

Pakistan US Bilateral Trade Agreement

1.0 Introduction

A **bilateral investment treaty (BIT)** is an agreement establishing the terms and conditions for private investment by nationals and companies of one state in another state. This type of investment is called foreign direct investment (FDI).

Most BITs grant investments made by an investor of one Contracting State in the territory of the other a number of guarantees, which typically include fair and equitable treatment, protection from expropriation, free transfers and full protection and security. The distinctive feature of many BITs is that they allow for an alternative dispute resolution mechanism, whereby an investor whose rights under the BIT have been violated could have recourse to international arbitration, often under the auspices of the ICSID (International Center for the Settlement of Investment Disputes), rather than suing the host State in its own courts.

2.0 Background to the US-PAK BIT Agreement

While multilateral agreements under the GATT and WTO have been the leading arrangements bringing greater trade liberalization in the world economy the world's first BIT was signed on November 25, 1959 between Pakistan and Germany. There are currently more than 3,000 BITs in force, involving most countries in the world. **Influential capital exporting states usually negotiate BITs on the basis of their own "model" texts (such as the US model BIT).**

Currently the Bilateral Trade Agreement (BIT) between the US and Pakistan which have been pending since 2004 has been fast tracked and there is a possibility that the Treaty may be signed in the very near future. Since the terms of the proposed US Pak BIT Treaty have not been made public this analysis of the likely impact of the BIT is based on the 2012 U.S. Model Bilateral Investment Treaty which is available from the net.

3.0 Likely Benefits to Pakistan of a Bilateral Trade Agreement (BIT) with the USA.

The greatest apparent benefit for Pakistan from signing the BIT would be a promise from the US government that the BIT will be followed by the initiation of negotiations for a Free Trade Agreement between the two Countries. Though no formal indication has been given by the US government that the signing of the BIT will lead to the initiation of FTA negotiations, the US's track record on this would indicate that this the route that the US normally follows:

Table 1: Countries with which the USA has signed Bilateral trade Agreements and FTA's¹

Sr. #	Country	BIT signed on	FTA signed on	Negotiations for FTA
1.	Albania	11 th January 1995	Not signed	
2.	Argentina	14 th November 1991	Not signed	
3.	Armenia	23 rd September 1992	Not signed	
4.	Azerbaijan	1 st August 1997	Not signed	
5.	Bahrain	29 th September 1999	11 th January 2006	
6.	Bangladesh	12 th March 1986	Not signed	Was in negotiations decided against it in 2010
7.	Bolivia	17 th April 1998	Not signed	In talks
8.	Bulgaria	23 rd September 1992	Not signed	
9.	Cameroon	26 th February 1986	Not signed	
10.	Congo, Democratic Republic Of (Kinshasa)	3 rd August 1984	Not signed	
11.	Congo, Republic Of (Brazzaville)	12 th February 1990	Not signed	
12.	Croatia	13 th July 1996	Not signed	
13.	Czech Republic	22 nd October 1991	Not signed	
14.	Ecuador	27 th August 1993	Not signed	Negotiations underway
15.	Egypt	12 th March 1986	1 st July 1999 (TIFA)	US froze FTA talks in 2005
16.	Estonia	19 th April 1994	Not signed	
17.	Georgia	7 th March 1994	20 th June 2007 (TIFA)	Negotiations underway since 2012
18.	Grenada	2 nd May 1986	Not signed	
19.	Honduras	1 st July 1995	1 st March 2007	
20.	Jamaica	4 th February 1994	1 st October 2000(via CBTPA)	
21.	Jordan	2 nd July 1997	1 st January 2010	
22.	Kazakhstan	19 th May 1992	Not signed	

¹Office of the United States Trade Representative.

Sr. #	Country	BIT signed on	FTA signed on	Negotiations for FTA
23.	Kyrgyzstan	19 th January 1993	Not signed	
24.	Latvia	13 th January 1995	Not signed	
25.	Lithuania	14 th January 1998	Not signed	
26.	Moldova	21 st April 1993	Not signed	
27.	Mongolia	6 th October 1994	Not signed	
28.	Morocco	22 nd July 1985	15 th June 2004	
29.	Mozambique	1 st September 1998	21 st June 2005	
30.	Panama	27 th October 1982	28 th June 2007	
31.	Poland	21 st March 1990	Not signed	
32.	Romania	28 th May 1992	Not signed	
33.	Rwanda	19 th February 2008	7 th June 2006 (TIFA)	
34.	Senegal	6 th December 1983	Not signed	
35.	Slovakia	22 nd October 1991	Not signed	
36.	Sri Lanka	20 th September 1991	25 th July 2002 (TIFA)	Talks ongoing since 2007
37.	Trinidad And Tobago	26 th September 1994	Not signed	Negotiations underway with CARICOM
38.	Tunisia	15 th May 1990	2 nd October 2002	
39.	Turkey	3 rd December 1985	29 th September 1999 (TIFA)	Negotiations underway
40.	Ukraine	4 th March 1994	28 th March 2008 (TIFA)	
41.	Uruguay	4 th November 2005	25 th January 2007	

*TIFA: TRADE AND INVESTMENT FRAME WORK AGREEMENT

The table above demonstrates that there is no apparent correlation between a Bilateral Trade Agreement and an FTA and that most countries that have a BIT agreement with the US do not have any other trade agreements in force. Those countries that do have other agreements are mostly Trade and Investment Frame Work Agreements (TIFA) which Pakistan already has with the US since 25th June 2005.

The second major benefit for Pakistan would appear to be a review of its legal system followed with legislation aimed at improving the laws that govern the business environment in the Country.

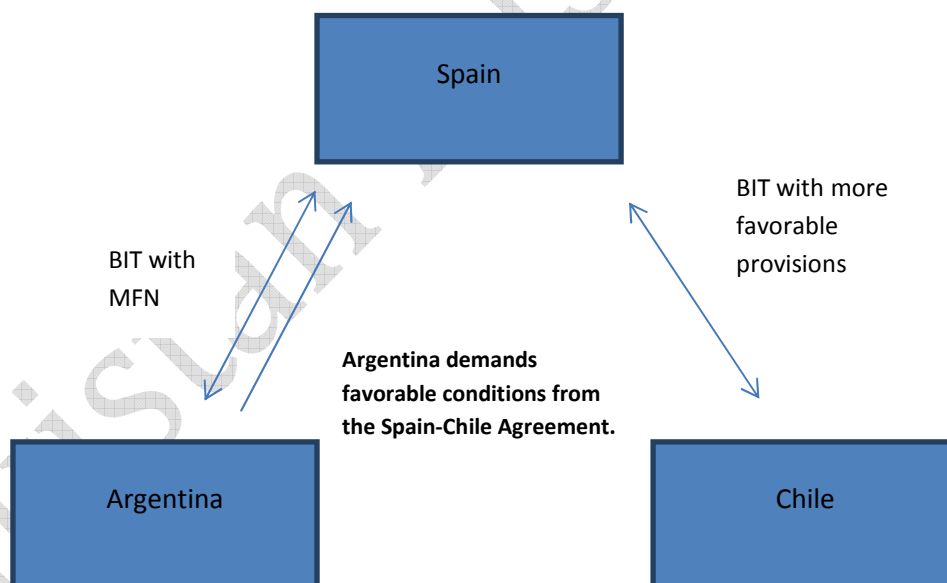
An obvious attraction of an FTA is that members obtain preferred access to the markets of other members. As noted below, this may not necessarily produce optimal outcomes in the long term. It depends on the overall impact of the arrangements and other concurrent trade policies. Trade agreements set rules for regulating trade and trade-related activity as well as incorporating commitments to remove trade barriers. The record has shown that members of trade agreements can also secure agreements in FTAs for rules that confer advantages upon their trading partners and reduce trade irritants and restrictions that could not otherwise be secured from multilateral trade agreements.

4.0 MFN and National Treatment:

The Most Favored Nation (MFN) clause is universally found in BIT Agreements signed with the exception of the India Singapore BIT.

The most important point to understand here is that as the WTO Agreement is for Trade the MFN clause contained therein does not apply to Investment Agreements Bilateral or otherwise.

MFN clauses can alter arrangements specifically agreed in a treaty between two states by importing standards from another treaty with a third state depending on the language of the clause. As demonstrated in the example below:



In the example stated above if there are no restrictions in the MFN clause Argentina can demand the more favorable provisions granted to Chile as its own in case of multiple treaties Argentina can analyze all the treaties signed by Spain and pick and choose the most favorable conditions it wants.

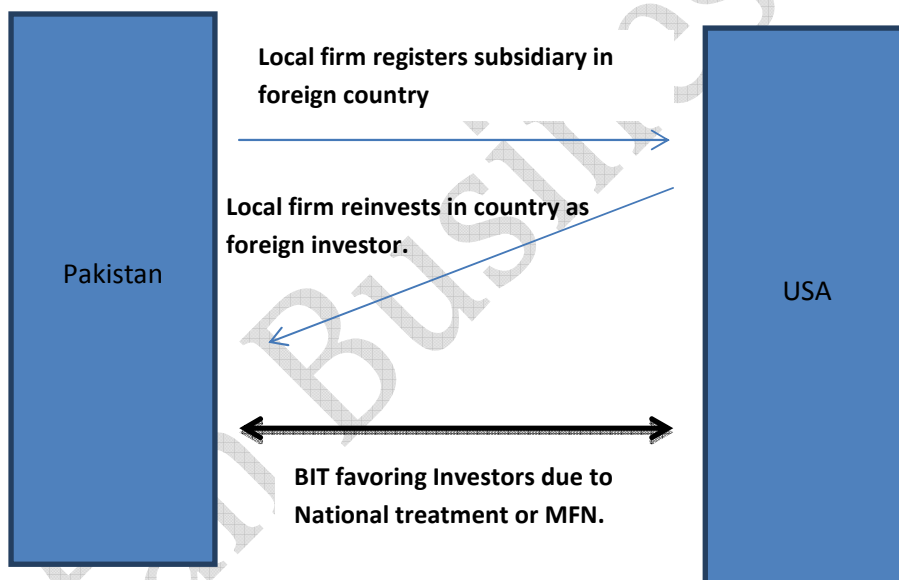
If Spain does not grant these to Argentina, then Argentina can seek Arbitration under ICSID rules for violation of contract.

This problem can be circumvented by Exceptions and state specific reservations incorporated in the negotiations limiting the application to certain activities such as management, conduct, operation, expansion and sale or other disposition of investments.

Canada had a policy of only signing BITs with prospective MFN clauses and adding exception thus protecting its self from such issues. In other words, Pakistan if this provision is not included in the US Pak BIT Pakistan can demand same treatment as US has granted to say Mexico under NAFTA. To obtain this the concerned countries or investors have to go through lengthy Arbitration to obtain such provisions.

National Treatment is included in the 2012 U.S. Model Bilateral Investment Treaty this means that the foreign investors are treated with no less favorable treatment then local investors this includes both *de jure* (by law) and *de facto*(by fact) discrimination.

This may also lead to local businesses registering themselves in foreign countries with favorable BIT Agreements and then investing back into the economy if circumstances favor investors.



National Treatment protects investors against discrimination but reduces the possibility of the government favoring domestic firms. To avoid such outcomes most treaties contain some exemptions permitting discrimination in some cases such as domestic subsidies to local businesses.

5.0 A BIT/FTA may not necessarily lead to an enhancement of trade:

The US Chile Free Trade Agreement (FTA) was signed in 2004 after which US exports to Chile decreased by 26% to \$8.8 Billion while US imports from Chile decreased by 29%to \$5.8 Billion in

2009 displaying a negative trend. It has been established by Third World Network and reported in 2012 that **“there is no clear relationship between inflow of FDI and BIT agreements.”**

Article 11 of the 2012 U.S. Model Bilateral Investment Treaty deals with transparency requiring the countries engaged in the BIT to inform each other of any changes in law via notification after which they have to wait for the comments and concerns from the other country and their businesses. Only after satisfying these conditions can the laws be implemented otherwise the country may face arbitration.

At the World Trade Organization’s public forum Mr. Xavier Carim, Chief Trade Negotiator of South Africa and one of the presenters at the international investment treaties session said:

“...as we assessed the bilateral investment treaties that we had entered into, we began to identify a range of inconsistencies with the Constitution...we soon became aware of challenges posed by international investment treaties. We observed the fractious debate in the OECD when its members were seeking to negotiate a multilateral investment agreement in the late 1990s. We were participants in the discussions in the WTO that sought to include, as one of the Singapore Issues - trade and investment - in the Doha Round negotiations, where many developmental concerns emerged in the engagements...Perhaps most seriously, the spike in international investment arbitrations that followed the financial crisis in 2008 laid bare that bilateral investment agreements can pose profound and serious risks to government policy”²

It becomes apparent from the statement above and the wordings of Article 11 of the 2012 U.S. Model Bilateral Investment Treaty that international input in local legislation may lead to delays in the formation and implementation of legislation that can be ill afforded by the partner country.

As a requirement under Article 11 of the 2012 U.S. Model Bilateral Investment Treaty the US will necessarily have to be informed of any legislative changes and this will hold true for all legislation put into force by the country and post USA input on the laws these can either be changed or the businesses and the US will have rights under Article 24 to pursue Arbitration.

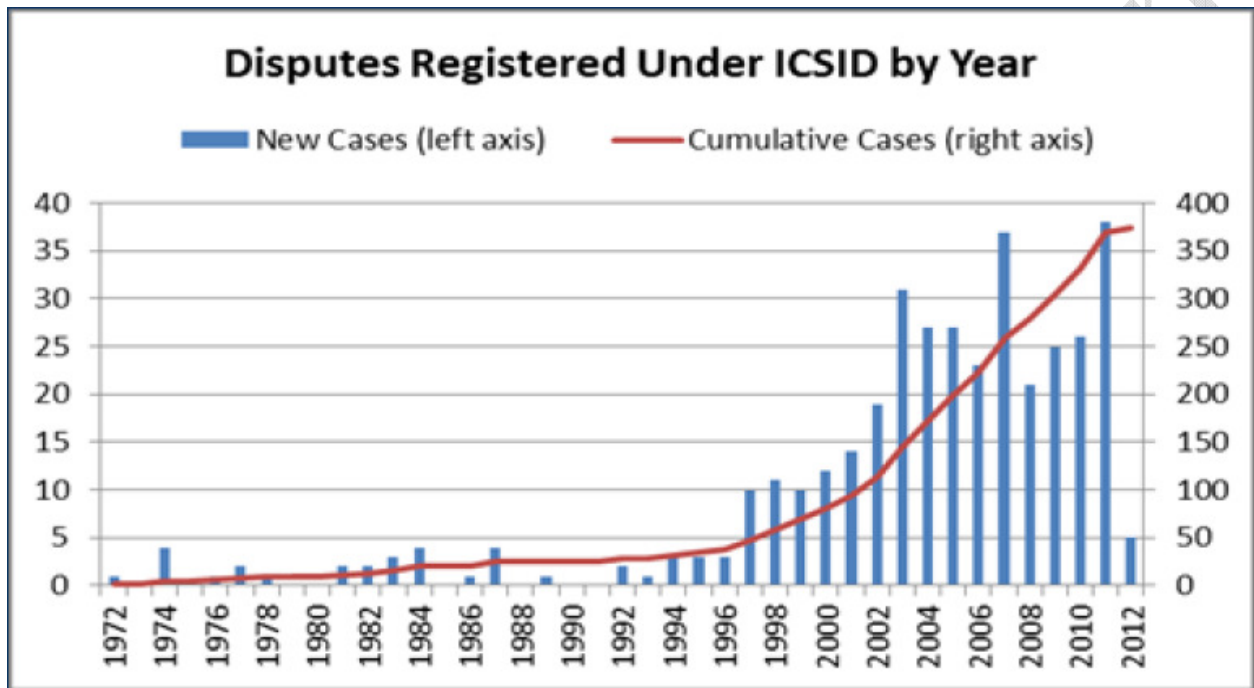
Article 20.6 elaborates on this matter by stating the same conditions for laws regarding Financial Services that at the time of adoption the comments have to be addressed in writing. These maybe numerous and cause delays in the decision making process.

Article 24 States that if there is a breach in the treaty the concerned party after following protocol may submit for arbitration to International Center for Settlement of Investment Disputes (ICSID) which is under the World Bank. A number of issues arise due to this primarily as the 2012 U.S. Model Bilateral Investment Treaty raises the investors to state level and they may enter a case for arbitration which bodes well for the investor. An average case costs \$8 Million to pursue and in the event they lose the case it is not reimbursable. As reported by some international organizations and the media the judges of these arbitration courts are paid by the hour hence the cases tend to drag on without resolution for an extended period of time. In the case of **Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines** (ICSID Case No. ARB/03/25) legal costs alone amounted to \$50Million to the German firm. The judges are not bound by precedence so there is no case law that can be enforced upon them for a favorable judgment. Also it is up to the tribunal’s

²<http://www.twinside.org.sg/title2/wto.info/2012/twninfo121001.htm>

discretion to set the damages. Tribunals have awarded injunctive relief which may cause severe conflict of laws.

The ICSID system favors investors as an Investor can sue a country but a Country cannot sue an Investor. And on non-payment of settlement amount the foreign assets of a country can be frozen by the order of ICSID.



5.0 Conclusion

1. When countries with lower economic status or when Third World countries contract with First world countries it may appear to be beneficial to get the opinion of the populous and the businesses to avoid negative impacts on the social and economic environment of the country.
2. Being a smaller economy Pakistan's negotiating position would appear weaker than the US's and this may result in the signing of an agreement that is more geared towards US interests especially since the proposed terms of the agreement remain undisclosed to the public..
3. As seen in the case of South Africa many unforeseen problems were faced prior to signing the agreements along with discontent from the populous as they saw the signing as a closed door process which they weren't a part of. It is therefore possible that adopting a similar closed door approach in the case of Pakistan might lead to widespread public discontent based more on speculation as opposed to the provisions of the Treaty.
4. Some of these problems identified with BITs include difficulties with respect to international arbitration including observed fragmentation in the system; the lack of common standards of protection; inconsistent interpretations by arbitration panels even on similar matters; as well the growing complexity of the international system through an evolving jurisprudence.
5. Even where a BIT had been signed between the USA and South Africa the Cabinet of South Africa decided that they would refrain from signing further BIT agreements unless it was very compelling for political and economic reasons. It was also decided that the current BITs would be viewed with the aim of termination or favorable changes.
6. In the absence of the documents specifying the terms of the US Pakistan BIT Agreement, it has been suggested that the United States is seeking clauses in the Treaty which would ensure that all disputes are settled in accordance with US laws and further it would provide protection to US companies that have invested from a third country of origin³.
7. If the US Pakistan BIT Agreement ultimately leads to a Free Trade Agreement it may be beneficial to the country and its businesses and can lead to increased trade with the US resulting in increased economic activity within Pakistan.

³<http://www.brecorder.com/business-a-economy/189/1218584/>

6.0 Recommendations

1. There appears to be considerable pressure on the Government of Pakistan for expediting the Bilateral Investment Treaty with the US; as currently similar agreements are under negotiation between the US and China and the US and India both of whom are Pakistan's competitors in exports to the US. However before moving forward due diligence needs to be performed on the impact of the various provisions as well efforts need to be initiated for building a national consensus on the proposed BIT.
2. Negotiations for agreements of this nature can at times be long drawn out as seen in the cases of:
 - Korea which took 5 years to negotiate with the USA and signed an FTA at the conclusion of the negotiations and,
 - Bahrain which negotiated the first Bilateral Agreement between the US and a GCC country.
3. PBC recommends the formation of an Advisory Board comprising, government, leading businesses, legal professionals and other stakeholders so that a comprehensive position can be taken on the impact of such an agreement on the country. This Advisory Board should debate the impact of the proposed clauses in the BIT and members of the Advisory Board should be part of the negotiation process.
4. Positive or Negative sector lists can be defined to include or exclude particular sectors from the confines of the BIT which is a common practice in BITs signed by the US, Canada and Japan.
5. Pakistan can initially sign a very basic version of the treaty not committing to any major changes and agree to form a committee that will meet every 3-5 years and renegotiate the terms. This is favorable as Bilateral Trade Agreements stay with the country for many year and thus need to be adaptable to current circumstances with mutual consent. This method is being practiced in China
6. As a start, PBC recommends that Pakistan follow the negotiation model used for the Bahrain US BIT model. In this model, after signing the BIT agreement Bahrain signed The Trade Investment Framework Agreement (TIFA) establishing the "United States-Bahrain Council on Trade and Investment." Main objectives of the Council included identifying opportunities for expanding trade and investment and working towards the removal of impediments to trade and investment flows. This agreement was signed as a prelude to the FTA and provided a platform for non-confrontational and mutually beneficial dialogue.
7. Incidentally Pakistan & the USA signed a TIFA in June 2003 however it has not yet been properly utilized as a platform for negotiation. It is recommended that the government of Pakistan intimate the US government regarding using this forum for negotiating an FTA.

8. PBC is of the view that if an FTA is not a logical concluding point of the Pak-US BIT, we may need to rethink our strategy as the effort involved in changing and implementing changes in the Law to conform to US requirements may far exceed the gains from the BIT.
9. PBC however would recommend that irrespective of progress or otherwise on the BIT with the US, Pakistan needs to review and bring about major changes in its legal environment so as to facilitate investments –both foreign and domestic as well as on how business is conducted within the Country.

Pakistan Business Council