

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Special Distribution

Consultative Group of Eighteen

INVESTMENT PERFORMANCE REQUIREMENTS

Note by the Secretariat

1. At the meeting of the Consultative Group in March 1981 the question of investment performance requirements and their possible effects on international trading interests was raised. The Group agreed that the secretariat should prepare a note describing the work being done in other international organizations on the question of export requirements and requirements regarding import substitution, listing the relevant provisions of the General Agreement (CG.18/14).

I. Investment performance requirements and the General Agreement

2. Investment performance requirements are not specifically dealt with in the text of the General Agreement. Investment performance requirements, however, may be enforced and implemented by specific measures which could be covered by one or other GATT provision. These implementing measures could be very varied indeed. For example: if quantitative restrictions were used or mixing regulations introduced to implement performance requirements, then the relevant GATT provisions would apply.

3. In this connexion, it is to be noted that among the several hundreds of notifications made in the context of establishing an Inventory of Non-Tariff Measures, there were only very few notifications of measures which could relate to investment performance requirements. As a result, there is very little factual information available in the secretariat about the nature and characteristics of performance requirements, the specific measures or regulations used to implement them and the extent to which these measures can have an impact on trade or involve a conflict with particular GATT provisions.

4. It is only possible to say whether there is a cause for GATT action that may be relevant to these measures when a specific case arises involving the use of measures implementing performance requirements, having regard to all GATT provisions that may be relevant.

5. It should be noted that it remains open to a contracting party to have recourse to the proceedings of Articles XXII or XXIII, when it considers that there is a matter affecting the operation of the General Agreement or that the benefits accruing to it from the Agreement or its objectives are being impeded and that its reasonable expectations under the Agreement are being thwarted by measures taken by another contracting party, or any other situation.

6. It should also be noted that Article XXV:1 provides for the contracting parties meeting jointly with a view to facilitating the operation and furthering the objectives of the General Agreement. These provisions permit the CONTRACTING PARTIES at any time whenever it is determined that international trading conditions are being affected, to seek joint action to deal with the problem.

II. Work on investment performance requirements in other organizations

A. OECD

1. Work in the field of international investment is done mainly in the Committee on International Investment and Multinational Enterprises (CIME) established in January 1975. Related work is also carried out in the Committee on Capital Movements and Invisible Transactions (CMIT).

2. OECD activities so far have been concentrated mainly on the problem of investment incentives in the international investment process and on the decision-making of multinational enterprises in that context. The questions of investment disincentives and performance requirements are dealt with mainly under the aspect of their possible effects on investment decisions by these enterprises and not in relation to their possible influence on international trade.

3. In June 1976 the OECD Council meeting at ministerial level adopted a Declaration on International Investment and Multinational Enterprises as well as three decisions dealing with intergovernmental consultation procedures on the guidelines for multinational enterprises, with national treatment for enterprises under foreign control, and with international investment incentives and disincentives, respectively.

4. The instruments mentioned in paragraph 3 aim at a better co-operation among member countries in order to improve the foreign investment climate. The Declaration covers guidelines for multinational enterprises, national treatment, international investment incentives and disincentives, consultation procedures and a review. The guidelines mention, inter alia, that the co-operation programme comes within the general aims of the OECD Convention which already covers many aspects of the rôle of multinational enterprises, notably in relation to international trade. It is also stated that in cases where multinational enterprises are made subject to conflicting requirements by member countries, the governments concerned will co-operate in good faith with a view to resolving such problems either within the CIME or through mutually acceptable arrangements. As regards national treatment, the Declaration states that member countries should accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another member country treatment no less favourable than that accorded in like situations to domestic

enterprises. As to international investment incentives and disincentives, the member countries recognize the need to give due weight to the interests of other member countries affected by specific laws, regulations and administrative practices in this field which provide for official incentives and disincentives to international direct investment. Member countries will endeavour to make such measures as transparent as possible. A review foreseen in the original Declaration within three years took place in June 1979 and it was decided to review the Declaration again at the latest in five years.

5. The Decision on Intergovernmental Consultation Procedures on the Guidelines for Multinational Enterprises states, among other things, that periodically or at the request of a member country, consultations shall be held in the CIME on any problem arising from the fact that multinational enterprises are made subject to conflicting requirements.

6. The Decision on National Treatment for enterprises under foreign control provides that measures taken by a member country constituting exceptions to national treatment in effect on 21 June 1976 shall be notified to the Organization within sixty days after that date. Furthermore, measures taken by a member country constituting new exceptions to national treatment taken after the above-mentioned date shall be notified to the Organization within thirty days of their introduction together with the specific reasons therefore and the proposed duration thereof. The CIME shall review periodically the application of national treatment with a view to extending such application, and shall make proposals as and when necessary in this connexion. The CIME shall also act as a forum for consultations.

7. The Decision on International Investment Incentives and Disincentives lays down that consultations shall take place in the CIME at the request of a member country which considers that its interests are adversely affected by measures taken by another member country specifically designed to provide incentives or disincentives for international investment.

8. Under instruction from the Working Group on International Investment Policies the OECD Secretariat has drawn up a report, to be submitted to the CIME at its December 1981 session, on the effects of investment incentives and disincentives on the international investment process. The report is part of a medium-term programme in the CIME of an analytical nature, concentrating on those types of incentive and disincentive measures which appear to be most relevant to the international investment process. While the report includes some considerations relevant to the influence of investment incentives and disincentives on the efficiency of the allocation of resources of OECD member countries' economies, or on the competitiveness of these economies and on trade flows between them, it is clearly stated that it is not concerned with trade-related investment incentives and disincentives in general.

9. As far as the OECD Trade Committee is concerned, it is to be noted that in February 1981 the United States delegation proposed to initiate a work programme on the trade-distorting impact of performance requirements. The exercise which is to complement the ongoing examination of investment policy measures in the CIME, would be limited to those performance requirements that have a direct influence on international trade. Export requirements and import substitution requirements are mentioned as the two major types of such measures. As an initial step it is suggested that the Committee should conduct a survey and analysis of trade-related performance requirements in member countries taking into account work done elsewhere. Consideration should also be given to establishing a regular system of notification of trade-related performance requirements. These notifications could then be included in the periodic Trade Committee review of changes in trade policies and practices. Upon completion of an adequate data base the Committee should consider whether there is a need to develop international discipline on the use of trade-related performance requirements. Other possible Trade Committee actions suggested are: reporting to Ministers on information and recommendations regarding performance requirements as part of the follow-up review of the Trade Pledge, and referring the OECD work of the Trade Committee (and possibly CIME) to the GATT for its consideration.

B. Development Committee

1. The Development Committee (the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries) has considered investment incentives and performance requirements, including requirements regarding exports and import substitution, in the context of its work on private foreign investment.

2. In September 1978, the Development Committee established a Task Force on Private Foreign Investment to continue the work on issues relating to direct investment that had been begun by the Development Committee's Working Group on Access to Capital Markets. The mandate of the Task Force was to "examine, within the framework of these general /home and host/ government policies /that affect the direct investment process/, possible government policies both in the host country and in the home country, on specific aspects of direct investment on which there is a need for better understanding, with a view towards general consensus on which of these policies are most likely to maximize the international benefits of direct investment".

3. The Task Force, which was composed of twelve government representatives drawn from both developed and developing countries, submitted its report to the September 1980 meeting of the Development Committee.

4. In recognition of the importance of foreign investment to development, the Task Force concentrated on policies in home and host countries which might promote an increase in the contribution of such investment to the developing countries. Export requirements and requirements relating to import substitution were taken up in the context of the Task Force's consideration of host country performance requirements, one of the two major categories of host country policies considered, the other being incentives to foreign investments.

5. In its report, the Task Force recognized that performance requirements can be an important component of host nation policies designed to achieve national development objectives and that performance requirements were generally tied up with rationalization schemes for certain sectors of the economy and were not usually imposed on foreign investors alone.

6. Among the types of performance requirement listed by the Task Force were:

- local content requirements, whereby the firm must shift procurement of inputs from foreign sources to sources within the host nation; and
- export requirements, whereby the firm is required to export some portion of its output.

Other types of performance requirements specifically mentioned were technology transfer requirements and local management and employment requirements.

7. The following views in regard to performance requirements are recorded in the report of the Task Force:

"While noting the rationale of performance requirements, the Task Force also noted that performance requirements under certain circumstances could have adverse effects on the host country by discouraging investment and reducing capital inflows and by promoting and sustaining high cost inefficient industries. They could in some cases also cause distortions in international trade flows and conflict with the principle of comparative advantage. They could become tantamount to a form of restrictive trade practice whose quantitative significance is not easily measured but which could lead to demands in other countries for countervailing action.

"Thus, while the Task Force concluded that performance requirements could play a rôle under certain economic circumstances, host countries should keep the various types of performance requirements, especially those which have an impact on international trade, under constant

review in light of changing development needs. Some members believed that any such requirements should be limited in time, while others were opposed to prescribing time limits.

"The Task Force believed that too little is known about the consequences of performance requirements. It would be desirable as a first step towards gaining a better understanding of these consequences to achieve a much greater degree of transparency on the part of host nations which use performance requirements as an instrument of development policy."

8. With regard to investment incentives, the Task Force, while recognizing the rationale of host countries providing incentives for foreign private investment, felt that competition among host nations in granting investment incentives could be counter-productive, especially when incentive packages were custom-tailored to lure a specific project into a nation or region. The Task Force considered that the problem of foreign investment incentives could in some cases be common to both developed and developing countries, to the detriment of the latter, and that any remedy, although primarily concerning developing nations, would have to involve developed host nations inasmuch as they offer foreign investment incentives competitive with those offered by developing nations for the same projects.

9. In considering existing international co-operation that could help establish an environment for direct investment flows to developing countries, the Task Force noted that the consultation and dispute settlement procedures of the GATT could be invoked with a view to seeking remedies in regard to incentives and performance requirements that adversely affected a GATT contracting party by means of their effects on international trade. The Task Force also considered the role of bilateral agreements and other international dispute settlement mechanisms, including the International Centre for the Settlement of Investment Disputes (ICSID).

10. The Task Force concluded that:

"The central issue with foreign investment incentives and performance requirements is how to reconcile host countries' legitimate needs to pursue their national interests through their use with the need to ensure that investment capital is channelled to its most productive uses. Therefore, it endorsed the objectives of seeking an understanding which would limit the adverse effects of foreign investment incentives and of considering what further actions might need to be taken concerning performance requirements.

"In view of the present lack of information concerning the precise impact of both incentives and performance requirements, a first step should be to study and analyze existing foreign investment incentives

and performance requirements and to consider how their quantitative and qualitative impact can be assessed. The Task Force recommends that this study be carried out under the general direction of the World Bank Group, in association with an intergovernmental group of experts, and taking into account work going on elsewhere. Thereafter, depending upon the outcome of the study, whose results will be reported to the Development Committee, an attempt could be made to develop a concept and terms upon which an understanding might evolve."

11. The Task Force proposed the following terms of reference for the study:

- "(a) Information on the actual incentives granted, and performance requirements imposed in host countries should be collected. Information collection might follow the model of the study of non-tariff barriers, conducted by GATT, wherein member countries were asked to identify both their own non-tariff barriers and those of other countries that had come to their attention.
- "(b) The quantitative and qualitative impact of incentives and performance requirements can be assessed in terms of:
- the level and country pattern of investment (geographical, sectoral);
 - technology choice and indigenization of management;
 - international trading patterns; and
 - financial and economic costs and benefits to host countries."

12. The Development Committee considered the Task Force's report and recommendations at its meeting in September 1980. Paragraph 14 of the communique issued at the conclusion of the meeting reads as follows:

"The Committee noted that further analysis of private foreign investment might lead to a better understanding of important factors in both investor and host countries that determine volume and nature of such investments. It suggested that the Board of the Bank consider the recommendation of the Task Force on Private Foreign Investment for a study of incentives and performance requirements."

13. The World Bank, in a submission to the Development Committee, has outlined the nature and scope of the study that it proposes to undertake, and complete by September 1982. The Bank's Executive Board, which has agreed to the study, will review it before it is submitted to the Development Committee. In its outline, the Bank said that it considered that the first part of the terms of reference of the proposed study prepared by the Task Force, the collection of data on incentives and performance requirements,

would be quite difficult for the Bank Group, indicating that large-scale data collection was not something that it was organized to do effectively. It suggested that this work might be better handled by the GATT or one of the UN agencies, such as UNCTAD or the UN Centre on Transnational Corporations. The World Bank, therefore, proposed that the International Finance Corporation (IFC) undertake a more modest study to attempt to answer the essential questions that were of concern to the Task Force. The study would focus on identifying the impact of investment incentives and performance requirements on direct investment and trade patterns. It would rely on selected industry-country cases to identify the influence of these policies, and to suggest whether they have had sufficient disturbing effects on the flow of investment and trade to warrant consideration of international rules to limit their scope and application.

C. United Nations

1. Apart from the World Bank and OECD, issues relating to foreign investment in developing countries have been considered in a number of international organizations and notably within the UN framework, including the UNCTAD, the UNIDO, Regional Commissions, the UN Department of International Economic and Social Affairs and the Centre for Transnational Corporations. Some work on incentives applied by developed countries for investment in developing countries has been done by the Development Assistance Committee of the OECD but is not considered directly relevant for the purposes of this work.

2. The greater part of the studies carried out by these organizations relate to practices concerning the activities of transnational corporations and issues relating to foreign investment in developing countries which would appear to require the attention of host governments. In general the available studies tend to describe the various forms of investment incentives offered by governments but provide little by way of an economic analysis of the effects on capital flows or trade. Likewise, the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the UN General Assembly in 1980 is primarily concerned with national policies and collaboration at the international level aimed at controlling restrictive business practices that might adversely affect international trade. Issues relating to the application of restrictions on transfer of technology which could involve the application of restrictions on exports, prior approval for exports, export prices, etc., are also sought to be dealt with in the proposed draft International Code of Conduct on the Transfer of Technology under discussion in the UNCTAD. Thus, it is proposed that parties to technology transfer transactions should, inter alia, refrain from restrictions hindering exports by means of quantitative limitations or prior approval for exports or export prices, etc.

3. Negotiations on a Code of Conduct on Transnational Corporations have also been proceeding under the auspices of the UN Commission on Transnational Corporations. One of the issues in these negotiations appears to have been whether obligations and disciplines established under the Code should apply only to the practices of transnational corporations or also to the dealings of governments with such corporations. The proposed paragraph 25 of the draft Code envisages that transnational corporations should contribute to the promotion of exports and the diversification of trade in countries in which they operate and would also seek an increased utilization by transnational corporations of goods, services and other resources which are available in these countries. The draft under negotiation contains a series of alternative proposals on the treatment which transnational corporations may enjoy in terms of domestic laws, rules and regulations, as well as concessions and incentives as compared to domestic enterprises. Certain proposals have also been put forward for action at international level in terms of which governments should be ready to engage in consultations at the request of another government regarding specific issues in the application of the Code relating to the governments concerned, including difficulties arising from conflicting requirements on transnational corporations. In addition, provisions have also been put forward permitting specific issues relating to the application of the Code being taken up by the Commission on Transnational Corporations at the request of an interested party.

4. It must be noted that both the UNCTAD draft International Code of Conduct on the Transfer of Technology and the Code of Conduct on Transnational Corporations are still under discussion and negotiation and therefore their specific relevance to issues relating to investment incentives and performance requirements as brought up in the GATT cannot be assessed at the present time.

5. The UN Centre on Transnational Corporations has also carried out a number of studies, some of which deal with trade policy issues posed by transnational corporations for host country governments. Thus, a CTC Report entitled "Transnational Corporations: Direct Effects on the Balance-of-Payments" (E/CN/10/84) seeks to assess the effects of the activities of transnational corporations on the host countries' balance of payments with reference to the impact on both trade flows and the capital account and suggests that the governments of host countries may find it necessary to adopt specific industrial and trade policies designed to influence the operation of transnational corporations in order to offset these effects.