Localisation provisions analysis – preliminary update

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Introduction

This April 2016 Localization Provisions document appears to be an updated version of the proposal on ‘New Provisions Applicable to All Services’ which was leaked in May 2016 (but the document itself was from 1 October 2015). This preliminary note updates the May 2016 analysis of that proposal by:

- Highlighting where there are new rules proposed compared to the leak in May 2016 and
- Some of the implications of agreeing to these proposed new rules and
- Whether these newly proposed rules are in some other recent trade and investment agreements

Local presence

Article X.1 on local presence is basically the same negative list restriction on requiring local presence as in the version leaked in May 2016 with the implications set out in the May 2016 analysis. More TISA countries support this proposal in this leaked version, however it still has not been agreed to by all TISA countries.

Local management and boards of directors

The USA is still making the same proposals as in May 2016 (negative list restrictions on the ability to require: senior management to be citizens of the host country and the majority of the board of directors to be citizens of the host country if it materially impairs the ability of the foreign investor to control the
company\(^b\)). The implications of this are outlined in the May 2016 analysis. These proposals have support from more TISA countries than the previous leaked version, but some TISA countries still have not agreed to them.

There are two new proposals in this Article, both of which are more extreme than the USA’s proposal above:

- **Hong Kong**\(^d\) is proposing an even more extreme version (also a negative list) of the USA’s proposed restrictions on requiring locals to be on the board of directors/a committee of the board of directors. If agreed to, Hong Kong’s proposal would prevent a TISA country eg Mauritius from requiring that companies from other TISA countries established in Mauritius have even one director on the board (or a committee of the board) who is a citizen or resident of Mauritius. The exception to this is if Mauritius schedules exceptions to this under Article X.4 (which presumably will be negotiated exceptions that all other TISA countries have to agree to), or the exceptions in Article X.5 apply. At the time of this leak, no TISA country was supporting Hong Kong’s proposal.

- **New Zealand**\(^c\) is proposing a third alternative (less extreme than Hong Kong’s, but more extreme than the USA’s) to the USA’s proposed restrictions on requiring locals to be on the board of directors/a committee of the board of directors. New Zealand’s proposal would prevent a TISA country (eg Israel) from: requiring companies from other TISA countries (eg Panama) which invest in Israel to have a majority of the board of directors/any committee of the board of directors be Israeli citizens or resident in Israel, even if this requirement to have Israeli directors does not materially impair the ability of Panamanians to control the company. The exception to this is if Israel schedules exceptions to this under Article X.4 (which presumably will be negotiated exceptions that all other TISA countries have to agree to), or the exceptions in Article X.5 apply.

### Restrictions on: local content and other performance requirements

#### Background

‘Performance requirements are stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country. They are and have been used by developed and developing countries . . . to enhance various development objectives.’\(^6\) Eg they can include requirements that foreign investors must buy inputs or employ locals from the country they are investing in (the ‘host country’) in order to maximise the benefits of the foreign investment for the host country’s economy and society.

Article X.3 of this leaked proposal restricts the ability of TISA governments to:

1) use these performance requirements or

2) incentivise these kinds of actions by service suppliers\(^c\) from any country.

These restrictions go beyond the existing World Trade Organization (WTO) rules in this area in the Agreement on Trade-Related Investment Measures (TRIMS)\(^7\) in a number of areas as indicated in the May 2016 analysis and below.

Article X.3 in this version appears to merge Article X.3 and X.4 from the version leaked in May 2016 and then adds further restrictions on policy space to those already in the version leaked in May 2016.

The structure in this version of Article X.3 is that:

- **Paragraph 1 restricts on a negative list basis requirements** by TISA governments on service suppliers from any country (or the enforcement by the government of any promises by service suppliers). AU, CA, AU, CA,

\(^b\) Although it is difficult to know ahead of time if the ability to control the company has been materially impaired, so to be sure, TISA countries would need to schedule exceptions anyway.

\(^c\) A ‘service supplier’ is defined in Article I-2 of the TISA core text to be a ‘person’ supplying a service and a ‘person’ is defined to include human beings (eg an architect) and companies.

https://wikileaks.org/tisa/document/20160621_TiSA_Core-Text/
JP and KR are proposing that these restrictions on performance requirements only apply to mode 3.\(^d\)

Whereas the European Union (EU), New Zealand and the USA want these restrictions to apply to services supplied by all four modes.\(^e\)

- Paragraph 2 restricts on a negative list basis the ability of a TISA government (eg Mauritius) to use incentives to encourage services suppliers from any country (eg France or China) which is commercially present in Mauritius to use locally made products etc.

- Paragraphs 3-8 are largely exceptions to the rules in paragraphs 1 and 2.

### Some of the implications of paragraph 1: \(^f\)

a) ‘domestic content’ has not been defined in this leaked proposal or in the TISA core text.\(^g\) If this covers both goods and services, then this is more restrictive than TRIMS, because TRIMS only applies to goods.\(^h\)

For example if Turkey wanted to require that an American TV station in Turkey broadcast Turkish advertising for 10% of the advertisements shown each day, this is prohibited by this provision, unless Turkey schedules exceptions to this under Article X.4 (which presumably will be negotiated exceptions that all other TISA countries have to agree to), or the exceptions in Article X.5 apply.

This restriction is likely to cover the specific rules on electronically transmitted content\(^i\) in the May 2016 leak. Therefore even though this leaked version does not specifically restrict requirements for locally-made electronically transmitted content, such requirements are likely to be restricted by this broader rule (and/or other restrictions on performance requirements below).

This restriction was not in the version leaked in May 2016 but is in other trade and investment agreements such as the recently signed Trans-Pacific Partnership Agreement (TPP)\(^j\) involving 8 TISA countries. It was also proposed in the Multilateral Agreement on Investment (MAI)\(^j\) which was never concluded due to strong opposition.\(^k\)

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\(^a\) Mode 1: is when the service supplier and the consumer are in different countries, eg call centres or an architect emailing plans in one TISA country to her client in another TISA country.

- Mode 2: is when the consumer from one TISA country (eg Mauritius) travels to another TISA country (eg Australia) to consume the service (eg study or have surgery).

- Mode 3: is when services companies from one TISA country (eg a US bank) is commercially present in another TISA country (eg Pakistan) eg by opening a bank branch in Pakistan, ie what is commonly thought of as foreign direct investment (FDI).

- Mode 4: is when the human being who is a service supplier (eg a doctor) from one TISA country (eg Canada) goes to work in another TISA country (eg New Zealand). Ie it is the TISA country which allows doctors from other TISA countries in which is making the mode 4 commitment.

These 4 modes are in Article I-1.2 of the TISA core text, [https://wikileaks.org/tisa/document/20160621_TiSA_Core-Text/](https://wikileaks.org/tisa/document/20160621_TiSA_Core-Text/)

See explanation of the 4 modes in footnote above

\(^b\) This preliminary note does not attempt to summarise the extensive literature on conditions for the successful use of these performance requirements (eg what flanking measures are required etc).

\(^c\) Eg under existing TRIMS rules, an American television (TV) station in Turkey cannot be required to buy Turkish television screens for its offices.

\(^d\) Article X.3.1a(ii) and b(ii). Article X.3.1b(iii) would prevent policies like the EU’s domestic proposal to force video-on-demand providers such as Netflix Inc., Amazon.com Inc. and iTunes to dedicate at least 20% of their catalogues to European content, [http://www.bloomberg.com/news/articles/2016-05-25/netflix-amazon-face-minimum-eu-quota-for-european-films-shows](http://www.bloomberg.com/news/articles/2016-05-25/netflix-amazon-face-minimum-eu-quota-for-european-films-shows), unless the relevant exceptions are agreed.


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\(^b\) Australia, Canada, Chile, Japan, Mexico, New Zealand, Peru, USA. The other 4 TPP countries (not in TISA) are: Brunei, Malaysia, Singapore and Vietnam, [http://dfat.gov.au/trade/agreements/](http://dfat.gov.au/trade/agreements/)

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\(^e\) Article X.3.1a(ii) and b(ii). Article X.3.1b(iii) would prevent policies like the EU’s domestic proposal to force video-on-demand providers such as Netflix Inc., Amazon.com Inc. and iTunes to dedicate at least 20% of their catalogues to European content, [http://www.bloomberg.com/news/articles/2016-05-25/netflix-amazon-face-minimum-eu-quota-for-european-films-shows](http://www.bloomberg.com/news/articles/2016-05-25/netflix-amazon-face-minimum-eu-quota-for-european-films-shows). Unless the relevant exceptions are agreed.

\(^f\) Article X.3.1a(ii) and b(ii). Article X.3.1b(iii) would prevent policies like the EU’s domestic proposal to force video-on-demand providers such as Netflix Inc., Amazon.com Inc. and iTunes to dedicate at least 20% of their catalogues to European content, [http://www.bloomberg.com/news/articles/2016-05-25/netflix-amazon-face-minimum-eu-quota-for-european-films-shows](http://www.bloomberg.com/news/articles/2016-05-25/netflix-amazon-face-minimum-eu-quota-for-european-films-shows). Unless the relevant exceptions are agreed.

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b) This is the same as the US proposal in the text leaked in May 2016, however Canada and the EU are proposing making it even more restrictive by also preventing TISA countries from requiring services suppliers from any country to buy services from the host country. Eg if Pakistan wanted to require supermarkets owned by transnational corporations (TNCs) in Pakistan to use Pakistani advertising companies when they advertised, this would not be possible if this Canada/EU proposal is accepted, unless Pakistan schedules exceptions to this under Article X.4 (which presumably will be negotiated exceptions that all other TISA countries have to agree to), or the exceptions in Article X.5 apply.

As noted above, extending this to services as Canada and the EU are proposing goes beyond TRIMS (‘TRIMS+') and also goes beyond the TPP (‘TPP+’). The Canada and EU proposal is consistent with the failed MAI proposed text.

If agreed to, these TRIMS+ proposals would mean that benefits such as those outlined below would not be available to TISA countries, unless relevant exceptions are agreed:

‘Studies have shown that TNC affiliates in developing countries tend to buy the bulk of their inputs from their parents or other associated suppliers and hence generate few domestic linkages . . . Local content requirements, therefore, may force TNCs to identify nascent local capabilities and provide them with know-how and technology. . . A number of theoretical and empirical studies have shown local content requirements to have welfare-improving and favourable developmental effects for host countries. . . Balasubramanyam (1991) argues that the dynamic benefits resulting from local content requirements such as the development of local supplier capabilities far outweigh the short-run welfare loses that they may impose. . . Lahiri and Ono (1998) develop a partial equilibrium model of an oligopolistic industry and show that local content requirements imposed on foreign firms increase employment in host countries.’

These restrictions on the ability to require technology transfer or the use of local technology are the same as in the May 2016 leak, except that Canada and the EU are further restricting policy space by proposing that TISA governments also cannot require the transfer of a production process on a negative list basis. An example of a production process could be how to plug an oil well. ‘the amount of knowledge required in production processes has grown remarkably.’ and innovative firms are unwilling ‘to provide knowledge of their production processes to firms in developing countries’, so without a requirement to do so, service suppliers are unlikely to willingly transfer their production processes.

Restrictions on requirements to transfer production processes is in the TPP and was proposed in the failed MAI.

d) This requirement was not in the May 2016 leak. These proposed restrictions on a TISA government’s ability to require a service supplier from any country to export a given percentage of goods or services is TRIMS+. ‘Export performance requirements have been imposed by host Governments to prompt foreign investors to integrate the affiliates in the host countries in their global/regional production networks and also bring other favourable externalities of export oriented production. . . [TNCs] are known to impose export restrictions on their subsidiaries’. Some examples of successful export performance requirements (often in manufacturing) include: ‘a detailed empirical analysis of United States and Japanese FDI in a sample of 74 countries in seven broad branches of manufacturing over the period from 1982 to 1994 found the export performance requirements to be effective in increasing the export orientation of TNC affiliates to third countries. . . China has successfully pushed foreign enterprises to export through export performance requirements. . . In Chile too, export performance requirements have been found to be useful in diversifying the country’s export base . . . Mexico, Brazil and Thailand, as observed earlier, have used export performance requirements successfully for “triggering a burst of export focused investments in the auto industry.” If this proposal is agreed to, the ability of TISA governments to use the development path above would be restricted on a negative list basis.

This proposed requirement is in the TPP and was proposed in the failed MAI.

e) this restriction on the ability of TISA countries to do trade balancing (relate the amount of imports allowed to the extent of exports, or imports only to the extent of foreign exchange inflows for that

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6 See analysis of May 2016 leak
1 See analysis of May 2016 leak
commercial presence was not in the May 2016 leak. In TRIMS, this only applies to imported products. If ‘imports’ is defined here to include services, then TISA would be TRIMS+. These types of performance requirements are some of the most common.\(^\text{17}\) The trade balancing objective of performance requirements could be important for some TISA countries because some of them have persistent trade deficits in goods and services, eg Pakistan.\(^\text{18}\)

This proposed requirement is in the TPP and was proposed in the failed MAI.

f) Agreeing to this proposed restriction would have an effect like agreeing to the restriction in d) above, just achieved through a different mechanism, ie: restricting the amount of sales in the host country by relating the amount of sales in the host country to the amount exported or foreign exchange earned.

This was not in the May 2016 leak, but it is in the TPP and a slightly less extreme version\(^\text{a}\) was proposed in the failed MAI.

g) This proposed restriction would prevent a TISA government such as Norway’s from: requiring a service supplier from any country which is in Norway to be the exclusive supplier for a region (such as Scandinavia), or the world, for the good it produces or service it provides, unless the relevant exceptions were agreed. This was not in the May 2016 leak, but it is in the TPP and was proposed in the MAI which was never concluded.

h) This EU proposal to restrict the ability of a TISA country (eg Pakistan) to require the investor’s headquarters for the region (eg Asia) or world to be located in Pakistan was not in the May 2016 leak. This rule is also not in the TPP. It has been proposed in the Regional Comprehensive Economic Partnership (RCEP) being negotiated between 16 countries, 4 of which are in TISA\(^\text{b}\) and it was proposed in the failed MAI.

Regional headquarter facilities are seen as high value added and so countries like Malaysia incentivise companies to locate their operational headquarters in Malaysia.\(^\text{18}\) (These kinds of incentives to locate headquarters in a TISA country are not covered by this proposed rule, because this proposed rule only restricts a TISA country (eg Pakistan) from requiring service suppliers from any country to locate their regional/global headquarters in Pakistan).

i) this restriction on the ability of a TISA country (eg Peru) to require that service suppliers from any country hire a given number or percentage of Peruvians was not in the May 2016 leak. If agreed to, this rule would restrict requirements to employ locals at all levels (not just the senior management and board of directors as proposed in Article X.2). This would obviously have implications for local employment if foreign workers can be employed by service suppliers from any country on a negative list basis.

This restriction is not in the TPP. It was proposed in the MAI, but since that was never concluded it did not come into effect for the MAI countries. It has also been proposed in RCEP.

j) this restriction on the ability of a TISA country (eg Mauritius) to require that service suppliers from any country do a given amount of research and development (R&D) in Mauritius was not in the May 2016 leak. R&D is seen as a high value added corporate function\(^\text{19}\) and it ‘is another area of international production activity of special importance to host countries. Innovatory activities, reflected partly in the number of researchers or R&D expenditures in foreign affiliates, contribute to the building of technological capacities and competitiveness of host countries’,\(^\text{20}\)

‘On the basis of data for Japanese and United States TNCs, it seems that the bulk of R&D expenditure is undertaken by parent firms in their home countries and, when located abroad, mostly in developed countries.

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\(^{17}\)The trade balancing objective of performance requirements could be important for some TISA countries because some of them have persistent trade deficits in goods and services, eg Pakistan.

\(^{18}\)This proposed restriction is in the TPP and was proposed in the failed MAI.

\(^{a}\)This proposed restriction would have an effect like agreeing to the restriction in d) above, just achieved through a different mechanism, ie: restricting the amount of sales in the host country to the amount exported or foreign exchange earned.

\(^{b}\)Regional headquarter facilities are seen as high value added and so countries like Malaysia incentivise companies to locate their operational headquarters in Malaysia. (These kinds of incentives to locate headquarters in a TISA country are not covered by this proposed rule, because this proposed rule only restricts a TISA country (eg Pakistan) from requiring service suppliers from any country to locate their regional/global headquarters in Pakistan).

\(^{c}\)This restriction on the ability of a TISA country (eg Peru) to require that service suppliers from any country hire a given number or percentage of Peruvians was not in the May 2016 leak. If agreed to, this rule would restrict requirements to employ locals at all levels (not just the senior management and board of directors as proposed in Article X.2). This would obviously have implications for local employment if foreign workers can be employed by service suppliers from any country on a negative list basis.

\(^{d}\)This restriction on the ability of a TISA country (eg Mauritius) to require that service suppliers from any country do a given amount of research and development (R&D) in Mauritius was not in the May 2016 leak. R&D is seen as a high value added corporate function and it ‘is another area of international production activity of special importance to host countries. Innovatory activities, reflected partly in the number of researchers or R&D expenditures in foreign affiliates, contribute to the building of technological capacities and competitiveness of host countries’.

\(^{e}\)On the basis of data for Japanese and United States TNCs, it seems that the bulk of R&D expenditure is undertaken by parent firms in their home countries and, when located abroad, mostly in developed countries.
foreign affiliates tend to do relatively little R&D. This may be acceptable for a while in the case of countries at low levels of industrial development, but can soon become a constraint on capability building as countries need to develop autonomous innovative capabilities. Once host countries build strong local capabilities, TNCs can contribute positively by setting up R&D facilities.\textsuperscript{,21}

However, if this proposed TISA restriction is agreed to, in sectors without the relevant sections, leaving it to foreign companies to voluntarily choose to do their R&D in a TISA country is unlikely to be very successful because ‘Foreign affiliates may be reluctant to invest in local R&D because of their established innovative activities abroad, with strong links to home country technology institutions and other enterprises’.\textsuperscript{22} Even when it is incentivised, this has not been enough to get significant local R&D: ‘In general, developing countries have not attracted much by way of TNC activities in R&D, despite their eagerness to attract technology-intensive FDI and, in some cases, special incentives offered to such FDI’.\textsuperscript{23} Therefore restricting the ability to require local R&D is likely to significantly restrict the ability of TISA countries to get this important aspect of FDI.

This proposed restriction is not in the TPP, but it has been proposed in RCEP and was proposed in the failed MAI.

\textbf{k)} this is a restriction on the ability of TISA governments to limit the amount exported (ie keep it for the domestic market). Eg a TISA country (eg Pakistan\textsuperscript{24}) that has an electricity shortage may want to ensure that any electricity distribution companies in Pakistan do not export the electricity generated.

This was not in the May 2016 leak. While TRIMS does cover restrictions on the export of products, it does not cover restrictions on the exports of services. Therefore if this proposed TISA provision also covers export of services, it is TRIMS+.

\textbf{Some of the implications of paragraph 2:}

As noted above, paragraph 2 restricts on a negative list basis the ability of a TISA government to use \textbf{incentives to encourage} services suppliers which are commercially present in its country to:

a): this is the same as paragraph 1a) above, except it restricts TISA countries from incentivising it instead of \textbf{requiring} it. This was not in the May 2016 leak, but it is in the TPP.

b): this is the same as paragraph 1b) above (but only for goods) and it restricts TISA countries from incentivising it instead of \textbf{requiring} it. This was proposed in the May 2016 leak and is in the TPP.

c): this is the same as paragraph 1e) above, except it restricts TISA countries from incentivising it instead of \textbf{requiring} it. This was not in the May 2016 leak, but it is in the TPP.

d): this is the same as paragraph 1f) above (but only for goods) and it restricts TISA countries from incentivising it instead of \textbf{requiring} it. This was not in the May 2016 leak, but it is in the TPP (for services as well).

e): this is the same as paragraph 1k) above, except it restricts TISA countries from incentivising it instead of \textbf{requiring} it. This was not in the May 2016 leak, but it is in TRIMS, but only for goods, see comments on paragraph 1k) above.

\textbf{Generally}

Even where the TISA proposed restrictions on performance requirements are the same as the TPP, the TPP had additional exceptions, eg for:

- Health.\textsuperscript{25} If the general exceptions in the TISA core text do not apply to these localisation provisions (see analysis of May 2016 leak), then there is no health exception to these localisation provisions.

- and for legitimate public welfare objectives, provided that such measures are not applied in an arbitrary or unjustifiable manner, or in a manner that constitutes a disguised restriction on international trade or investment\textsuperscript{v}.

\textsuperscript{v} As an exception to the restrictions on the ability to require the use of local technology, Article 9.10.3h).
Paragraphs 3 and 4:
Paragraph 3 is the same as the proposal leaked in May 2016, however this exception applies to technology transfer and all the other proposed restrictions on performance requirements in paragraphs 1 and 2 in this version.

Paragraph 4 is the same as the proposal leaked in May 2016, so see the analysis of that text.

Paragraph 5:
This paragraph is basically the same as the proposal leaked in May 2016, however two new footnotes have been proposed:

- Footnote 2 is useful because it broadens the exception for compulsory licensing to also cover the new WTO rules on compulsory licences which are predominantly for export.
- In footnote 3, New Zealand is basically proposing the US government’s position in competition law that a patent does not necessarily confer market power. Agreeing to this footnote would prevent a TISA country from automatically finding that a patent confers market power and therefore leads to an abuse of dominance (and so a finding that it is anti-competitive and so this exception applies and the TISA country could require technology transfer (even if it has not been able to get the agreement of the other TISA countries to schedule an exception in that sector to the restrictions on technology transfer requirements)). I.e. with this footnote, a TISA country has to actually have evidence that this particular patent leads to an abuse of dominance position before this exception can be used.

Paragraph 6
There are two proposed paragraph 6s which do not appear to be alternatives to each other because they cover different issues:

- Without knowing the exact cross-references, this EU proposal appears to prevent TISA countries from undermining their commitments at the WTO (e.g. via TRIMS or the General Agreement on Trade in Services (GATS)), or other TISA provisions.
- The Australian and US proposal to have an environmental exception to paragraphs 1 and 2 is the same as in the May 2016 leak, so the comments on that leak apply.

Paragraphs 7 and 8
Paragraphs 7 and 8 are the same as Articles X.6.1 and X.6.2 of the May 2016 leak, so the comments on that leak apply.

Scheduling of country-specific exceptions to these rules
Article X.4 of this leak is basically the same as Article X.6.5 of the May 2016 leak (including the standstill and ratchet etc).

It is unclear if paragraphs 2 and 3 of Article X.4 have been agreed by all TISA countries because there seems to be an orphaned square bracket at the end of paragraph 3. If that ] is a typo, then paragraphs 2 and 3 of Article X.4 in this leak appear to be agreed by all TISA countries (i.e. the ratchet and the Section A broader exceptions).

Exceptions
These exceptions would apply to all TISA countries automatically (once agreed), i.e. they do not have to be scheduled by each TISA country.

Article X.5.1 is the same as Article X.6.4 in the May 2016 leak, so the May 2016 leak analysis applies. The same goes for Article X.5.2 which is the same as Article X.6.5 in the May 2016 leak.

In this version, there is a new proposal by three TISA countries that the local presence and local content rules do not apply to financial services. If this exception is agreed to, it would at least prevent the problematic
implications for financial services. However two of these three countries (Canada and Colombia) are also still saying in the next paragraph that they are considering allowing these two rules to apply to certain financial services.

**Conclusion**

The changes to this text since the leak in May 2016 have become more restrictive of the ability of TISA governments to regulate services suppliers. The new rules which have been added are worse than the TPP in a number of areas and often reflect the failed MAI and proposals in RCEP. If accepted without sufficient exceptions, these proposals would require significant changes to laws and policies in both the developed and developing countries in TISA.

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1 tisa-leaks.org
3 https://wikileaks.org/tisa/analysis/Analysis-of-20151001_New-provisions/
4 Article X.2 alternative paragraph 2.
5 Article X.2 alternative paragraph 2.
7 https://www.wto.org/english/docs_e/legal_e/18-trims_e.htm
8 https://wikileaks.org/tisa/document/20160621_TiSA_Core-Text/
24 http://www.radio.gov.pk/18-Sep-2016/govt-taking-steps-to-end-electricity-shortage-cm-punjab
25 Article 9.10.3d)(ii)
26 Article X.3.2
27 Article X.3.3
28 Article X.4.2
29 Eg http://unctad.org/Sections/wcmu/docs/c2elp_ige8p16USA_en.pdf
30 Article X.6.3
31 Article X.5.3