PACER-Plus Trade in Services and Investment Analysis: Limiting regulatory powers of FIC governments

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Introduction

The chapters on services and investment in the Pacific Agreement on Closer Economic Relations 'Plus' (PACER-Plus) show Australia and New Zealand (NZ) have dominated the negotiations to advance their commercial and strategic self-interest, just as they drove the original PACER signed in 2001. Commitments that development would be at the core of PACER-Plus for island countries have never materialised.

For services and investment trade, the Pacific Islands are not an insignificant market for Australia and New Zealand. This must be remembered when assessing the intent behind the outcomes of these chapters and in whose interest they really are. In 2016 New Zealand sold NZD$278million of services to PACER-Plus countries (excluding Australia) and describes the new commitments made by the Forum Island Countries in Services as "commercially significant" and importantly protected against any future deals the Pacific signs with other nations.[1]

The focus in this paper[2] is on the implications for Forum Islands Country (FIC) governments' ability to regulate in the national interest.

The rules on services and investment may appear neutral on their face, but that disguises the reality that Australia and NZ currently dominate both activities in the South Pacific. These chapters will deepen the existing economic and development gap with the FICs and impose World Trade Organization-plus obligations on states that are not even parties to the World Trade Organization (WTO).

Broad-ranging trade agreements have become highly controversial over the constraints they place on democratic governance and the sovereign right of states to regulate in the national interest. A growing number of countries are withdrawing from investment agreements that have similar rules and developing substitutes that balance commercial interests with regulatory sovereignty and social rights. Negotiations for a mega-Trade in Services Agreement (TiSA) broke down in late 2016. The PACER-Plus texts do not contain even the limited safeguards found in the services protocol to the Pacific Island Countries Trade Agreement (PICTA TiS)[3], or in similar chapters in the recently concluded Trans-Pacific Partnership Agreement[4] (TPP). An independent review is urgently required to, at the very least, expand on these safeguards and develop state of the art provisions that can provide best protection for the interests of states and their people, while advancing the commercial objectives of the parties.

Regrettably, the investment and services chapters in PACER-Plus suggest the Forum Islands governments have accepted, or at least not opposed, that outdated model. The text was negotiated in secret over many years without a comprehensive and independent cost-benefit analysis and often in

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1 New Zealand Ministry of Foreign Affairs and Trade, 2017, Pacific Agreement on Closer Economic Relations (PACER) Plus National Interest Assessment, https://www.mfat.govt.nz/assets/FTA-Publications/PACER-Plus/PACER-Plus-National-Interest-Analysis.pdf

2 PANG would like to acknowledge the critical work of Professor Jane Kelsey, this analysis builds on her assessment of PACER-Plus in the *'Defending Pacific Ways of Being: A Social Impact Assessment of PACER-Plus'*.

3 Article 12 of the PICTA Trade in Services Protocol allows Emergency Safeguard Measures to protect threatened services sectors, although that is subject to restrictive conditions.

4 Article 9.2.3 of the TPP allows an exception for acts that took place before the TPP came into force. Further to this is an attempt to rein in the rule on Fair and Equitable Treatment in TPP Art 9.6.4 and an interpretion of 'like circumstances' for the purposes of National Treatment in TPP Art 9.4 footnote 14 and Art 10.3 footnote 2 that requires consideration of 'legitimate public welfare objectives'. Whilst these exceptions are limited, they are more than offered under PACER-Plus despite the TPP being signed before the PACER-Plus negotiations were finalised. Officials from Australia and New Zealand would most certainly have known about these exceptions but for whatever reason they were not offered to FICs.

the absence of the second largest Pacific country, Fiji.

This paper addresses four issues: fetters on state sovereignty, development asymmetries, ineffective protections, and enforce compliance, followed by some recommendations. Further aspects of these chapters warrant attention by others, including financial regulation and balance of payments, movement of professionals and recognition of qualifications, and the fraught question of labour mobility for remittance workers.

I. FETTERS ON STATE SOVEREIGNTY

The reach of this agreement is vast. Its rules implicate a broad range of services that affect the daily lives of Pacific communities, from schools and tertiary training providers, water and electricity companies, health clinics, sports facilities, and newspapers, to businesses such as supermarkets and duty free stores, banks, lawyers, advertising firms, fish canning factories and logging or mining operations.

What counts as an 'investment' is equally open ended and includes land and buildings, businesses, shares, licenses (telecoms, transport, mining, fishing), concessions or contracts (water supply, forestry), intellectual property (copyright, patents), debt instruments, etc. Foreign direct investment (known technically as establishing a commercial presence in relation to services) covers any type of business or professional establishment, whether greenfields or buying an existing business or asset. Foreign firms can also operate through a branch or representative office, which means they do not have a separate existence from their parent overseas company but operate as that company.

The core services and investment rules apply to 'measures', which are basically anything a government does, whether laws on land use, foreign investment, regulations on health and safety, environmental and conservation standards, rules that govern tourism operators or taxis, administrative decisions of a licensing body, school curriculum requirements, approval to operate a restaurant, banking regulation, or granting planning consents. The restrictions apply even where the measure doesn't directly target the service, but *affects* it, such as a tourist resort's rights to own or lease land or have unlimited access to fresh water.

The services chapter aims to give foreign firms from PACER-Plus countries the right to sell services to customers in each other's territory on the same terms as locals and not face restrictions on how big they grow or how much foreign ownership they have. A foreign firm or person might 'trade' their services by setting up a local business or a branch inside the country, or by providing the service from outside the country, especially by the Internet. Someone might travel temporarily to the FIC to deliver the service, such as a consultant or tour operator. Alternatively, a tourist or student from a FIC might go to another country to access the service there. The services rules potentially restrict how governments can regulate all these activities.

Investors and investments from PACER-Plus countries are also protected from discrimination, for example if certain sectors are reserved for locals. In addition, foreign services firms and other foreign investors who own, say, mining rights, leaseholds over land, or a public-private partnership contract, are given special guarantees that governments won't regulate in ways that significantly erode the security or value of their investment. They can freely move their capital and earnings in and out of the country, which raises concerns about transfer pricing and profit shifting to avoid tax. As per the WTO, investors cannot be required to process a certain amount of product locally or use local content. Non-WTO FICs have two years to list any measures they have that are inconsistent with this rule and after that they can't adopt any additional non-complying measures! (Art 11)).

Obligations in the services and investment chapters are not limited to central government, or even regional or local government. They also apply to any non-government body that has been given authority by central or local government to make those kinds of decisions. This could even see a decision by a village council being challenged by another state or one of its investors on the grounds that the central government recognised its authority. The final chapter of PACER-Plus says central government must take ‘reasonable measures available’ to it to ensure those lower levels comply, which requires a positive effort to do so (Art 2).

Core rules

The core rules of the services and investment chapters restrain what governments can do to provide opportunities for locals providing services such as shops, tourism ventures, media, health care facilities, education, professions, or transport, and protect them from being overwhelmed by big well-resourced foreign firms. For example, the rules say governments can’t give better treatment to locals (aside from subsidies and grants). They can’t restrict foreign investment generally, or in specific sectors, or require investment through a joint venture with someone local. The number of firms or people who can supply a particular service across the country or in a particular place can’t be capped to prevent over-supply, even when that makes it difficult for small local firms to survive. Nor can the government limit the number of clients of a firm, or its total output, which is a way of ensuring that one or more big businesses do not dominate the market.

Countries’ schedules of commitments

A government has a schedule which sets out which services sectors or parts of sectors it will subject to these core rules. That schedule has to be agreed by the other parties. Services have many component parts. The tourism industry in the Pacific, for instance, spans hotels, tour guides, restaurants, cruise ships, souvenir shops, eco-tourism operators, airports and seaports, computer booking systems, airline catering, advertising, golf courses, foreign exchange dealers, and much more.

It is clear from the PACER-Plus text that Australia and NZ intend to strengthen their control over core parts of the tourism industry in which they have strong commercial interests. Many of these services can be supplied to FICs from outside the country, such as sales and marketing of air travel, computerised reservation systems and flight planning. Other tourism-related services supplied inside the country, such as ground handling at airports and the operation of airport facilities and infrastructure, and related activities such as retail and parking, are often delivered through management contracts or public-private partnerships. They don’t develop local capacity, mainly employ low-skilled local workers, and the profits usually leave the country.

Where a government does bring a service under the PACER-Plus rules it can still limit which parts of the service it is agreeing to – for example, retail stores *except* souvenir shops, ground transport *except* for bus services that carry fewer than 10 people, requiring a percentage of local content on broadcast television, or that lawyers or engineers must be nationals to deliver certain services. A broad commitment, such as private education or services related to fishing, can have unforeseen consequences, especially over the years as the way those services are structured changes and new technologies emerge. Pressure to commit a large number of services can lead governments to tick the boxes they think might not have much impact, such as the long list of financial service sub-sectors, that can cause major problems for governments when difficulties arise and they need to re-regulate.

If no limitations are entered for a service that is committed, then that service sector is fully subject to the rules. Once commitments are made they are almost impossible to change. Governments must also anticipate the flow-on effect of those commitments to other rules that they can't limit in their schedules, such as licensing or technical standards for a service. It was critically important for the FICs to anticipate the present and future implications of committing specific sub-sectors, write their schedules as narrowly and precisely as possible, and future-proof them to preserve as much policy space as they can – and that Australia and NZ allowed them to do so. The extensive schedules of almost all the FICs suggests that did not happen.

Vanuatu, Tonga and Samoa, on account of their accession to the WTO have already committed a significant number of their service sectors, but that has expanded under PACER-Plus to include new areas like social services, tourist guide services, entertainment services, services provided by midwives, nurses, physiotherapists and para-medical personnel, and wholesale trade services. Australia, in its national interest analysis singled out Maritime passenger transportation services (Solomon Islands); Maritime freight transportation services (Solomon Islands); and Air transport services (Solomon Islands, Tonga, Vanuatu), as among the additional sectors committed by WTO Member FICs.[5]

The Solomon Islands' obligations will expand to many more service sectors. Currently its services commitments in the WTO are limited to only 9 of over 160 sub-sectors. Under PACER-Plus this expands to almost 70 sub-sectors and includes sectors like telecommunications, courier services, travel agencies and tour operator services as well as a host of services associated with maritime transport and air travel. This level of commitments greatly extends the limits on regulations of services to address the needs of Solomon Islander society.

Australia has noted that each of the FICs have made commitments in its key export sectors - tourism and travel services, transport services, and financial services (including insurance) – with "many committing to market access for the first time."[6] It also highlighted the market access commitments of the non-WTO Member FICs as being "broadly similar" to those of the WTO Member FICs and "providing new opportunities for Australian service businesses."

Similar schedules for the investment chapter identify the sectors or measures that are subject to the non-discrimination rule, including vetting of investments.

Samoa, Tonga and Vanuatu have committed to minimal restrictions on foreign investments.. The Cook Islands, Federated States of Micronesia, Kiribati, Nauru, Niue, Palau, Republic of Marshall Islands, the Solomon Islands and Tuvalu maintain the right to screen all foreign investment, but may be locked into their current vetting regime. Australia summed up the commitments by the FICs as saying that "While several [F]ICs have retained an investment admission review process, these are bound and may not become more restrictive."[7] Contrary to the approach taken by all other Parties (including New Zealand), Australia has exempted its investment screening regime in its entirety from the most-favoured-nation obligation. That means Australia can deny the FICs any better treatment that it gives to other countries' investors.

Importantly, a country's schedule cannot exclude certain sectors or measures from the special

5 Australia Department of Foreign Affairs and Trade, 2017, National Interest Analysis Pacific Agreement on Closer Economic Relations Plus, https://dfat.gov.au/trade/agreements/not-yet-in-force/pacer/Documents/pacer-plus-national-interest-analysis.pdf
6 Ibid.
7 Ibid.

protections for foreign investors against expropriation or minimum standards of treatment.

‘Disciplines’ on domestic regulation

There are other intrusive restrictions on future choices about how to regulate services and which criteria should have priority when governments make those decisions. A cookie cutter approach to drafting saw these ‘disciplines’ imported from the WTO’s General Agreement on Trade in Services (GATS) into PICTA Trade in Services Protocol (PICTA TiS) and now into PACER-Plus. Some rules apply to all services, while others apply to the sectors that a government has committed in its services schedule.

The impacts on governments’ options are more severe in PACER-Plus than in PICTA because they apply to more services sectors. Australia and NZ actively promote a hands-off approach to regulating services and can be expected to pressure the FICs to do so too.

There are three main obligations:

1. General laws and policies that apply to the services in a country’s schedule must be administered in a reasonable, objective and impartial manner (Art10.1). That may sound benign, but it opens up decisions to challenge for being ‘unreasonable’, ‘subjective’, and based on partisan considerations, such as giving priority to community concerns or indigenous rights.
2. Every PACER-Plus government must set up tribunals or other procedures for aggrieved service firms to have decisions reviewed and receive ‘appropriate’ remedies (Art 10.2). This is not limited to services sectors that a country has committed in its schedule. In addition to the burden that this imposes on FIC governments with limited capacity and budgets, the potential for a challenge may have a chilling effect on those who make the original decisions.
3. The aim is to require licensing and qualification requirements or technical standards to reflect narrow considerations like the technical quality of a service, rather than social or cultural factors, and be the option that has the least impact on the rights of the service supplier under the chapter. (Art 10.4) Technical standards, for example, include water quality standards, toxic discharge levels from mining operations, environment and health and safety rules for logging, eco-tourism accreditation, supermarket size and trading hours, zoning for town planning purposes, mandated school curriculum, etc. That has not been agreed yet in the WTO, but PACER-plus will be reviewed if and when that happens.

These restrictions apply to the expanded range of services that FICs have committed in their PACER-Plus schedules.

Special protections for foreign investors

The constraints in the investment chapter go deeper and intensify the legal risks for the FICs under PACER-Plus.

Two special protections for investors pose particular risks. The first is a vague guarantee that an investor or investment must receive a ‘*minimum standard of treatment’* under customary international law that includes ‘fair and equitable treatment’ and ‘full protection and security’ (Art 9.2). These concepts are open ended and, in practice, unbalanced. The ‘fair and equitable treatment’ obligation is the one that investors commonly rely on. They argue that this entitles them to a stable regulatory environment, ie the rules don’t change in ways that significantly erode their investment’s value or profits, even when they cause social or environmental problems. The ad hoc system of investment dispute settlement has resulted in routinely pro-investor but inconsistent interpretations of these rules.

The PACER-Plus investment chapter attempts to tie down the ‘fair and equitable treatment’ rule (Art 9, footnote 6), following similar moves in the TPP and Canada EU agreement. But the underlying concepts are still opaque and open to inconsistent interpretation. Despite the same wording in the Central America-USFTA (CAFTA), the investment tribunal interpreted fair and equitable treatment broadly and the governments lost.[8] Even though foreign investors can’t bring a dispute directly against a government under PACER-Plus, they are likely to push the broadest possible interpretation in their dealings with FIC governments. The only safe approach is to drop the provision altogether - something that countries like South Africa and Brazil have been doing in their recent new investment agreements.

The second problematic rule is on *expropriation* (Art 13). There is an obligation to compensate an investor when any level of government confiscates the investment, such as the nationalisation of a mine or cancelling a contract for privatised water supply to a village. The rule also applies to actions that have an *indirect* but equivalent effect on the investment. Indirect expropriation has been used to challenge decisions such as stricter environmental regulations or moves to restrict price increases on necessities like water or electricity. Annex 9-C to the investment chapter sets out criteria for deciding if there is an indirect expropriation, and restricts its application where a government regulates to achieve ‘legitimate public welfare objectives’, such as public health, safety and environment. That is important, and should make disputes on those issues unlikely, but it is unclear whether ‘legitimate public objectives’ extends to employment related measures or affordable access to utilities like mobile phone networks.

‘Legitimate’ has been interpreted in a WTO dispute to mean widely recognized state practice.[9] If this interpretation was followed under PACER-Plus, regulations that have not yet been widely adopted, such as large health warnings for alcohol or regulations to address climate change, might also be considered an expropriation.

Foreign investors tend to rely more on the minimum standard of treatment protection than on expropriation. It is unclear how foreign investors, or Australia and NZ as their home states, will use these rules, especially as the investors can’t bring a dispute directly against the host government. However, claims that proposed actions of a FIC would breach the PACER-Plus rules, with the implied threat of a state-state dispute, may have a serious chilling effect on the government’s decision whether or not to proceed with a measure that they believe is in the best interests of the country.

Performance requirements

PACER-Plus imports the existing prohibition on performance requirements from the WTO’s TRIMS Agreement, which include requirements that foreign investors source local inputs (including material or human resources), known as Local Content Requirements (LCRs). Existing WTO members cannot impose these requirements on investments from *any country in the world.*
In the WTO the initial TRIMS agreement gave developed members two years to comply, developing country members five years and LDC members seven years (with some extensions

[8] http://www.citizen.org/documents/RDC-vs-Guatemala-Memo.pdf, http://www.citizen.org/documents/rdc-v-guatemala-rebuttal.pdf and the TECO case in http://www.citizen.org/documents/investor-state-chart.pdf.
[9] DS 114, Panel Report dated 17 March, 2000, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds114_e.htm

possible)[10].

Both Vanuatu[11] and Samoa[12], in their accessions to the WTO waived the transition periods on implementing TRIMs measures, but they remain important for the others. The recent proposals by the G90[13] in the WTO relating to the TRIMS agreement highlights the importance of performance requirements for development. The proposals seek an exemption for LDCs from the TRIMS agreement for the duration of their LDC status and to allow developing countries to deviate temporarily (no longer than 15 years). The gap between the G90 proposals and what has been agreed to in PACER-Plus demonstrate the failure of Australia and NZ to deliver the promised pro-development outcome.

This provision is especially significant for FICs who are non-WTO members. PACER-Plus requires them to conform to the TRIMS agreement in two different ways. Initially the country must comply "to the extent of its capacity". But within two years they must list all of their measures that don't conform to the rule and cannot add more measures later to that list. [14]

The importance of these transition periods and retaining the policy space for non-WTO Members so that FICs can still require foreign investors to use local inputs can be seen in the amount that foreign firms spend on inputs and the number of developed and developing countries which required local content to help them develop. For example:

> 'According to British Petroleum (BP) and Anglo American, for example, they spent an estimated 87% and 64%, respectively, of total value created on suppliers in 2014. These expenditures dwarf tax and royalty payments which, for BP and Anglo American, amounted to 2% and 11%, respectively. These figures help explain why governments are increasingly seeking to require or encourage extractive industry firms to purchase goods and services from domestic providers.'[15]

According to UNCTAD, 'studies have shown that TNC affiliates in developing countries tend to buy the bulk of their inputs from their parents or other associated suppliers and hence generate few domestic linkages... Local content requirements, therefore, may force TNCs to identify nascent local capabilities and provide them with know-how and technology...'[16]

Local content rules have also been an important way of obtaining technology transfer in the past,[17]which is essential to development, whether in fisheries, tourism, or the digital economy. 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

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10 See the summary of the TRIMs Agreement at: https://www.wto.org/english/tratop_e/invest_e/invest_info_e.htm#top

11 Report of the Working Party on the Accession of Vanuatu to the World Trade Organization, 2011, WTO document: WT/ACC/VUT/17

12 Report of the Working Party on the Accession of Samoa to the World Trade Organization, 2011, WTO document:WT/ACC/SAM/30

13 The proposals are contained in the restricted WTO Document "JOB/DEV/47" as cited here: http://twn.my/title2/wto.info/2017/ti170705.htm

14 Art 11.2b

15 GIZ, Lise Johnson, July 2016, *Space for Local Content Policies and Strategies – A crucial time to revisit an old debate*, https://www.giz.de/expertise/downloads/giz2016-en-local-content-policies-study.pdf

16 UNCTAD, Proceedings of the Expert Meeting held in Geneva from 6 to 8 November 2002, *The Development dimension of FDI: Policy and Rule-Making Perspectives,* UNCTAD/ITE/IIA/2003/4, http://unctad.org/en/Docs/iteiia20034_en.pdf

17 Eg Stephan Haggard and Yu Zheng, *Institutional Innovation and Private Investment in Taiwan,* 'Singer was subject to stringent local content requirements that could only be met through effective technology transfer to suppliers', http://siteresources.worldbank.org/INTEXPCOMNET/Resources/Institutional_Innovation_and_Private_Investment_in_Taiwan.doc

companies within one year.[18] 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.[19]

Senior management and boards of directors

Like other countries, FIC governments may want to ensure that locals are in senior management and decision making positions of foreign firms that establish in their countries. There are strong development arguments for building the management and governance capacity of nationals, which is a pre-requisite to establishing their own enterprises. They also bring cultural understandings that are important to most commercial enterprises in the FICs. Research suggests that 'having board members be resident in the host country can help increase the value added of and spillovers generated by activities of that affiliate in the host country, and can also help promote management decisions beneficial to the host country.'[20] Further, it can become much more difficult to effectively regulate foreign service companies if there are no local managers. In particular, it can be very difficult to hold senior managers or directors from other countries liable for a breach of the host country's law or to enforce any resulting penalties, especially if they live or move outside the country.

Yet PACER-Plus prevents the parties from requiring senior managers, or a majority of the board of directors, to be of a particular nationality (Investment Art.10). PACER-Plus countries which want to continue to have these kinds of laws and policies (or introduce them) need to reserve the right to do so in a schedule of exemptions. Those schedules take a negative list form, meaning only those sectors or measures that are listed by an individual country are exempted from the rule. 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 PACER-Plus, other FTAs or at the WTO). PACER-Plus does not allow its parties to unilaterally add exceptions to their schedule, so additional exceptions for these changed sensitivities will not be possible.

In New Zealand, the local incorporation policy for banks 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'.[21] Australia, was careful to ensure an exception in the TPP that allows it to require the Chairperson and a majority of directors of Telstra (the privatised telecommunications company) are Australian citizens. However, even though PACER-Plus allows such exceptions to be scheduled , if a party privatises additional companies in the future and public sensitivities require the senior managers and/or directors to be citizens, this would not be possible. The FICs have included a broad exception in their schedules that allows this requirement when privatising a state-owned company, but it can't be introduced afterwards.

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[18] Oxfam International,Watkins Kevin and Fowler Penny, 01 May 2002, *Rigged Rules and Double Standards: Trade, globalization and the fight against poverty*, http://policy-practice.oxfam.org.uk/publications/rigged-rules-and-double-standards-trade-globalisation-and-the-fight-against-pov-112391

[19] Myers, Ramon H. "The Economic Transformation of the Republic of China on Taiwan." The China Quarterly, No. 99 (Sept. 1984): 517.

[20] Lise Johnson, July 2016, *Space for Local Content Policies and Strategies – A crucial time to revisit an old debate,* https://www.giz.de/expertise/downloads/giz2016-en-local-content-policies-study.pdf

[21] David Tripe, Centre for Financial Services and Markets, Massey University, 1 November 2012, *Regulation in New Zealand Banking and Financial Services,* http://www.nzfc.ac.nz/archives/2013/papers/updated/57.pdf

In relation to boards of directors, every Party to PACER-Plus has also included an exemption that allows it to specify the nationality of a majority of directors, or that they reside in the host country, provided that doesn't 'materially impair' the investor's ability to exercise control over the investment. That vague condition creates uncertainty, especially as the investor could claim such an impact at any time, converting an acceptable requirement into an unacceptable one.

Cross-fertilisation with other agreements

A standard rule in services and investment chapters (but not labour mobility!) is that a country must give the firms from one party to the agreement the best treatment it gives to firms of any other party, and often to any other country. This is known as the most-favoured-nation (MFN) rule. For example, Australia and NZ would get the benefit of any deal between the FICs and the EU, or among the MSG group, or between any FIC and China. The effect is to constantly ratchet up the investor protections and liberalisation commitments and investor protections that governments make. It also means that an agreement that had extensive commitments and few safeguards on an issue because it was expected to have little impact between the parties (eg PICTA TiS), has far greater impact and risk when it is extended to countries that have more significant interests, such as Australia and NZ.

Because of this risk, agreements have taken different approaches to MFN.

The PICTA TiS protocol explicitly excludes treatment given to other countries in *existing* agreements listed in an Annex (Art 4.2), although publicly available versions of that annex are blank. It only excludes *future* agreements between developing countries in the Pacific region from the MFN rule. The Cariforum EC EPA only applies MFN treatment to future deals with major exporting countries, but that includes China, Russia and Taiwan. New model investment agreements from countries like Brazil and India do not include the MFN provision at all.

The services (Art 3) and investment (Art 7) chapters in PACER-Plus instead require that any better treatment given by one party to another country is shared with all the PACER-Plus parties. Any country-specific exceptions must be listed in an annex. But each entry on that annex had to be negotiated and approved by all the parties. All of them, including Australia and NZ, have excluded their existing multilateral or bilateral agreements signed before PACER-Plus comes into force. The FICs have all excluded future agreements with Pacific countries that are not parties to PACER-Plus and with Least Developed Countries. New Zealand – which has the longest list of MFN exceptions - has described this provision as "strong", and goes on to claim that "Parties provide most-favoured-nation commitments across virtually all service sectors" except for those limited exemptions listed by FICs.[22] This patch protection is driven by naked self-interest with no concern with the development implications for FICs individually or collectively.

Predictably, Australia and NZ have protected their own interests by not extending the MFN obligation to the Temporary Movement of Natural Persons.

DEVELOPMENT ASYMMETRIES

Four reasons are usually given for developing country governments to agree to services and investment chapters in regional agreements. All are problematic for the FICs.

[22] New Zealand Ministry of Foreign Affairs and Trade, 2017, Pacific Agreement on Closer Economic Relations (PACER) Plus National Interest Assessment, https://www.mfat.govt.nz/assets/FTA-Publications/PACER-Plus/PACER-Plus-National-Interest-Analysis.pdf

1. *To attract investors who would not come otherwise*. Evidence that this occurs is mixed at best,[23] but is especially questionable for remote small island states. They are not attractive venues for investors seeking a market. Investors in extractive and resource industries, which have poor records for reinvestment, human rights, sustainability, and cultural responsibility, are more likely to invest through contracts that provide greater rights and benefits than services and investment agreements do. Services firms in banking, education or media may take advantage of new openings, but the rules make it harder to require those firms to have a grounded presence in the country, rather than operating from offshore or through visiting consultants, or as branches whose operations are driven by the interests of their parent companies. There is no requirement that investors are greenfields investment that create new businesses, jobs, downstream commercial opportunities and generate foreign exchange. Again, the rules make it harder for governments to direct investment to the sectors and places it is needed. Even where new ventures are established, such as in tourism, the costs of imports, offshore sales of package deals and repatriation of earnings can neutralise the expected gains. Tax avoidance through transfer pricing and profit shifting by transnational companies is now seen as a major problem.[24]

2. *To build capacity for long term development.* There is no commitment in PACER-Plus to technology transfer and infrastructure development, or for foreign firms to recruit and train local people in sectors such as tourism, finance, telecommunications, fisheries, education or health care. The ‘development’ provision merely talks of strengthening FICs domestic capacity through access to technology accessible on a commercial basis (Art 4.1(a)). When Australia and NZ seek more access for services, such as private education providers, that is driven by commercial not development objectives.

3. *To secure better treatment for their services providers and investors offshore*. Australia and NZ have been the dominant sources of capital and services in the region. Few FICs invest offshore and that tends to be in other FICs, which are already covered by PICTA Services (not yet in force) and the recently revised Melanesian Spearhead Group (MSG) agreement (known as MSGTA3). PACER-Plus promises liberalisation in sectors and modes of supply of export interest to the FICs. But the consistent demand of the FICs for greater, binding commitments on labour mobility has not been met, and is relegated to a non-binding side arrangement.

4. *As a quid pro quo for beneficial concessions in other parts of the agreement.* Again, there is no evidence that Australia and NZ have made any significant concessions in areas of importance to the FICs, notably labour mobility and quarantine and testing requirements for fruit and other products. PACER-Plus replaces the preferential arrangements previously available under SPARTECA. Australia and NZ already have very low tariffs for any FICs that do have capacity to increase supply.

There is a further motivation underlying these agreements: power politics. Some FICs managed to push out the timeline for the PACER-Plus negotiations for a number of years. Despite reservations expressed publicly by several governments, it was difficult to continue to say ‘no’ to demands and pressure from Australia and NZ when they remain the major aid donors for many FICs and are past-masters at divide and rule. However, the decisions of Fiji and Papua New Guinea not to sign PACER-Plus shows it is possible to reject a bad deal, and provides a precedent that others who have signed could follow by not ratifying the Agreement.

Development Obligations

[23] Joachim Paul, *Societal Benefits and Costs of International Investment Agreements,* OECD Working Papers on International Investment, 2018/1, OECd Publishing, Paris.

[24] OECD Action Plan on Base Erosion and Profit Shifting, 2013

From the start, PACER was designed so as to ensure the European Union (EU) did not secure advantages in the South Pacific over Australia and New Zealand, and to maintain the historic influence over the region. Despite the official rhetoric, the agreement was never about 'development' – even less so than the EU's Economic Partnership Agreements.

Article 4 of the services chapter makes a token gesture towards development. It asserts that the FICs will strengthen their capacity, efficiency and competitiveness with access to technology on a commercial basis by making commitments to liberalise the services rules in *the FICs* economies. That is disingenuous. A FIC can already choose to liberalise those services, but it also has the space to retreat if problems emerge. PACER-Plus won't guarantee them any better access to technology any cheaper. Instead, it dictates how the FICs need to make these changes and makes it practically impossible for them to alter or revoke those commitments if they prove damaging or alternative approaches would have better outcomes.

There is a development assistance chapter in the agreement. It makes carefully worded promises to address 'mutually determined and prioritised' activities, merely 'taking into account' needs as identified by developing countries. Aid funding is linked to trade cooperation, with specific funding commitments from Australia and NZ to a work programme that is designed to benefit their commercial interests. Any promises in the chapter are also unenforceable!

Survival of local businesses

Unequal agreements like PACER-Plus carry a major risk that foreign services and services companies will threaten the survival of local firms or the livelihoods of individuals who provide similar services or compete with foreign investors in producing goods. That risk can arise whether the foreign firm operates within a FIC or from outside the country.

Rich countries have consistently rejected special safeguards to provide protections when a FIC faces such threats. When the WTO was formed in 1995 a safeguard mechanism for services was promised within 3 years. Nothing has happened. PACER-Plus will review the question if these negotiations are ever concluded (Art 14.1), but there is no chance they ever will be.

In PICTA TiS (Art 12) a country could impose restrictions that breached its commitments in 'response to problematic market conditions in particular service sectors, the correction of structural problems within the market, or the threat of the disappearance of service sectors'. That was subject to very tight restrictions on the kind of measures that could be adopted and for how long, but even that is not in PACER-Plus. Instead, PACER-Plus says where commitments have a serious adverse impact on a Party's domestic service sector, that country can seek consultations with other Parties whose firms have caused the problem. They are required to discuss it in good faith and try to reach an agreement over a reasonable time, but nothing can be done if they don't agree.

Asymmetrical commitments

There is minimal recognition of the intrinsic development asymmetries between the FICs and Australia and New Zealand, and how the PACER-Plus services and investment chapters would deepen them.

Many FICs are not members of the WTO, for good reason: it is not relevant to their realities, the rules are lopsided in benefiting larger and richer countries, and the obligations are too onerous. Yet

PACER-Plus imposes *WTO-plus* obligations on those countries. This is unconscionable and any such obligations should at least be unenforceable through dispute settlement mechanisms.

For WTO members, Article V of the General Agreement on Trade in Services (GATS) says developing countries should make fewer commitments in regional trade agreements than developed countries. Under the Doha round developing countries are to have 'appropriate flexibility to open fewer sectors', while LDCs do not have to make any new GATS commitments at all. In other words, all FICs should face far fewer new obligations than Australia and NZ. But, even if the overall level of sectoral commitments that FICs make in PACER-Plus is considerably lower than those made by Australia and NZ, the gap between the FICs' existing and *new* commitments will be much greater than for Australia and NZ, who will have to do very little if anything new. In other words the already dominant countries could effectively get PACER-Plus for free.

As for future negotiations, the services chapter mirrors the words of the GATS about recognising 'appropriate flexibility' in reviews to extend each country's schedule (Art 18). However, the investment chapter just says parties will 'take into account' the limited capacities of developing countries (Art 23).

It may be argued that the FICs have already made extensive services commitments under the PICTA TiS protocol. That agreement adopted the inappropriate GATS model for the FICs with minimal modifications, and countries made commitments that are far beyond what developing countries and LDCs have been required to do in the WTO (except for countries like Samoa, Vanuatu and Tonga when they acceded). The PICTA TiS protocol has been signed by 10 countries: the Cook Islands, Federated States of Micronesia, Kiribati, Nauru, Republic of the Marshall Islands, Samoa, Solomon Islands, Kingdom of Tonga, Tuvalu and Vanuatu, but it needs to be ratified by 6 of the signatories before it comes into force. It remains to be seen whether and how far those countries would comply with the technical rules and relatively high level of commitments they have adopted in PICTA TiS.

Fiji and Papua New Guinea (PNG), the largest FICs, have not ratified either PICTA TiS or PACER-Plus. Nor have the Federated States of Micronesia, Marshall Islands and Palau. As Fiji and PNG would be the most likely to seek to enforce PICTA TiS, their absence means its overall impact is likely to be minimal. Moreover, PICTA TiS has limited application to investment, whereas PACER-Plus has a comprehensive investment chapter.

Institutional arrangements

The Joint Committee that oversees PACER-Plus and any subsidiary bodies, including the technical committee on Services, Movement of Natural Persons and Investment, is comprised of all the parties. Decisions are by 'mutual agreement', rather than consensus. This will have been deliberate. A decision will be binding if no country present at a meeting formally objects – hence any Pacific Way silence will be taken as consent. If a country is not at a meeting there is no provision for a proxy and it will be bound by any decision (Institutional Arrangements, Art 3). There is a promise of 'appropriate' funding for FICs' participation at meetings (Art 4), but this is through the un-enforceable Arrangement for Development Assistance and Economic Cooperation.

INNEFFECTIVE PROTECTIONS FOR THE RIGHT TO REGULATE

The text has various provisions that give an illusion that sovereign rights to regulate are protected. These assurances are either weak or meaningless. The very purpose of these agreements is to constrain the way that governments can regulate. The WTO panel that heard the dispute on *US*

Gambling famously said:

> *Members' regulatory sovereignty is an essential pillar of the progressive liberalization of trade in services, but this sovereignty ends whenever rights of other Members under the GATS are impaired.*

The services chapter (Art 2.3) recognises the right of parties to regulate and introduce new regulations, *provided that regulation is not inconsistent with the chapter.* In other words, it confirms that governments can do what the chapter allows them to do anyway, but can't do anything that would breach the chapter.

The objectives of the investment chapter (Art 2) are to encourage a *stable and predictable environment* to attract and promote investment flows, with 'due respect' to national policy objectives and the government's right to regulate. A *stable and predictable environment* is the phrase that foreign investors commonly use to describe 'fair and equitable treatment' (Art 9), which they believe means the government should not change how it regulates their activities during the term of their investment. National policy objectives are subordinated to foreign investors' rights.

PACER-Plus 'acknowledges' that parties' investors and investments are subject to the laws, regulations and standards of the host country (Art 5.1). But any measures that don't comply with the investment chapter could be challenged under the dispute settlement provisions. In a similar vein, a government can keep or introduce any measure that is *otherwise consistent with this Agreement* that it thinks is appropriate to ensure an investment's activity is sensitive to its environmental or other regulatory objectives (Art 19.2). In other words, a government can't pursue those objectives in a way that breaches the chapter, unless it has preserved the right to do so in its schedule or can bring the measure within another exception in the Agreement.

Exceptions

Every contemporary agreement has general exceptions that provide a limited defence for governments when they adopt measures to protect public order and morals, human health, environment and conservation. PACER-Plus copies those exceptions from the WTO GATT and GATS. However, they look more effective than they are in practice, because there are many layers of conditions that have to be satisfied before they apply. In the WTO the general exception has only provided an effective defence once in the forty-four times it has been relied on.[25] The very restrictive circumstances in which the national security exception can be invoked in the WTO is broadened to include threats to public infrastructure, but does not apply to situations such as climate change or cybercrime by private actors (Art 2).

Cross-border services and foreign investment involve flows of capital. FICs must not restrict these flows for investments or services covered by PACER-Plus, or payments for cross-border services. That can be problematic for small vulnerable economies with minimal foreign reserves, for example if they wish to stem the outflow of income from tourism or transfer pricing by foreign companies for tax avoidance. The global financial crisis showed how destabilising large inflows of speculative or shady capital and rapid capital outflows can be. PICTA TiS at least allowed unusually large payments and transfers to be staggered (Art 11.1); there is no such flexibility in the Investment Chapter in PACER-Plus. The conditions set out in the Balance of Payments emergency provision of the Exceptions Chapter (Art 3) are very restrictive, although they do recognise that developing

[25] Public Citizen, "Only One of 44 Attempts to Use the GATT Article XX/GATS Article XIV "General Exception" Has Ever Succeeded: Replicating the WTO Exception Construct Will Not Provide for an Effective TPP General Exception", August 2015, accessed at https://www.citizen.org/sites/default/files/general-exception_0.pdf

countries face particular pressures on balance of payments.

Social responsibility

The investment chapter has another ineffectual provision on social responsibility. The parties reaffirm the importance of *encouraging* enterprises to *voluntarily* incorporate internationally recognized standards of social responsibility into their internal policies where they have been *endorsed by the particular government* (Art 5.2). It is merely 'inappropriate' for a government *not to enforce its own laws* on environment, health, labour, safety or other regulatory standards (Art 19.1)!

Public services

A further feeble protection is the standard exclusion of 'services supplied in the exercise of governmental authority' (Services Art 2.2(a)). This phrase is drawn from the GATS. It only applies where services are not commercial *and* have no competitor – meaning the service is provided as a monopoly free of charge or possibly at a nominal payment. Very few services meet both these requirements and those that do face constant pressure to adopt user charges or allow competition, which would mean losing the protection. By contrast, the PICTA Trade in Services Protocol (Art 3.4(b)) said the term includes 'activities forming part of a system of social security or public retirement plans or the public provision of health, education or water services.' That means PACER-Plus has much more serious consequences for FICs, but has fewer protections for their basic public services.

There is also an important requirement that a monopoly or restricted number of authorised providers is not allowed to 'abuse' its monopoly. That is code for cross-subsidising the provision of a monopoly service in high-cost locations from revenue earned in low-cost areas, or using earnings from the monopoly service to support the provision of other activities, whether for social or commercial reasons. Cash-strapped governments often fund core public services in that way (Art 13.2). This restriction again comes from the GATS (Art VIII.2). Under PACER-Plus it will be applied to a greater number of sectors for existing WTO members and expanded to non-WTO members.

A footnote says the services chapter doesn't require privatisation of public services (fn2). That is a red herring (although some accessions to the WTO have required privatisations). The privatising effect of PACER-Plus is more subtle: it creates conditions that erode the public good dimension of government services operations and privilege the commercial dimension and the role of private, especially foreign competitors.

The PACER-Plus services chapter does have several positive variations to the GATS. Consistent with some other recent agreements, subsidies are excluded from the services chapter, and they are broadly defined to include loans, grants, insurance etc (Art 2.2(c)). However, if a country's subsidies for services are seen to undermine the benefits that another government expects from PACER-Plus it must agree to consultations, with an expectation of reaching a mutually satisfactory outcome (Art 15.1). Whether they agree on an outcome is likely to depend on the leverage of the countries involved.

Withdrawing commitments

Schedules are technical high-risk undertakings. The rules are complex and it can be hard to identify what they would mean in practice inside the country and therefore what needs to be protected. Mistakes are easily made – even the US has done so. Local needs and conditions change unexpectedly. New technologies emerge that were inconceivable when the schedule was drafted. But there are real barriers to adjusting a country's schedule. Under PACER-Plus no changes are allowed for 3 years. After that a Party can tell the others it wants to make a change, and if no other country objects within 3 months it can do so. But if another Party objects, the request goes to the joint committee of all the parties for a decision. Consensus decision-making basically gives the country that objected a veto. If they allow the change, they can require new commitments to compensate for what is being withdrawn. No changes can be made until those new concessions are in place. If the government goes ahead without making those changes, it can face forms of retaliation from the other party that can hurt its other businesses or exports.

This power has rarely been invoked in the WTO and the outcomes were pure power politics. In November 2008 the Bolivian government of Evo Morales sought to rescind a commitment made by a previous neoliberal government that allowed foreign control of hospital services, because its new constitution declared health care a human right that could not be privatised. The EU consented to the change. At the last minute, the Bush administration in the US lodged an objection requiring the Bolivian government to negotiate compensatory liberalisation in other services sectors with the US. Bolivia's request is still unresolved.

By contrast, changes have been agreed when it serves the interests of powerful countries. The US announced in May 2007 it would amend the commitment on 'recreational services' that was the subject of the *US-Gambling* case, rather than comply with the ruling Antigua had secured in 2005. The US successfully negotiated the change with the EU in 2007. Antigua is still awaiting a resolution of the dispute it won over a decade ago.[26]

PICTA TiS allows a government in the first 5 years to notify the others if it wants to modify its schedule of commitments and the others collectively decide whether to agree (Art 27.5). It says that consent should not be withheld if that would hinder the country's development. Yet the FIC is still meant to maintain the overall level of its commitments, suggesting some new compensatory liberalisation would be required if the change affects a commercially meaningful service. There is no equivalent reference to development in PACER-Plus. FICs who seek to change their schedules may face significant risk of a veto or demands for unacceptably high compensatory liberalisation, especially from Australia and/or NZ, and pressure to withdraw a measure to avoid the threat of legal action.

Blocking back door entry

A business from a country outside PACER-Plus, for instance Taiwan or Russia, could try to use the back door by setting up under the law of a PACER-Plus country and claiming benefits as a national, including the right to challenge measures adopted by Australia and NZ that impact on their operations.

The Investment (Art 18) and Services (Art 16) chapters allow a PACER-Plus country to refuse to provide those benefits, but it must show that the owners come from outside the PACER-Plus group and the business doesn't have any substantive operations in the country it has set up in. This is a judgement call.[27] It could be especially contentious where the business involves services delivered

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[26] United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services, WT/DS285, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm

[27] An Investor-State Dispute Settlement tribunal did find that an investor (whose main activity was in the field of financial

electronically across the border, with little on the ground presence, or when there is limited value added to their global operations.

A PACER-Plus government could also refuse to extend the benefits of the Agreement to one of its domestic businesses that claims it belongs to another PACER-Plus country, such as a Samoan business in Australia, without a genuine commercial presence there.

COMPLIANCE

Governments of small or remote countries may assume they can enter into these agreements and make promises that are not going to be closely monitored or enforced. Even if that were true of the WTO or PICTA TiS, which have some similar obligations, it is not true of new regional agreements. PACER-Plus provides multiple pressure points for Australia and NZ to demand compliance, culminating in actual enforcement, in addition to leverage through their aid budgets.

‘Transparency’

Several chapters of PACER-Plus set down procedures and ‘transparency’ rules relating to goods and services. This will impose a heavy burden on central government, which must also take ‘such reasonable measures available to ensure their observance’ by local government and non-government bodies performing delegated functions.

There is a long list of measures that FIC governments will have to publish in print or post online, including licensing requirements and procedures, qualification requirements and procedures and technical standards for services (Art 17.3). The information must include details like requirements, criteria, procedures, fees, timeframes and monitoring mechanisms. Because the services chapter applies to sub-central government and non-government decision makers, this requirement includes their general rules and procedures. The objective of publicising this information is not simply to make it easier to do business; it also aims to remove discretion from decision makers as far as possible and empower commercial interests to intervene with government to advance their interests. Although it only applies ‘to the extent of the government’s capacity’; the other parties can contest whether they have done so.

PACER-Plus governments must respond promptly to all requests from other parties for information about laws, policies, procedures that ‘pertain to or affect’ the operation of the services chapter, even if they do not *directly* relate to a particular service or obligation. There is no flexibility in that provision (Art 17.4), even ‘to the extent of their capacity’.

Institutional oversight

Australia and NZ will dominate the institutional mechanisms of contacts points, cooperation and technical discussions because they have the expertise, resources and commercial interests to drive the process in the direction that benefits them. The Joint Committee will oversee implementation of the services and investment chapters. This will involve much stronger oversight than the periodic Trade Policy Reviews of WTO members and focus on compliance with the rules and obligations,

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investments by participating as a shareholder in companies) had ‘substantial business activities’ when it had a small but permanent staff in a rented office. The findings state that “Accordingly, 'substantial' in this context means 'of substance, and not merely of form'. It does not mean 'large', and the materiality not the magnitude of the business activity is the decisive question. In the present case, the Tribunal is satisfied that the Claimant has substantial business activity in Latvia, on the basis of its investment related activities conducted from premises in Latvia, and involving the employment of a small but permanent staff”. http://www.italaw.com/sites/default/files/case-documents/ita0030.pdf involving officials from government agencies that may have little or no understanding of trade rules.

A general review of the Agreement is scheduled for 3 years after entry into force and 5-yearly after that (Institutional Art 1.2(k)) with a view to 'furthering its objectives'. Such reviews (Trade in Services – Art.18; and Investment Art. 23) are intended to extend the liberalisation agenda of PACER-Plus, not to review how it operates in the FICs and adjust or remove obligations if they have adverse development impacts. By contrast, at the time the Cariforum EC EPA was signed the Cariforum countries insisted on a Declaration that guaranteed a review after 5 years of the costs and consequences of implementation of the EPA. The first review in July 2015 makes for sober reading and should be considered closely by the FICs before they ratify PACER-Plus.[28]

In addition, the Committee on Services, Investment and Natural Persons is to review those chapters and related annexes within just 2 years after the agreement comes into force and report to the main committee (Institutional Art 2.1(e)). Negotiations to extend the FICs commitments must begin within 3 years after PACER-Plus comes into force (Investment Art 23, Services Art 18), with 'appropriate flexibility' in services for developing countries as required by GATS Article V (discussed earlier). That means pressure to commit more services to the rules and more resources to negotiations while FICs are trying to implement the obligations they have already agreed to.

State-state enforcement

One of the most outdated parts of the proposed agreement is the process for settling disputes. States can enforce the rules and obligations against other states before ad hoc tribunals with each state appointing one arbitrator and the chair by agreement. Unlike most recent agreements, including the TPPA, there is no commitment to openness (hearings are to be open unless Parties agree otherwise) and disclosure of documents, no provision for amicus curiae briefs from concerned parties, and no code of conduct for arbitrators or rules on conflicts of interest. Because Australia and NZ are the most likely complainants on behalf of their commercial interests, these omissions strip the FICs of crucial protections, including pressure from concerned community groups in those two countries.

Enforcement of investment rules

The enforcement of the rules in the Investment Chapter as well as the rest of PACER-Plus allows Parties recourse to bring a dispute against another Party they believe are not implementing the agreement. Thankfully PACER-Plus does not have an Investor-State Disputes Settlement (ISDS) mechanism, a mechanism that is widely seen as bad for development.[29] The State-State process for dispute settlement could still see FICs having to defend their policies before a tribunal. Whilst technically they are equally able to instigate a dispute process against Australia and New Zealand, the enormous legal costs plus the damage to the diplomatic relationship makes such an outcome unlikely.

An actual dispute is not the only problem. Arguably, the bigger danger is the 'chilling effect' of potential disputes on domestic decisions. This was evident in NZ with the plain packaging law after the tobacco companies threatened an investment dispute, but it also holds true for the threat of litigation from other government parties to PACER-Plus. The possibility of litigation can also cast a

[28] http://www.europarl.europa.eu/meetdocs/2014_2019/documents/dcar/dv/working_/working_en.pdf

[29] Investor-state dispute settlement (ISDS) allows foreign investors to sue governments in private ad hoc offshore tribunals, whose arbitrators are often practicing investment lawyers and can award unlimited compensation against governments, including lost future profits with compound interest.

more general shadow over decision making, so that governments become super-cautious when passing laws or making policy decisions that foreign governments or their investors don’t support.
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