

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## INVESTMENT

The following communication, dated 10 June 1986, has been received from the delegation of the United States with the request that it be circulated to all members of the Preparatory Committee.

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### Proposed Text for Ministerial Declaration

Ministers recognise that increased flows of foreign direct investment will play an important rôle in stimulating a sustainable growth in world trade, as well as raising the standards of living and real income for all the parties participating in the negotiations, thereby lessening the pressures for trade-restrictive practices. To this end, Ministers agree that the negotiations should address, inter alia, the means to increase discipline over government investment measures which divert investment flows or distort trade flows, thereby reducing the contribution of trade liberalisation to expanding world trade and economic growth. These measures should be controlled and reduced in the light of the specific Articles of the GATT, as well as its overall objectives.

Accompanying PaperIMPORTANCE OF INVESTMENT ISSUES TO INTERNATIONAL TRADE

Government investment policies can have a strong dampening and distorting impact on world trade. The trade effects of these measures are comparable to those created by tariffs or non-tariff barriers such as quantitative restrictions, yet, they are not subject to effective multilateral discipline. Increased discipline in this area would reduce distortions to, and facilitate increased international investment benefitting both home and host countries.

Foreign direct investment is a powerful force which serves to integrate the world economy and to diversify and stimulate world trade. The historic book value of world foreign direct investment was conservatively estimated to be \$625 billion in 1983. The integrating effects of trade in goods and services and of foreign investment do not act independently of each other; there tends to be a strong and positive relationship between the two for both home and host countries.

Like free trade, foreign investment, when responding to actual market conditions rather than distortive government policies, can make the economic pie larger. Both freer international trade and investment increase world trade and the efficiency of resource-use, create jobs, and raise the level of national and global income. Positive governmental and institutional actions to expand the flow of trade and investment are in the interest of the world trading system.

When a host government unnecessarily restricts the ability of a foreign firm to establish itself in the host country, it denies producers and consumers in the host country the benefits of services and goods exports. The producers and consumers in the host country are also denied the benefits of additional production and export capability associated with such investment. When governments refuse to grant foreign investment on the same basis as domestic investment they deny themselves the associated trade benefits of international investment. Excessive restrictions on the right of establishment also limit host country firms' ability to compete internationally and service the host and third markets with their products.

Governments imposing trade-related performance requirements linked to investment, in a way which is contrary to the objectives of the General Agreement, distort the pattern of trade as well as investment flows. For example, export requirements may artificially increase the supply of affected products in world markets and displace more efficient home market production and exports. In this sense, they have effects similar to export subsidies. Similarly, local content requirements displace imports from home or third countries and have effects equivalent to import quotas. Incentives given to attract foreign investment may also distort trade and investment flows and are often linked to performance requirements.

Both developed and developing countries maintain investment restrictions and trade-related performance requirements. All countries must recognise the costs associated with these policies and the need for improvement in the international rules.

#### WHY INVESTMENT IS AN APPROPRIATE TOPIC FOR THE NEW ROUND

##### Limitations of Present Instruments

Recognising the importance of the free flow of investment, the OECD countries in 1976 agreed to grant national treatment to established investment from other member countries and to consider the impact on other members of their use of investment incentives and performance requirements. In a separate agreement, the OECD members also continued to work to expand the right of establishment. While these agreements are significant accomplishments, they fall short because of the OECD's limited membership.

A Code embodying some of the same type of principles has been under negotiation in the UN for the last ten years, but many of the key issues are not agreed.

While the World Bank has done some important work to point out the benefits of foreign direct investment from a development perspective, the focus of the Bank's activities is primarily finance-related. We recognise that the Bank, including MIGA (Multilateral Investment Guarantee Authority), will do more work in this area.

##### Competence of the GATT

The GATT is the most competent organisation that can realistically address the mutual trade benefits arising from foreign direct investment through the establishment of principles of conduct and the resolution of policy disputes among member countries.

The appropriateness of institutionally linking investment issues with trade goes back to the late forties and the International Trade Organisation Charter - from which the GATT emerged - which contained important sections on investment.

The GATT has agreed to principles in trade, including procedures for addressing disputes and the principle of non-discrimination, which are applicable to investment issues, and which could form the basis for further discussion.

In 1955, the CONTRACTING PARTIES adopted a resolution on treatment of investment in member countries which inter alia recognised "... that an increased flow of capital into countries in need of investment from abroad and, in particular into under-developed countries would facilitate the objective of the General Agreement by stimulating economic development of these countries whilst at the same time rendering it less necessary for them to resort to import restrictions". Moreover, they recommend using "... their best endeavours to create conditions calculated to stimulate the investment flow of capital ...".

There are many GATT Articles which apply to investment-related policies. Article III, paragraph 4 was directly linked to the trade effects of certain investment policies by a 1983 GATT panel. There are other GATT Articles the provisions of which similarly could apply to investment-related policies.

#### MULTILATERAL ACTIONS

The CONTRACTING PARTIES should:

(1) Seek to increase discipline over investment measures which divert trade and investment flows at the expense of other contracting parties, in contravention of a major objective of the GATT, i.e., "the elimination of discriminatory treatment in international commerce" and at the expense of sustainable economic growth and liberalisation.

(2) Explore a broad range of investment issues in the negotiations, including:

- National/MFN treatment for new and established direct investment and the right to establish an investment:

Addressing these issues is fundamental to the goals and benefits of the GATT. Application of GATT provisions for infant industry development and discussions of structural adjustment to clarify conditions of international competition will only partially meet objectives unless they take into account policies which affect the flow of direct investment. The 1955 GATT resolution (cited above) recognised that significant restrictions are often the net result of restrictions on direct investment flows.

- Various types of trade-related investment measures:

GATT contracting parties must examine ways to stem, and ultimately reverse, the use of these measures. Among these practices are: local content requirements, export requirements, incentives and product mandating.

#### CONCLUSION

Addressing investment in the new round is necessary if the GATT is to remain relevant and fulfil its mission of handling key matters directly relating to and affecting trade flows. It will enable us to develop a measure of discipline that will strengthen the economies of investors and recipients alike. Furthermore, by agreeing on specified principles governing investment, we will facilitate the flow of capital to developing countries and reduce the use of measures that distort trade flows.