

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

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Investment Measures

SUBMISSION BY THE UNITED STATES

The following communication, dated 9 June 1987, has been received from the delegation of the United States with the request that it be circulated to members of the Group.

In light of the language of the CONTRACTING PARTIES issued in the Punta del Este Declaration and in accordance with the work program developed at the first meeting of this negotiating group on trade-related investment measures, the United States submits the following discussion of the relationship between GATT objectives, principles and articles, and the trade restrictive and distorting effects of certain investment measures.

In brief, the United States believes that investment measures, as detailed below, can have the following trade-restrictive and distorting effects:

- Prevent, reduce or divert imports by limiting the sale, purchase and use of imported products;
- Restrict the ability to export by home and third country producers; and,
- Artificially inflate exports from a host country, thereby distorting trade flows in world markets.

Below we describe a number of investment measures which produce these effects and identify certain of the relevant GATT articles. We also indicate GATT articles and principles which are generally relevant to all of these measures.

The following inventory of measures and description of effects is an initial one. As the work of this group and our mutual understanding of the issues progresses, we would expect further refinements and additions. Similarly, the identification of GATT articles relevant to the effects of these measures will also evolve.

A. INVESTMENT MEASURES WHICH LIMIT THE SALE, PURCHASE AND USE OF IMPORTS IN THE HOST COUNTRY

- Local Content Requirements typically specify that some percentage or absolute amount of the value of the investor's production be purchased from local sources or be produced locally. These measures may be stated inversely as import substitution requirements. Either of these measures effectively limits demand for and access to imports, creating prima facie discrimination against imports in favor of local production.
- Local Equity Requirements specify that a certain percentage of a firm's equity must be held by local investors, or conversely, that there is a ceiling on foreign equity. In many instances, the percentage of local ownership required expands over the life of the investment. Among the most clearcut impacts on import flows is the conditioning of permitted foreign equity upon the achievement of local content. Additionally, import flows may be affected by shifting management decisions to local entities, particularly state enterprises of the host country, whose production and sourcing decisions may be influenced by factors other than commercial considerations.
- Trade Balancing Requirements typically specify that (i) an investor must export an amount equal to some proportion of the amount imported, (ii) an investor's imports are limited to some proportion of the amount exported, or (iii) that a minimum trade surplus be maintained. However stated, all of these practices arbitrarily discriminate against imports.
- Technology Requirements commonly require that specified technologies be transferred by the foreign investor on non-commercial terms, and/or that specific levels of research and development must be conducted on an ongoing basis. These policies have a number of implications for trade flows. In order to obtain an economic return on the investment, product levels, mix and pricing must be altered to compensate for technology which was mandated rather than justified by economies of scale, market development or competitive conditions. Technology requirements can lead to commercially unjustified manufacturing levels, and in so doing, significantly reduce market opportunities in the host country for imports from other countries.
- Licensing Requirements require the investor to license production of a product in the host country. The agreement typically identifies a range or limit on the amount of royalties which the investor will receive. In a manner similar to the technology requirements described above, production is directed by government fiat, and imports correspondingly displaced.

- Remittance Restrictions limit or restrict the right of the foreign investor to repatriate returns related to an investment (e.g. profits, dividends, royalties, capital). By encouraging an investor to reduce the scale of foreign operations to a point consistent with permitted remittance levels, the mix and quantity of inputs and end products is affected, and therefore, the associated import and export flows of any of those items. Also, where foreign sourced inputs might be cost efficient spread over large scale production, they may not be so at lower levels of output. The remittance constraint, in this case, may induce the investor to substitute local for foreign-sourced inputs. Finally, by leaving an investor with a supply of local currency in excess of his needs, an investor is encouraged to shift sourcing to local rather than imported products. Thus, a multiple bias against the purchase of imports has been created.

- Manufacturing Requirements/Limitations include (i) requirements that a company only manufacture certain products or product lines, or (ii) limitations or prohibitions on the manufacture of certain products or product lines, reserving them for local producers. These measures may be applied to those products destined for either domestic or export markets. Manufacturing limitations which restrict the manufacture and marketing of certain products to local producers preclude the import of associated inputs and equipment which further investment might generate. The policy effectively seals off the domestic market, disrupting pre-existing, market determined trade relationships.

- Incentives are fiscal or financial rewards, or other benefits, such as subsidies, tax and duty reductions, import rights and guarantees. Such incentives influence trade and investment decisions. Incentives are often granted in exchange for a specified local content level or some form of market protection.

Relevant GATT Articles:

Articles III, XI, XIII and XV, in particular, should be examined in this context as they are clearly relevant to discrimination against and restrictions placed upon imported products.

B. INVESTMENT MEASURES WHICH RESTRICT THE ABILITY OF THIRD PARTIES TO EXPORT

- Product Mandating Requirements bind an investor to supply certain markets, which may be regional, national or global, with a designated product or products exclusively manufactured by a specified facility or operation. Such an obligation or restriction preempts exports from any alternative site.
- Manufacturing Requirements which require that an investor manufacture certain products for the local market, reduce the opportunity for manufacturers from other countries to participate in that market.

Relevant GATT Articles:

The principles underlying Articles XI and XIII should be examined in the context of the above measures as they apply to the restriction of exports.

C. INVESTMENT MEASURES WHICH FORCE INCREASED EXPORTS FROM A HOST COUNTRY AND/OR DISPLACE OR DISTORT TRADE FLOWS IN WORLD MARKETS

- Export Requirements commonly specify a fixed percentage of production or a minimum quantity or value of goods which must be exported. These measures result in export levels unresponsive to changes in the marketplace, providing an obvious export push. Export requirements artificially increase the supply of affected products in world markets displacing other home or third country production and exports. In this sense, they have effects similar to export subsidies. Mandatory export levels create pressure to sell those products at any price necessary, effectively forcing dumping.
- Technology and Licensing Requirements tend to increase export levels and alter trade patterns by forcing the diffusion of production of the resulting products, creating levels of production which are not necessarily justified by commercial considerations. These practices can not only alter production levels, but also product mix and pricing, in turn affecting the export and import of not only the end product, but also of raw materials and intermediate products.

- Remittance Restrictions are often waived contingent upon, and therefore act as an inducement to, fulfilling another investment measure. If an investor can increase allowable profit remittances by committing to export, the profit remittance limitation may induce dumping in export markets. In other cases, investors' profit remittances are tied to a percentage of registered capital. Given the relationship between capital structure and subsequent procurement, complex and distortive trade effects on both the export and import sides may result.
- Trade Balancing distorts trade in world markets and artificially increases export flows as an investor exports in order to earn the right to purchase necessary imports.
- Local Equity Requirements may artificially stimulate exports by conditioning the permitted level of foreign equity upon the achievement of export targets.
- Product Mandating Requirements distort patterns and levels of exports and imports by requiring that a particular site be the exclusive manufacturing operation for given products to a regional, or in some cases, global market.
- Incentives which reward the attainment of export targets, inter alia, with financial or fiscal favors, or market protection, both stimulate and/or subsidize exports.

Relevant GATT Articles:

Each of the investment measures named above distorts trade flows by increasing exports or world supplies of affected products and also disturb normal trade flows determined by commercial factors. In this context, Articles XVI and XVII should be given special attention. Article VI should also be examined given the likelihood that certain of the government-mandated measures lead to cases of dumping.

D. GATT ARTICLES GENERALLY RELEVANT TO THE FOREGOING INVESTMENT MEASURES

As indicated previously, the United States believes that certain investment measures can have effects similar to non-tariff trade barriers. In this regard, certain GATT principles and articles generally applicable to trade measures should be examined in this exercise with respect to all of the investment measures mentioned herein.

- Article I Most favored nation principle
- Article II Principles of mutual advantage
- Article X Transparency provisions as well as the provisions of Articles VIII, XVI, XVII and XVIII relevant to transparency
- Article XVII The principle of commercial consideration as applied to state or state-privileged enterprises
- Article XXIII The principle of nullification and impairment of trade concessions