broadly accounts for the massive participation and the interest shown by countries of Latin America and the Caribbean in the WTO and FTAA negotiations regarding FDI and aiming at creating a multilateral regulation framework for FDI within the international trade system. It also explains the serious situation through which Latin America and the Caribbean are going for the fourth consecutive year with a considerable contraction of net FDI flows at a pace that goes faster than the world trend.⁴ This raises the need, not only to examine the policies that have been implemented so far, but also to design new ones to attract FDI while preserving the countries’ development goals. In this context, having sound legal standards for multilateral application to rely on could be of a particular significance.

III. NEGOTIATIONS ON INVESTMENTS IN THE WTO⁵

As a consequence of the Uruguay Round, the Agreement on Trade Related Investment Measures (TRIM Agreement) was adopted in 1995.⁶ This agreement is applied exclusively to those measures affecting trade or goods (TRIM) and it does not cover services. In that relevant instrument, the Parties admitted that certain measures concerning investment may have some restriction and distortion effects on international trade and they established that no member country will apply any measure that was previously forbidden by old fundamental GATT provisions on limits to the liberalisation of trade. Among the measures that are incompatible, we could cite requirements related to local content, trade balancing and technology transfer.

In December 1996, the WTO ministers gathered at the Singapore Ministerial Conference and set up the WTO Work Group on the Relation between Trade and Investment to study the following agenda: the scope and definition of investment, transparency, non-discrimination, modalities of the commitments prior to the establishment based on a positive list approach, provisions on development, exceptions and safeguards based on the balance of payments, and consultation and settlement of differences between countries involved in the Agreement.

³ For more information on the topic, see: UNCTAD (1998), Bilateral Investment Treaties in the Mid-1990s, p. 6, New York and Geneva.

⁴ For more information on the topic, see: UNCTAD (2004), World Report on Investment: the shift towards services, New York and Geneva. Page. 12 reads: “Latin America and the Caribbean, however, experienced a fourth consecutive year of decline, although it was marginal, from $51 billion in 2002 to $50 billion” in 2003, with a downfall of 3%. This is the lowest figure since 1995. Out of 40 economies in the region, 19 suffered a reduction of their inflow. These inflows contracted especially in Brazil and Mexico, the more important receivers in the region”.

⁵ A thorough analysis of these negotiations can be found in: SELA (2004), el Sistema Multilateral de Comercio en el escenario post-Cancún. Las discusiones en relación con los temas de Singapur y el Trato Especial y Diferenciado, SP/CL/XXX.O/Di Nº 8-04.

⁶ Trade related investment measures for goods, known as TRIMs, are regulations applied by governments to foreign investors willing to operate in their territory as a condition to authorise investment and grant, if deemed relevant, additional incentives. See: WTO, (1995) TRIM Agreements, Reference Text.
Likewise, they agreed that any potential framework ought to reflect a balance between the interests of the countries of origin and those of the receiving countries, and take into due account the development policies and objectives of governments receiving FDI, as well as their right to regulate in favour of public interest, within the scope of their special necessities for development, trade and finances. The objective of this consensus is for countries to acquire obligations and commitments that are proportional to their own needs and circumstances, and for bilateral and regional agreements in force concerning FDI to be taken into account as required.

Five years later, in the WTO Doha Conference, the ministers dealt with the issue of investment in even greater detail. They particularly acknowledged the arguments in favour of a multilateral framework for the direct investment – in spite of the failure of OECD negotiations for a Multilateral Agreement on Investment – to make a contribution to the expansion of trade, and the need to maximise technical assistance and the creation of capabilities in this field. The ministers also agreed that the actual negotiations would take place after the Fifth WTO Ministerial Conference and they identified several issues that should be clarified during those discussions.

After more than seven years, the preliminary work of the Group was crowned with results that were deemed technically appropriate concerning the clarification of the topics discussed, but lacking negotiation alternatives to guarantee the achievement of balance between the Parties. the Group examined and debated tenths of communications coming from the different countries, from other international organisations and from the WTO Secretariat, all of which amount to a vast specialised documentation touching not only all the points of the agenda that was agreed upon, but also some additional issues.

Everything appeared to be ready to move into the following phase of work to which the ministers had been referring for years: the negotiations on a multilateral framework for investments within the WTO, the launching point of which should have been announced at the fruitless Fifth WTO Ministerial Conference. This, of course, does not imply that the countries participating in the Work Group have reached total consensus, although the final Group reports show that progress was made in the elimination of the hurdles that stood in the way to a better comprehension of core aspects in negotiations; and they also evidence a better grasp of other considerations pertaining to the drafting of an agreement on investments in the framework of the WTO.

The position of developing countries was systematically portrayed in several communications and particularly in the joint Communication submitted to the Group. The basis for this position was that since the Uruguay Round, arguments against the use of investment measures have lost most of their theoretical validity and there has been no empirical evidence to prove that the arguments according to which resorting to such measures inevitably causes distortions in trade stood true.

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7 The Fifth WTO Ministerial Conference was held in Cancun, Mexico, from September 10th to 14th, 2003, and it was rated as a failure in this matter as it did not summon negotiations as had been expected.


9 Communiqué from Brazil and India “A review on the TRIM Agreement stemming from the Mandate contained in item b) paragraph 12 of the Doha Ministerial Declaration and on the questions and concerns on implementation (parenthesis 40), WTO, Group on TRIM, October 9, 2002.
This position poses the followings elements:

i. The disparity between developed and developing countries regarding technology tends to grow larger in time as an indicator that international economy is shifting from traditional production factors to a production model based on technology, knowledge and innovation. TRIMs are necessary in the sphere of science and technology for these countries to increase their participation in the segment of technology beyond international trade.

ii. Regarding competition policy, there is new evidence that, if properly implemented, TRIMs may generate benefits for the competitive environment. In the last 20 years there has been a massive expansion of the power exercised by transnational corporations in all countries, both developed and developing, and precisely, the risk of excessive corporate power may be reduced through incentives meant to encouraging new investors to enter and compete in the domestic market.

iii. TRIMs can also be valuable instruments in the implementation of regional development policies. There are circumstances in which the goods coming from underdeveloped regions in developing countries cannot compete, at least in the short run, with those produced with more sophisticated methods or technologies. TRIMs, in conjunction with purchases to companies located in those underdeveloped regions, might give these enterprises an extra push to grow and enhance their competitiveness.

iv. TRIMs could as well walk hand in hand with sustainable development as long as they respond to environmental concerns. Unlike developed economies, developing countries do not have enough means to ensure protection of the environment and, in consequence, they need to generate additional income for that purpose.

v. Developing countries have been seriously affected by the financial turmoil of these last few years, as they must face deep structural imbalances in their foreign sectors. TRIMs associated to exports could be less restrictive than deflation policies applied to foreign trade flows and to the entire multilateral trade system.

In sum, TRIM Agreement disciplines do not consider these structural inequalities between member countries and, except for some transition periods already closed, neither do they include any significant specific clauses on special and differential treatment. The material submitted by developing countries focused on the following proposals geared at allowing developing countries to use TRIMs for the following purposes:

1. Fostering domestic manufacturing capability in sectors with a high added value or in sectors involving the application of intensive technology.
2. Encouraging technology transfer or development at a domestic level.
3. Promoting domestic competition or correcting restrictive trade practices.
4. Promoting purchases from underdeveloped regions in an attempt to reduce regional disparities within their own domestic territories.
5. Encouraging environmentally friendly methods or products that may contribute to sustainable development.
6. Increasing their exports capabilities in those cases in which structural deficits on payments have caused or threatened to cause a heavy reduction of imports.
7. Promoting small and medium enterprises (SMEs), as they help generate employment.
Despite their good intentions, these proposals have plunged into nothingness as this topic has been excluded from the final phase of the Doha Round. In fact, the agreement reached on August 1st, 2004, to unlock the negotiations of the Doha Round did not include the subject of investment and established that "...no work related to the negotiation of this issue shall take place within the WTO during the Doha Round".

Thus, a process that was already several years old and meant to fulfill a mandate according to which the Work Group was supposed to "examine the functioning of this agreement and, whenever suitable, propose modifications of its text to the Ministerial Conference and study whether it must be supplemented with provisions on investments and competition policies" is postponed for a yet undefined period. Thus, the opportunity to integrate the dimension of development into a restrictive instrument, yet with a multilateral application, such as a TRIM Agreement is postponed once more, and yet, the Doha Round has been euphemistically called the "Development Round".

For Latin American and Caribbean countries, in which the legislation for the protection and promotion of foreign investment is almost exclusively bilateral, there is still the chance in FTAA negotiations to try to achieve a set of standards for multilateral application. However limited to a hemispheric scale, this set of rules might help integrate investment to their economic, social and technological development.

IV. NEGOTIATIONS ON INVESTMENT IN THE FTAA

Considering the failure of the negotiations in the OECD for an FDI agreement with a multilateral nature, restrictions arising from WTO TRIM Agreements and the recent suspension of the topic of investment from the Doha Round, negotiations on FDI in the framework of the FTAA take on a heavy significance, and not only for Latin American and Caribbean countries, as any agreements stemming from these negotiations might become, to a certain extent, the seed for an eventual FDI regime with a worldwide scope encompassing the dimension of development.

Even so, the evolution of this topic's treatment in the FTAA negotiations has not been too encouraging so far.

During the first stage, the Work Group on Investment in FTAAAs detected broad areas of coincidence in traditional standards and large divergences in their application in phases preceding or following the establishment of investment, as well as in the application of performance requirements.

During the second stage, the Group identified the elements required for the negotiation itself and the modalities to deal with each one of them, such as: (i) setting up a fair and transparent legal framework that will provide a stable and predictable environment protecting investors, their investment and any related inflows, without raising obstacles either to investments or outside the hemisphere; (ii) developing a comprehensive regulation framework encompassing rights and obligations on investment while taking into account the pinpointed areas; and (iii) developing a methodology that will provide for any eventual reserves and exceptions to obligations.¹⁰ This last objective might enable the inclusion of the development issue in the negotiations.

¹⁰ Some exceptions to the obligations might be cases meant to integrate the development dimension.
Once the Group of Negotiation on Investments had been established, negotiations started in twelve substantial areas that had been outlined by the Work Group, and upon which there is already consensus around the following aspects:

i. definition of foreign investment;
ii. granting domestic treatment and most favoured nation treatment;
iii. protection measures for investment;
iv. unrestricted liberty to transfer earnings; and
v. adhesion to international arbitrage Conventions.

The most notorious divergences were found around three fundamental elements:

i. the application of domestic treatment and most favoured nation treatment during the enterprise pre-establishment phase. Many countries in the region are still applying previous authorisation mechanisms based on this premise;
ii. the modalities and content of performance requirements to be applied; and
iii. the scope and breadth of the reserves to be accepted.

Part of the text in the Chapter on Investment is still in square brackets as no definitive agreement has been reached on its wording.

As for the proposals submitted by Latin-American and Caribbean countries aimed at integrating the development component, few concrete results have actually been achieved so far and most of their proposals are still in brackets too.

The alternative of adopting or building upon existing WTO disciplines deriving from TRIM Agreements is now under discussion within the Negotiating Group. In other words, the idea is adding up to the set of performance requirements that are not allowed within the WTO to achieve a WTO-plus Agreement, including no less than a prohibition of measures establishing the mandatory nature of technology transfer, among others.

There is, thus, a risk that some other key aspects will also be written off by the FTAA Agreement, as it happened in the WTO. This might be the case of those performance requirements, which are but domestic policies in countries receiving FDI meaning to make sure that foreign investment will have a positive effect on employment, trade balance, availability of foreign currency, productive chaining, technology transfer, increased exports, among others.

Another opportunity that would be lost in this case would be the chance for the FTAA to cover for the lack of a multilateral instrument or body having an incidence on international capital movements around the hemisphere, thus assuring in a general and mandatory fashion, the facilities and guarantees required for such movement and yet encouraging economic and technological development in less developed countries, and playing the role that the GATT/WTO has been fulfilling so far in connection with the flow of goods.

the Annex features a transcription of Article 10 of the Chapter on Investment of the FTAA Draft Agreement on Performance requirements. This implies that, should it be adopted as it is, it would be explicitly forbidden for governments in the hemisphere to place any demands whatsoever on foreign companies regarding the volume of their exports,

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domestic productive chains, procurement of domestic goods, positive results in their trade balance, technology transfer, geographic location and employment generation.

In the context of the FTAA and considering the differences in economic strength and levels of development existing between participating countries, the addressees of the chapter on investment are mostly U.S. and Canadian corporations and capital. Compared to those two countries most of the other economies in the region are meant to play the part of recipients to their investments almost exclusively, even if some Latin American countries have begun to generate some FDI in other countries in the region – like the concrete cases of Mexico, Chile and Brazil. Furthermore, those huge disparities in absolute size and relative capabilities are very likely to deepen rather than remain equal, if “equal footing” treatment is imposed between economies and companies that are extremely uneven.

In consequence, the FTAA Agreement on foreign investment threatens to become an instrument of little use for the development of Latin American and Caribbean economies, unless compensation mechanisms are devised to adopt special and differential treatment in investment matters as a means to allow for the implementation of performance policies on FDI for development purposes, as well as in other similar areas of the FTAA negotiations.

In sum, the FTAA Agreement on investment, as well as TRIM Agreements in force within the WTO, might once more entail the impossibility for countries in the region to apply traditional measures to foster development, industrialisation and employment such as, for instance, demanding the integration of domestic content or technology transfer.

It is worth mentioning that the positions adopted by the U.S. and Canada vis-à-vis this issue are not univocal. In general terms, Canada does not support the inclusion of performance requirements, but acknowledges the special situation of countries with a lower level of development and weaker economies in the region and, in consequence, it admits the need to establish certain exceptions or reserves to their obligations in order to favour their development. The United States, however, aspires to a WTO-plus kind of agreement, adopting the model of the North American Free Trade Agreement (NAFTA) while admitting certain performance requirements beyond WTO TRIM Agreements such as, for example, very specific exceptions as measures to solve competition issues and for access to assistance programmes and promotion to exports, protection of human life or the environment.

V. CONCLUSIONS AND RECOMMENDATIONS

In view of the suspension of the negotiations in the framework of the WTO and the importance gained by the negotiations on investment in the FTAA, it would seem convenient for the region to advance towards a more robust FDI negotiation strategy and try to overcome the limitations of BITs to fulfill their expectations for development.

In such a frame of mind, the followings elements could be worth considering:

1. For the fourth consecutive year Latin America and the Caribbean are experiencing a considerable reduction in their net FDI inflows at a pace that outruns the world

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12 Most of the conclusions and recommendations submitted by SELA in 2003 (SP/CL/XXIX.O/Di N° 2-03) are still valid, given the little progress that has been made in the negotiations.
trend. This calls for an analysis of the policies that have been applied so far and points to the need to design new policies to attract FDI without losing sight of their development goals.

2. In this perspective, the key objective of the hemispheric agreement on investment within the FTAA should be the liberalisation and protection of FDI in a context that favours the countries' development objectives. If properly integrated into domestic development policies, FDI may favour employment, technology transfer, the growth of non traditional exports and even pave the way for a better integration of Latin America and the Caribbean into the world market.

3. The hemispheric framework agreed upon in FDI terms should take into account the special development, trade and financial needs of countries in the region, particularly those with weaker economies, as a tool to materialise the much discussed differential and more favourable treatment at a political level.

4. The hemispheric standard on FDI should allow – even if it is in a negotiated way and in accordance with the actual needs of the receiving country – for the inclusion of performance requirements, subsidies and incentives, as these are key mechanisms to capture FDI inflows and steer them towards specific priority sectors or regions, such as generating employment, diversifying exports and markets, and developing human capital, including management skills, technology transfer and development of infrastructures.

5. The hemispheric standard should also enable incentives and performance requirements to lead to a better access of industries and sectors in the economies of countries receiving FDI to international productive circuits and competitive marketing networks, including the possibility of negotiating the access of FDI, under these conditions, to productive and service sectors that have been so far reserved to the State and domestic capitals.

6. In view of the suspension of the FDI negotiations in the WTO Doha Round, it would be convenient to rescue the thorough technical papers and proposals submitted by developing countries in the framework of their respective WTO Work Groups and take them into consideration in the FTAA Negotiation Group, so that negotiations may enable the application of development policies, such as:

   a) Fostering domestic manufacturing capabilities in high added value sectors or in sectors with an intensive application of technology.
   b) Encouraging technology transfer or development in the domestic sphere.
   c) Promoting internal competition or correcting restrictive trade practices.
   d) Promoting procurement in underperforming regions to help reduce regional disparities in their territories.
   e) Encouraging the use of environmentally friendly methods or products contributing to sustainable development.
   f) Increasing their exporting capabilities in the cases in which their structural deficits have caused or threatened to cause a heavy reduction of imports.
   g) Promoting small- and medium-sized enterprises (SMEs), which are already making a fundamental contribution to the generation of employment.
### ANNEX

**ARTICLE 10 OF CHAPTER XVII ON INVESTMENTS FROM THE FTAA DRAFT AGREEMENT**

1. **Performance requirements:**
   No Party may impose or enforce any of the following requirements or hold other Parties to any commitments in connection with the establishment, acquisition, expansion, administration, management or operation, sale or other provisions of any investment by any investor from any Party in its territory in order to make them:

   - (a) export a given type, level or percentage of goods or services
   - (b) achieve any degree or percentage of domestic content;
   - (c) acquire, use or give preference to goods produced or services provided in their territory, or to purchase goods from producers or services from service providers from their territory;
   - (d) relate in any way the volume or value of exports to the amount of foreign exchange inflows associated with such investment;
   - (e) restrict the sales of goods or services produced or provided by such investment by relating such sales in any way whatsoever to the volume or value of its exports or foreign exchange earnings;
   - (f) transfer any technology, production process or any other proprietary knowledge to any person in their territory except when such requirement is imposed by a court of law, administrative tribunal or competent authority to remedy an alleged violation of competition laws or to act in any manner not consistent with other provisions of this Agreement;
   - (g) act as sole supplier of the goods produced or services provided by that Party for a specific regional market or for the world market.

None of the notions stated in this article shall be construed as an impediment preventing one Party from setting up specific requirements on the geographic setup of production units, employment generation or staff training, or research and development activities on any other Party or investor from a non-Party country in connection with any investments in their territory;

Performance Incentives: No Party may condition receiving or continuing to receive any incentives or advantages in connection with the establishment, acquisition, expansion, administration, management, operation, sale or any other provision of an investment in its territory by investors from any other Party or from a non-Party country to their compliance with any of the following requirements:

( the texts of items b, c, d and e from the previous paragraph are repeated at this point).
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