Challenges of international trade and investment in the 21st century

edited by
Zoltan Vig

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Editorial: Challenges of international trade and investment in the 21st century

The 21st century has been marked by new challenges facing the global economy in general, and international trade and investment in particular. We can see that the world economy is currently undergoing irreversible transformation. It can be said that Hungary, Moldova, and Turkey due to geographical proximity have similar issues when it comes to trade and investment, however, we should not forget that international trade and investment affect either directly or indirectly everybody on the globe. This is well illustrated by small Pacific nations which isolated themselves during the Covid pandemic, but after several months gave up for one or other reason this isolation, and joined again international trade flows.

One of the current challenges of international trade and investment is that national economies are becoming increasingly anti-globalist as well as isolationist. Earlier achievements of multilateralism and market liberalization seem to disappear bit by bit. All this has serious effects on international trade and investment. The main drive of globalization and trade liberalization worldwide was the United States of America during the twentieth century. However, at the beginning of the twenty first century it lost its leading position as main exporter of the world, and it seems that with it also lost its interest in the promotion of globalization and the idea of free trade. During the Obama administration there were already signs of this: the United States obstructed the work of the WTO

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Appellate Body. Donald Trump withdrew from free trade agreements and did a lot to isolate the United States. President Biden hasn't done too much to leave this path. So, after the bipolar and unipolar world, currently we are witnessing the fragmentation of the world into interest groups or blocks. Although China took over the place of the United States as the largest exporter of the world, economically and politically it is not dominant as the United States is or was earlier. It is simply not a global hegemon yet, not even a local one in Asia. In addition, it is incapable of leading a neo-liberal economic order, as the so-called socialist market economy (or state capitalism) is still too strong in China. A neo-liberal economic order would require it to play by the rules, but in reality, it does not play by the rules. So, China is constrained by its own autocratic approach to economic matters. Therefore, we can observe a slow process of isolation and strengthening protectionism in global trade and investment.

In addition, we have experienced historically the worst crisis of the global economy in 2008, and the next one is around the corner. National economies have been facing the problem of indebtedness for years now, which is becoming increasingly difficult to solve. In addition, high inflation and recession are looming on a global scale. It is true that economic crises in capitalism are recurrent and cyclical. However, in the 21st century, due to the enormous volume and overall presence of global trade and investments, such crises have more serious effects on economy, and specifically on these sectors of the economy. In addition, there are new inventions, modern technologies, like special financial instruments, smart contracts, cryptocurrencies, and so on, and their weak regulation. So, the impact of any economic crisis in this century might be much deeper in a globalized world.

At the same time, we have to admit, that the already mentioned innovations like blockchain, smart contracts, or Artificial Intelligence, increase efficiency in trade. For example, a huge part of international trade is financed by letter of credit. Such transactions are relatively slow and costly. With developments in information and communications technology electronic letter of credit (eL/C) has been introduced, which eliminates the need for correspondent banks, and at the same time, provides transparency and immutability to transactions.

However, we have seen during the 2008 economic crisis that these innovations might be very dangerous without adequate regulation. One only needs to remember mortgage-backed securities or collateralized debt obligations (CDO).

Another issue affecting international trade and investments is that powerful multinational companies continue to operate on an all-encompassing, global scale and sometimes ruthlessly compete for markets and resources under the new circumstances on the world stage. In some countries, this led to the so-called "business leads politics" phenomenon. At the same time, there is a strong competition among these multinational companies, and the intensification of competition at global level might in turn lead to the intensification of negative processes in international trade and investment.

Due to the presence of these factors, many experts talk about future low growth rates of the world economy and various risks, which will not only affect international trade and investment, but also create new problems in the legal relationship between the subjects of international law.

There is definitely need for an international organization which coordinates international trade, and which offers a forum for solving trade disputes among States. However, instead of global

integration under the umbrella of the WTO, there are more and more initiatives for local economic integrations. Recently concluded free trade agreements by the European Union are good examples for this. This might be the sign that the WTO members do not trust that there is future for the global system under this organization.

All this might lead to serious challenges for small and mid-sized economies like that of Hungary, Moldova, or Turkey. Therefore, the primary aim of the conference was to examine the challenges of international trade and investment in the 21st century by identifying legal issues and finding potential solutions.

Gabor Hajdu's paper "Future of the EU and UK trade relations in light of the EU-UK Trade and Cooperation Agreement: contextualizing Brexit and trade" first examines the political background of Brexit and gives a short analysis of the UK's trading regime within the context of the EU system. Following this it covers the history of negotiations surrounding the UK's exit from the EU and the adoption and the content of the EU-UK Trade and Cooperation Agreement. Finally, the author assesses the most important results of this Agreement.

Irina Iacovleva's work "Problems Related to Jurisdiction in ICSID Arbitration" deals with issues related to ICSID jurisdiction when considering investment disputes, as well as how non-compliance with the conditions of jurisdiction may affect the exercise of the right to investment protection.

Muhammad Abdul Khalique in his work "The critique of reform proposals for ISDS: solutions to existing and future problems" analyses the work and proposals of the UNCITRAL Working Group III (WGIII) on the reform of the Investor-State Dispute Settlement (ISDS) system. The author, beside the

constructive critic, also shares his own views on the most critical issues.

The paper of Thembi Pearl Madalane "EU DCFTAs: carrot-and-stick?" scrutinizes trade dispute resolution under the European Union's Deep and Comprehensive Free Trade Area established with Georgia, Moldova and Ukraine and its long-term effects. Besides, as the EU has pursued similar DCFTAs in North Africa under its European Neighbourhood Policy, the paper considers the EU's pursuit of the DCFTAs in North Africa in the context of dispute settlement costs of EU DCFTAs.

Shady Mawad's work which bears the title "To what extent can tax incentives be challenged under the WTO's Subsidy Agreement?" focuses on tax incentives which can be at the same time government subsidies distorting the competition in the global market. It starts by analysing the definition and categories of subsidies under the Agreement on Subsidy and Countervailing Measures, what is followed by a discussion on tax incentives, and finally the author analyses the provisions of the Agreement in the light of the current case law.

Bengi Sargin's paper "Acquisition of citizenship by investment (*ius pecuniae*): the case of Turkey" explores the acquisition methods of Turkish citizenship and examines the conditions of citizenship by investment in Turkey. The author also gives suggestions how to improve the current regulation taking into consideration practices of other countries.

Gabor Hajdu*

Future of the EU and UK trade relations in light of the EU-UK Trade and Cooperation Agreement: contextualizing Brexit and trade

Abstract: This paper aims to contextualize Brexit from the perspective of international trade law. It first discusses the history of Brexit from a general and trade perspective. This is followed by an overview of the negotiations also from an international trade perspective. It then proceeds to examine the general context and content of the EU-UK Trade and Cooperation Agreement and evaluate it in comparison to the pre-Brexit trade situation. In the conclusion the author briefly discusses existing trade disputes between the EU and the UK, before attempting to conjecture on the future of the trade relationship.

Keywords: Brexit, international trade law, trade, European Single Market

1. Introduction

In the wake of Brexit, years of uncertainty followed on multiple fronts. One of these was the question of trade relations and how they would unfold, given the UK's decision to leave the EU, which above all was an economic union. There were multiple different approaches and ideas on both sides during the negotiations regarding how this could be handled, some realistic, others less so. In the end, an agreement was reached, the EU-UK Trade and Cooperation Agreement, which largely handled the international trade issues surrounding Brexit.

This paper does not aim to merely produce a simple textual analysis of the Agreement. Instead, its principal aim is to provide an in-depth contextual analysis surrounding the origins of the Agreement and provide the reader with an overview of

Brexit from an international trade perspective. It accomplishes this in the following structure: First, we discuss the political background of Brexit, followed by a brief analysis of the UK's trading regime within the context of the EU system. This is in turn followed by an in-depth play-by-play of the chaotic and prolonged negotiations surrounding the UK's exit from the EU, and the adoption of the Agreement. The final segment of the discourse is a brief overview of the final contents of the Agreement. In the concluding part, we aim to show how this Agreement has worked out so far in actual practice and attempt to establish theories regarding the future trajectory of the trade relationship between the UK and the EU.

2. Political background of the Brexit

The relationship between the UK and the rest of the EU has always been contentious. In this section, we briefly explore the political background and reasons behind Brexit, focusing on the perspective of both the UK citizenry, and that of its politicians. Anti-EU sentiments were nothing new in the UK. Even at the time it joined the EU's predecessor, the European Communities (EC), there was significant (but not major enough to meaningfully counteract the joining) opposition within both the country's political class (not to mention the EC's political class, as shown by French president Charles de Gaulle's veto on the UK joining the European Economic Community)[1] and residents.[2] There were concerns about sacrificing sovereignty, and tying the UK too closely to continental affairs both politically and economically, which ran contrary to the tried-and-true tradition of British disengagement from continental

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[1] *See:* de Gaulle (1963).

[2] *See in general:* Davis (2017).

affairs outside of maintaining a balance of powers.[3] However, the promise of economic advancement through cooperation was found to be too powerful of a factor to be ignored.

This economy-centric promotion of the European Communities (a not unreasonable position at the time, as the EC was still chiefly about economic integration and cooperation) would ultimately prove to be a double-bladed sword for the pro-EC(EU) parts of the British political establishment. In essence, joining the EC was sold to the British public as an almost purely economic affair. Hence, it became commonplace in the later development of the European project for the United Kingdom to oppose political integration measures, and to secure various exemptions from different harmonization efforts. This represented a carefully balanced tightrope walk between securing as much benefit as possible from this cooperation with the continentals, while ensuring that the British retained the ability to control their affairs with as much freedom as it was possible.[4]

The "problem" of immigration into the UK from the rest of Europe was another issue.[5] It also became commonplace to associate this immigration with the EU, given the free movement of laborers and people between Member States being a fundamental pillar of the whole EU.[6] Adding to the woes related to immigration concerns was the Lisbon Treaty in 2007 (2009), which significantly expanded the scope of the European Union's power and competency. Notably, the British Prime Minister (PM) of the time, Gordon Brown, opted out of publicly signing the treaty, and instead signed it later.[7]

[3] Davis (2017) 3-4.
[4] Campos and Coricelli (2015).
[5] The Migration Observatory (2020).
[6] EC (2022c).
[7] Virunurm (2020).

Finally, we can't fail to mention the effect of the 2008 global economic crisis.[8] Even though the economy had recovered, negative feelings towards the EU were aroused and not easily silenced. This was reflected by the rising popularity of the United Kingdom Independence Party (UKIP), a political party solely dedicated to the goal of removing the United Kingdom from the European Union.[9]

All these slowly boiling political factors led to a political gambit. David Cameron, the next PM of the UK after Gordon Brown, decided to announce a renegotiation of the EU-UK relationship and a referendum on the EU membership if the Conservative Party won the general election of 2015.[10] His reasons for this announcement were complex. In general, there was an internal pressure on the Tories to decisively address the growing problem of the EU attempting to hasten political integration of its Member States, something that was still deeply controversial in British society. Secondly, the rise of the UKIP threatened some traditional Conservative voter bases. If the Tories seemed to falter, to appear weak against the EU, they would risk losing the more concerned Conservative voters to the UKIP. Thus, Cameron's decision was to attempt to build political capital and cordon off UKIP's growth with his promise of renegotiation and a public referendum on EU membership, if said renegotiations would fail.[11]

Bolstered by these promises, the Conservative Party managed to eke out a victory, and set off to fulfil the promises made to their electorate by first attempting to renegotiate the UK's

[8] Crafts (2019).
[9] Hunt (2014).
[10] BBC (2013).
[11] *See in general:* Tournier-Sol (2015).

relationship with the EU.[12] Suffice to say, this attempt ended up not fulfilling all of the expectations, though it resulted in a potential deal, leading Cameron to announce public referendum on the membership.[13]

As a result, British society divided into two camps: Leave and Remain. In the end, the situation culminated in a narrow win for the Leave faction on June 23, 2016,[14] which set the stage for Brexit proper, and was followed shortly by the resignation of David Cameron, paving the way for a new era in UK-EU trade relations.

3. Trading regime within the EU

In order to properly appreciate the changes brought by Brexit in relation to international trade law, first of all it is necessary to examine succinctly the so-called European Single Market. Furthermore, it is also necessary to give a short general exposé on the trading system the EU employs with third countries, and in which the UK also participated.

The foundation of the original internal trade relationship lay in the so-called four freedoms, that together comprise the main principles of the European Single Market: the free movement of goods, capital, services and labour.[15] From an international trade law perspective, the existence of this European Single Market affords a unique opportunity to its Member States to trade among each other in a completely free manner. Rather than being purely a result of a single legal act, this European Single Market developed over the course of decades, alongside the European Communities and later the European Union. The

[12] BBC (2015).
[13] BBC (2016b).
[14] BBC (2016a).
[15] Eu3doms (2017) 3.

fundamentals of this single market were already laid by the European Economic Community. It then properly took shape after the second half of the 1980s and the first two years of the 1990s were spent by the EEC negotiating this single market.[16] The rest of the 1990s produced further developments, as the Amsterdam Treaty of 1997 abolished physical barriers through adopting the concept of the Schengen Area, though the UK was not a part of it. In general, each of the four freedoms underwent evolution and expansion during this period of EU legislation.[17]

From our perspective, the most important aspect of the European Single Market is the customs union, closely tied to the freedom of movement of goods. As evidenced by its name, we are talking here about a customs union, a more advanced form of economic integration than a simple free trade area. While in a free trade area, Member States abolish tariffs and other barriers to trade among themselves, they still retain control over tariffs towards third countries. Not so in a customs union. Member States of a customs union go beyond simply abolishing tariffs and non-tariff barriers to trade, and apply single tariffs to goods from third countries.[18]

We can see that this European Single Market thus largely erased trade barriers. All this allowed the creation of a vigorous and active internal market within the EU, where goods (services, capital and labour) could flow freely without restraint. While this increased competition faced by British goods, it also provided them with a more accessible market on the continent. Not to mention, that from a consumer perspective this state of affairs was highly beneficial.[19]

[16] Gerbet (2016) 2.
[17] Gerbet (2016) 3.
[18] EC (2020).
[19] Berlingieri, Breinlich, Dhingra (2018).

Regarding third countries, there were two main aspects that ought to be discussed. First, we have to briefly explain the World Trade organization (WTO) system. The WTO's primary aim was to reduce tariffs and non-tariff barriers to trade and facilitate free trade between its signatory members.[20] The EU as a whole dealt with third countries on the basis of the principles laid down in the WTO system, which while advantageous, were nowhere near to the freedom of trade found within the internal market of the Union. Beyond the WTO system, as part of the shared trade policy, the EU also negotiated a large number of free trade agreements with different countries (most recently, Canada and Japan both signed notable free trade agreements with the EU), that offered a more liberalized trade regime compared to the WTO rules. Of course, these free trade agreements had different degrees of comprehensiveness: some only covered goods or services, or only particular sectors in each area. This was dependent on the negotiation of the parties, and their willingness to compromise on various trade matters. Naturally, as part of the EU, the UK also benefited from these agreements.

Furthermore, it is prudent to highlight a particular array of goods that face greatly increased difficulties if arriving from third countries, outside the European Union. Here we mean the rigorousness of EU procedures when it comes to food products and livestock coming to the EU from third countries. These products face increased scrutiny and can be subjected to examinations on a sectoral basis, which delays their arrival to the market. And with perishable goods, even a delay of a day or two could easily serve to drive up costs and reduce profits.[21] In particular, live animals, products of animal origin, plants and plant products coming from third countries are channelled in a mandatory fashion to border control entities and subjected to

[20] WTO (2020).
[21] *See in general as an example:* Beestermöller, Disdier, Fontagné (2016).

checks. These checks are designed to ensure that all imports fulfil the same (rather high) standards of food safety and quality as similar goods from the EU's own single, internal market would.[22] The high requirements the EU places on food safety is thus reflected in an international trade law context as well, and this in fact has been a source of various trade disputes with third countries.[23] The already mentioned high food safety standards were also an issue the parties had great trouble working out when negotiating the ultimately failed TTIP (Transatlantic Trade and Investment Partnership) free trade agreement between the EU and the US.[24]

4. Negotiating trade: from chaos to chaos

Trade negotiations over Brexit had been a long process for both parties. However, from our perspective, the most important facets occurred during the final year of negotiations, amidst the pressing deadlines following the formal withdrawal of the UK from the European Union. However, the preceding period should be also discussed to some extent, mostly in relation to the so-called Theresa May deal that ultimately failed.

In the immediate aftermath of the Brexit referendum, it became clear that it was fundamentally necessary to resolve issues related to the UK's continued access to the European Single Market. However, much of 2016 was spent resolving the domestic political situation with PM David Cameron resigning

[22] EC (2022b).

[23] A good example of this was the EC - Hormones (European Communities (2022b)) WTO case, where the EU (then the European Communities) found issue with the usage of growth hormones in livestock by USA producers. In a similar fashion, the EU also came into "trouble" over GMO food products in the EC – Biotech (European Communities (2022a)) where the USA found issue with the EC's slow approval process and eventual moratorium on the approval of GMO products.

[24] Inman (2015).

and Theresa May coming into power in July 2016.[25] At this juncture, the discussion still focused on whether there would be a "soft Brexit" (the UK retains close ties to the European Union from a trade perspective) or a "hard Brexit" (the UK separates from the European Union in most ways, and from a trade perspective a free trade agreement is the likeliest solution). "Soft Brexit" was seen as more advantageous from a purely economic perspective, as it would have caused the least damage and impact economically, while "hard Brexit" was considered more favourable from a sovereignty perspective.[26] A fundamental issue here was that the Brexit referendum did not specify how Brexit should be handled, and thus, there was vigorous debate over which approach to Brexit would better represent the people's mandate to leave the European Union that was given to the United Kingdom's government. However, by the end of 2016, it seemed that "hard Brexit" was slowly emerging as the more viable option politically, partially due to sovereignty-prioritization being seen as more in the spirit of the voters' will.[27] This latter policy would calcify by January 2017, when Therese May officially announced in a speech that her government would aim for a "hard Brexit", and on the front of trade will attempt to negotiate a free trade agreement with the European Union on a sector-to-sector basis. During this time, she also set the free trade agreement's negotiation period to be two years, a very ambitious scheduling, as free trade agreements frequently take several years to negotiate.[28] At this stage, the UK government was clear in its intention to leave both the European Single Market and the customs union as well.

Over the course of January and February 2017 further preparations were made by the United Kingdom to prepare for

[25] McKenzie, McLaughlin (2016).
[26] The Economist (2018).
[27] Springford (2016) 1-2.
[28] Grant (2017e) 1-2.

the newly set goal of a "hard Brexit".[29] Then, at the end of March 2017, art. 50 was triggered, and the United Kingdom began the formal process of withdrawing from the European Union.[30] Shortly afterwards, there was a snap election in the UK. Though the election was not solely about how to handle Brexit, there was an implication that the results would either empower the sitting government to pursue its course of "hard Brexit" or it would do the opposite.[31] The results were not rosy for the reigning Conservative Party, and Theresa May lost her majority in the Parliament[32] (which later forced her to form a coalition with the North Irish DUP party in order to retain control)[33]. This created an expectation that perhaps a somewhat softer Brexit was still a possibility.[34] Amidst these circumstances did the formal exit negotiations begin in June 2017. During this period, much of the negotiations centred around resolving the Irish border question, a very thorny issue for both Ireland and the United Kingdom, and one that would be potentially jeopardized by Brexit.[35] By February 2018, an early Withdrawal Agreement draft was completed.[36] Further negotiations took place over the course of 2018, with the final version being published in November 2018, and it was shortly endorsed by the EU.[37] However, this agreement could not be agreed to by the UK, after Theresa May called for a vote on the agreement, which failed in January 2019, and then ended in a second failed vote in March.[38] This caused a complicated situation and severe political fallout, which ended up in the

[29] Grant (2017d) 2-18.
[30] BBC (2017a).
[31] Mackintosh (2017).
[32] BBC (2017b).
[33] Hunt (2017).
[34] Grant (2017c) *See also:* Grant (2017b) 1-5.
[35] Jenkins (2017).
[36] EC (2022d).
[37] Department for Exiting the European Union (2019).
[38] BBC (2019).

downfall of the May government and the ascension of Boris Johnson as the new Prime Minister in July 2019.[39]

By this point, the situation increasingly shifted towards the parties planning for a no-deal exit, as it seemed likely that the UK and the EU couldn't agree on trade issues on time, though it was not necessarily an inevitable outcome at this time.[40] Ultimately, Boris Johnson and the EU managed to reach a new Withdrawal Agreement by the end of 2019. This allowed the UK to complete Brexit and leave the EU.[41] However, this Withdrawal Agreement didn't cover trade issues, which were instead deferred to be resolved in the transitional period from January 2020 to December 2020, during which the UK remained in the European Single Market and in the customs union.[42]

At this point, it became clear that the "softer" trade deal was off the table, and it became a serious question if any deal at all could be negotiated at all between the parties. During this period, the so-called "Canada plus" emerged as the most desirable option for the UK, a version of CETA that was expanded to cover services as well.[43] However, achieving this goal seemed difficult given the year of mostly unsuccessful trade negotiations, which were further hampered by the COVID-19 pandemic.[44]

In general, negotiations about the EU-UK trade deal were mostly stuck on three different questions: fishing, level playing field, and governance/dispute resolution.[45] The first issue,

[39] Lyall, Castle (2019).
[40] Grant (2017a) 1-5.
[41] Department for Exiting the European Union (2019).
[42] Edington (2020).
[43] Jackson (2020).
[44] Casert, Lawless (2020).
[45] Brunsden, Foster (2020).

despite the comparatively small size of the fishing industry in relation to total UK GDP[46], was thorny and problematic for the UK, as one of the primary arguments of the Leave campaign was retrieving control over the British fishing industry.[47] As fish don't respect Exclusive Economic Zones (EEZs), it was necessary for EU Member States to collaborate with each other on fishing matters through the use of quotas and other measures. This system allows proportionate access to relevant fish stock for all affected Member States, and ensures that problems, such as one Member State deliberately overfishing, don't happen. However, this system can only work if all involved parties agree on it.[48] Moreover, if the UK would leave in a "no deal" scenario, the sea regions would suddenly find themselves in a relative state of chaos, as the local fishing industries would enter an uncertain situation. Hence, the necessity of figuring this out for both parties. Especially as the UK desired to regain control over its own fishing waters, while the EU was keen on EU fisheries retaining access to UK waters under the old system.[49]

The second issue that hampered negotiations was the question of level playing field. This essentially entailed both parties agreeing to follow a similar set of competition law, ensuring that they don't undercut each other's businesses by degrading environmental regulations or by utilizing excessive subsidies. This is considered an important facet of any free trade agreement, as such undercutting measures could easily result in unfair outcomes. However, the UK and the EU remained divided over the issue, as the latter would have preferred the UK to follow the EU's existing competition law standards and regulations, while from the United Kingdom's perspective, doing so would undermine one of the major positive aspects of

[46] Morris (2020).
[47] Morris (2020).
[48] Corbett (2020).
[49] Morris (2020).

Brexit (regaining control over competition law and business subsidization).[50]

The final major issue that the parties had trouble agreeing on was governance or dispute resolution. While a signed free trade agreement is well and good, there was the question of what happens if one side breaches it. This is another field where there seemed to be severe difference in opinion between the negotiating partners. In particular, the EU seemed to be focusing on establishing that the Commission should be able to unilaterally determine that the UK had breached the agreement and restrict single market access through retaliatory measures as most appropriate in the situation.[51]

In the end, a final agreement was reached at the end of December 2020 and was signed on December 30 of the same year.[52] This would be the EU-UK Trade and Cooperation Agreement.

5. The EU-UK Trade and Cooperation Agreement

Having examined the context surrounding its creation, we can now briefly summarize the contents of the Agreement. Naturally, it is not within the scope of this paper to provide a thorough overview of every single detail. Instead, we focus on two approaches. First, we discuss the general structure of the Agreement, as well as its scope. Second, we summarize the most important provisions and their overall "result" from an international trade perspective.

[50] Brunsden, Foster (2020).
[51] Morris (2020).
[52] Pub Affairs Bruxelles (2021).

First of all, the EU-UK Trade and Cooperation Agreement's structure can be divided into seven parts.[53] The first part concerns common and institutional provisions, the second includes trade, transport, fisheries and other arrangements, the third is about law enforcement and judicial cooperation in criminal matters, the fourth deals with thematic cooperation (on health and cyber security), the fifth handles the issues of participation in union programmes, sound financial management and financial provisions, the sixth consists of dispute settlement and horizontal provisions, and the seventh part covers final provisions. This is further accompanied by dozens of annexes. For the purposes of this paper, we only discuss the second part in detail.

This second part is further subdivided into six headings: trade, aviation, road transport, social security coordination and visas for short-term visits, fisheries, and other provisions. The trade heading is the most important for us here. This heading is also subdivided into titles: trade in goods, services and investment, digital trade, intellectual property, public procurement, small and medium-sized enterprises, energy, transparency, good regulatory practices and regulatory cooperation, level playing field for open and fair competition and sustainable development and exceptions. The titles themselves are further subdivided into chapters and sections, but we do not cover these in too much detail here. We can already ascertain from the discussed information that the free trade agreement, as part of the EU-UK Trade and Cooperation Agreement, is quite extensive in its scope. There are specific rules in place for all the major categories of trade and trade-related questions. The trade in goods title engages with the common international trade questions of national treatment, market access, rules of origin, technical barriers, customs, sanitary and phytosanitary

[53] The Trade and Cooperation Agreement (2021).

measures, etc. Likewise, the trade in services and investment title is also rather broad in scope. It dedicates separate portions of the Agreement to investment liberalization and cross-border trade in services, as well as including specific sections for delivery, telecommunications, financial and legal services, among others. The title concerning digital trade is fortuitous, evidencing the modernity of the Agreement in general. And for the other titles, we can perhaps highlight intellectual property, energy and the level playing field title for being particularly extensive. In all of these, the Agreement seems to cover all notable topics without fail, including topics such as patents, electricity and gas and environmental standards, just to name a few. In conclusion, we can state that the scope of the Agreement is rather extensive from an international trade perspective.

We have seen the structure and scope of the agreement, at least in relation to trade. So, the question arises, what did this new Agreement exactly accomplish in this field? The previous parts of this paper detailed the nuances of international trade with relation to Brexit, and what sort of severe issues the UK's exit from the EU caused. Does this Agreement address those issues (or at least the trade-related ones)? The answer to that seems to be at least partially yes. The Agreement does establish zero tariffs and zero quotas on goods (that comply with appropriate rules of origin), and this notably includes even traditionally contentious categories of goods (when it comes to free trade negotiations), such as farming goods. However, we must also note that this does not imply that the free trade agreement essentially allows for the same degree of free trade between the UK and the EU as it was before the Brexit. The rules of origin provisions of the agreement are extremely detailed (especially if one also considers the annexes), and while we can notice some leeway in certain aspects (such as the wide range of goods, as previously noted), some sectors still face much stricter rules than previously. These can include rules regarding a minimum

percent of added value that is either British or European, or mandating that certain materials or components of the good must be EU or British in origin, before a tariff exemption can be granted.[54] In case of goods that went through a complicated value chain, complying with the Agreement's rules could naturally pose severe issues for British enterprises, especially smaller ones.

By contrast, the services part of the agreement likewise appears somewhat limited, even considering the broad range of questions covered by the agreement that we previously mentioned. While they do provide a degree of liberalization, they arguably seem to provide less freedom compared to the pre-Brexit status of UK service providers.[55]

Given the issues surrounding the question of fishing, perhaps it would be also prudent to briefly dwell on the question of fisheries, which as previously noted, was also covered by the Agreement, though in a separate heading from trade proper. In this case, it seems the final resolution agreed upon by the UK and the EU was annual consultations, determining exact fishing opportunities and water access on a yearly basis.[56] This could be considered a compromise solution between the two extremes mentioned earlier.

As for the other two "hot topics" we mentioned in the previous part, level playing field seemed to have been worked out in the Agreement as a sort of bilateral procedure to asses any potential divergence from EU norms, with the possibility of arbitration if no agreement is forthcoming.[57] As for dispute resolution, the Agreement came to contain a general dispute resolution

[54] The Trade and Cooperation Agreement (2021) Annex 3.
[55] The Trade and Cooperation Agreement (2021) Heading One, Title II.
[56] The Trade and Cooperation Agreement (2021) art. 498, art. 500.
[57] The Trade and Cooperation Agreement (2021) Heading One, Title XI.

mechanism, with the potential for binding external arbitration if the parties can't come to terms.[58]

In conclusion, we can assess the Agreement as having averted the worst potential outcomes of Brexit. However, it still cannot be truly called as having been without economic cost, and the business conditions are noticeably less favourable under the Agreement than they were while the UK was still part of the EU.

6. Conclusions

As we had seen from the findings of this paper, the Agreement was a definite step down from the earlier state of affairs from an international trade perspective. However, we can also confidently state that it was a superior solution to return to just utilizing WTO rules on trade.

Since the Agreement was signed and became applicable more than a year has passed. The question arises whether it has fulfilled its promises or not. So far, it seems that the Agreement has somewhat stabilized the trading between the UK and the EU, however, it still caused a decline in certain sectors (which was perhaps unavoidable)[59], and it failed to prevent a number of trade disputes between the UK and the EU that had arisen since the signing of the Agreement. This includes the WTO dispute over the UK's Contracts for Difference (CfD) scheme, which erupted in March 2022. This scheme was the UK's main mechanism for supporting low-carbon electricity generation.[60] Another example is the dispute over the Norther Ireland Protocol deal, which allowed for Northern Ireland to stay part of the EU single market in practice, as opposed to the rest of the

[58] The Trade and Cooperation Agreement (2021) Part Six.
[59] O'Carroll (2022).
[60] EC (2022a).

UK. The dispute was caused by the UK attempting to introduce a new bill that would unilaterally alter the Protocol, by allowing goods to enter Northern Ireland under either UK or EU rules.[61]

These examples show that the Agreement and related deals are far from perfect, and the complex relationship the UK had with the EU before Brexit was not easily untangled by the UK's exit and the Agreement. As previously stated, it can still be considered an adequate solution to Brexit, but it is far from perfect. In our opinion there will be further debates and disputes in the future, as both sides, especially the UK, will likely push for more favourable terms than what currently exists. Furthermore, we can state that some more time is needed before we can evaluate conclusively the long-term effect of the Agreement.

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Problems related to jurisdiction in ICSID arbitration

Abstract: Problems related to ICSID jurisdiction are extremely relevant, and the mistakes made during the drafting of an arbitration clause may exclude the competence of the Centre. When drafting a document that designates ICSID as a forum for resolving emerging disputes, it is necessary to carefully check the compliance of the document with the requirements of the Convention and international law. Deviation from the ICSID jurisdiction criteria may result in the State hosting the investment pleading that the Centre lacks jurisdiction. This article will examine in detail issues related to ICSID jurisdiction when considering investment disputes, as well as how non-compliance with the conditions of jurisdiction may affect the exercise of the right to investment protection under ICSID.

Keywords: ICSID, jurisdiction, investment, arbitration

1. Introduction

In accordance with the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington Convention of 1965), the International Centre for the Settlement of Investment Disputes (ICSID) was established in 1966. ICSID is the dispute resolution arm of the World Bank Group that provides "*facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of this Convention*".[1] ICSID arbitration is regularly used to resolve

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[1] ICSID Convention (1966) art. 1 para. 2.

investment disputes and is administered by the International Centre for the Settlement of Investment Disputes, which has become a household name in the past few decades. Unlike other arbitral institutions, ICSID plays a role only in investment arbitration disputes. The ICSID system is the only institutional system of international arbitration specifically designed to resolve investment disputes.

Although ICSID has become the main forum for settling investment disputes, it is not the only institution for investment arbitration and not all States have become party to the ICSID Convention.[2] In accordance with arts. 53 and 54 of the Convention, the decision of the ICSID Tribunal is binding on all parties to the proceedings, and each party must comply with it in accordance with its terms. The Convention limits the role of national courts to the recognition and enforcement of these awards. National courts of each State Party to the ICSID Convention are required to enforce the pecuniary obligations imposed by the ICSID decision as if it were the State Party's final judgment. ICSID decisions are a type of public law decisions. In fact, ICSID decisions awarded by tribunals acting under an international treaty are not subject to any domestic law. This distinguishes ICSID proceedings (and decisions) from other investment dispute proceedings, whether *ad hoc*, under the UNCITRAL Rules or the rules of arbitration institutions.[3]

In order to refer a dispute to ICSID for consideration, it is necessary to fulfill certain conditions that ensure the emergence of the Centre's jurisdiction. Firstly, an agreement of the parties is necessary on the submission of the dispute that has arisen for consideration by the ICSID. This can be an individual investment agreement, a bilateral or multilateral investment agreement (however, domestic legislation of the host State, in

[2] Billiet (2016) 250.
[3] Krajewski (2019) 225.

which the State accepts ICSID's jurisdiction is also accepted instead of such agreement). Such an agreement may be concluded not only in relation to disputes that may arise in the future, but also in relation to a dispute that has already arisen. At the same time, the parties to the agreement must be a contracting State and a natural or legal person of another contracting State. The final criterion for submitting a dispute to ICSID is the fact that the dispute must be of a legal nature and arise from investment relations with a foreign element.[4]

Paragraph 1 of art. 25 of the Washington Convention establishes the jurisdiction of ICSID:

> The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

Thus, before including in the text of an international agreement an arbitration clause on the submission of a dispute to ICSID, the parties must verify not only the validity of the arbitration clause itself, but also that the agreement and the potential dispute meet all the criteria for the emergence of the jurisdiction of the Centre. At the same time, the parties must understand that these criteria cannot be changed or excluded by adding a certain clause to the contract, since the criteria specified in the convention are mandatory. It should be noted that in the absence of one or more of the conditions specified in the Convention, the ICSID Secretariat is obliged to refuse to consider the dispute between the parties, even if the parties have identified ICSID as

[4] Абашидзе (2012) 180.

the institution to which they submit disputes arising between them for consideration. According to art. 41 of the Washington Convention:

> The Tribunal shall be the judge of its own competence. Any objection by a party to the dispute that that dispute is not within the jurisdiction of the Centre, or for other reasons is not within the competence of the Tribunal, shall be considered by the Tribunal which shall determine whether to deal with it as a preliminary question or to join it to the merits of the dispute.

2. Subject jurisdiction (*ratione materiae*)

Ratione materiae of ICSID are disputes that are, firstly, of a legal nature and, secondly, are directly related to investments. It should be noted that fixing the legal nature of the dispute aims to exclude political and moral disagreements, while requiring that the dispute is related to investments, excludes disputes of a commercial nature from the competence of the Centre. At the same time, the 1965 Washington Convention itself does not contain a definition of the "legal nature" of a dispute, and the practice of interpreting the legal nature of a dispute by ICSID arbitration mainly refers to the existence and limits of certain rights and obligations of the parties or the possibility of compensation if the parties violate certain legal obligations.[5] Due to the fact that it is not possible to foresee all potential disputes that may arise during an investment relationship, the criterion of the "legal nature" of the dispute is an extremely important condition. This element should be taken into account when drafting the arbitration clause, in which it is necessary to formulate the conditions for applying to ICSID as broadly as possible.

[5] Schreuer (2001) 103–104.

It should be noted that, despite the absence of a definition of "legal dispute" in the final version of the Convention, the text of the original draft qualified this term as: "*any dispute concerning a legal right or obligation or concerning a fact relevant to the determination of a legal right or obligation*".[6] At the same time, most of the doctrinaires and practitioners who commented on the convention defined the concept of a legal dispute based on a list of actual situations and issues that they may entail. The most common include expropriation, violation or termination of an agreement, application of tax or customs rules. According to the opinion of Schreuer, despite its practical value, such an approach to the definition of a "legal dispute" does not provide a clear explanation of the very essence of this term. According to Schreuer, a dispute can be qualified as legal when one of the parties resorts to such legal remedies as damages or restitution, and the legal rights and obligations of the parties are based on the rules of law applicable to the dispute.[7] Despite certain difficulties arising from the absence of this concept in the text of the Convention, the text provides for another mechanism to determine the nature of legal relations from which a dispute may arise. According to art. 25 para. 4 of the Convention, any Contracting State may, at the time of ratification, acceptance or approval of Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre.[8]

The second element of the subject matter jurisdiction of ICSID is the direct connection with investments, that is, relations arising from investment agreements ("*any legal dispute arising directly out of investment*"). It should be noted that in the text of the Convention there is no definition of the concept of

[6] ICSID (1970) 116.
[7] Schreuer (2001) 105.
[8] ICSID Convention (1965) art. 25 para. 4.

"investment", which leads to certain difficulties in interpreting and identifying the nature of legal relations from which a dispute may arise.[9] According to the preliminary text of the Convention, "investment" was understood as "*any contribution of money or other asset of economic value for an indefinite period or, if the period be defined, for not less than five years*".[10] However, in the final version of the Convention, the drafters did not include this definition in the text, due to the fact that the inclusion of a provision defining the concept of "investment" could affect the role assigned to the concept of mutual consent and could raise controversies.[11] In this regard, the final version of the text of the Convention focuses on the mutual agreement of the parties to refer the dispute to ICSID.

Although the final text of the convention abandoned the qualification of the term "investment", States are free to determine which categories of disputes are not subject to the jurisdiction of the Centre. According to para. 4 of art. 25 of the Washington Convention, any Contracting State may, at the time of ratification, accession or approval of the Convention, and at any time thereafter, notify ICSID of the category or categories of disputes that fall or do not fall under the jurisdiction of ICSID. At the same time, it should be taken into account that it only allows States to determine the categories of disputes related to investment activities for which they (at their discretion) are willing to give their consent to submit to ICSID. It should be noted that the burden of proving the fact of the presence of investments and the fact that the dispute arose as a result of investment activities lies with the party applying to ICSID. This is due to the fact that the parties themselves have the right to designate the criteria that, in their opinion, determine the concept of investment, and if the arbitral tribunal finds these

[9] ICSID (1970) 123.
[10] ICSID (1970) 116.
[11] ICSID (1968) 564.

criteria convincing, it will establish its jurisdiction to consider the dispute.

Over the years of the Centre's activity, through arbitration practice, a certain number of criteria have been established to distinguish investments from the circle of foreign economic operations and transactions taking place in the international community. In most cases, for a project or transaction to be recognized as an investment, it must: "1) be of significant duration; 2) to give the investor a guarantee of a commensurate return on invested funds; 3) include an element of risk for both parties; 4) constitute a significant involvement of an investor in a project or transaction; 5) be of great importance for the development of the host state".[12]

Despite the extensive practice of the Centre, the problem of the lack of consolidation of the concept of investment and the lack of a unified approach in the consideration of cases remains relevant. An analysis of ICSID decisions made during this study shows that arbitrators tend to use the concept of "investment" in the sense of the definition enshrined in the national legislation of the host State or in bilateral (or multilateral) agreements on the protection of investments. At the same time, the position of Schreuer is of interest, who, in a commentary to the Convention, also proposed to qualify investments in accordance with such criteria as a certain period, regularity of profit, the presence of risk, the materiality of the obligation and the importance for the development of the State that hosts the investment.[13]

It should be noted that not all countries have taken advantage of the right granted by para. 4 of art. 25 of the Convention, which allows reservations to be made about the category or categories of disputes that fall or do not fall under the jurisdiction of

[12] *Salini Costruttori S. P. A.* (2001).
[13] Schreuer (2001) 140.

ICSID.[14]For example, Indonesia excluded from ICSID jurisdiction disputes related to administrative decisions of Indonesian government bodies; Saudi Arabia has ruled out disputes related to oil and acts of sovereignty. At the same time, China excluded disputes related to the payment of compensation for expropriation and nationalization; Jamaica disputes concerning mineral and other natural resources; Papua New Guinea limited the competence of the Centre to disputes material to the investment itself; Guatemala has excluded disputes arising from compensation for damages due to armed conflict or civil strife. Turkey also limited the jurisdiction of ICSID to disputes directly arising from investment activities carried out in accordance with permits under Turkish Foreign capital law, and excluded disputes related to ownership and other rights *in rem* to real estate, due to the reason that they are subject to the exclusive jurisdiction of Turkish courts.[15]

As noted earlier, initially the concept of "investment" in the doctrine of international law included a combination of such components as: a contribution, a certain period of execution of an investment agreement (or investment activity in another form) and the assumption of risks under an investment agreement. This interpretation excluded from the jurisdiction of ICSID disputes that may arise under a supply agreement or a bank guarantee, which was confirmed by the decision in the case of *Joy Mining Machinery Ltd. v. Arab Republic of Egypt*.[16] At the same time, the importance of meeting the investment, duration and risk triad as the minimum requirement for holding an investment was further highlighted in *Nova Scotia Power Incorporated v. Bolivian Republic of Venezuela*[17]. In this case, the arbitral tribunal upheld the defendant's objections regarding

[14] ICSID Convention (1966) art. 25 para. 4.
[15] ICSID/8-D (2020).
[16] *Joy Mining Machinery Ltd.* (2004).
[17] *Nova Scotia Power Incorporated* (2014).

the competence of the ICSID to adjudicate a dispute that arose essentially from a coal sale and purchase relationship, despite its more complex nature and composition, due to the absence of the three minimum requirements.

It should be noted that the first arbitral award to apply these criteria was in the case of *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*[18], which was subsequently called the "Salini test".[19] In this case, the arbitral tribunal was faced with the question of whether the implementation of a socially important project - the construction of a highway - is considered an investment. Answering this question, the arbitration added to the list of investment criteria the case of contribution to the economic development of the recipient State. Despite the fact that the Salini test was widely used and was applied in many disputes, some arbitrators considered such use unjustified, since these criteria are doctrinal and not fixed at the level of international law. The absence of a normative consolidation of the criteria shows that they do not have the effect of an imperative prescription, which is necessary for the emergence of ICSID jurisdiction. One example of arbitrators refusing the Salini test would be the case of *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*.[20] The arbitral tribunal held that, given that the contracting parties have expressly abandoned the notion of "investment" in the Washington Convention, there is no justification for the mechanical application of the five criteria

[18] *Salini Costruttori S. P. A.* (2001).

[19] The Salini test is used to determine the existence of an investment and, accordingly, the investor's right to require the host state to fulfill obligations to protect such an investment. According to its criteria, the investment must represent the contribution of the investor, which is carried out over a significant period of time, with a balance of risks of the state and the investor, taking into account the presence of contributions to the economy of the host state.

[20] *Biwater Gauff (Tanzania) Ltd.* (2006).

of the Salini test in each particular case, since these criteria are not fixed or legally binding and may be subject to agreement between the contracting States. At the same time, it was concluded that this test cannot act as a strict criterion for investments, since there is no normative fixing of it, and careless use of the test may unreasonably exclude certain categories of transactions from the jurisdiction of ICSID. Based on these factors, the arbitration leaned towards a more balanced approach with regard to "investment", noting the need for an analysis of the actual circumstances of the case and the consent of the State to apply to ICSID. A more flexible approach to the Salini test was enshrined in the *Phoenix Action, Ltd. v. Czech Republic*[21] decision, where the tribunal added an additional criterion to the test in the form of the need to meet the *bona fide* criterion (assets are invested in good faith). In this case, ICSID argued that there was no *ratione materiae* jurisdiction because the investment did not meet the *bona fide* principle.

3. Personal jurisdiction (*ratione personae*)

As noted earlier, the State parties to the Washington Convention (or an authorized body about which the States informed the Centre) and a legal entity or individual of another State party to the Washington Convention can act as parties to an investment dispute. In accordance with paragraph 2 of Art. 25 of the Washington Convention, the term "National of another Contracting State" means:

> (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does

[21] *Phoenix Action, Ltd.* (2009).

> not include any person who on either date also had the nationality of the Contracting State party to the dispute; and (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

As a general rule, nationality is the determining factor in assessing the status of an individual. When analysing the text of the Convention, it can be concluded that an individual can act as a party to a dispute before ICSID in the case he has the nationality of a country party to the Convention when the dispute arises. For example, a Turkish national can file a claim with ICSID on the basis of a dispute that has arisen in relation to investments made in the territory of Moldova. At the same time, ICSID will not have jurisdiction if a Turkish national acquires Moldovan nationality before the commencement of the dispute. Therefore, the presence of dual nationality of the investor, if such nationality is obtained in the country of investment, deprives the Centre of jurisdiction, even if the country accepting the investment agrees to consider the person a foreign national.

At the same time, the determination of the nationality of a legal entity is a more complex procedure. When analysing the practice of ICSID, it can be concluded that arbitrators tend to be of the opinion that a legal entity, at the time of reaching a mutual agreement to submit a dispute to ICSID, must have the nationality of a contracting State that is different from the contracting State receiving the investment (host country). Where a legal entity does not have such a nationality, the parties

may agree that, by virtue of the control exercised by foreign persons over such legal entity, it may be considered as a person of another Contracting State for the purposes of the Convention. Subject to such an agreement, ICSID will have jurisdiction in the event of a dispute. An example would be a situation where a legal entity is established under the law of the host country, but the parties have agreed to treat it as a party to another contracting State under the Convention, provided there is a full control over such legal entity by persons of investors State.

It should be noted that the text of the Convention does not contain a definition of the "nationality" of a person and "foreign control", and the evaluation criteria were developed in the ICSID arbitration practice itself. One example of developing parameters for assessing "foreign control" is the decision of the Centre in the case of *Amco v. Indonesia*, where the plaintiff was an American corporation that established PT Amco in Indonesia for the purpose of making investments. Upon incorporation in Indonesia, Amco applied to the Indonesian Foreign Investment Authority to obtain permission to incorporate PT Amco as an Indonesian company to build and operate a hotel in Indonesia. At the time of the dispute, Indonesia referred to the fact that, despite the full control of the American corporation over PT Amco, the parties had not agreed to recognize PT Amco as a legal entity of another State within the meaning of the Convention. Despite the lack of express agreement, the arbitral tribunal ruled that:

> It thus appears obvious that when agreeing to the Application, the Indonesian Government knew perfectly that PT Amco would be under foreign control. Knowing this expressly stated fact, the Government has agreed to the Application and to the arbitration clause in it: therefore, it is crystal clear that it agreed to treat PT Amco as a national

> of another Contracting State, for the purpose of the Convention.[22]

At the same time, the requirement for a Contracting State to recognize the investor's foreign nationality as a condition for establishing ICSID jurisdiction was emphasized in *Tokios Tokeles v. Ukraine*[23] decision on jurisdiction dated April 2004. In this case, the arbitral tribunal emphasized that, in conditions where the Convention does not provide for a method for determining the nationality of an investor, the parties have the widest possible margin of appreciation regarding the criterion for determining the nationality of an investor and the form of such an expression of will.

The nationality of a legal entity can be determined based on the principle of incorporation, the principle of seat or the principle of the centre of exploitation, or through the application of the principle of control. It should be noted that when establishing a company based on the law of the host State, the mere consent of the recipient State to refer the dispute to ICSID might not be enough. Under the Convention, it is necessary to conclude a special agreement between the legal entity of the host State, controlled by a foreign investor, and the recipient State, which will indicate the recognition of foreign nationality.[24] Such an agreement was entered into by the parties in the case of *SOABI v. State of Senegal*[25], where the Centre accepted its jurisdiction. The dispute arose between Senegal and a Senegalese company owned by a Panamanian joint venture, which in turn was owned by Belgian investors, despite the fact that Panama was not a State party to the Washington Convention, unlike Belgium. The investment agreement on the basis of which the dispute arose

[22] *Amco Asia Corp.* (1983).
[23] *Tokios Tokeles* (2004).
[24] Бабкина (2016) 67.
[25] *Société Ouest Africaine des Bétons Industriels (SOABI)* (1988).

included a provision according to which, the parties expressly agreed that arbitration will be carried out in accordance with the rules established by the Convention for the Settlement of Disputes between States and Nationals of Other States, developed by the International Bank for Reconstruction and Development. In this regard, the Government of the host State agreed to recognize the nationality of the investor as being in conformity with art. 25 of the Convention, specifically:

> any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

At the same time, in the case of *LETKO v. Liberia*, an agreement was concluded between the Liberian government and the claimant, a Liberian company, under the full control of French persons, for the implementation of investment activities, but there was no express agreement between the parties regarding the criteria for determining the nationality of LETKO. However, ICSID noted that a Contracting State, by signing an investment agreement containing an arbitration clause with a person wholly controlled by foreign persons, has agreed to submit the case to ICSID for arbitration in accordance with the Convention containing a provision regarding the determination of the nationality of a company through persons exercising control over such company.[26] An additional factor in favor of the recognition of the foreign nationality of the investor was the provision of Liberian legislation, according to which foreign

[26] *Liberian Eastern Timber Corporation (LETCO)* (1986).

investors are required to establish local companies in order to carry out investment activities.

Also, ICSID case law shows that the agreement of the parties prevails over the principle of control used in the practice of private international law. For example, in the case of *Autopista Concesionaria de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, the main shareholder of a Venezuelan company, at the time of the signing of the contract, was a citizen of Mexico, which was not a party to the Convention. The arbitration clause in the concession agreement concluded between the parties provided for *ad hoc* arbitration in Venezuela, referring at the same time to the fact that if the main shareholder of the company acquires the nationality of a Contracting State, the dispute will be referred to the ICSID. After the signing of the agreement, 75% of the company's shares were transferred to an American company. When considering the case, Venezuela referred to the lack of ICSID jurisdiction, since after the transfer of shares to an USA person, effective control continued to be exercised by a Mexican person. In turn, ICSID rejected the arguments of Venezuela, and noted that:

> The Tribunal has found no element allowing it to find that, by the words the "majority shareholder(s) of THE CONCESSIONAIRE", the parties did not mean the person holding the majority shares, but rather the person exercising effective control over Aucoven. In other words, there is no indication on record that the parties intended to exclude share transfers among ICA Holding's subsidiaries and meant to condition their agreement upon a change of effective or ultimate control over Aucoven.[27]

At the same time, the criteria for the presence of foreign control include the size of the share, the degree of influence in decision-

[27] *Autopista Concesionaria de Venezuela, C.A.* (2001).

making and the management of the company's activities.[28] It should be noted that these criteria are considered in each individual case after assessing the actual circumstances of the case. For example, in *Vacuum Salt v. Ghana*[29], it was stated that the Centre did not have jurisdiction, despite the fact that the bilateral investment agreement contained an arbitration clause with the competence of ICSID. In this case, the arbitration did not recognize the investor as a foreign national, due to the fact that only 20% of the shares belonged to Greek persons, and the remaining 80% belonged to citizens of Ghana. An additional factor in the lack of competence, the Centre considered the lack of an agreement between the parties that would determine the nationality of Vacuum Salt. At the same time, the fact that Greek citizens held the positions of directors and technical adviser, which, according to ICSID, did not meet the objective criteria for control over the legal entity, and the role of a Greek shareholder in controlling a company is not so significant that the company could be considered a foreign entity. Accordingly, the dispute was not considered to be in accordance with the Convention in the framework of ICSID arbitration.[30]

The other party to an investment dispute may be a State that is a party to the Washington Convention. In most cases, authorized State bodies act on behalf of the State, however, the Convention does not indicate specific authorized bodies (divisions or institutions) of the State, which gives the State a wide margin of appreciation. In this matter, the main role is played not by the institutional aspect (organizational and legal form, form of ownership, State share in the authorized capital of a legal entity), but by the functional one - the organization

[28] Богуславский (2004) 148.
[29] *Vacuum Salt Products Ltd.* (1994).
[30] *Vacuum Salt Products Ltd.* (1994).

must perform public functions on behalf of the State party to the Washington Convention.[31]

An important issue is whether the constituent subdivision or agency of a Contracting State is considered a party to a treaty under the Washington Convention. In accordance with the Convention, a constituent subdivision or agency of a Contracting State may act as a party to an investment agreement subject to two conditions:
(1) the contracting State has authorized the constituent subdivision or agency to be a party to the investment agreement and to submit disputes for settlement to ICSID with the appropriate consent and in accordance with para. 1 of art. 25 of the Convention;
(2) the host State has agreed to refer the dispute to ICSID, where the party is constituent subdivision or agency of this State, (unless it notifies ICSID that such consent is not required in accordance with paragraph 3 of Art. 25 of the Convention).

Thus, on the basis of paragraph 1 of Art. 25 the host State may make a reservation for all disputes that involve a subdivision or body of that State in respect of certain investment projects or a certain dispute that has arisen. According to the provisions, paragraph 3 of Art. 25 of the Convention, the State can also notify ICSID of relinquishing its authority to approve certain categories of transactions, and territorial-administrative units and State bodies can on their own behalf enter into agreements with investors and refer emerging disputes to ICSID. In the event that a State has notified ICSID of its authorized body, its authority to participate in the dispute on behalf of the State is presumed. At the same time, the lack of notification of authorized bodies entails the lack of jurisdiction of the Centre. Given the absence in the text of the Convention of a clear time

[31] Schreuer (2001) 151.

at which a State must notify ICSID of its authorized bodies, as a general rule, such notification can be sent at any time before filing a dispute with ICSID.

A party to a dispute may also be an administrative-territorial unit of a State, as in the case of *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A v. Argentine Republic*[32], where a lawsuit was brought against Argentina in connection with the violation by officials of the concession agreement concluded between investors and the province of Tucuman of the Argentine Republic.

It should be noted that even when the host State delegates its powers regarding the jurisdiction of ICSID and approves both the investment agreement and the consent to arbitration, which is enshrined in the arbitration clause, the investor cannot initiate arbitration proceedings against this State before ICSID, even if the State itself has actively accepted participation in the negotiations on the investment project and its actions led to a controversial situation. The investor must enter into an ICSID referral agreement directly with the State itself in order to refer the case to the Centre and initiate arbitration proceedings against the State. For example, in *Cable Television v. Saint Kitts and Nevis*[33], an investor entered into an agreement with the administration of Nevis, which is an administrative-territorial unit of the federal State of Saint Kitts and Nevis. According to the agreement, the arbitration clause referred to ICSID as a mechanism for resolving possible disputes. However, Nevis has not been authorized by the government of Saint Kitts and Nevis as a body that can appear before ICSID in disputes. At the same time, the government did not approve the arbitration clause contained in the agreement, therefore the Centre did not recognize its jurisdiction.

[32] *Suez, Sociedad General de Aguas de Barcelona S.A.* (2006).
[33] *Cable Television of Nevis, Ltd.* (1996).

In this regard, when concluding an investment agreement with an administrative-territorial unit or body of a contracting State that contains a reference to ICSID, it is necessary to carefully analyse the arbitration clause for its validity under the jurisdiction of ICSID. Based on this, it is necessary to include in the arbitration clause with reference to ICSID: (1) the exact name of the relevant body or territorial-administrative unit; (2) details of the contracting State's vesting in that unit with the authority to refer disputes to ICSID; (3) an instrument by which a contracting State gives its consent to the conclusion of investment agreements by subdivisions that include an ICSID arbitration clause, or where the consent of the State to such actions of its subdivision, addressed directly to ICSID, would be indicated.

Despite the general difficulties in not meeting the criterion *ratione personae*, it does not necessarily entail the inability to apply to ICSID to resolve the dispute between the investor and the State. ICSID adopted the Additional Facility Rules in 1978, allowing in the case where one of the parties is a State not party to the Washington Convention, or the investor has the citizenship of such a State, to apply to the Centre. At the same time, thanks to these Rules, it became possible to resolve disputes that are not directly related to investments. When considering a dispute under the Additional Facility Rules[34], the direct enforceability rule of the Washington Convention does not apply; the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 shall apply to the enforcement of the award.

4. The presence of the written consent of the State

[34] ICSID Additional Facility Rules (April 2006).

One of the main requirements of having ICSID arbitration is the consent of the parties, which must be in writing. In the report on the adoption of the Convention, the Board of Directors of the World Bank noted that "*The most important feature was that the jurisdiction of the Centre was based on the consent of the parties*".[35]

While investors generally agree to refer to the Centre for all categories of disputes, States may consent to such referral for a specific dispute that has arisen or for specific categories of disputes. It should be noted that being party to the Convention is not the same as a consent, since consent must be further enshrined in an additional instrument. Such an additional tool can be either an arbitration clause in an investment agreement or contract, or a bilateral (or multilateral) investment treaty, or an indication of the acceptance of the jurisdiction of ICSID in the national legislation of the State.

At the same time, according to Art. 26 of the Convention, the consent of the parties is absolute: "*Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy*".[36] Such consolidation in the Convention indicates that the parties are obliged to address the dispute to the Centre, unless otherwise provided by the agreement. This limitation in practice extends to the prohibition of applying to local or international bodies to resolve a dispute.

An additional issue regarding the jurisdiction of the Centre is the situation when, due to certain economic difficulties, the investor transfers part of his rights, for example, the right to apply to ICSID, to another person. Due to the fact that investment relations are distinguished by their long-term nature,

[35] ICSID (1968) 320.
[36] ICSID Convention (1966) art. 26.

at some point the investor may transfer all or part of his rights and obligations to another person. In the event of such a succession, the parties must provide in advance in their agreement a provision that will govern the relationship of the parties upon transfer. At the same time, the assignee must meet all the requirements of the Convention necessary to establish the jurisdiction of the Centre, in particular in matters of nationality. With that, the host State may challenge the jurisdiction of ICSID if the assignee is not a party to the arbitration agreement.[37]

In general, the consent of the State to the jurisdiction of the Centre can be expressed in various forms:

(1) Bilateral investment agreement (BIT) - for example, in accordance with paragraph 3 of Art. 10 of the Agreement concluded between the Government of the Republic of Moldova and the Government of the Republic of Turkey on the promotion and mutual protection of investments dated December 16, 2016 states:

> If disputes cannot be resolved within six (6) months, disputes may be referred, at the option of the investor, to:
> a) the competent commission of the Contracting Party in whose property the investment was made; or
> b) International Centre for the Settlement of Investment Disputes (ICSID), established by the "Convention for the Settlement of Investment Disputes between States and Nationals of Other States", signed on March 18, 1965 in Washington;
> c) ad hoc arbitral tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL); or
> d) Council of the Arbitration Institute of the Stockholm Chamber of Commerce (CCI);

[37] Козменко (2011) 57.

e) any other arbitral institution or any other arbitration rules, if the parties to the dispute so agree.

According to the ICSID Annual Report for 2022, in cases registered this year, the competence of the Centre was determined by bilateral investment agreements in 56% of cases.[38]

(2) Multilateral investment agreements and free trade agreements - such international treaties are, as a rule, regional in nature, for example, the Energy Charter Treaty, the North American Free Trade Agreement (replaced by the U.S.-Mexico-Canada Agreement (USMCA)). According to the ICSID Annual Report for 2022, the competence of the Centre was determined by international investment agreements and free trade agreements in 27% of cases.

(3) Investment (concession) agreement. The second most commonly used for securing the jurisdiction of ICSID is a consent in the arbitration clause contained in the investment agreement concluded between the investor and the host State. According to the ICSID Annual Activity Report for 2022, the competence of the Centre was determined by investment agreements in 13% of cases. It should be noted that the inclusion of the jurisdiction of the Centre in the investment agreement allows minimizing the issue of determining the competence of the ICSID to consider the dispute and does not require the study of the problem of the umbrella clause.

(4) investment legislation of the host State - this form of expressing the consent of the State to refer the dispute to the Centre took place in only 4% of cases registered in 2022.[39]

[38] ICSID (2022) 23.
[39] ICSID (2022) 23.

Based on the latest ICSID annual report, it can be concluded that the inclusion of a provision on the jurisdiction of the Centre in a bilateral investment agreement is the most common form of expressing consent. At the same time, the issue of what to consider as reached agreement was considered by the Centre in *Tradex Hellas S. A. v. Republic of Albania*[40], in which the Albanian government referred to the absence of a written agreement between the parties to refer the dispute to ICSID. The panel of arbitrators came to the conclusion that the Convention does not require the consent of the parties to be expressed in a separate document, and the inclusion in the text a reference to an international treaty or an act of national legislation of a provision on the competence of ICSID indicates the consent of the State to refer possible disputes to the Centre for consideration. Despite this, the jurisdiction was rejected, due to the fact that the appeal to the Centre was received before the entry into force of the bilateral international treaty between Greece and Albania on the promotion and mutual protection of investments.[41]

Indeed, there are no specific requirements in the Convention for the form of consent other than written form. At the same time, there is also the possibility of limiting the jurisdiction of ICSID in accordance with paragraph 4 of Art. 25, stating that "*any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre*".[42] However, one of the main safeguards in this regard is the impossibility of withdrawing consent to ICSID jurisdiction. For example, in *Kaiser Bauxite v. Jamaica*, the parties entered into an investment agreement that contained an

[40] *Tradex Hellas S. A.* (1996).
[41] Литовченко (2016) 99-103.
[42] ICSID Convention (1966) art. 25, para. 4.

arbitration clause to refer disputes related to bauxite mines in Jamaica to ICSID. Following the signing of the agreement, Jamaica sent a notice to the Centre stating that it did not accept ICSID jurisdiction over disputes arising from investments related to mineral resources and minerals. After the dispute arose, Jamaica referred to that notice when the jurisdiction of the Centre was considered, however, the arbitral tribunal indicated that the application was made after an agreement was reached between the parties to refer the dispute to ICSID, and Jamaica's notice can only apply to disputes, arising in the future and cannot be retroactive.[43] At the same time, the absolute nature of consent is enshrined in Art. 26 of the Convention as it was mentioned *supra*.

It should be noted that consent can also be conditional, for example, in the case when the parties to the investment agreement, which are not subject to the jurisdiction of ICSID, stipulate in the agreement the transfer of dispute to ICSID if in the future the relationship between them develops in a certain way or the status of the parties changes, which will allow them to submit the dispute to ICSID for consideration. For example, in the case of *Holiday Inns v. Morocco*, the jurisdiction of the Centre was established despite the fact that the agreement was concluded before the ratification of the Convention by one of the parties. In this case, the arbitrators referred to the fact that the Convention allows the parties to enter into an arbitration agreement that will enter into force upon the fulfilment of certain requirements, such as the full accession of the States concerned to the Convention, or the incorporation of the company mentioned in the agreement. Subject to this presumption and within the meaning of the Convention, the date of consent expressed by a party will be the date on which all

[43] *Kaiser Bauxite Company* (1975).

jurisdictional requirements against one of the parties are satisfied.[44]

Another question regarding the jurisdiction of the Centre arises when there is no express arbitration clause in the investment agreement, but the dispute resolution is based on a BIT provisions. In this case, international investment law uses a special mechanism called the "umbrella clause", which consists in including in the text of the international investment agreement a provision that the recipient State undertakes to fulfil any obligation assumed in relation to investments made on its territory by foreign investors. According to experts, this provision is present in about 40% of bilateral investment agreements.[45] In international investment law, umbrella clauses are applied in accordance with the principle of *pacta sunt servanda* (agreements must be kept). However, there is no single approach to resolving disputes in the event of a conflict between an investment agreement and a BIT. For example, in *SGS v. Pakistan*[46], in resolving the issue of the priority of the arbitration clause of the bilateral agreement over the investment agreement clause, the arbitrators noted that:

> We recognize that disputes arising from claims grounded on alleged violation of the BIT, and disputes arising from claims based wholly on supposed violations of the PSI Agreement, can both be described as "disputes with respect to investments," the phrase used in Article 9 of the BIT. … In other words, from that description alone, without more, we believe that no implication necessarily arises that both BIT and purely contract claims are intended to be covered by the Contracting Parties in Article 9. Neither, accordingly, does an implication arise that the Article 9 dispute settlement mechanism would supersede and set at

[44] Лалив (1993) 667–668.
[45] OECD (2008).
[46] *SGS Société Générale de Surveillance S.A.* (2003).

> naught all otherwise valid non-ICSID forum selection clauses in all earlier agreements between Swiss investors and the Respondent ... We believe that Article 11.1 of the PSI Agreement is a valid forum selection clause so far as concerns the Claimant's contract claims which do not also amount to BIT claims, and it is a clause that this Tribunal should respect.[47]

At the same time, in the decision in the case of *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*[48], it was noted that a violation by the State of its contractual obligations can simultaneously act as a violation of international legal norms and a bilateral investment agreement. The panel of arbitrators pointed out that in the presence of a valid arbitration agreement between the parties, the Centre should not recognize its competence to the detriment of such an agreement. However, in the practice of the tribunal there is no unified approach to this issue, as, for example, in the case of *Noble Ventures Inc. v. Romania*[49], where Art. 31 of the Vienna Convention on the Law of Treaties and the intentions of the parties were taken into account. According to the provisions of the Vienna Convention, *"A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".*[50] In this regard, ICSID referred to the fact that the bilateral agreement imposes obligations on the host State that go beyond the guarantees provided by the investment agreement, and any other interpretation of art. II (2) (c) of the bilateral agreement between Romania and the United States completely deprives its provision of practical significance.

5. Conclusions

[47] *SGS Société Générale de Surveillance S.A.* (2003).
[48] *SGS Société Générale de Surveillance S.A.* (2004).
[49] *Noble Ventures Inc.* (2005).
[50] The Vienna Convention on the Law of Treaties (1969) art. 31.

Summing up, it can be concluded that the problems of ICSID jurisdiction are extremely relevant, and mistakes made during drafting of investment agreements, as well as bilateral and multilateral investment treaties may exclude the competence of the Centre. When drafting a document that identifies ICSID as a forum for resolving emerging disputes, it is necessary to carefully check the compliance of the document with the requirements of the Convention and international law. Deviation from the aforementioned criteria may result in the State hosting the investment pleading that the Centre lacks jurisdiction. At the same time, in order to minimize risks, it is recommended to use the Model Clauses developed by specialists and published on the Centre's website when drawing up investment agreements.[51]

It should be noted that a State that aims to attract more investment should clearly establish in investment agreements, as well as in bilateral and multilateral investment treaties the possibility of applying to ICSID in accordance with art. 25 of the Convention. At the same time, the question of the jurisdiction of the Centre is paramount for investors, due to the fact that an incorrect reference or interpretation of the request of arbitration, may lead to significant financial losses (including expenses for applying to ICSID) for the investor. It is necessary to note that the understanding by the lawyer, representing interests in the dispute, of the basic structure and case law of ICSID in determining jurisdiction, would be a crucial element when referring to the Centre. Such an understanding on the part of lawyers will make it possible to build the correct structure of actions at the preliminary stage of the proceedings.

[51] ICSID (2022).

In this regard, when concluding an investment agreement with an administrative-territorial unit or body of a contracting State that contains a reference to ICSID, it is necessary to carefully analyse the arbitration clause for its validity under the jurisdiction of ICSID.

As has been proven throughout this study, the main line of defence for host States is to invoke the lack of jurisdiction of the Centre, which is based on art. 25 of the Convention. The most common argument cited by States are the inexistence of the legal nature of the dispute, the invalidity of consent to the dispute before ICSID, and the lack of a Convention-compliant nationality of the investor. At the same time, States may allege that the investment does not meet the investment evaluation criteria or has not sufficiently contributed to the development of the host State. This leads to the conclusion that the very concept of investment is one of the key issues in determining the jurisdiction of the Centre. In this sense, one of the main problems in defining this concept is not only an unclear definition of what is considered an investment, but also a common tautology in the definition. A large number of definitions explain the term by the term itself, without revealing clear evaluation criteria, which leads to incorrect logical reasoning. In order to give the concept of "investment" a clear meaning in which this term is understood by the parties when concluding contracts, it is necessary to avoid any tautologies and vagueness. As practice shows, an unclear definition can lead to a broader interpretation on the part of the Centre, which is not always beneficial to one side or another.

In practice, both ICSID doctrine and case law, when interpreting the term investment, in most cases refer to: significant length of time; a guarantee of a commensurate return on investment; element of risk for both parties; significant involvement of an investor in a project or transaction; and of

great importance for the development of the host State (this item is sometimes combined with others).

The development factor has recently become more and more ambiguous in the practice of the Centre, and its use as a sub-element of other criteria does not allow unifying the practice of ICSID on the issue of determining investments. The concept of economic development is enshrined in the preamble to the Convention and the report of the Executive Directors. In this regard, it can be concluded that in the case when investments do not lead to the development of the recipient State it is not covered by the Convention. Notwithstanding, the practice of the Centre is ambiguous in this matter, since the arbitration system of the Centre is not bound by the principle of *stare decisis*, which in turn reduces the predictability of the outcome when applying for dispute resolution to ICSID.

As has been shown throughout the study, compliance with the conditions discussed above and following the recommendations provided, ensures the emergence of ICSID jurisdiction and allows the parties to submit disputes to the Centre. The parties should take into account these conditions already at the early stages of entering into international investment activities. At the same time, it may be difficult for the parties to fulfil these conditions due to a number of reasons, such as different criteria that define the concept of "investment", the question of how to reach agreement to refer a dispute to ICSID *etc.*, which indicates the need for further improvement of legal regulation on this issue.

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The critique of reform proposals for ISDS: solutions to existing and future problems

Abstract: Addressing wide ranging dissatisfactions regarding the current Investor-State Dispute Settlement (ISDS) system, the UNCITRAL working group III (WGIII) members are working continuously to put forward necessary reforms to the system which may take couple of more years. Considering their works till to date, the proposals might bring great improvement to the current system and will also add significant qualities. However, still, they did not put forward elaborate proposals on some of the important matters for an effective and sustainable dispute settlement system. Moreover, they might follow little bit the similar track of the WTO which is in crisis itself.

Keywords: ISDS, UNCITRAL, WTO, WGIII, reform

1. Introduction

The initiative by the United Nations Commission on International Trade Law (hereinafter: UNCITRAL) Working Group III (hereinafter: WGIII) to reform the procedural aspects of the Investor-State Dispute Settlement (hereinafter: ISDS) is very significant, even though dealing with substantive reform is much needed. The proposals by the WGIII are focusing on creating a permanent procedural mechanism for investment law. The WGIII is working on many important procedural issues, for instance, multilateral mechanism, multilateral advisory center, selection and appointment of ISDS tribunal members, code of conduct, mediation, assessment of damages and compensation, control mechanisms on treaty interpretation, multilateral instrument on ISDS reform, and third-party

funding.[1] In this article, the author analyses some of the important matters related to the reform of ISDS by the WGIII.

2. The critique of reform proposals for ISDS

2.1. One- or two-tier system

There are two proposals regarding the reform of dispute settlement mechanism. Firstly, stand-alone review or appellate mechanism, and secondly, setting-up of a multilateral investment court with first instance and appellate mechanism.[2] Many members of the WGIII expressed their support for an appellate mechanism regardless of tribunal structure. Some of the members backed the first option and some others have supported the second option. For instance, the European Union and its member States have proposed a first instance tribunal and an appellate tribunal.[3] Morocco has proposed setting up of a standing appellate mechanism.[4] And last but not the least, China also backs a permanent appellate mechanism.[5]

The members who support setting up of an appellate mechanism seek to strengthen the correctness of the arbitral decisions and resolving errors in decisions by the first instance tribunal or court.[6] This view was also reemphasized in another proposal where it is expressed that appellate mechanism would enable

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[1] Lavranos (2021) 845.

[2] Bungenberg and Reinisch (2011) 3.

[3] UNCITRAL (24 January 2019) A/CN.9/WG.III/WP.159/Add.1, para. 13 and 14.

[4] UNCITRAL (4 March 2019) A/CN.9/WG.III/WP.161, para. 34.

[5] UNCITRAL (19 July 2019) A/CN.9/WG.III/WP.177, para. 4.

[6] UNCITRAL (4 March 2019) A/CN.9/WG.III/WP.161; UNCITRAL (17 July 2019) A/CN.9/WG.III/WP.175; UNCITRAL (19 July 2019) A/CN.9/WG.III/WP.177.

the tribunal to recheck and correct the decisions, and the mechanism would empower the parties to seek coherent and fair decisions.[7] Some of the members of the WGIII strongly believe that this mechanism will enhance consistency and predictability in arbitral decisions. The aim of this mechanism is to bring more accountability to the system, and develop a body of legally authoritative interpretations in the international investment law regime.[8]

From the active participation of the members, it is observed that the second option is more supported and in-line with their expected reformation option. So many rules have to be laid down to take such step. Right now, the WGIII is in its initial stage laying the foundation for reform and getting proposals and feedbacks from the members. Considering the importance and demand of appellate mechanism in the ISDS, it shall be incorporated in the system. This would be a significant reform to the current system, and would enable more check and balance.

2.2. Arbitrators and adjudicators appointment methods

One of the central criticisms related to the current ISDS system is related to the arbitrators. The criticisms range from their appointment method to their interpretation of the treaties.[9] Acknowledging the critical nature of the situation, the WGIII members have initiated significant reformation to this matter. As of September 19, 2022, several members of the WGIII have submitted their proposals, and the WGIII has comprised many

[7] UNCITRAL (17 July 2019) A/CN.9/WG.III/WP.175, para. 9.
[8] UNCITRAL (4 March 2019) A/CN.9/WG.III/WP.161; UNCITRAL (17 July 2019) A/CN.9/WG.III/WP.175; UNCITRAL (19 July 2019) A/CN.9/WG.III/WP.177.
[9] Dimsey and Pramod (2021) 1154.

of those proposals into one file that has been reviewed and changed over time following continuous discussions.

The appointment methods might be very challenging and tricky. This needs to be handled carefully. The dispute settlement system in international investment law might take over some solutions from the World Trade Organization (hereinafter WTO) system, however, we may not forget that there are some issues with that system as well. From the WGIII reform initiative, we've learned that they're proposing to incorporate more stricter regulations. For instance, they support creating an appointing authority which will be regulated by more transparent processes, they also support creating pre-established list of arbitrators or adjudicators.[10] However, which framework or method will be used to create such a list, still need to be addressed carefully.[11] Important thing to note that such mechanism might directly impact the current system where parties have power to deal with the appointment of arbitrators. Moreover, some members of the WGIII think that there should be an impact assessment on domestic legislations.[12]

As many State actors and scholars have expressed their dissatisfaction towards the double-hatting characteristic of the adjudicators under the current system, it is essential to standardize the current method.[13] The EU and its Member States

[10] UNCITRAL (31 July 2019) A/CN.9/WG.III/WP.169, UNCITRAL (24 January 2019) A/CN.9/WG.III/WP.159/Add.1, UNCITRAL (8 March 2019) A/CN.9/WG.III/WP.162. UNCITRAL (29 August 2019) A/CN.9/WG.III/WP.180.
[11] UNCITRAL (15 March 2019) A/CN.9/WG.III/WP.163, para. 5.
[12] UNCITRAL (22 March 2019) A/CN.9/WG.III/WP.164 and UNCITRAL (31 July 2019) A/CN.9/WG.III/WP.178. UNCITRAL (11 July 2019) A/CN.9/WG.III/WP.174, UNCITRAL (17 July 2019) A/CN.9/WG.III/WP.175. UNCITRAL (19 July 2019) A/CN.9/WG.III/WP.177.
[13] Bao (2021) 925.

proposed some of the features of the adjudicators who would be appointed to the standing arbitration mechanism, for instance, they must commit full time, long term and non-renewable positions. This means that they would be barred from outside activities specially that lead to conflict of interest. The diversity and representativeness in terms of geography, know-how and gender have to be insured.[14]

This issue may remain critical in the dispute settlement system, as it is evident in the WTO dispute settlement system. One of the lessons of the WTO is to appoint the judges not by consensus or unanimity, but by majority of votes. Two-thirds majority when deciding might be the best solution. The WTO's consensus-based election process does not work.

2.3. The appointing authority

Appointing authority is another necessity in the system that needs to be sort out. The WTO has its own appointing authority for the selection of judges to the Appellate Body. The task of choosing Appellate Body members is considered very tough. It is evident from its maiden selection process which takes several months. Out of this experience, the members prepared a selection mechanism that was used couple of times. However, that has also proven to be unhelpful as powerful members of the WTO try to push their hegemony into the system.

However, the WGIII still did not lay down specific details about the appointing authority, although there is proposal to create an independent appointing authority. Until now, more emphasize were given to characteristics of the arbitrators and nature of their involvement as adjudicators. The WGIII members shall learn from the mistakes of the WTO dispute settlement

[14] Fach Gomez (2021) 1208.

mechanism and adopt such rules so that the system can be sustainable and reliable for the parties.

2.4. Treaty interpretation

Under the current Investor-State Dispute Settlement system, there is alleged arbitrariness in the awards which goes beyond the mandate of the arbitrators and there is also inconsistency in different awards. This issue not only engender alleged 'chilling effect' on the States' right to regulate, but also generates a lot of public outrage. Regulatory chill has been a deeply concerned issue around the legitimacy of ISDS.

There is also lack of coherence in investment arbitration. Because of this, there is perception of biasness.[15] To tackle this issue, some interesting proposals were suggested by some of the members of the WGIII, however, no detailed plans proposed yet. For instance, the suggestion is made to set-up mechanism for treaty interpretation. This can be dealt with by introducing *ad hoc* authoritative interpretation mechanism. Authoritative interpretation by treaty institutions can be also a crucial mechanism to deal with this issue. Moreover, release of *travaux préparatoires*, and renvoi of interpretative questions can be useful way to address this issue.[16] These can be dealt with in three stages of engagement by a party or parties, *i.e.* unilateral interpretations, joint interpretations, and multilateral interpretations. In addition, it is important to note that confirming compliance by arbitrators might be very significant.[17] The proposals also were made to strengthen the

[15] Kahale III (2012) 1.

[16] UNCITRAL (24 January 2019) A/CN.9/WG.III/WP.159/Add.1, UNCITRAL (4 March 2019) A/CN.9/WG.III/WP.161. UNCITRAL (17 July 2019) A/CN.9/WG.III/WP.176.

[17] UNCITRAL (8 March 2019) A/CN.9/WG.III/WP.162, UNCITRAL (15 March 2019) A/CN.9/WG.III/WP.163.

framework between State to State. The framework for technical consultations and setting up a joint review committee by the treaty Parties are significant in this regard.[18]

These proposals need to be discussed further, especially the matter related to unilateral and joint interpretations. The WGIII need to provide specifics, so that this can set guidelines and restrict arbitrariness of the arbitrators.

2.5. Cost reduction and access to justice

High cost of arbitration is a headache for everybody in the ISDS. One study shows that the average costs in investor-State arbitration is around 10–11 million USD (for both parties together).[19] By reducing and expediting some processes the cost can be curtailed. Under the WGIII, the proposals were made to expedite certain aspects of the procedure, for instance, appointment of arbitrators and preliminary objections.[20] Moreover, proposals were made to implement stricter timeline,[21] and to give parties improved, real-time information

[18] UNCITRAL (24 January 2019) A/CN.9/WG.III/WP.159/Add.1, UNCITRAL (29 August 2019) A/CN.9/WG.III/WP.180.
[19] Zamir (2021) 1456.
[20] UNCITRAL (8 March 2019) A/CN.9/WG.III/WP.162, UNCITRAL (15 March 2019) A/CN.9/WG.III/WP.163, UNCITRAL (22 March 2019) A/CN.9/WG.III/WP.164 and UNCITRAL (31 July 2019) A/CN.9/WG.III/WP.178, UNCITRAL (11 July 2019) A/CN.9/WG.III/WP.174.
[21] UNCITRAL (4 March 2019) A/CN.9/WG.III/WP.161, UNCITRAL (8 March 2019) A/CN.9/WG.III/WP.162, UNCITRAL (22 March 2019) A/CN.9/WG.III/WP.164 and UNCITRAL (31 July 2019) A/CN.9/WG.III/WP.178, UNCITRAL (17 July 2019) A/CN.9/WG.III/WP.176.

on the status of the case.[22] In addition, to reduce the burden of the cost, proposals were made to include the loser-pays rule.[23]

2.5.1. Access to justice

Access to justice is one of the most important elements for ensuring justice. Developing countries lack resources and expertise to represent their cases in front of international tribunals. To tackle this issue, proposal was made at the WGIII to set up an advisory center for international investment law. The proposal of this center is inspired by the success of similar initiative run by the WTO. The European Union and its member States included this in their negotiating directives, and this proposal is supported by a number of developing countries. The main objective of this initiative would be to develop capacity to the disadvantaged countries, and in doing so ensure access to justice. Although this might not solve all the problems related to discussing issue as it is the case under the WTO, however, it may improve the level of access to justice for developing countries.

2.5.2. Cost reduction

Another aspect of access to justice is to reduce the cost. A set of proposals were recommended by several States. Strengthening mediation for early settlement of disputes can be very crucial to avoid costly dispute settlement, so is execution of waiting (cooling-off) period before the launch of disputes. In another proposal, a mechanism for an early dismissal of claims is suggested, that may prevent excessive dispute procedures (frivolous claims). In such case, the claimant will be required to

[22] UNCITRAL (15 March 2019) A/CN.9/WG.III/WP.163.
[23] UNCITRAL (4 March 2019) A/CN.9/WG.III/WP.161, UNCITRAL (8 March 2019) A/CN.9/WG.III/WP.162, UNCITRAL (15 March 2019) A/CN.9/WG.III/WP.163.

pay all costs for the procedure. In some treaties, including some of the European Union Member States, such clauses have already been incorporated.

Some of the WGIII members are of the view that establishing a standing mechanism may bring stability and coherence to the system, and it will allow better handling of multiple claims. The standing mechanism will be more efficient in handling *CME/Lauder* type cases[24] brought under different treaties. The system can deal with such cases through joinder of cases, consolidation, stay of proceedings or even dismissal of cases.[25] Thus, it may engender greater predictability regarding interpretation. Some of the members of the WGIII think that the reformation will bring greater predictability of legal interpretation by allowing stable understanding of provisions, make the system more effective in terms of time, and hence will make the system more cost-effective. Under such circumstances where there are the predictable and stable legal interpretations, an investor most likely will not make 'adventurous' claims based on a legal reasoning that has been already rejected.[26]

Under the current reformation initiative, it is expected that, firstly, significant amount of time will be saved by opting for the proposed selection processes of the arbitrators. Unlike the current system, the parties will save cost on counsel fees by not spending time on the appointment of arbitrators. Under the current system, the appointment of arbitrators is very time-intensive and involves substantial counsel charges.[27] Secondly, unlike the current system, there would be no scope for 'double-hatting' characteristic of arbitrators, hence there might not be

[24] UNCITRAL, *Lauder v. Czech Republic* (3 September 2001), UNCITRAL, *CME v. Czech Republic* (14 March 2003).
[25] UNCITRAL (6 November 2018) A/CN.9/964, para. 56.
[26] UNCITRAL (6 November 2018) A/CN.9/964, para. 42.
[27] UNCITRAL (19 December 2017) A/CN.9/930/Rev.1.

any challenge for conflict of interests. This definitely will speed up the process and will help to be more cost-effective.[28] Thirdly, there will be no incentives associated with the adjudicators for prolonging a case unnecessarily. This most likely would speed up the process.[29] Fourthly, the system most likely would engender predictability by consistent rulings of the tribunal as it is evident also in the WTO dispute settlement system. This would negate the relitigation, hence would save time and money. However, under the current system, different *ad hoc* tribunals in different cases might have different positions.[30]

However, these reform proposals might improve the cost management, but may not reduce the cost greatly as expected, which is present in the WTO having similar dispute settlement system. So, this will continue to be an issue of concern for developing countries.[31]

2.6. Localizing international investment arbitration

Localizing the ISDS can play a vital role to boost strong participation and to empower the developing countries. As the functions of the States require coordinating among a number of departments, experts and legal counsel; they usually need considerable time to prepare their defense to ISDS claims. That means, if the location of the arbitration is near, they can communicate and prepare their defense more effectively and speedily. Moreover, localizing the ISDS might deal with some of the concerns by developing countries, for instance, cost and time issue, and understanding sensitivity of governmental works by arbitrators with regional background.

[28] UNCITRAL (6 November 2018) A/CN.9/964, para. 53.
[29] Sands (2018).
[30] UNCITRAL (6 November 2018) A/CN.9/964, para. 55.
[31] UNCITRAL (12 December 2017) A/CN.9/WG.III/WP.145.

There are many arbitration institutions in different locations outside of Europe and the United States of America. However, there is very little probability to utilize such hearing facilities. The study of Kidane confirms such concern under the current system. It shows that out of 64 cases involving an African State, no case was heard in Africa, but Europe was the hearing location overwhelmingly.[32]

Using Europe and the United States of America as arbitration location can be attached to the location of small groups of arbitrators and law firms. They have preferential choice to go to the location where their firms or occupation locate, and also ISDS institutions preferably choose arbitrators who are available nearby.[33] Given this behavior pattern, it is in the interest of the States to have ISDS hearing nearby their geographical presence.

There are some benefits for allowing localization of ISDS. Firstly, it might boost confidence of the States to participate in such proceedings. Secondly, it might reduce grievances of States towards the ISDS awards. Thirdly, it will present more opportunities of informal dialogue between parties that may increase the chance of mediation. Fourthly, it will speed up the process as the parties will be able to present the evidence and expert testimony quickly. Fifthly, it might increase trust of the public and civil society by making the process more transparent and allowing local media. And finally, it will reduce institutional fee as arbitration institutions outside of Europe and the United States generally charge less fee. For instance, upon the registration of a request for arbitration, ICSID charges US$

[32] Kidane (2014) 597.
[33] Gaukrodger (2018).

42,000;[34] on the other hand, the charges at the Cairo Regional Centre for International Commercial Arbitration start at $750.[35]

3. The key solutions to existing and future problems

On the issue of expected and acceptable framework for the ISDS, the WGIII should opt for two-tier system. This is the classical approach in traditional judicial system and also gained support under the WTO. One-tier system with other reform options might be better than the current system, however, wouldn't satisfy the demands of the stakeholders.

Regarding the issue of arbitrators' appointment method, the WGIII members should deal with this as a most significant factor for ensuring fair awards. The process should be democratic as it involves multilateral parties, and it should enfranchise all members to the new agreement, specially the least developed. The new system should learn from both the positive and negative experiences of the WTO, *e.g.* to incorporate from the positive experiences of the WTO, and to improve regarding the negative experiences of the WTO. The arbitrators should be elected by the members, and two-third majority should be the decider, instead of consensus method of the WTO that tend to be slow and stagnant at times. If the WGIII members somehow opt for consensus method that would create problems in the future, and the system might become unsustainable.

On the issue of appointing authority, the WGIII members till now did not put forward concrete proposal. It might adopt dispute settlement body (DSB) like feature of the WTO into the system. The principal responsibility of this body would be to manage and appoint arbitrators and adjudicators. It also can

[34] ICSID (2022).
[35] CRCICA (2011).

look after other matters, for instance, to impose code of conduct of the arbitrators, etc. A treaty will be required to form such authority, and all the signatories, like the WTO system, can be the members of such body.

On the issue of treaty interpretation, the WGIII members may adopt some measures to deal with their frustration regarding the aggressive interpretative approach of the arbitrators. This might include sending the matter to the parties involved to decide their intention behind the text. They can also include guidelines in the code of conduct of the arbitrators, and violations may depose the arbitrators from their positions.

On the issue of cost reduction and access to justice, the WGIII members should take pertinent measures to empower the disadvantaged countries and enable them equal access to justice. If they can take necessary reforms, the system might be more predictable and may consume less time. Although, still, the process might be very expensive as it is in the case of WTO disputes.

On the issue of localization of international investment arbitration, the WGIII members should take this seriously. This will not only diversify the arbitration, but will also contribute to empower every regional member. This might further reduce the cost and give more access to justice to the disadvantaged members.

4. Conclusion

The current reform initiative under the WGIII is addressing merely half of the problems by only addressing procedural reform. This will not be able to address some critical issues associated with the substantive aspects. The proposed dispute settlement system, a multilateral investment court, under the

WGIII in principle is quite similar to the EU's multilateral investment court project, and to the World Trade Organization's dispute settlement system. As the WTO dispute settlement system itself faces trouble and fierce criticisms, the multilateral investment court certainly will face similar issues. During the reform process, it is essential to tackle such issues. However, it seems that the reform proposals under the WGIII is yet to address such issues effectively.

The author is of the view that a multilateral investment court is a very good proposal to start with, however, there is more to add to make it successful. Firstly, to strengthen the selection process of arbitrators. Instead of the WTO method, it can adopt some key features from the International Criminal Court's selection process related to judges, *e.g.,* two-third majority shall be the decider instead of consensus voting system. Secondly, to enfranchise developing countries, localization of dispute settlement can be a key step. The seat of the dispute settlement body can be region-based, *i.e.,* Africa, Asia, Latin America, Europe, North America, etc. The arbitrators can be selected from the respective region only. This might help to understand regional issues better and the arbitrators can be sensitive to the issues related to the public welfare. This will also reduce the cost of arbitration proceedings.

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EU DCFTAs: carrot-and-stick

Abstract: Deep and Comprehensive Free Trade Agreements are described as the EU's new assertive approach in trade matters. They provide a far-reaching and progressive regulatory approximation to EU law in trade-related areas. Largely inspired by the WTO dispute settlement rules, specific features of DCFTA DSMs also include a procedure that obliges the arbitration panel to ask the Court of Justice of the European Union for a binding preliminary ruling when there is a dispute concerning the interpretation and application of EU legislation. The EU established DCFTAs with some Eastern European States in its neighbourhood, with prospects to apply for future EU membership. Notwithstanding the costs of its European neighbours in the east, the EU has pursued similar DCFTAs in North Africa, under its European Neighbourhood Policy. In the context of dispute settlement costs of EU DCFTAs, this paper considers the EUs pursuit of the DCFTAs in North Africa. The problem is that experience in Africa reveals a strong discontent and apathy towards a highly legalised and formal trade dispute system. Ratification of the African Continental Free Trade Area Agreement is argued to add a new dispute settlement system designed to resolve trade disputes in Africa, unlike many of the regional courts in Africa which are modelled on the CJEU. It is not clear how the EU DCFTAs may look to harmonise dispute settlement rules with Africa, either than through a carrot-and-stick approach.

Keywords: DCFTA, WTO DSM, AfCFTA, EU, North Africa

1. Introduction

States have aimed for economic development with the assistance of international instruments such as Free Trade Agreements (FTAs) to achieve this goal. As economies are more integrated and interconnected than ever before, international agreements have been involved to harmonise the

varying legal systems as well. Such a case is with the European Union (EU), in use of international legal agreements with other States, to forge closer (political and economic) ties with the EU. These are the EU Deep and Comprehensive Free Trade Agreements (EU DCFTAs) with partner States in its neighbourhood. These agreements with partner States have required an approximation to the EU's body of law. Its efforts, however, raise questions in context of varying legal systems and perspectives on integration. Difficulties and challenges have been noted of EU DCFTAs with partner States in Eastern Europe, whom the EU considers as with a 'European perspective'.

Despite difficulties with its European neighbours, the EU has pursued similar agreements with its African neighbours to the south. These States may be neighbours of Europe in the south but are however members of the African Union (AU), with a rather more African perspective. It is, after all, said that modern legal systems tend to increasingly use carrots than sticks. Without a disputation that documentary evidence of the idiom's origins has been scattered, it is nonetheless interesting and perhaps relevant to antithesize the idiom with the EU DCFTAs. As, the Carrot and Stick Approach is understood (in English language) as a traditional motivation theory that is based on the principles of reinforcement. Requiring a certain level of harmonisation of laws between the EU and the other partner States to the agreement, EU DCFTAs beg the question on the principles of reinforcement considering the potential differing perspectives of the parties.

Some respond that, in light of "carrot or stick", the best way to move the donkey is to put a carrot in front of it.[1] Others are sure

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that the correct version is rather "carrot and stick". That the best way to move the donkey is to put a carrot in front of it and jab it with a stick from behind as further reinforcement that it will move. In the context of the dispute settlement provisions of EU DCFTAs, this paper considers the EUs pursuit of similar DCFTAs in North Africa, under its European Neighbourhood Policy (ENP). The paper adds to the discourse on EUs pursuit of DCFTAs to Egypt, Tunisia and Morocco, with one such new cooperation arrangement that could involve harmonising regulations. The endeavour leaves wonder how the EU aims to promote harmonisation of rules with these North African States that have rather ratified the African Continental Free Trade Area Agreement (AfCFTA). The AfCFTA aims for a dispute settlement system with an 'African perspective' that contrasts with the rules-based "African Courts of Justice" regime mostly modelled on the Court of Justice of the European Union (CJEU). The consideration of differing perspectives puts to question the path to harmonisation of rules between partner States, whether led by carrots or rely on sticks.

2. EU DCFTAS

A brief background on EU DCFTAs is required, to serve as a basis for the questions that the paper seeks to probe.[2] In first understanding what the EU DCFTAs are, reference will first need to be made to the new generation of FTAs. That is on those agreements that seek to substantially liberalise all trade by addressing trade and investment in a "comprehensive" manner.[3] Subsequently, scholars have described the EU DCFTAs as the

[1] That is, what people say is the proper phrase "carrot on a stick" meaning an incentive - a carrot dangled in front of a donkey.
[2] That is, the context and purpose of the questions on whether EU DCFTAs dangle carrots towards harmonization with EU laws or suspiciously relying on a stick.
[3] That is in reference to a broad coverage of these instruments.

EU's new assertive approach in trade matters, extending on the ambitions of a new generation of FTAs.[4]

2.1. A new generation

Towards economic integration, traditional FTAs have served to coordinate trade policies. A new generation has served towards achieving greater economic integration to go beyond traditional FTAs. This new generation provides for comprehensive chapters on investment including provisions on ISDS.[5] In cognisance that there are broader areas restricting trade and investment beyond the traditional, we have seen this new generation seek to substantially liberalise all trade by addressing trade and investment in a "comprehensive" manner.[6]

The EU's new generation of agreements followed the North American Free Trade Agreement (NAFTA) that was described as "the most comprehensive regional trade agreement" of its time.[7] It had for long been the 'poster child' for comprehensive FTAs. The agreement ushered in a new generation of FTAs,

[4] Delimatsis (2021).

[5] The EUs so-called new generation FTAs negotiated after 2006 is the EUs "second generation" FTAs that are described as comprehensive FTAs that go beyond trade in goods, also covering services and potentially other aspects such as investment related issues. *See:* European Commission (2018a).

[6] The new generation of EU FTAs provide for 'comprehensive' chapters on investment. Although, international trade and investment instruments now refer to the term "comprehensive" in their titles, there seems to be no particular legal definition of the term in the agreements. Seemingly, a general, not necessarily legal understanding of the word 'comprehensive' is followed, in that it is 'including or dealing with all or nearly all elements or aspects of something', or 'covering completely or broadly'. In cognizance that there are broader areas restricting trade and investment beyond the traditional, we have seen new generation trade agreements such as EU FTAs seek to substantially liberalize all trade by addressing trade and investment in a "comprehensive" manner.

[7] *See:* United Nations Economic Commission for Latin America and the Caribbean (1996) 3.

with NAFTA somewhat of a prototype.[8] In many regards, the EU-South Korea FTA was considered historic as the first in the series of EUs new generation FTAs building on the prototype.[9] At the time of signing, it was the second largest FTA after NAFTA.[10] Later, the EU signed a new generation of FTAs with other States, including Canada that had participated in NAFTA in pursuance of regional economic integration.[11] The EU-Canada Comprehensive Economic and Trade Agreement (CETA) marked new milestones.[12] With lessons from NAFTA, this new generation of agreements are identified as overlapping the disciplines of both trade and investment. We see this in recent FTAs that the EU has concluded with partner States.

Overlapping disciplines, these trade agreements provide the same protection to foreign investors as investment agreements, with the main novelty being dispute resolution.[13] One such novelty is an Investment Court System (ICS) proposed to set up

[8] Although a trilateral agreement, it emanated from the initial plan of the US to make separate FTAs with Canada and Mexico with the main goals including the '*lifting the restrictions on trade, fostering the movement of goods and services across the borders*' by addressing other aspects such as investment. *See:* Víg (2019) 145-146. This comprehensive approach to trade is seen in the CETA (2016) and other new generation FTAs that have followed.

[9] Some scholars write that '*it is the most important trade agreement concluded by the European Union (EU) since the conclusion of the Marrakesh Agreement establishing the World Trade Organization (WTO) in 1994*.' *See:* Lasik and Brown (2013).

[10] The EU-South Korea, signed on 15 October 2009 (entered into force 2011) was the EU's first FTA in Asia and South Korea's first with one of the current three largest economies (ahead of the US and China).

[11] The EU-Canada Comprehensive Economic and Trade Agreement (CETA), signed: 30 October 2016.

[12] *Also see:* Víg (2019) 143-144. Víg enlightens that the original CETA was to be more of a traditional FTA which due to public pressure resulted in a more comprehensive agreement that *'surpasses traditional trade questions to deal with a diverse range of topics, such as investment…*'.

[13] *See:* Makarenko and Chernikova (2020).

a permanent body to decide investment disputes, making it unclear whether or not it will conflict with the jurisdiction of the CJEU.[14] The CJEU has jurisdiction in disputes concerning the interpretation and application of EU legislation. Nonetheless, contained in the CETA to replace the Investor-State Dispute Settlement System (ISDS) mechanism, a permanent court system has been the EU's new approach to the protection of investor rights.[15]

2.2. Deep Trade Agreements (DTAs)

A step further, with distinctive components, DCFTAs go beyond the 'new generation' FTAs and represent "a unique type of trade agreements".[16] Understood to be built on the merely "comprehensive" new generation of FTAs, DCFTAs aim to provide a 'far-reaching and progressive regulatory approximation' to the laws of the parties.[17] This refers to the

[14] *See:* Lévesque (2016) 17-18. Horváthy also pointed that the ICS introduced in CETA raised questions of incompatibility with EU law. At the time of writing, he noted that the ongoing procedure of Opinion 1/17 had not profoundly assessed the ISDS mechanism as a specific forum. *See:* Horváthy (2018) 134-136. On April 30, 2019, the court confirmed that CETA's ICS is compatible with EU law but provided that "the autonomy of the EU and its legal order is respected". *See:* Opinion 1/17 pursuant to art. 218(11) TFEU. However, this still may pose practical problems as there is no provision for the ICS to refer a question to the CJEU. Although it is also argued that ICS does not jeopardize the principle of autonomy of EU law and the CJEU's exclusive jurisdiction over the definitive interpretation of EU law. *See:* Szyszczak (2019).

[15] The CETA (2016) chap. 8.

[16] *See:* European Commission (2021a).

[17] To achieve the objective of deepening political association and economic integration between the EU and its associated partners, '*the DCFTAs provide far-reaching and progressive regulatory approximation to EU law in trade-related areas and foresee gradual reciprocal market opening. With these distinctive components they go beyond the 'new generation' FTAs and represent "a unique type of trade agreements*".' *See:* European Commission

"deep" nature of the DCFTAs. Or perhaps to speak of them as Deep Trade Agreements (DTAs) as we address the regulatory approximation of laws.

The aim of DTAs is understood to establish "economic integration" rights as well as include enforcement provisions that limit the discretion of importing States and the behaviour of exporters in these areas.[18] They are deemed as much more than tariff liberalisation agreements but as a meaningful liberalisation of trade[19] by providing a far-reaching and progressive regulatory approximation to EU law in trade-related areas. Accepting that not all trade and investment agreements are necessarily "deep",[20] those agreements that are, seek to codify regulatory alignment through binding commitments and a dispute settlement mechanism. In particular to the Dispute Settlement Mechanisms (DSMs) of the DTAs, they are largely inspired by the rules-based World Trade Organisation Dispute Settlement Understanding (WTO DSU). Going beyond FTAs, they are reported to be prompted by the failure of the World Trade Organisation (WTO) member countries to reach a 'comprehensive' agreement on trade liberalisation that would

(2021a). Also, towards 'predictable and enforceable trade rules'. *See:* the DCFTA (2016).

[18] Mattoo et al (2020) 3, write that DTAs aim at establishing five "economic integration" rights: free (or freer) movement of goods, services, capital, people, and ideas.

[19] In its position paper on the Trade Sustainability Impact Assessment in support of negotiations of DCFTAs, the EC describes DCFTAs as intended to provide for substantial liberalization of trade and investment conditions'. *See:* European Commission (2012).

[20] For instance, Great Britain was considered to be opposed to deepening by accepting market integration but with behind the border issues remaining autonomous. *See:* European Commission, (2012). *Also see:* Stubbs (n.d.). Although, in 2018 it was reported to be headed towards the model of a Deep and Comprehensive Free Trade Agreement (DCFTA) embedded within a broader Association Agreement (AA). *See:* Emerson (2018).

include the ‘behind the border’ issues such as rules on foreign investment and investment protection.[21]

2.3. Extension of the EU Internal Market

Considerably more ambitious than the FTAs with States outside its neighbourhood, the EU has pursued these “deep” DCFTAs with emerging markets within its neighbourhood, to mutually open markets for goods and services based on predictable and enforceable trade rules.[22] Unlike traditional FTAs, EU DCFTAs allow access to the "four freedoms" of the EU Single Market as part of each country's EU Association Agreement (AA).[23] The

[21] Koeth (2014) 25. Prior to the Uruguay Round negotiations spanning from 1986 to 1993, the linkage between trade and investment received little attention in the framework of the General Agreement on Tariffs and Trade (GATTs). The original GATT had reached ‘behind the border’, although the extent of the prohibitions was not clear. The GATT prohibited investment measures that violated the principles of national treatment and the general elimination of quantitative restrictions, obligations which the Agreement on Trade-Related Investment Measures (TRIMs) negotiated during the Uruguay Round intended to clarify. In this sense, there was a call for a widening of GATT and the deepening in the context of behind-the-border disputes by going beyond traditional trade liberalization in talking of the rules and disciplines of the trading system. *See:* Narlikar et al. (2012). For its effectiveness as ‘the foundation of the trading system’, it is believed that the WTO needs to negotiate new rules and adopt reforms. However, WTO members have not reached consensus for a new comprehensive agreement on trade liberalization and rules, which supports the impetus of member states concluding comprehensive’ agreements to include the ‘behind the border’ issues that the WTO has failed to address. *See:* Cimino-Isaacs and Fefer (2021) 3, 37-38.

[22] DCFTA projects have been benchmarked against FTAs that the EU has signed in recent years with emerging markets outside its neighbourhood.

[23] These DCFTAs have been established with Georgia, Moldova, and Ukraine as part of each country's EU Association Agreement, allowing access to the EU Single Market. That is, comprising the 27 member states of the European Union (EU) as well as Iceland, Liechtenstein, and Norway through the Agreement on the European Economic Area, and Switzerland through sectoral treaties.

EU AAs have been the legal framework towards the ENP that aims at bringing Europe and its neighbours closer.[24]

2.3.1. The European Neighbourhood Policy

The ENP was initiated in 2004, as a means of the EU to connect countries to the east and south of the EU Member States' territories in mainland Europe, to the Union.[25] The policy offers these neighbours the opportunity to participate in various EU activities including economic cooperation. But, the one main objective and incentive, reportedly, is the potential extension of the EU Internal Market to neighbouring countries. It is understood that the goal of the Policy is to bring added value to both these neighbours and the EU by going beyond existing cooperation such as going beyond existing bilateral FTAs. The ENP offers support and financial assistance in exchange for the undertaking of reforms in line with European values.

With a clear difference between the States, the EU claims to offer tailor made partnerships through Partnership Priorities, Association Agendas and the likes, focusing on shared interests with each State. Specifically, the interest of this paper is in the DCFTAs that are the economic and trade pillars of the AAs. On a more challenging note, requiring these differing States to fulfil their negotiated commitments by making the necessary legal, regulatory, and administrative changes towards the harmonisation of their laws with the EU's laws. With this in mind, some scholars write that EU DCFTAs are necessary immediately with its members in the east.[26]

2.3.2. Georgia, Moldova and Ukraine

[24] A significant part of the EU AAs is devoted to the elimination of regulatory barriers to trade.
[25] European Neighborhood Policy (2021).
[26] Emerson (2011) 4.

As it is written that our most significant relationships are with those who are geographically closest to us, the EU established DCFTAs with Georgia, Moldova and Ukraine in its neighbourhood and as an "example of the integration of a Non-EEA-Member into the EU Single Market".[27] The European Parliament has also passed a resolution that Georgia, Moldova and Ukraine, as well as any other European country, have a European perspective and can apply for EU membership. Thus, formally recognizing the possibility of a future EU membership of these three States. Notwithstanding, scholars have noted the costs of DCFTAs for these three States, such as the difficulty in the harmonisation of domestic regulations with the EU *acquis* and implementation of EU standards that may not always be beneficial, such as the DCFTA standards on dispute settlement rules. All three EUs DCFTA States are members of the WTO. In their evaluation, separate attention is paid to the dispute settlement.[28] The DCFTAs' DSMs are without prejudice to possible dispute settlement under the WTO but prohibit the pursuit of dispute settlement under both systems at the same time. Specific features include a procedure that obliges the arbitration panel to ask the CJEU for a binding preliminary ruling when there is a dispute concerning the interpretation and application EU legislation.[29]

One may wonder whether the Parties would actually choose to resort to the DCFTAs DSM for settling their trade dispute instead of solving a dispute in already familiar WTO forum. But clearly, the obligation of the arbitration panel to ask the CJEU

[27] This order is also seemingly consistent with the EU stages of integration over the past decades. *See:* Víg (2019) 143 discussion on the EU stages of integration in the past seventy years.
[28] European Commission (2021a).
[29] This procedure aims to ensure a uniform interpretation and application of EU legislation without jeopardizing the exclusive jurisdiction of the CJEU to interpret EU law. *See:* European Commission (2021a) 16-17.

for a binding preliminary ruling,[30] limits the options as disputes usually involve interpretation of the governing documents.[31] So, towards the commitment of the EUs neighbours to harmonise their rules with those of the EU, is there a reward (a carrot)? The approximation of law is a unique obligation of membership in the EU. Although the rationale behind the ENP is to establish privileged relationships in a way that is distinct from EU membership, these neighbours are primarily developing countries that include some who seek to one day become either a Member State of the EU, or more closely integrated with the EU. As the European Parliament has also passed a resolution that European States have a European perspective and can apply for EU membership, it is not far-fetched to imagine the incentive as the possibility of a future EU membership of the East European States.[32]

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[30] When there is a dispute concerning the interpretation and application EU legislation.

[31] The prerogative of the CJEU to decide on the effect of WTO law within the EU is also demonstrated by the *Commission v. Hungary* case. *See eg:* Nagy (2021) 700-706. Nagy notes the contradictions of the CJEU judgement, in using WTO law as a tool of interpretation in a trade dispute that was not at all about trade. Moreover, despite Hungary arguing that the interpretation of WTO law is the exclusive remit of the WTO Dispute Settlement Body (DSB), the CJEU treated the GATS as part of the EU's internal law in spite of previously rejecting WTO law and remaining firm that WTO law has no direct effect. Nagy describes the decision as an expansion of "the EU's 'federal powers.'" Horváthy echoes that in addition to previous practice of the CJEU, the GATS rules applied in the *Commission v. Hungary* case can be considered as a norm which it intends to comply. *See:* Horváthy (2021) 300-325.

[32] Currently, these states benefit from detailed policy advice and EU funding aimed at supporting the DCFTA-related reforms. *See e.g.*, Regulation (EU) No 232/2014 of the European Parliament and of the Council of 11 March 2014 establishing a European Neighborhood Instrument. *Also see e.g.*, European Commission (2015). In June 2022, a resolution was adopted to "*grant EU candidate status to Ukraine and the Republic of Moldova "without dela*y". They should do the same with Georgia "*once its government has delivered*" *on the priorities indicated by the European Commission*." *See:* European Parliament (2022). Jointly with the European Commission, a DCFTA facility for small and medium enterprises (SMEs) was also launched in Moldova,

3. North Africa – EU DCFTAs

In the context of dispute settlement costs of EU DCFTAs, this paper questions the EU's pursuit of similar DCFTAs in North Africa, under its ENP, with one such new cooperation arrangement that could involve harmonising regulations as well. The problem is that experience in Africa reveals a strong discontent and apathy towards a highly legalised and formal trade dispute system. Moreso, possibly a lost incentive to align with European values, the EU makes no mention of the prospect of EU membership of its North African neighbours.

This paper adds to the discourse on EU's pursuit of DCFTAs to Egypt, Tunisia and Morocco. Particularly, in ratification of the African AfCFTA, argued to add a new dispute settlement system to the judicial mechanisms designed to resolve trade disputes in Africa.[33] Scholars are of the view that EU DCFTAs are necessary immediately with its members in the east but only necessary in the medium to long term with its neighbours in the south.[34] Although the negotiations are on hold, the DCFTAs with Egypt, Tunisia, Morocco are still pursued. In considering the merits of this paper, the provisions in AfCFTA may be considered a proxy for these agreements. The AfCFTA may not be a direct confirmation of the North African States' approach with the EU, but serves as an implied indication which the respective North African States have expressed through ratification of the AfCFTA agreement that entered into force on May 30, 2019.

Georgia, and Ukraine to provide financial assistance from the EU budget for 10 years. *See:* European Commission (2018b). As potential EU candidates, these states would also receive funding to support additional reforms. *See:* European Commission (2021b).

[33] Akinkugbe (2020).

[34] Emerson (2011) 4.

3.1. An African perspective

Showing support for the global investment regime, African States became parties to a number of international investment agreements including both Bilateral Investment Treaties (BITs) and the investment chapters of FTAs. However, economic integration in Africa has also long been a discussion.[35] At the continental level, it is the AU that is mandated by its Member States to enhance economic integration, decided in 2008 to initiate the work on a comprehensive investment code for Africa. Containing innovating features, the Pan-African Investment Code (PAIC) is the first comprehensive investment treaty model in Africa, adopted in March 2016.[36] Developing on that, today the consolidation of the African economic integration will hinge upon the AfCFTA as the world's largest free trade agreement since the formation of the WTO.[37] The AfCFTA is more than a traditional FTA and more like a comprehensive agreement.[38] It is a flagship project of the AU with an overall mandate to create a single continental market.[39]

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[35] The *AU* has designated the *regional economic communities* as the building blocks towards achieving an *African* Economic Community. *See:* United Nations (1993). Regional integration in Africa has a long history, from the South African Customs Union (SACU) in 1910 and the East African Community (EAC) in 1919. Regional economic communities have since been formed across the continent from these earlier initiatives. *See:* Hartzenberg (2011). Overall, the AU considers Africa's integration Agenda as enshrined in the Abuja Treaty (1991). *See:* African Union (2022).

[36] *See:* Mbengue and Schacherer (2017).

[37] Mbengue and Schacherer (2017). *Also see:* African Union (2022).

[38] *See:* the AfCFTA (2018), art. 6, "*This Agreement shall cover trade in goods, trade in services, investment, intellectual property rights and competition policy*". *Also see:* Ofodile (2019).

[39] The AfCFTA (2018). In January 2018, the Protocol to the Treaty Relating to the Free Movement of Persons, Right of Residence and Right of Establishment, opened for signature and ratification. *See:* Protocol on Free Movement of Persons, Right of Residence and Right of Establishment.

Through better harmonisation and coordination of trade liberalisation, it will also expand intra-African trade. The agreement, however, supports the African perspective that is despondent of rules-based dispute settlement. Notwithstanding that regional courts regime in Africa ("African Courts of Justice") are mostly modelled on the CJEU. African Governments do not litigate on multilateral nor regional levels, despite its formal court systems and agreements suggesting the contrary.[40] This is also to be considered in light of national, regional and continental policies of African States. Shying away from international arbitration, many African States have expressed discontent with formal dispute settlement systems. Some, such as South Africa have gone to reflect their perspectives in their national policies, such as consent to international arbitration 'subject to the exhaustion of domestic remedies.'[41] Although with consistent general views across the continent, South Africa is the only country in Africa that has openly and formally rejected international investment arbitration.[42] 'On the road to greater Intra-Africa trade', importance has been placed on both ISDS and State-to-State dispute settlement.[43] Increasingly seen as an alternative to ISDS, State-State dispute settlement mechanism has been noted to be gaining popularity in both BITs and FTAs. Accordingly, discontent with the WTO-styled dispute settlement system has also regionally been expressed by the likes of Southern African Development Community (SADC) Member States. In 2014, the SADC Summit adopted a new Protocol limiting the Tribunal's jurisdiction to State-State disputes which South Africa also

[40] Erasmus (2022) 1-2.
[41] Section 15(5), The South African Promotion of Investment Act, 2015.
[42] Section 15(5), The South African Promotion of Investment Act, 2015. *Also see:* Ofodile (2019).
[43] African Union, *Training on the Settlement of Disputes: The African Continental Free Trade Area* (2019).

withdrew its signature from.[44] In August 2016, SADC member States negotiated in line with their decision to remove the ISDS from the amended annex of the Southern African Development Community Finance and Investment Protocol (SADC FIP).[45]

3.2. AfCFTA Dispute Settlement Mechanism

Dispute settlement systems are vital in international economic integration not only settling disputes between the State parties in upholding a rules-based regime but also in developing relevant legal system that will guide the single market economy objective of the trade agreements such as AfCFTA.[46] Following the African trend as discussed, the AfCFTA Dispute Resolution Protocol also stipulates a State-to-State dispute mechanism. The AfCFTA DSM lies against regional and national attitudes towards dispute settlement. In particular, the culture against formal settlement of economic integration disputes and an attitude against ISDS.

Although the responses to ISDS have however been varied, African States have, in the recent years, raised concerns about the traditional ISDS. Prior to AfCFTA, South Africa had,

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[44]The Protocol (2018) art. 33. SADC member states recently amended the Annex 1 to the Protocol Finance and Investment to, inter alia, remove ISDS by international arbitration, and rather require the use of domestic courts and tribunals. *Also see:* SADC (2019).

[45] SADC Investment Protocol (2006), amended Annex 1.

[46] The AfCFTA (2018) the preamble notes "*Having regard to the aspirations of Agenda 2063 for a continental market with the free movement of persons, capital, goods and services, which are crucial for deepening economic integration, and promoting agricultural development, food security, industrialization and structural economic transformation*." Furthermore, The AfCFTA (2018) art. 3(a) stipulates that the general objectives are to "*Create a single market for goods, services, facilitated by movement of persons in order to deepen the economic integration of the African continent and in accordance with the Pan African Vision of "An integrated, prosperous and peaceful Africa" enshrined in Agenda 2063*."

together with other African States from the SADC region, argued for the exclusion of the ISDS from the PAIC. In consideration of criticism, a number of other African States were however in support of ISDS. Thus, granting a middle ground, the ISDS provisions under the PAIC include a number of reform provisions.[47] The PAIC allowing states to exercise discretion in implementing ISDS, has influenced the drafting of subsequent bilateral and regional investment instruments in Africa. The North African states that are pursued by the EU, have rather recently ratified the AfCFTA, argued to add a new dispute settlement system that is designed to resolve trade disputes in Africa. Akin to the United States–Mexico–Canada Agreement (USMCA) also referred to as the "New NAFTA", excluding ISDS between US and Canada,[48] AfCFTA DSM also excludes the private sector as actors. There are no provisions for resolving disputes between states and private parties.[49] Art. 20 of the AfCFTA establishes the DSM that is administered in

[47] Qumba (2021) 18.

[48] The USMCA (2020) replacing the North American Free Trade Agreement (NAFTA), which had been in effect since January 1, 1994. *See:* Villarreal (2021). Canada has not agreed to the ISDS mechanism. Even the US, once the world's leading proponent of ISDS, has largely eliminated ISDS from the "New NAFTA" as the scope of ISDS is reduced considerably. And by July 2023, ISDS will be altogether terminated between the United States and Canada. As Canada has not agreed to ISDS, investors may still raise claims under NAFTA Chapter XI with respect to legacy investments up to three years after NAFTA's termination (*i.e.*, 2020 to 2023).

[49] The AfCFTA (2018) art. 3 (1), the AfCFTA Protocol on Rules and Procedures on the Settlement of Disputes (the Dispute Protocol) states on the Scope of Application that 'This Protocol shall apply to disputes arising between State Parties concerning their rights and obligations under the provisions of the Agreement.'. Another possibility for investors is the AfTFCA Investment Protocol which is still being negotiated under Phase II of AfTFCA. The AfCFTA Negotiations are scheduled in phases which can generally be divided into three phases: Phase I – Trade in Goods and Services, Phase II – Intellectual Property Rights (IPR), Investment and Competition Policy, Phase III – E-commerce. AfCFTA Phase II Negotiations also aim to arrive at harmonization. *See:* Habte (2020) 6.

accordance with a dedicated Protocol, the '*Protocol on Rules and Procedures on the Settlement of Disputes*'.[50] This Protocol on Dispute Settlement has been noted as an important feature of the AfCFTA.[51] The view is that in addition to the AfCFTA Protocol on Rules and Procedures on the Settlement of Disputes, the AfCFTA Investment Protocol that is currently being negotiated can be predicted by the PAIC.[52] This may offer a possible option for investors, offering AfTFCA a middle ground. However, problems with a rules-based system remain, whether with or without a middle ground. Although the dispute settlement mechanism of the AfCFTA aims to provide for a rules-based continental trading regime towards '… predictability to the regional trading system,'[53] it is not consistent in practice.[54] African states have also expressed discontent of WTO-styled DSM.[55] In practice, disputes involving African states have not even gone beyond the consultation phase of the WTO-DSM.[56]

Indeed, many of the regional courts in Africa are still modelled on the CJEU.[57] Considered as the world's largest free trade agreement since the formation of the WTO,[58] AfCFTA is however not the first time that an African trade dispute

[50] The AfCFTA (2018) art. 20; the Dispute Protocol.
[51] Akinkugbe (2020).
[52] The Pan-African Investment Code (2017).
[53] The AfCFTA (2018) art. 4 (1); the Dispute Protocol.
[54] The AfCFTA (2018) art. 4 (1); the Dispute Protocol; Also *see:* Akinkugbe (2020).
[55] Akinkugbe (2020).
[56] Akinkugbe (2019). As it is known, consultation between parties in dispute is obligatory and the first of the multiple phases of the WTO dispute settlement process. It is when the parties cannot find a solution to their dispute that the Dispute Settlement Body receives a request from a complaining party, to establish a panel to hear the dispute. *See:* Víg (2019) 140.
[57] *E.g.*, the EAC, COMESA and ECOWA. *See:* Osiemo (2014).
[58] UNECA (2019).

mechanism has been modelled after the WTO.[59] Yet, there is no history of active litigation among African States over trade issues and no examples of such litigation between the Member States of the RECs, also despite the existence of African Courts of Justice. Even with key WTO improvements by AfCFTA,[60] it is still not clear how a commitment to a judicial settlement of disputes can be explained. Contrary, with the EUs procedure that aims to ensure a uniform interpretation and application of EU legislation without jeopardising the exclusive jurisdiction of the CJEU, it is thus difficult to predict how the EU DCFTAs with North African states look to harmonise dispute settlement rules.

4. Conclusion

The EU new generation FTAs have served towards achieving greater economic integration to go beyond traditional FTAs. Going beyond the 'new generation' FTAs, DCFTAs provide a ‘far-reaching and progressive regulatory approximation’ to the laws of the parties. Requiring a certain level harmonisation of rules between the EU and the other partner states to the agreement, it is an opportunity for Non-EEA-Members to demonstrate a European perspective for the consideration of EU membership in future. This possibility of a future EU membership of its neighbours in the east has been recognised.

[59] The Tripartite Free Trade Area Agreement (signed on10 June 2015 in Egypt) between three regional economic communities in Africa – COMESA, EAC and SADC – preceded the AfCFTA (signed in March 2018, three years after the TFTA). The TFTA is based on the WTO model given that “*the TFTA Parties are WTO Members and that the TFTA will eventually have to be consistent with the WTO norms as a result*.” *See:* Trademark Southern Africa (2018), addressing the drafting of trade agreements in the context of the negotiating process leading to the establishment of the TFTA. *Also see:* Siziba, (2018).

[60] There are differences in terms of procedures, membership, and jurisdiction. *See:* Erasmus (2021) *Also see:* African Business (2020).

However, there is no mention of its Non-EEA-Members in the south, that are on the African continent. Yet the EU has still pursued DCFTAs with its African neighbours, south of Europe.

It is probably safer to say that the EUs neighbours in North Africa do not have that 'European perspective'. The North African states pursued by the EU, have rather expressed alignment with the AU and African perspectives, in ratification of the AfCFTA that is argued to add a new dispute settlement system designed to resolve trade disputes in Africa. The pursuit of EU DCFTAs with its neighbours in Africa thus beg the question on the principles of reinforcement considering the potential differing perspectives of the parties.

With difficulties of harmonisation of rules by states in the east that are viewed to be with a 'European perspective', one can only wonder how the EU looks to motivate its neighbours in North Africa with an 'African perspective'. With DCFTA negotiations on hold with North Africa, we can only hope that the EU has not run out of carrots to motivate its neighbours. Unless it is indeed a scenario of the carrot-and-stick approach. Well, this is the most commonly understood use of the carrot and stick idiom, referring to a policy of offering a combination of reward and punishment to induce cooperation.

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To what extent can tax incentives be challenged under the WTO's Subsidy Agreement?

Abstract: This article focuses on government subsidies which distort the competition in the market due to discriminatory treatment of certain private economic actors. The WTO Agreement, like the GATT, regulates these government practices under the title 'Subsidy'. Although 'tax incentives' are adequate instruments to attract foreign investments, create job opportunities, and spread new projects in specific geographical areas, favorable tax treatment is one of the measures through which the subsidy can materialize. Therefore, the goal of this paper is to scrutinize the question when is tax incentive considered a subsidy from the WTO perspective? In short, every tax incentive is deemed a subsidy, but not every subsidy is prohibited under the WTO law. In order to challenge the tax incentive before the WTO Dispute Settlement Body some strict requirements must be met.

Keywords: Agreement on Subsidies and Countervailing Measures, traffic-light subsidies, tax incentives, WTO dispute settlement.

1. Introduction

In 1970s the theory of separation between state and economy has almost been out-of-date. The majority of governments have followed the modern universal trend which is known as the Economic Regulation or the State Economic Interventionism.[1] Economic interventionism has various forms that attempt to lead or control the commercial activities of firms or individuals. According to the traditional theory of economic interventionism

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[1] Karagiannis (2001) 20.

the government interferes into the market seeking to stabilize market inefficiency or inequitable market practices. Thus, the government might control the prices of essential utilities such as electricity, gas, telecommunication, *etc*., or it might impose or remove restrictions on economic activities, for example, taxes, tariffs, and quotas.[2] On the other hand, the rationale behind such intervention can also aim to enhance domestic production or to favour certain undertakings over other (foreign) competitors. For instance, the case of providing loans with lower interest, tax breaks or relief, and others, which have distortive effects on the competition.[3]

The World Trade Organization (WTO), like the General Agreement on Tariffs and Trade (GATT), focuses on the elimination or reduction of tariffs and non-tariff trade barriers, for example, licenses, import quotas, and subsidies.[4] In 1994, the WTO Members have signed the Agreement on Subsidy and Countervailing Measures (ASCM) in order to cease the distortive effects of subsidies. The ASCM is one of the subsidiary agreements that belongs to the GATT. Therefore, it is deemed the main instrument in the field of subsidies regarding trade in goods particularly.[5] According to the ASCM subsidy is not prohibited unless specific requirements are satisfied.Favourable tax treatment is one of the measures through which the subsidy might exist. It has to be acknowledged that tax is deemed the cornerstone of the government revenue which enables the government to fund its expenditures. But, on some occasions, the government decides to concede a part of its revenue seeking greater advantages such

[2] Bailey (1995) 18. These contributions to the market can be justified by public interest purposes, ensuring fair competition, or even equal distribution of wealth.
[3] Mises (2011) 59.
[4] Vig (2019) 137.
[5] The Marrakesh Agreement (1994).

as attracting foreign investments, creating job opportunities, spreading new projects in specific geographical areas. This policy is known as 'tax incentive'.[6] Professor Luja calls tax incentives as 'harmful tax competition' that might have a negative effect on trade and competition.[7]

This paper aims at examining the question of when is tax incentive considered as state subsidy under the WTO agreements? The research follows the doctrinal legal method to describe and analyse legal rules contained in international agreements, especially, the ASCM and case law. The author has done the research after considering the assumption that tax incentives comply with all the general principles provided for in the GATT, General Agreement on Trade in Services (GATS), and Agreement on Trade - Related Investment Measures (TRIMs). For instance, Most Favoured Nation Treatment (MFN), National Treatment (NT), Transparency, and others. Therefore, the legality of tax incentives, from the above-mentioned aspects, fall outside the scheme of this paper. The paper consists of three main sections along with the introduction and conclusion. The first part analyses the definition and categories of subsidies under the ASCM. The second part answers the question what is the reason for having tax incentives? Finally, the third part provides a thorough explanation of the tax provisions within the framework of the ASCM by the mean of case analysis.

2. The definition of subsidy from the ASCM perspective in brief

Over the decades the regulation of subsidies has been a complicated task for policymakers. This can be partially traced back to the uncertainty regarding the definition of subsidies and

[6] Rogers (2000) 445.
[7] Raymond (2017) 72.

their various objectives. According to the Oxford Dictionary, subsidy is defined as 'money that is paid by a government or an organization to reduce the costs of services or of producing goods so that their prices can be kept low'. The narrowest interpretation would be limited to the direct grant of money. In contrast, the practice has showed that tax concessions can serve as a subsidy while there is no direct transfer of money. From the recipient's perspective, it does not really matter if the benefit is obtained as a direct grant of money or as tax reduction. Thus, to regulate this issue and to remove trade distortive effects of certain subsidies first the definition of subsidies should be determined.

It is the ASCM that gave the first international definition of subsidy. This definition is contained in art. 1, which states that a 'subsidy is a financial contribution by a government or any public body within the territory of a Member that conferred a benefit'.[8] Along with art. 2 subsidy must be specific to an enterprise or industry or group of enterprises or industries. This definition requires three elements for a subsidy to exist. Hence, the recipient of the subsidy usually has a superior economic position compared to domestic or foreign competitors. That means the economic competition has been perverted by an external factor which is the government.

The first element of the definition is the 'financial contribution by the government'. The ASCM stipulates several examples for government activities based on which the financial contribution might emerge. Those examples are mentioned in an illustrative list through art. 1(a)(1). The first form is the direct or potential transfer of funds or liabilities. For instance, the amount of money that is given for a particular purpose as a grant, loan, or loan guarantee, increasing the capital of a company by

[8] The ASCM (1994) art. 1.

purchasing some of its stakes (equity infusion), etc. This way, the monetary contribution, or in–kind contribution[9], passes directly from the government's account to the recipient's hand. The enrichment of the recipient leaves no room for doubt.

The second form includes two practices: on one hand, engaging in economic practices that go beyond the general infrastructure. The United Nations Department of Economic and Social Affairs defines infrastructure as 'The system of public works in a country, state, or region, including roads, utility lines, and public buildings'.[10] Thus, the financial support exists when the government exceeds its ordinary activities for the public purpose. On the other hand, acquiring goods at artificial prices. This type of transaction intends to increase the revenues of the enterprise through purchasing its product at price higher than its actual value. Thus, this form of subsidy does not represent ordinary market transaction.[11]

The third form is any form of income or price support in the sense of art. XVI of the GATT 1994. This practice involves any contribution that ends with export escalation or import diminish from/to a territory of any Member. Additionally, the government can conduct any of the before-mentioned activities either by itself or through making payments to funding mechanism or directing or controlling a private body.[12] Moreover, one of the activities mentioned in the ASCM, which is discussed thoroughly later in this paper, is 'government

[9] The Appellate Body found that the term 'funds' included not only 'money' as a cash flow but also any form of financial resource. (Footnote original) Appellate Body Report, *United States - Countervailing Duty Investigation on Dynamic Random-Access Memory Semiconductors (DRAMS) from Korea* (2005) para 250; Appellate Body Report, *US-Large Civil Aircraft (2nd complaint)* (2019) para. 614. (emphasis added).
[10] Department of Economic and Social Affairs (2000) 188.
[11] Steenblik (2012) 26.
[12] The ASCM (1994) art. 1.1(a) 1(iv).

revenue that is otherwise due is foregone or not collected (*e.g.*, fiscal incentives such as tax credits)'.[13]

The second element of the subsidy is the benefit in the account of the recipient. The ASCM does not bring forth a certain method to calculate the benefit resulting from the subsidy. Instead, it sets out two requirements to be considered by the investigating authority of the concerned Member: (a) the method of the benefit calculation should be contained in the national legislation or implementing regulation of the concerned Member, and (b) the application of the method should be transparent and well explained on a case-by-case basis. The ASCM compares the situation of the actual market and the situation after the financial contribution occurred.[14] For instance, the benefit exists in the case of equity capital if the investment decision is inconsistent with the usual investment practice of private investors in the territory of issuing Member. Additionally, in the case of a loan, the benefit is materialized if there is a difference between the amount that the firm receiving the loan pays on the subsidized loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. Furthermore, the benefit is conferred either when the government provides goods or services for less than adequate remuneration, or when the government purchases goods at price higher than adequate remuneration. Taking into consideration that adequate remuneration is to be determined according to the prevailing market of the country in which the provision is made or goods are purchased.[15]

[13] The ASCM (1994) art. 1(a)(1)(ii).
[14] The ASCM (1994) art. 14.
[15] The ASCM (1994) art. 14 (d). The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question.

The issue of the presence of a benefit was examined in various cases. For example, in Canada-Aircraft, the Appellate Body upheld the Panel's finding that the benefit existed within the meaning of the ASCM when the economic position of the receipt had been 'better off' than it would have been compared with the ordinary marketplace.[16] However, it is important to remember that the subsidy is not prohibited or subject to countervailing measures, unless it is 'specific' as explained in art. 2 of the ASCM.

So, the specificity is the third element. The subsidy is specific if the access to it is limited, in law or in fact, to certain enterprises or group of enterprises/industry of group of industries/certain enterprises located within a designated geographical region.[17] On contrary, if receiving the subsidy is based on objective and automatic criteria, like size or date of establishment, then specificity does not exist. Moreover, positive evidence shall be submitted to prove the existence of specificity,[18] considering the exception with regard to red-light subsidies (explained in the following section).

The ASCM has a unique classification of subsidies. This trio classification is also known as 'traffic-light subsidies' due to the legitimacy of the action (subsidy) and the reaction (countervailing measure). The first one are so-called red-light subsidies. These are prohibited subsidies that shall not be conducted by any Member, while the injured Member has the right to impose countervailing duties[19] as compensation.

[16]Appellate Body Report, *Canada-Measures Affecting the Export of Civilian Aircraft* (1999) para. 157.
[17] The ASCM (1994) art. 2.
[18] The ASCM (1994) art. 2.
[19] The GATT (1994) art. VI para. 3. "… *The term countervailing duty shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise*".

Regarding the group at hand, the ASCM adopts an irrebuttable assumption on specificity, which says that subsidies falling into this group are specific without submitting any positive evidence.[20] This category consists of two kinds of subsidies: export subsidies that are contingent, in law or in fact, upon export performance, and domestic subsidies that are contingent upon the use of domestic over imported goods.[21] In Canada-Aircrafts dispute, the Appellate Body upheld the Panel's interpterion regarding the term 'conditioned' as a synonym of 'contingency', then a relationship of conditionality or dependence must be demonstrated.[22] Therefore, the investigation authority must prove the statement that the subsidy would not have been granted unless anticipated exportation/favouritism had been the main goal. However, the ASCM stipulates an illustrative list of what is considered for export subsidy. This list is contained in Annex I of the ASCM. The second, the green-light subsidies are actionable subsidies, because they are not prohibited generally unless the injured Member demonstrates the adverse effects of such subsidies; then, they can be subject to countervailing measures. However, the adverse effects may have three different forms determined in art. 5 of the ASCM: (a) injury to the domestic industry of another Member, (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994, (c) serious prejudice to the interests of other Members calculated in the line with art. 6 of the ASCM. Into the third group fall so-called yellow-light subsidies which are non-actionable subsidies. In contrast to actionable subsidies, this group is always legitimate and can neither be prohibited nor countervailed. This group covers: (a) subsidies that are not specified according to art. 2, (b) subsidies that are specific,

[20] WTO (2003) 899.
[21] The ASCM (1994) art. 3.
[22] Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)* (2019) para. 171.

based on specific purposes such as assistance to disadvantaged regions within the territory of a Member,[23] and assistance to promote the adaptation of existing facilities to new environmental requirements imposed by law and/or regulations.[24]

Finally, it should be noted that one activity should not fall within the scope of two groups due to the different rights and obligations of the Members. Therefore, if the investigating authority claims that the financial contribution of a Member constitutes a prohibited subsidy, it should prove it based on the requirements codified under the related provisions.

3. Tax incentives

Economic development is one of the essential goals of every government. Generally, economic development includes growth of industrialization and role of environment, understanding essential institutional changes, and changing trade pattens.[25] To that end, governments may prefer to scarify some of their public revenue, through which it can pay for services, enhance the infrastructure, and run commercial activities, in order to achieve long-term goals.[26] For instance, economic growth, job creation, spreading economic activity throughout the state (through geographic targeting), focusing on high-value industries, competing with other states and foreign countries for business investments that promise jobs, and increased economic activity.

[23] Regions must be considered disadvantages according to neutral and objective criteria that must be indicated in any legal instrument.
[24] The ASCM (1994) art. 8.
[25] Cypher (2004) 19.
[26] McCleary (1991) 82.

The tax system is the cornerstone of public revenue.[27] Therefore, governments tend to use the tax system to accomplish the task of economic development. In particular, tax incentives are a key part of many states' economic development strategies, because it is easier to use these tools, than correcting deficits in the legal system, and they do not need a direct consumption of the funds, even if it causes a reduction in the government revenue. Moreover, proponents argue that on one hand, tax incentives are a successful tool to attract new investments. On the other hand, the costs of those incentives are partially or wholly recompensed by the additional tax revenue derived from the increased economic activity.[28]

Determining the term tax incentives is the first important step. According to the Cambridge Dictionary, 'incentives' are tools that stimulate or encourage someone to take a specific action. While 'tax' is a compulsory payment levied by the government on individuals or corporations - national or foreigner - on different bases such as income, property, sales, *etc*.[29] When the incentive is followed by the noun 'tax', it means a special tax treatment is provided to taxpayers encouraging them to do a specific economic activity.

Moreover, due to the important role of tax incentives in attracting new investments, it can be said that they have a great influence on investment decision. In this sense, the government should not build up its own tax system without considering the tax regimes of other countries. Thus, investors become more enthusiastic about running their business in a state where the tax rate is lower than in their own states. Tax invectives can be classified into three major categories:

[27] Shaviro (2006) 9.
[28] Organization for Economic Cooperation and Development (2001) 18.
[29] Hines (1996) 4.

3.1. Tax deduction

It is also known as tax concession or tax break. It occurs when the government subtracts the tax liability of certain taxpayers by reducing the total taxable income.[30] As an illustrative example: the government provides a tax deduction at 30 percent for the undertakings that operate their business in a specific area. If the taxable income of one of the undertakings is $200.000, this undertaking can subtract $60.000. Thus, the new taxable income is $140.000.
Some scholars have justified the tax deduction because, firstly, it can increase the ability of taxpayers to tolerate the state taxation and reduce tax avoidance. Secondly, on long term it enhances the government revenue and escalates the quality of the public infrastructure.[31] Conversely, other scholars have criticized tax deduction due to the crucial role of the tax in financing public benefits.[32]

3.2. Tax credit

It occurs when the government subtracts the tax liability of certain taxpayers by reducing the total amount of tax bills that should have been paid.[33] Continuing with the previous example, mentioned regarding the tax deduction, when the government provides a 30 percent tax credit. Then, the $60.000 should be subtracted not from the taxable income, but instead from the total tax bill. Obviously, the tax credit system constitutes, like the other incentives, a direct foregone revenue. However, one can ask, do the taxpayers receive money from the government based on the tax credit? Undoubtedly, yes, they do. According

[30] Welner (2008) 32.
[31] Gladriel (2016) 331.
[32] Galle (2008) 808.
[33] Welner (2008).

to the ASCM, foregone revenue is deemed as a financial contribution.

3.3. Tax exemption or forgiveness

It is a temporary reduction or elimination of a tax, meaning that a certain tax is reduced or ceased for a certain period of time by the end of which the advantaged taxpayers should pay the usual tax. It is commonly known as 'tax holiday'.[34] Historically, tax holiday can be traced back to Pakistan where it was adopted in 1959. The first tax holiday provided the industrial firms with a full income tax exemption. The duration of the exemption ranked from eight to two years based on the degree of the economic development of the area in which those firms were located. Indeed, the less developed area had the longest period. The program was terminated in 1972.[35]

4. Regulation of tax incentives under the ASCM

After a brief presentation of tax incentives, this part comprehensively analyses the tax provisions of the ASCM in order to answer the question raised in this paper. As stated earlier, the second form through which the subsidy can appear is 'government revenue that is otherwise due is foregone or not collected (*e.g.,* fiscal incentives such as tax credits)'.[36] Government revenue is the amount of money that is allocated to provide public services, promote the infrastructure, fund public economic activities. Thus, better services demand greater government revenue.[37] Revenue can be sourced from two major groups: a) tax revenue, including the internal tax and tariffs that are levied on the cross - border goods and services; b) non-tax

[34] Bond (1981) 88.
[35] Azhar(1974) 410.
[36] The ASCM (1994) art. 1.
[37] Bhandari (ed) (2017) 1.

revenue involves administrative and commercial revenue, for example, 'fees' that are charged for the enjoyment of certain services, such as issuing a passport, driving license, etc.[38] 'Fines and penalties' are sanctions imposed in case of law infringement and failure to comply with some regulations.[39] Notedly, they are not a main source of revenue. Furthermore, 'commercial revenue' includes the surplus of the public enterprises that are involved in a commercial transaction, for example, utilities (gas, electricity etc.), railway, banking *etc*.[40]

The meaning of 'foregone' has been defined by the Appellate Body (AB) in the US-Large Civil Aircraft (2nd complaint) as 'the government has given up an entitlement to raise revenue that it could otherwise have raised'. Additionally, the AB, in the same dispute, stated that 'the foregoing of revenue otherwise due implies that less revenue has been raised by the government than would have been raised in a different situation'.[41] Thus, when the government decides to forgive to an undertaking any due and anticipated revenue, it can constitute a subsidy under the ASCM. To dive into the details, the starting point is footnote 1 of the ASCM which indicates two situations where the exemption of an exported product from duties or taxes is allowed and is not deemed as a subsidy. First, when the like product, allocated for domestic use, bears the duties or tax instead of the exported product. Second, when the percent of remission is less than the total amount that is actually due.[42]

[38] Shoup (2004) 764.
[39] Manns (1993) 267.
[40] Tarschys (1988) 8.
[41] Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)* (2019) para. 806.
[42] Panel Report, *European Union - Countervailing Measures on Certain Polyethylene Terephthalate from Pakistan*, (2018), paras. 7.36-7.37. The Panel stated that '*the 'duties' that 'accrued' in this context are import duties that accrued on imported inputs consumed in the production of a subsequently exported product. Thus, the comparison under Article 1.1(a)(1)(ii) is between*

Moreover, the difference between exemption and remission is based on the liability to pay. In case of remission, unlike the exemption, the liability to pay was annulled after it has risen.[43] Besides, remission includes a refund and rebate, fully or partially, of the taxes.[44]

To better understand this issue, two leading cases are discussed the first one being the dispute between the U.S. and European Community (EC) on tax treatment for Foreign Sales Corporation (FSC). The FSC means any corporation which is established or regulated either under the law of a qualified foreign country or under U.S. possession[45].[46]

A FSC attains a tax exemption on an amount of its 'foreign trade income'[47] that is earned by the corporation run outside of the US Besides, two kinds of administrative pricing rules. The first affords the FSC an exemption of 23 % of the total combined taxable income earned by the related supplier and the FSC

remissions of duties obtained by a company under a duty drawback scheme, on the one hand, and duties that accrued on imported production inputs used by that company to produce a subsequently exported product, on the other hand. A subsidy exists insofar as the former exceeds the latter'.

[43] Panel Report, *India - Export Related Measures* (2019) para. 7.169.

[44] The ASCM (1994) fn. 58.

[45] Cornell Law School (2014). The term U.S. possession means American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands.

[46] Cornell Law School (1987). There are some certain requirements must be fulfilled, such ac a) FSC may not have more than 25 shareholders at any time during the taxable year. b) A FSC must conserve an office outside of the United States and maintain a set of permanent books of account (including invoices or summaries of invoices) at such office.

[47] It means the gross income which are generated by qualifying transactions that involve the sale or lease of 'export property'.

together. The second permits the FSC to take 1.83 % of the total foreign trading gross receipts to form its transaction.[48]

The panel was established upon the request of the EC, complainant, due to the failure of the consultation with the US respondent. The EC alleged that both the tax exemptions and special administrative pricing rules provided by the US to the FSCs are subsidies contingent upon export performance. Canada, a third party, has confirmed the EC's claim by stating that 'the tax reduction offered to United States exporters through the FSC program clearly represents tax revenue which would otherwise be due were it not for the operation of the FSC program'.[49] Firstly, the US justified its tax exemptions regarding FSC by claiming that art. 3 of the ASCM, on export subsidies, must be implemented in the light of the Illustrative List of Export Subsidies contained in Annex I to the Agreement. In particular, subparagraph (e), which deals with the issue in question, stated that the 'full or partial exemption, remission, or deferral specifically related to exports, of direct taxes' is a probable export subsidy for purposes of the SCM Agreement.

Footnote 59, referred to in the mentioned subparagraph, excluded one case from the scope of this provision which is the measures aim to avoid the double taxation of foreign-source income. The US claimed that its FSC tax rules meet this exemption.[50] The US approved its arguments by relying on the principle set forth in the GATT original ban on export subsidies.[51] This principle declares that the decision not to tax

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[48] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) paras. 2.5 and 2.6.

[49] Panel Report, *United States – Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 5.11.

[50] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 4.93.

[51] This decision was adopted by the GATT Council based on the reports of four Panels. Those Panels were established, in 1972, to solve the dispute

the earnings that are obtained from businesses allocated outside the tax jurisdiction of a country, is not a prohibited subsidy.[52] On the flip side, the EC contended this justification in three points. Essentially, the members of the Organization of Economic Cooperation and Development (OECD) and many non-member countries have adopted various bilateral double taxation treaties and the US is a party to many of them.[53] Secondly, the US has created comprehensive tax rules, in order to avoid double taxation, based on the principle of 'capital-export neutrality' that encourages the investors, who are willing to launch their businesses domestically or broadly, not to take into account the local or foreign tax considerations.[54] Thirdly, the decision, on which the US relied, (a) is not obligatory and does not ban the GATT Members from levying taxes on the cross-border profits, and (b) neither deprives the Member of enjoying their rights nor abolish or reduce their obligations.[55]

Furthermore, the Panel continued its reasoning by illustrating the meaning of the adjective 'due', according to Oxford English

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between the US and the E.C. on direct taxation. The US applied a differential tax treatment scheme, such as exempting the Domestic International Sales Corporation (DISC) from corporate income tax. Daly (2005) 5.

[52] Panel Report, *United States – Tax Treatment for 'Foreign Sales Corporations*' (2000) para. 4.352.

[53] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 4.166. For more information, see the U.S. Model Income Tax Convention (2016).

[54] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 4.167. This argument was supported by Canada that discussed thoroughly and accurately the U.S. tax law and emphasized the absolute intent of the FSC program to promote the U.S. For more detail, paras. 5.7 and 5.42 of the Panel Report.

[55] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 7.54 and 7.68. The statement of the Chairman of the Council which was attached to the 1981 decision '*Finally,* [the Chairman] *noted that the adoption of these reports together with the understanding does not affect the rights and obligations of contracting parties under the General Agreement*".

Dictionary, as a debt that is 'owing or payable'. Then, it suggested that government revenue is otherwise 'owing or payable' shall be determined by reference to that government's own tax regime.[56] In other words, the determination of whether the government revenue is otherwise due must include a comparison of the situations before and after the measure has been implemented.[57] For that comparison, the 'but for' test should be applied.[58] The major question that should be asked is whether that is the foregone amount payable in the case of elimination of the measure? By applying this test to the FSC scheme, it is obvious that in the absence of the FSC scheme, the income taxes on dividends earned from foreign trade would be paid by the parent of a foreign corporation.[59]

Moreover, the Panel recognized that the FSC scheme includes various exemptions that are deemed as foregoing revenue which is otherwise due and thus constitutes a financial contribution within the meaning of art. 1.1(a)(1)(ii) of the SCM Agreement.[60] This finding was evidenced through an OECD report on tax expenditures which illustrates 'revenue foregone' of US $1.4 billion in 1995 arising from the 'exclusion of income from foreign sales corporations'.[61] Finally, the AB, like Canada and Japan as a third parties, upheld the finding of the panel and concluded that 'The FSC measure creates a 'subsidy' because it

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[56] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 7.42.
[57] Panel Report, *Indonesia - Certain Measures Affecting the Automobile Industry* (1998) para. 14.155.
[58] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 7.93. As the panel suggested the application of this test requires panels to apply their best judgement on a case-by-case basis.
[59] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 7.98.
[60] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 7.102.
[61] OECD (1996) 107.

creates a 'benefit' by means of a 'financial contribution', in that government revenue is foregone that is 'otherwise due'. This 'subsidy' is a 'prohibited export subsidy' under the SCM Agreement because it is contingent upon export performance'.[62]

The second leading dispute in this regard is Brazil-Certain Measures Concerning Taxation and Charges. The EU and Japan, complainants, have requested the establishment of the Panel to rule against Brazil, defendant, as follows:
(a) INOVAR - AUTO Program and Informatics, PADIS, PATVD and Digital Inclusion programs provide tax subsidies contingent upon the use of domestic over imported products,[63] and
(b) RECAP Program constitutes tax subsidies contingent upon export performance.[64]

In order to solve this dispute, the Panel started with explaining the challenged measures as demonstrated. Firstly, Informatics program,[65] covers the tax on Industrial Products (IPI tax)[66] on information technology and automation goods. This program offered a 95% reduction until 31 Dec 2024, a 90% reduction until 31 Dec 2026, and a 85% reduction until 31 Dec 2029. The

[62] Panel Report, *United States - Tax Treatment for 'Foreign Sales Corporations'* (2000) para. 180.
[63] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) paras. 3.1.i.f-3.2.i.f-3.1.ii.f-3.2.ii.f.
[64] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) paras. 3.1.iii-3.2.iii.
[65] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 2.2.1.
[66] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 2.3. The IPI tax is a Brazilian Federal tax that applies to all national or foreign industrialized (*i.e.*, manufactured) products. The rate of this tax is based on the value, or the price of the industrialized products and it must be borne by the purchaser of the finished products.

beneficiaries of the program at hand are goods produced in Central - West Region, SUDAM, and SUDENE.[67]

Additionally, The PADIS program[68] involves semiconductors and information displays (displays), as well as inputs, tools, equipment, machinery, and software (so for 'production goods'). Under this program, the tax exemptions (through zero rates) entered into force in 2007 and were in effect until January 22, 2022. This program benefited every legal person previously accredited, by the Brazilian Federal Revenue Service (RFB), to import or sell the mentioned products in the Brazilian market. Besides, the RECAP program,[69] involves new machinery, tools, apparatuses, instruments, and equipment for incorporation into the tangible fixed assets by legal persons registered as predominantly exporting companies. The incentive presents the suspension of the PIS/PASEP, COFINS, PIS/PASEP - Importation and COFINS - Importation contributions.

One of the essential arguments of Brazil is that the challenged programs fall outside the scope of the ASCM because they include only the pre-marketing obligations by producers. Besides, the provisions of the ASCM are limited to factors related to the origin and the use of products or to percentages of domestically produced inputs.[70] On one hand, the European Union contested Brazil's argument and noted that the fundamental fact to be considered while determining the scope of the ASCM is whether the measures negatively affect the equality of conditions of competition between domestic and

[67] Regions of influence of the Superintendence for the Development of Amazonia (SUDAM) and the Northeast (SUDENE).
[68] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 2.2.1.
[69] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 2.2.2.
[70] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.61.

imported products. On the other hand, Japan further argued that 'if merely being directed towards particular producers or pertaining to production processes cured any WTO - inconsistency, then circumvention of WTO disciplines would be trivially easy'.[71]

The Panel upheld the Appellate Body' finding in China - Publications and Audio-visual Products and found that government measures are inconsistent with the GATT and then with the ASCM, if they affect trade in products by imposing obligations on enterprises, whether or not they regulate goods or importation of goods.[72] However, the Panel concluded that INOVAR-AUTO program[73] and the tax exemptions, reductions, and suspensions under the ICT Programs constitute a financial contribution in the form of government revenue that is otherwise due.[74] The Panel proved the former case by stating that if the buyers of the incentivized products do not have to pay the full amount of taxes and contributions concerned, they are better off with the reductions than in the benchmark scenario of

[71] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.62.

[72] Appellate Body Report, China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audio-visual Entertainment Products (2010) para. 227.

[73] Panel Report, Brazil - Certain Measures Concerning Taxation and Charges (2019), paras. 2.25-2.113. The INOVAR - AUTO program includes Motor cars and other motor vehicles subject to certain conditions. For instance,

1 - To be entitled to presumed IPI tax credits, a company must be accredited as a 'domestic manufacturer', an 'investor', or an 'importer/distributor'.

2 - To be entitled to the reduced IPI tax rates, a company must

a. Be accredited as a 'domestic manufacturer' or 'investor' imports from countries that are signatories to the relevant agreements);

b. Import certain vehicles from Uruguay under the relevant agreements.

c. Be accredited as an 'importer/distributor' of certain vehicles under the INOVAR - AUTO program. Ibid, para 2.110.

[74] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) paras. 7.4.5.5-7.488.

having to pay the full amount of taxes concerned on their purchases on non-incentivized products.[75]

Moreover, this case was evidenced through comparing the customs duties collected from accredited and non - accredited companies.[76] Thus, the Brazilian Government will receive the full amount of ordinary customs duties from the non-accredited company purchasing the inputs, capital goods and computational tools, but not from the accredited companies that are beneficiaries of these tax incentives programs.[77]

Regarding PEC and RECAP, the Panel decided that they are contingent upon export performance within the meaning of art. 3.1(a) of the SCM Agreement. Thus, they are prohibited subsidies.[78] The Panel based its finding on the previous benchmark comparison (accredited and non - accredited companies) and, thus, concluded the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used.[79] In return, Brazil rebutted the Panel's determination of the benchmark for comparison and claimed that the tax suspensions are the benchmark treatment for structurally credit-accumulating companies, including the predominantly exporting companies, and not an exemption to the rule.[80] Thus,

[75] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.844.
[76] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.414.
[77] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.483.
[78] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.1224.
[79] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) paras. 7.1179, 7.1194, and 7.1207
[80] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 7.1197.

it was more appropriate for the Panel to determine the benchmark after a better understanding of the principles and structure of Brazil's taxation regime and selecting comparably situated taxpayers.[81]

In conclusion, the AB's final statement can be divided into two groups confirming and reversing the Panel's findings. On the one hand, the AB relatively upheld the Panel's finding with regard to the ICT Programs and INOVAR - AUTO program as to constitute financial contributions where 'government revenue that is otherwise due is foregone or not collected'.[82] Hence, The Panel succeed in implementing the three - phase test, pointed out by the AB, to prove whether the revenue is foregone: '(i) identify the tax treatment that applies to the income of the alleged subsidy recipients; (ii) identify a benchmark for comparison, and (iii) compare the challenged treatment and reasons for it with the benchmark tax treatment'.[83]

Furthermore, the AB decided, unlike the Panel, that the ICT programs and INOVAR - AUTO programs are subsidies contingent upon the use of domestic over imported goods only if they involve what is called 'nested basic productive processes' (PPBS). By the way of explanation, the PPBSs are the production - step requirements that must be met by a particular company in order to be eligible for the tax treatment available under the mentioned programs.[84] However, the 'nested PPBSs' are the requirements that specific input or

[81] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 5.140.
[82] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 5.222.
[83] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) para. 5.196.
[84] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) Appendix, para. 9.1.

component can be produced by third parties in Brazil.[85] Thus, a company can only retain the tax benefits in question if those inputs or components are produced in Brazil in accordance with their own PPBS, and thus are domestic products.[86] On the other hand, the AB reversed the Panel's finding and supported Brazil's argument with regard to benchmark treatment for the PEC and RECAP programs. Therefore, the AB found that tax suspension under the mentioned programs is not a subsidy contingent upon the export performance.[87] The AB justified that the Panel applied the comparison to prove the existence of revenue foregone only to predominantly exporting companies, while the tax suspensions are available to various groups of companies, including predominantly exporting companies, among them the comparison should have been done.[88]

5. Conclusion

Subsidies in the form of tax incentives can be adequate instruments for enhancing and stimulating business. Indeed, the reactions of businesses are significantly different to each kind of government interventionism policy. At the same time, distortion effects of interventions on cross-border trade is almost certain. Therefore, the WTO, as an inter-governmental organization that regulates, facilitates and observes the flow of international trade, endeavours to ensure that the economic transactions between nations are not distorted. To that end, the Marrakesh Agreement, which created the WTO, contains several agreements which guarantee the rights and obligations

[85] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019), fn. 1619.
[86] Panel Report, *Brazil - Certain Measures Concerning Taxation and Charges* (2019) Appendix, para. 9.40.
[87] Appellate Body Report, *Brazil – Certain Measures Concerning Taxation and Charges* (2019) para. 6.21.
[88] Appellate Body Report, *Brazil – Certain Measures Concerning Taxation and Charges* (2019) para. 5.170.

of the Contracting Members and reduce and eliminate trade barriers, such as subsidies. Moreover, the ASCM contains a set of rules that regulate the use of the subsidies, particularly in the trade in the goods sector, and stipulate for adequate compensation for the adversely affected Members. The government through tax incentives subtracts some of the government revenue that is maintained through the tax system. This revenue reduction, on most occasions, meets the definition of subsidies provided for in the ASCM.

As a result, every tax incentive is a subsidy because it constitutes the basis for government revenue that is foregone and conferred a benefit in the account of the recipient, but not every tax incentive is a subsidy, tax incentives provided in the service sector are still unregulated within the WTO regime. Therefore, the WTO Members are required to respond promptly in order to subject subsidies on trade in services to strict multilateral disciplines.[89] Besides, most of the tax incentives, when certain conditions are met, can be classified as either: (a) a prohibited subsidy if they are provided upon export (export subsidies), or favour/promote the domestic over imported products, or (b) an actionable subsidy when they are provided particularly within a specific geographical area or for a specific field of industry or for certain undertakings. Bearing in mind that, there is no presumption on the prohibition of actionable subsidy, but instead it is subject to challenge before the WTO Dispute Settlement Body. Therefore, it would be difficult for a country to prove the existence of subsidies in the form of tax incentives as long as the specificity is not meant to exist. Thus, the 'specificity' test, in particular *de facto* specificity, shall be paid more consideration and stricter rules in the case of challenged tax incentives.

[89] The GATS (1995) art. 15.

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Bengi Sargin*

Acquisition of citizenship by investment (*ius pecuniae*): the case of Turkey

Abstract: It's an indisputable fact that economic challenges are widely seen all around the world in the 21st century. Unfortunately, these challenges more seriously affect small and mid-size economies. In order to lure in more capital, countries often offer permanent residency or even citizenship to foreign investors. Several national laws provide for simplified naturalization procedures in certain cases. In some countries, residency is required before applying for citizenship, however, some others allow investors to acquire citizenship without previous residency. In order to make it easier for investors to acquire Turkish citizenship, the Turkish legislator has adopted the institution of extraordinary naturalization based on investment. This paper explains briefly the acquisition methods of Turkish citizenship, and following this, it examines the issue of citizenship by investment in Turkey. Last but not least, it gives suggestions how to improve the current regulation taking into consideration practices of other states.

Keywords: naturalization, citizenship, investment, *ius pecuniae*, Turkey

1. Introduction

Under international law, citizenship can be defined as a legal and political bond, which binds individuals to states.[1] This bond creates rights and obligations both for individuals and the state,

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[1] Doğan (2017) 5; Nomer (2018) 3; Aybay, Özbek and Ersen-Perçin (2019) 4; Güngör (2019) 1; Yılmaz (2018) 192; Gölcüklü (2020) 128.

such as diplomatic patronage, right to elect and be elected, etc.[2] Granting citizenship to foreigners who have helped the state financially by investing, buying government bonds or buying real estate is a route usually used by countries in financial difficulty. Foreigners who acquired citizenship in this way, lot of times reside in other country and have no strong bond to the country of newly acquired citizenship.

There are mainly two types of citizenship by investment programs in comparative law: investor citizenship programs with residency condition and direct investor citizenship program. In the investor citizenship program with residency condition the foreigner obtains residence permit as a first step. Following a certain prescribed time, the residence permit is extended, and finally the foreigner obtains citizenship.[3] So, under this program, obtaining residence permit is a pre-requisite for acquisition of the citizenship.[4] For example, in the USA the EB-5 Visa program was introduced in 1990[5], under which foreigner has to invest minimum $500.000 in fields of agriculture or other economic fields in which unemployment is an issue.[6] Based on this, the foreigner obtains a conditional green card for two years.[7] A permanent residence permit is granted if during this period the foreigner provides full-time employment for ten persons at least.[8] If the foreigner wants to acquire the USA citizenship through the EB-5 program, the foreigner must be actually present in the USA for half of the first two years of residency.[9]

[2] Kaya (2021) 116; Yılmaz (2018) 192; Gölcüklü (2020) 128.
[3] Yılmaz (2018) 197.
[4] Yılmaz (2018) 197.
[5] Schneider and Diaz-Cortes (2017) 37.
[6] Schneider and Diaz-Cortes (2017) 37.
[7] Schneider and Diaz-Cortes (2017) 37.
[8] Yılmaz (2018) 199.
[9] Yılmaz (2018) 199.

In the direct investor citizenship program, there is no need to obtain residence permit to get the citizenship.[10] In other words, as soon as the foreigner meets the requirements, he or she can apply for the acquisition of the citizenship. For example, St. Kitts and Nevis has been implementing investor citizenship program since 1984.[11] Foreigners should invest into real estate at least $400.000 (and keep it for seven years) or donate at least $150.000 to a public institution.[12]

One of the most controversial examples related to citizenship by investment in the EU can be seen in Malta. The Maltese legislators amended the Maltese Citizenship Act in 2013. Under the Individual Investor Programme, foreigners who donate EUR650.000 to the National Development and Social Fund and to the government, are entitled to obtain Maltese citizenship without residency requirement.[13] In addition to the above-mentioned investment, it is also required to invest into one of the following: (1) purchasing real estate in the amount of at least EUR350.000 and holding it for minimum five years, (2) renting real estate for at least EUR16.000/per year, (3) investing EUR150.000 into a project (such as the purchase of government bonds) determined by the Maltese state authorities, provided that it is not disposed of for five years.[14]

This program resulted in a huge debate in the EU, and in 2014 the European Parliament resolution on EU citizenship for sale was published.[15] In this resolution, the Parliament emphasized the value of EU citizenship and being European. Thus, the Parliament warned all EU Member States, with a special focus

[10] Yılmaz (2018) 201.
[11] Yılmaz (2018) 201.
[12] St. Kitts and Nevis Citizenship (2021).
[13] Carrera (2014) 3.
[14] Carrera (2014) 3, 4.
[15] European Parliament Resolution (2014).

on Malta, and highlighted the consequences of EU citizenship (such as free movement of people, the privilege of obtaining EU passport, entering into Schengen zone without visa etc.), and recommended that Member States should regulate these programs stricter.[16]

In this paper first we explain briefly the acquisition methods of Turkish citizenship, and following this, examine the issue of citizenship by investment in Turkey.

2. Turkish citizenship

According to art. 66/1 of the Turkish Constitution, which is entitled "*Turkish Citizenship*", "*Everyone bound to the Turkish State through the bond of citizenship is a Turk.*". Although there has been disputes over the perception of the meaning of "Turk", it's generally accepted in the Turkish legal doctrine that the word "Turk" includes every type of race, ethnical groups if they have Turkish citizenship.[17]

Art. 66/3 of the same document provides that "*Citizenship can be acquired under the conditions stipulated by law, and shall be forfeited only in cases determined by law.*". The main legal document regulating acquisition and loss of Turkish citizenship is the Turkish Citizenship Act (hereinafter: TCA) No. 5901.[18] The Regulation on the Implementation of the Turkish Citizenship Act (hereinafter: Regulation) was adopted in 2010 in order to determine the procedures and principles to be applied in the execution of transactions regarding the acquisition, loss

[16] European Parliament Resolution (2014).
[17] For further information, Doğan (2017) 16-24; Nomer (2018) 58-62; Aybay, Özbek and Ersen-Perçin (2019) 70-72; Güngör (2019) 50-51.
[18] Turkish Citizenship Act (2009).

and proof of Turkish citizenship and multiple citizenship and to ensure uniform practice.[19]

According to art. 5 of the TCA "*Turkish citizenship is acquired by birth or after birth.*". Acquiring citizenship by birth is the main or fundamental way. Citizenship by birth (*ius originis*) is based on law, that is to say on descent (*ius sanguinis* – art. 7 of the TCA) or place of birth (*ius soli* – art. 8 of the TCA).[20] A person who acquires Turkish citizenship by one of the above-mentioned ways is called a citizen.[21] The incidence of birth plays an essential and important role for the determination of citizenship.[22] In other words, citizenship by birth is self-acquired and comes into effect from the moment of birth.

Acquisition of citizenship based on the principle of *ius sanguinis* requires a Turkish citizen mother and/or father, to whom he or she is bound by lineage.[23] According to art. 7 of the TCA *"(1) A child born in or out of Turkey to a Turkish citizen mother or father in a marriage union is a Turkish citizen. (2) A child born out of marriage union to a Turkish citizen mother and a foreign father is a Turkish citizen. (3) A child born outside the marriage union of a Turkish citizen father and a foreign mother acquires Turkish citizenship if the procedures and*

[19] The Regulation on the Implementation of the Turkish Citizenship Act (2010).
[20] Doğan (2017) 31; Nomer (2018) 66; Aybay, Özbek, and Ersen-Perçin (2019) 90-91; Güngör (2019) 56; Kaya (2021) 116; Gölcüklü (2020) 130.
[21] Doğan (2017) 31; Nomer (2018) 67; Aybay, Özbek, and Ersen-Perçin (2019) 93; Güngör (2019) 57.
[22] Doğan (2017) 31; Nomer (2018) 67; Aybay, Özbek, and Ersen-Perçin (2019) 93; Güngör (2019) 57.
[23] Doğan (2017) 40; Nomer (2018) 68; Aybay, Özbek, and Ersen-Perçin (2019) 96; Güngör (2019) 60.

principles that ensure the establishment of lineage are fulfilled.".[24]

Ius soli principle is the type of acquisition that is based on the territorial relationship between the person and the country of birth.[25] This is accepted by the Turkish law, thus, according to art. 8 of the TCA *"(1) A child born in Turkey who cannot acquire citizenship of any country by birth due to foreign parents is a Turkish citizen from birth. (2) A child who has been in Turkey is deemed to have been born in Turkey, unless otherwise proven."*.

Another way of acquisition of Turkish citizenship is by naturalization. Acquisition of citizenship by naturalization is citizenship acquired by a person after his or her birth for a reason other than birth.[26] Just like citizenship by birth, this is also continuous.[27] The Turkish legal system does not differentiate between citizenship by birth and citizenship acquired after birth by naturalization in terms of rights and obligations.[28] In other words, there is no difference regarding the legal status of a Turkish citizen, whether he or she has acquired his or her citizenship by birth or after birth by naturalization. Art. 9 of the TCA provides that Turkish

[24] Lineage shall be set up via art. 16 of Turkish International Law and Procedural Law Act (Turkish PILA) no. 5718. The establishment of the lineage is subject to the national law of the child at the time of birth, and if it cannot be established, the law of the habitual residence of the child applies; According to the Turkish law, there are three ways to establish the lineage: marriage, acknowledgement of child (*actio de liberis agnoscendis*) and paternity suit. Doğan (2017) 48-54; Nomer (2018) 69-72; Aybay, Özbek, Ersen-Perçin (2019) 97-101; Güngör (2019) 62-68.

[25] Doğan (2017) 54; Nomer (2018) 72; Aybay, Özbek, Ersen-Perçin (2019) 101; Güngör (2019) 69.

[26] Doğan (2017) 59; Nomer (2018) 75; Aybay, Özbek, Ersen-Perçin (2019) 106; Güngör (2019) 76; Kaya (2021) 116.

[27] Doğan (2017) 59; Güngör (2019) 76.

[28] Doğan (2017) 59; Güngör (2019) 76.

citizenship shall be acquired after birth either by a decision of the competent authority or by adoption or by exercising the right of choice.[29] Naturalization can be ordinary naturalization (art. 11 of TCA)[30], extraordinary naturalization (art. 12 of TCA), re-acquisition of Turkish citizenship without stipulating the residence condition (art. 13 of TCA[31]), re-acquisition of Turkish citizenship with residence condition (art. 14 of TCA[32]), and naturalization by marriage (art. 16 of TCA[33]). In the following

[29] However, it should be noted, that even though the potential applicant fulfils all the requirements for acquiring citizenship by naturalization, the competent authority does not have to grant it automatically. (art. 10/1 of TCA).

[30] *"(1) Foreigners who wish to acquire Turkish citizenship; a) The legal age and capacity to discriminate according to his/her national law or, if he/she is stateless, according to Turkish law to have, b) To reside in Turkey for an uninterrupted period of five years prior to the date of application, c) confirming by his/her behavior that he/she has decided to settle in Turkey, ç) Not having a disease that poses a danger to general health, d) Having good morals, e) To speak Turkish sufficiently, f) To ensure the subsistence of himself/herself and his/her dependents in Turkey have an income or occupation, g) Not having any situation that would constitute an obstacle in terms of homeland security and public order conditions are required."*

[31] *"(1) Provided that there is no obstacle in terms of homeland security, the following persons may re-acquire Turkish citizenship by a decision of the President, regardless of the duration of their residence in Turkey. a) Those who lost their Turkish citizenship by obtaining an exit permit. b) Those who lost their Turkish citizenship due to their parents may regain Turkish citizenship by a decision of the Ministry in accordance with Article 21 those who do not exercise their right to vote within the period stipulated in the article."*

[32] *"Those who have lost Turkish citizenship pursuant to Article 29 may re-acquire Turkish citizenship by Presidential decree, and those who have lost Turkish citizenship pursuant to Article 34 may re-acquire Turkish citizenship by Presidential decree, provided that they do not pose an obstacle in terms of homeland security and reside in Turkey for three years."*

[33] *"(1) Marriage to a Turkish citizen does not directly acquire Turkish citizenship. However, foreigners who have been married to a Turkish citizen for at least three years and whose marriage continues may apply to acquire Turkish citizenship. The applicants shall be required to: a) live in family unity, b) not engage in any activity incompatible with the union of marriage, c) not*

part of this paper, the acquisition of Turkish citizenship by investment (*ius pecuniae*), *i.e.*, extraordinary naturalization (art. 12 of TCA), is explained in detail.

3. Acquisition of Turkish citizenship by investment (*ius pecuniae*)

It is an indisputable fact that economic challenges are widely seen all around the world in the 21st century. Unfortunately, these challenges more seriously affect small and mid-size economies. In order to lure in more capital, developing countries often offer permanent residency or even citizenship to foreign investors. Several national laws provide for simplified naturalization procedures in certain cases.[34] For instance, Montenegro offers investment visas, Portugal and Malta offer so-called golden visas, and so on. In some countries residency is required before applying for citizenship, however, some others allow investors to acquire citizenship without previous residency.

Turkey also offers special residence permits based on investment, as well as citizenship. According to art. 12 of the TCA:

> The following foreigners may acquire Turkish citizenship by the decision of the President of the Turkish Republic, provided that they do not have an obstacle to homeland

have any condition that would constitute an obstacle in terms of national security and public order.
(2) In case the marriage is terminated due to the death of the Turkish citizen spouse after the application, the condition in subparagraph (a) of the first paragraph shall not be sought.
(3) Foreigners who acquire Turkish citizenship through marriage shall retain their Turkish citizenship in case the marriage is declared null and void if they were in good faith in the marriage."

[34] Kaya (2021) 116; Shachar and Hirschl (2014) 231.

> security and public order: … b) Foreigners who have a residence permit pursuant to subparagraph (j) of the first paragraph of Article 31 of the Law on Foreigners and International Protection dated 4/4/2013 and numbered 6458, and foreigners holding Turquoise Card and their foreign spouses, minor or dependent foreign children of themselves and their spouses.

In order to make it easier for investors to acquire Turkish citizenship, the Turkish legislator has adopted the institution of extraordinary naturalization[35] or citizenship by investment (*ius pecuniae*)[36]. The idea behind *ius pecuniae* is to grant Turkish citizenship to foreigners who can contribute to Turkey's economic and social life (solving problems related to migration, promoting foreign investment, increasing employment in Turkey or meeting the need for a qualified labour force).[37] The preconditions of acquiring Turkish citizenship through extraordinary naturalization are investment and fulfilling homeland security and public order requirements.[38] It means that a foreigner can obtain Turkish citizenship with the President's decision if there are no such obstacles. However,

[35] According to the TCA, there are four ways for extraordinary naturalization: a) Persons who bring industrial facilities to Turkey or who have rendered or are expected to render extraordinary services in scientific, technological, economic, social, sportive, cultural, artistic fields and for whom a reasoned proposal is made by the relevant ministries, b) Foreigners who have obtained a residence permit pursuant to subparagraph (j) of the first paragraph of art. 31 of the Law on Foreigners and International Protection No. 6458 dated 4/4/2013 and numbered 6458, foreigners holding Turquoise Cards and their foreign spouses, and their minor or dependent foreign children, c) Persons deemed necessary to be naturalized, d) Persons recognized as immigrants. Since subtitles a, c and d are beyond the scope of this study, they will only be mentioned by name.

[36] Doğan (2017) 77; Küpe (2021) 413; Nomer (2018) 88; Güngör (2019) 100; Kaya (2021) 123; Yılmaz (2018) 207; Gölcüklü (2020) 131.

[37] Doğan (2017) 77; Küpe (2021) 414; Nomer (2018) 89; Güngör (2019) 100.

[38] Doğan (2017) 78-79; Nomer (2018) 88-89; Güngör (2019) 101; Yılmaz (2018) 208.

these latter conditions are relatively vaguely regulated by the TCA implementation Regulation.[39] In our view, the lack of concretization of conditions specified in the TCA by the Regulation is contrary to the principle of legality and the Constitution.[40] In order to protect Turkey and the value of Turkish citizenship, there should be provisions which require stronger link between Turkey and the foreigner who wants to acquire Turkish citizenship.

There is uncertainty whether the applicant must be of full age or not. According to one view in Turkish doctrine, the applicant (foreigner) is not required to be of full age and sound state of mind.[41] Other view upholds that there is a gap in law related to this issue.[42] In our opinion, since the right to application to acquisition of Turkish citizenship is one of the strictly bounded

[39] Art. 72/5 of the Regulation: *"As a result of the research carried out by the relevant institutions, it was found that he was engaged in activities aimed at overthrowing the state order established by the Constitution, that he cooperated with or financially supported those who were engaged in these activities, that he was engaged in activities related to crimes against the indivisible integrity of the Republic of Turkey with its country and nation, at home or abroad, within the scope of the Anti-Terror Law No. 3713, those who have been found to have participated in the crimes of rebellion, espionage and treason, arms and narcotics smuggling, human smuggling and human trafficking, or to have been in contact with them, and those who have been deferred, statute of limitations, suspended, deferred pronouncement of judgment, converted into money or pardoned, except for negligent crimes Those who are sentenced to imprisonment for more than six months, even if they have been convicted, cannot acquire Turkish citizenship."*.

[40] For further information, Erkan (2019) 329-356.

[41] Güngör (2019) 101; Küpe (2021) 420.

[42] Nomer (2018) 89; Küpe (2021) 421. According to the Küpe's view, on the grounds of the Regulation art. 64/2, it's possible to conclude that citizenship applications of minors and lack of mental competence shall be made by parents or guardians. Doğan (2017) 80. Doğan also points out that application for citizenship is one of the strictly bound right to that person. For that reason, people with partial disability and absolute disability shall not apply for acquisition of Turkish citizenship on their own.

rights to the person, the person must be of full age and of sound state of mind.

Getting back to art. 12 of the TCA, the first group regulated under art. 12/1-b are foreigners who have short term residence permit on the grounds of art. 31/1-j of the Law on Foreigners and International Protection.[43] Actually this type of group is accepted in 2016 with International Labour Law which made amendments to the Law on Foreigners and International Protection.[44] According to art. 31/1-j of Law on Foreigners and International Protection, foreigners who do not work in Turkey, but are willing to invest within the scope and amount determined by the President, and their foreign spouses, minors or dependent foreign children can obtain short-term residence permit. Thus, for this method of acquisition of Turkish Citizenship, valid residence permit is also needed.

One of the major legal problems related to art. 12/1-b of the TCA is the application time for foreigners once she or he got her or his residence permit, because it is not regulated by the law. There are mainly two views in Turkish doctrine. One view argues that as soon as the foreigner ensures the thresholds, she or he can apply for Turkish citizenship immediately.[45] However, it should not be forgotten that short term residence permit is given maximum for five-year term according to art. 31/5 of Law on Foreigners and International Protection. The other view supports that the foreigner must be actually present in Turkey.[46] In our opinion, for all types of investments, the foreigner's presence and residence in Turkey for a certain period of time should be required.[47] Thus, a real connection between

[43] The Law on Foreigners and International Protection (April 2013).
[44] The International Labour Force (July 2016).
[45] Kaya (2021) 124; Küpe (2021) 424.
[46] Yılmaz (2018) 211.
[47] Küpe (2021) 424.

the foreigner and the Turkish society and Turkey will be established. Furthermore, there will be no obstacle to granting citizenship through the facilitated route, because in addition to the investment, only the fulfilment of homeland security and public order conditions are required here.

The other important legal problem related to art. 12 /1-b of the TCA is the issue of dependent children. Apart from minors, the term of "dependent children" is also used several times in the law, however, there is no definition neither in the TCA nor in the Law on Foreigners and International Protection.[48] Thus, the term "child" is used in the sense of persons/children who is related to the parent. In our opinion, this term ("dependent children") needs to be understood as adult child economically dependent on the applicant.[49] Economic and physical dependencies should be considered while interpreting 'dependent children'.[50]

Investment types and thresholds are regulated in Regulation on Application of Turkish Citizenship Law art. 20. The President has the discretion to decide investment types and thresholds. When the regulation is analysed, foreigners who invest a fixed capital and create employment will be able to take exceptional initiatives to acquire Turkish citizenship if they document the investment with the relevant Ministry.[51]

After the coming into force of the Regulation on investment types and thresholds, three major amendments were made to it between 2016 and 2022. There are several types of investments offered to foreigners who want to acquire Turkish citizenship

[48] Küpe (2021) 425; Güngör (2019) 107.
[49] This view is also supported by: Güngör (2019) 104, 107; Küpe (2021) 426; Yılmaz (2018) 210.
[50] Küpe (2021) 426; Güngör (2019) 107.
[51] Doğan (2017) 81.

through investment, like fixed capital investment, investment into real estate, and so on. The following table shows investment types and the change of the thresholds:[52]

Investment type	First threshold[53]	Second threshold[54]	Third threshold[55]
Fixed capital investment	2.000.000 USD	500.000 USD	500.000 USD
Real estate purchase/promise	1.000.000 USD	250.000 USD	400.000 USD
Creation of employment	100 person	50 person	50 person
Deposit in Turkish banks	3.000.000 USD	500.000 USD	500.000 USD
Purchase of governmental debt instruments	3.000.000 USD	500.000 USD	500.000 USD
Real estate investment fund or venture capital investment fund[56]	1.500.000 USD	500.000 USD	500.000 USD
Investing in the private pension system[57]	-	-	500.000 USD

Investment types and thresholds under the Regulation on the Implementation of the Turkish Citizenship Act (prepared by the author)

[52] Küpe (2021) 418; the Regulation on the Implementation of the Turkish Citizenship Act (February 2010), art. 20.
[53] The Amending Regulation on the Implementation of the Turkish Citizenship Act (December 2016).
[54] The Amending Regulation on the Implementation of the Turkish Citizenship Act, (September 2018).
[55] The Amending Regulation on the Implementation of the Turkish Citizenship Act (May 2022).
[56] This type of threshold came into power in 2017. The Amending Regulation on the Implementation of the Turkish Citizenship Act (March 2017).
[57] This type of threshold came into power in 13 May 2022. The Amending Regulation on the Implementation of the Turkish Citizenship Act (May 2022).

The effective selling rate and/or cross-exchange rate of the Central Bank of the Republic of Turkey on the date of decision is taken as the basis in determining the monetary values specified in the investment in the purchase of real estate if done in other currency. Apart from this, in the case of other investment types, the amounts should be exchanged into Turkish Lira and must be sold to a Turkish bank or to the Central Bank of Turkey. The exchange rate is decided by the Central Bank of Turkey.

Based on the above data it can be said that Turkish citizenship can be acquired by foreign investors for a relatively low amount.[58] In addition, only a short-term residence is required.[59] Here, we would like to mention, that although there are various options for acquiring citizenship by investment, real estate purchase is the most frequently used by foreigners. In December, Istanbul took the first place in housing sales to foreigners with the sale of 3300 properties. Antalya took the second place with 827 property sales and Ankara took the third place with 489 property sales, respectively. However, currently there is no data how many of these sales are related to acquisition of Turkish citizenship.[60] According to the nationality of the country, the most residential sales were made to Iranian citizens in 2021. Iranian citizens bought 10056 properties in Turkey in 2021. Iran was followed by the citizens of Iraq with 8661 residences and the citizens of the Russian Federation with 5379 residences.[61]

The second group regulated under art. 12/1-b of TCA are foreigners holding Turquoise Card and their foreign spouses, minors or dependent foreign children. According to the art. 3/1-

[58] For comparison please see 1. Introduction.
[59] Gölcüklü (2020) 135.
[60] Source: Turkish Statistical Institute (2021).
[61] Source: Turkish Statistical Institute (2021).

ğ of International Labour Law, Turquoise Card ensures indefinite work permit to its holder and residence permit to spouse and children for whom they are responsible.[62]

[62] Art. 11 of the International Labour Law regulates Turquoise Card issue in detail. (*"(1) In line with the international labour policy, a Turquoise Card shall be issued to foreigners whose applications are deemed appropriate based on their educational level, professional experience, contribution to science and technology, the impact of their activities or investments in Turkey on the national economy and employment, and the recommendations of the International Labour Policy Advisory Board and the procedures and principles determined by the Ministry. (2) The Turquoise Card shall be issued with a transition period of the first three years. During the transition period, the Ministry may request information and documents from the employer or foreigner regarding the activities carried out. The transitional period record on the Turquoise Card that is not cancelled within the transitional period in accordance with Article 15 shall be removed upon the application of the foreigner and an indefinite Turquoise Card shall be issued. This application shall be made one hundred and eighty days before the expiration of the transition period, in any case before the expiration of the transition period. After the expiry of this period, the application for removal of the transitional period shall be rejected and the Turquoise Card shall become invalid. (3) The spouse and dependent children of the Turquoise Card holder foreigner, according to the provisions of the legislation, shall be given a document indicating that they are relatives of the Turquoise Card holder and replacing the residence permit. (4) The Turquoise Card holder foreigner shall benefit from the rights provided by the indefinite work permit regulated in this Law. (5) In the Turquoise Card application; those who have internationally recognized studies in the academic field, those who have come to the forefront in a field considered strategic for our country in science, industry and technology, or those who make or are envisaged to make a significant contribution to the national economy in terms of export, employment or investment capacity shall be considered as qualified foreigners. (6) The provisions of this Article shall not apply to foreigners under temporary protection."*.); It's not so wrong to say that the Turquoise Card is the Turkish version of the EU's blue card. Further more information related to EU's Blue Card, please see EU Immigration Portal (2021); Foreigners who can obtain Turquoise Card are also considered as qualified foreigners for citizenship. See, Güngör (2019) 106; The Turquoise Card Regulation (2017), Turkey, regulates qualified foreigners into five groups: (1) foreigners who are considered to be highly qualified workforce, (2) foreigners who are considered to be highly qualified investors, (3) highly qualified scientists and

4. Conclusions and suggestions

The perception behind citizenship by investment has been criticized for discrediting states and their citizenships. Therefore, it is clear that regulation that is not clear but at the same time paves the way for the acquisition of Turkish citizenship by investing in instruments might damage the reputation of Turkish citizenship.[63]

The major reason of countries' facilitation of granting citizenship to foreigners for investment is to maintain internal economic vitality. However, the main criticism of citizenship by investment is regarded the claim that citizenship is granted without a real bond between the individual and the state. Normally, in granting of citizenship, the foreigner's integration into the relevant state (society) is sought through various criteria.[64] If the foreigner has no other link to the country (such as marriage or adoption for example), this link is usually established through residence.[65] It also comes to the fore in the determined investment type. Recognition of citizenship by soft criteria developed as a result of the imposition of markets does not match with the definition and essence of citizenship. Accordingly, it is not possible to expect a bond between the individual and the state when the investment condition is limited to the purchase of real estate or in cases where the investment does not provide continuity, does not positively

researchers, (4) foreigners who are internationally successful in cultural, artistic or sporting activities, (5) foreigners who are active at the international level in matters related to Turkey's national interests or who contribute to the international recognition or promotion of Turkey or Turkish culture. Once transition period removal is made, the foreigner can apply for acquisition of Turkish citizenship by investment Doğan (2017) 83.

[63] Küpe (2021) 420.

[64] Nomer (2018) 91; Bauböck and Wallace Goodman (2010) 4.

[65] Bauböck and Wallace Goodman (2010) 2.

contribute to the employment generation of the country or the investor does not move the commercial transaction centre to Turkey.[66] On the other hand, providing citizenship to those who have not established a bond of belonging to that society in exchange for an investment, regardless of the amount, weakens the bond it represents.[67] For example, Canada gave up such program on the grounds of lack of bond between the individual and the state.[68]

In our opinion, the current regulation should be revised, keeping the opportunity of foreigners to acquire Turkish citizenship through investment, but at the same time protecting the integrity of Turkish citizenship. Therefore, we would like to make the following suggestions: (1) As many countries have done in recent years, it would be appropriate to increase the required minimum amount to be invested. Of course, when deciding on this amount, not only Turkey's economic data, but also socio-political aspects should be taken into account, as well as the practices of other states. This should be done by an expert commission. (2) For foreigners who are willing to invest the required amount, national security screening should be conducted. The European Union has a resolution[69] in this regard, what should be taken into consideration to avoid granting citizenship to people involved into money laundering, and other criminal activities. (3) Instead of granting citizenship on the condition of a short-term residence, provided that a certain amount of investment is made, it would be more appropriate to impose a longer-term residence requirement for investors who meet the required minimum investment amount, and to re-evaluate the foreign investor after a certain period of time (such as 3 years, 5 years) before granting the citizenship.

[66] Kaya (2021) 125; Shachar (2017) 492.
[67] Shachar and Hirschl (2014) 249; Kaya (2021) 126; Gölcüklü (2019) 138.
[68] The Road to Balance (2014).
[69] European Parliament Resolution (2014).

(4) Investment into a real estate as a base for granting citizenship should be abolished.

Citizenship is a legal and political bond between the individual and the state. Therefore, the foreigner who receives citizenship is expected to have a connection with Turkey. It is important to ensure this connection by actually residing in Turkey. In this way, the citizen will have the chance to get to know both the country and the culture, and will feel herself/himself as a part of that society. The idea that only investment will ensure this link is beyond explanation and completely wrong in our opinion. To do otherwise would devalue Turkish citizenship in the eyes of both foreigners and citizens. Moreover, the "sale" of citizenship to foreigners without maintaining contact with the country will lower Turkey's economic, social and political image and reduce the value of Turkish citizenship. For example, it might have the result that other states impose more stringent visa requirements for Turkish passport holders.

It is an undoubted fact that every country – including Turkey - has the sovereign right to decide on granting citizenship to foreigners. Without a strong bond to the country (living, working in Turkey) it is not in the interest of Turkey and the Turkish society to grant citizenship based only on investment. However, we have to admit, that this is controversial issue, not only among Turkish scholars, but also among legal scientist of several other countries.

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