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Negotiating Group on Trade-Related
Investment Measures

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SUBMISSION BY THE JAPANESE GOVERNMENT

The following submission, dated 12 June 1987, has been received from the Government of Japan with the request that it be circulated to members of the Group.

Trade-Related Investment Measures

Introduction

The Japanese Government submits this document on the basis of the work programme developed at the first meeting of the Negotiating Group on Trade-Related Investment Measures held on 2 April 1987. The aim of this document is to contribute to the work of the Group to identify the trade restrictive and distorting effects of the trade-related investment measures and the related GATT Articles on which this negotiating group should focus its deliberation.

Overseas direct investments are increasing in volume and number, but at the same time measures taken by various governments on these investments which affect trade are also multiplying. The Government of Japan thinks it important to establish within the GATT a new system to regulate these measures in order to assure the free flow of trade, and moreover to contribute to the development of the world economy through smooth development of the international exchange of investment which will lead to the economic development of host countries, creation of new jobs and to the realization of increased industrial and technological cooperation.

To this end, the Government of Japan expects this group to progress smoothly in its work, through positive and constructive discussions on the trade-related investment measures.

General remarks

There are many cases in which host countries take measures on overseas direct investment that produce trade restrictive or distorting effects. The Government of Japan thinks it necessary to prohibit or limit these measures in principle and if necessary to establish new international rules from the viewpoint of alleviating and eliminating various obstacles to

trade based on the principle of free competition as well as from the viewpoint of maintaining and strengthening free trade.

To this end, the Government of Japan thinks that while focusing its attention on the effects on trade of various investment measures the reasonable approach for this negotiating group to take is to identify the trade-related investment measures which will be the object of the negotiation, as well as to clarify the interpretation and operation of existing GATT articles and if necessary to establish new rules from the point of view of prohibiting or limiting these measures.

This document mainly examines the effects of the investment measures of the host country on the trading activities of the foreign enterprises established in that country, but it should be noted that these measures also affect trade between these enterprises and their overseas affiliates.

The Government of Japan thinks that incentives given by host country governments to investors and which accompany trade related investment measures should also be considered from the above mentioned viewpoint.

Various forms of restrictions on trade related investment measures exist. Japan considers that not only the measures based on the legislation and the regulations applied by central governments but also those applied by local governments should be the object of the negotiation. Furthermore measures which are not based on legislation, such as directives or guidances imposed by host country governments requiring investors to fulfill certain conditions, should also be the object of the discussion of this negotiating group when such measures have trade restrictive or distorting effects.

Trade-related investment measures often lack transparency in their existence and operation. This lack of transparency increases their trade restrictive or distorting effects. Accordingly the question of transparency of the trade-related investment measures should also be discussed. The assurance of transparency is stipulated in the various articles of the GATT such as Article X.

Japan judges that through the negotiations on trade-related investment measures aimed at establishing a system in the framework of the GATT, discussions should also focus on assuring procedures, organs for dispute settlement and consultations designed to resolve in a rational manner and within a reasonable length of time any disputes arising from trade-related investment measures. To this end, Articles XXII and XXIII together with the various codes established in the Tokyo Round could be taken into consideration. (Naturally this process should take into account the negotiation on the general improvement of the procedures of dispute settlement.)

Individual measures

Understanding that trade-related investment measures, as the subject of this negotiating group, are investment measures that have trade restrictive and distorting effects, Japan believes that the following measures should be included. The following list is not exhaustive and additional submissions could be made:

1. Local content requirements;
2. Export performance requirements;
3. Trade balancing requirements
4. Domestic sales requirements
5. Technology transfer requirements.

Trade restrictive and distorting effects of the above mentioned measures and the GATT articles which Japan thinks have relevancy are described hereinafter.

1. Local content requirements

With a view to protecting the domestic industry, the host country requires the investor to purchase locally, instead of importing from the parent companies or other foreign sources, more than a specified percentage of the total parts of the production or specified parts of the production. Generally, the investor is required to achieve a certain percentage of local procurement and in some cases a penalty is charged when the investor fails to achieve that percentage. Rules related to the concepts of origin of goods or local content requirements related to government procurement should also be studied since they have similar effects.

Furthermore, there exist cases in which local content requirements are applied with other measures, for example:

(i) the percentage of local content is modified as exports of manufactured products increase;

(ii) local content requirements are applied on the one hand and preferential treatment on taxes is offered on the other as an incentive.

Local content requirements, because of their differentiated treatment of imported and local products, cause various effects on trade. The effects are obvious especially in the following cases:

(i) If the specified percentage of local content requirements is higher than the portion of parts which the company intended to procure locally, judging on the basis of economic rationality from its productive capacity or from the level of technology and the industrial developments of the host country, local content requirements have effects similar to import restrictions, since the import of foreign

products which have a comparative advantage over local products will be limited. The same effect can also be observed when obligations exist in procuring specified parts locally;

(ii) If the investor must invest more than was initially intended in the host country in order to fulfill the local content requirements and to maintain competitiveness, imports of capital goods will exceed the level judged economically necessary;

(iii) In the event that higher costs and insufficient quality of production are caused by using locally produced parts, exports of the products will not attain the level deemed necessary from the commercial viewpoint because of their lowered competitiveness.

With regard to the GATT Articles, local content requirements restricting the use of imported goods are inconsistent with Article III. The relation with Article XI must be considered with regard to measures having the effect of import restriction. Furthermore, the relation with the Code on Government Procurement must be studied for measures concerning the governmental requirement of the host country which have similar trade effects.

2. Export performance requirements

In order to adjust the imbalance in the balance of payments or to protect the domestic industry, the host country requires the investor to export a specified percentage (either in quantity or in volume) of goods produced.

There are cases in which the export performance requirements are applied with other measures, such as:

(i) easing of restrictions on imports of parts either in volume or in percentage according to the degree of achievement of the export performance requirement by the company;

(ii) preferential treatment on taxes or export financing with low interest rates applied with the export performance requirements in order to give incentives to fulfill the requirement.

Because of the implementation of the export performance requirements, there are cases in which the investor is compelled to export more goods than originally intended or to export goods without sufficient international competitiveness.

If the preferential treatment on taxes accompanies these requirements as an incentive to export, this has the same effect as an export subsidy.

In cases where investors are compelled to export goods against their initial intention, they might set low export prices which may be considered as dumping and which will distort the international market.

Article XI which requires the general elimination of quantitative restrictions and also Article XVI and the Code on Subsidies should be examined as the relevant Articles.

3. Trade balancing requirements

This measure refers to cases in which the investor is required to earn by his own exports all the foreign currency necessary for the payment of his import requirements, and also to cases in which the investor is required to export certain goods of the host country in exchange for its import requirements in the form of barter trade.

The trade effect of the requirements is similar to that of import restrictions, as the investor can only import within the limit of his exportation.

With regard to trade balancing requirements, Article XI which requires the general elimination of quantitative restrictions as well as the operation of the exclusion clauses such as Article XII "Restrictions to Safeguard the Balance of Payments" and Article XVIII "Governmental Assistance to Economic Development" should be examined.

4. Domestic sales requirements

In contrast to the export performance requirements presented above, this measure imposes requirements on the investor to conduct certain types of domestic sales.

Having the tightening of domestic demand for specific manufactured products as its background, this measure is employed with a view to preventing the domestic prices of the products in question from soaring and thereby to stabilizing the domestic economy.

Some examples are seen where sales are required to be conducted at a price lower than the international price for this purpose.

As a result of the imposition of domestic sales requirements on the investor, manufactured goods intended originally for exports cannot be exported.

Although its nature depends upon its specific content, such a measure is in substance an export restriction, and it must therefore be examined in terms of its relationship to Article XI for the possibility of violation of the Article.

5. Technology transfer requirements

There are measures with regard to overseas direct investment which compel the transfer of advanced technologies or which impose certain restraints on the conditions for royalties for the technology transfer.

In cases in which technologies concerning parts are required to be transferred, the investor is sometimes required to make a direct investment and produce locally in the host country the parts as well. In such cases, opportunities for entry are diminished for parts produced either in the investor's home country or in a third country. Furthermore, in some cases production by the local manufacturers of rival products intended for export is facilitated when transfer of technologies related to the production of these products is imposed as a requirement. If production by the investor's enterprises operating in the host country is originally intended for export, then their exports will be decreased in these cases contrary to their original intention.

Moreover, even if the required technology transfer is made, depending upon the technological level of the host country, the outcome of this measure may be a fall in exports due to a loss of export competitiveness of the product because of (i) insufficient quality or higher costs of the parts supplied by local manufacturers, or (ii) a fall in production capacity in the manufacturing process of the product.

Also, if proper royalties for the technology transfer cannot be obtained, and consequently the originally intended level of technological transfer is not made, exports will fall due to the resulting fall in product quality or the rise in cost.

With regard to this measure, we consider that ways of eliminating its trade restrictive and distorting effects, and thereby ensuring free flows of trade, should be examined in this negotiation from the angle of substantial reductions of trade barriers.