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Group of Negotiations on Goods (GATT)
Negotiating Group on Trade-Related
Investment Measures

MEETING OF 15-17 FEBRUARY 1988

Note by the Secretariat

1. The Group held its sixth meeting on 15-17 February 1988 under the chairmanship of Ambassador T. Kobayashi (Japan). The agenda set out in GATT/AIR/2537 was adopted.

Examination of the trade effects of investment measures cited by participants

2. The Chairman invited views on the trade effects of investment measures that had been mentioned in written submissions or oral statements and, wherever possible, empirical evidence of these trade effects. A new submission describing investment measures and their trade effects had been made by the United States (MTN.GNG/NG12/W/9).

3. One participant presented orally a series of documented case studies drawn from the experience of investors in various industries and countries which had been subject to the application of one or more of all of the investment measures cited in MTN.GNG/NG12/W/9. The trade effects that could be attributed to these investment measures were described and, in many cases, also quantified. Efforts had been made to adjust for the influence of other factors such as exchange rates so that the trade effects indicated were the effects of TRIMs, in some cases in combination with trade measures. The purpose of the exercise was to respond to requests made in the Group for empirical evidence of the trade effects of TRIMs in order to dispel the notion that investment measures were not trade-related and to demonstrate that they needed to be brought under the multilateral disciplines of the GATT.

4. The following conclusions were drawn by this participant from the case studies. Each of the TRIMs cited could have important restrictive and distorting effects on the trade of home and host countries to the investment and on the trade of third countries. A number of difficulties were involved in calculating the quantitative trade effects of individual TRIMs, since often several TRIMs were applied at the same time and in conjunction with other market reserve policies and with trade measures. Trade policies and investment policies were frequently mutually reinforcing in their effects on trade. It was also difficult to generalize about the size of the trade effects since much depended upon how the TRIMs were applied and administered. While the precise magnitude of the trade effects

involved in any particular case might therefore be open to some dispute, the direction of the effects on trade was clear. These effects were analogous to, and in some cases exactly the same as, those of traditional trade policy measures. Trade policy measures were subject to GATT disciplines without any requirement for case-by-case evidence of their quantitative significance and the same should hold true for TRIMs. The evidence showed that TRIMs could and often did have adverse trade effects and this should be sufficient to make the case for applying general principles and disciplines to control them. Furthermore, it seemed reasonable to infer from surveys which showed the widespread incidence of TRIMs among developed and developing countries that governments would not employ them unless they believed that they were gaining some kind of trade advantage. Such advantages were at the expense of other countries and TRIMs lay, therefore, squarely within the kind of trade policy considerations that were at the heart of the whole GATT system. The evidence demonstrated amply that TRIMs did have significant trade restrictive and distorting effects which were the proper business of GATT and he challenged those participants that wished to continue to assert the contrary to provide their own empirical evidence to support their views. Otherwise, the Group should return as soon as possible to its discussion of how adequately existing Articles covered these trade effects and where further disciplines might be necessary.

5. In response to requests, this participant agreed to try to summarize the case studies in written form after the meeting for distribution to members of the Group.

6. Two other participants presented the results of enquiries that had been conducted by their governments into the trade effects of investment measures.

7. One stated that the negotiating mandate required the Group to discuss only those aspects of investment policies which had a direct impact on trade flows, not investment policies per se. Confidentiality considerations precluded the provision of detailed results, but studies had found that export performance and local content requirements had particularly direct and significant restrictive and distorting effects on trade and that their incidence was increasing gradually. There was a strong desire to find a multilateral solution to these problems. Negotiations in the Group should focus on the trade effects of these two measures which, in his delegation's view, had a direct link to GATT disciplines. The description of the trade effects of these measures in MTN.GNG/NG12/W/9 corresponded with his delegation's views, except that the stated effect of local content requirements in reducing the efficiency and competitiveness of domestic industry appeared to be more a matter of economic mismanagement than impairment of GATT rights and might have greater relevance to market access than to TRIMs. Other TRIMs cited in MTN.GNG/NG12/W/9 might directly or indirectly affect trade flows but their impact and their relationship to the GATT needed further elaboration. This was the case for domestic sales requirements, manufacturing requirements and limitations, remittance restrictions, technology transfer requirements

and investment incentives. Incentives were in most cases part of industrial policy and their excessive use in isolated cases might be addressed more appropriately in the context of subsidies. It was doubtful that local equity requirements fell within the scope of the negotiating mandate since the ratio of domestic to foreign ownership was a matter of national sovereignty and the arguments put forward on the trade distorting effects of this measure were not convincing.

8. The other participant provided examples of trade effects which had been found by his government to be typical of certain TRIMs and related these trade effects to the operation of specific GATT Articles (see paragraph 129). He elaborated on the description in MTN.GNG/NG12/W/7 of these TRIMs and their trade effects. In addition to many of the points made there, he noted that trade balancing requirements could lead to the artificial expansion of exports and to dumping and that technology transfer requirements could produce effects similar to those of manufacturing requirements. Apart from these and domestic sales, export performance and local content requirements, which his delegation was convinced could have important trade restrictive and distorting effects, other TRIMs cited by other participants should not be excluded from consideration without sufficient debate in the Group. It was not necessary to show that investment measures always produced trade effects in order to make the case for applying general GATT principles and disciplines to them.

9. Several participants stated that the extensive empirical evidence which had been provided showed that investment measures could have trade restrictive and distorting effects.

10. One considered that the demonstration of distortions to the trade of host countries implementing TRIMs and of restrictions on trade flows between home and host countries was particularly interesting and her delegation was ready to continue the debate on all of the TRIMs that had been listed. It appeared that many investment measures had similar trade effects and many could fit within the principles of the GATT, especially those restricting market access or operating as subsidies. She considered that if it was clear that an investment measure was highly likely to have adverse trade effects then it was appropriate to subject it to multilateral disciplines to minimize these effects. This was recognized practice in GATT with respect to trade measures for which no precise quantification of trade effects was required.

11. Another stated that export performance, local content, product mandating and trade balancing requirements as well as manufacturing requirements applied to the production of components appeared to have direct trade effects by influencing investors' decisions on purchases and sales. Licensing, local equity and technology transfer requirements, remittance and exchange restrictions and investment incentives appeared to have only indirect trade effects. Incentives were important to stimulate economic and regional development beyond what could be achieved through trade policies. Manufacturing requirements on final products and manufacturing limitations were directly related to the issue of rights of

investment itself and even the OECD Declaration on International Investment and Multinational Enterprises recognized this to be a matter of national sovereignty. His delegation was willing to discuss those measures which had direct trade effects and prepared to consider additional measures that other participants perceived had significant trade effects. The Group should reach a common understanding on the distinction between direct and indirect trade effects. Also it should recognize that investment measures were the product of negotiations between profit-maximizing foreign investors and host governments and that the acceptance of TRIMs by foreign investors was in payment for the concession of national sovereignty by a host government.

12. One participant said that the observable trade effects were not always attributable to an individual TRIM and the Group should be mindful of the need to draw a distinction between the effects of a TRIM and the effects of other factors when it came time to consider what Articles were relevant and what kind of general rules it might wish to apply to individual TRIMs. It was important also to bear in mind who was affected by TRIMs: the investor, the host country or third countries. There was a need to distinguish direct and indirect trade effects of TRIMs and while the Group may not need to define the distinction it should focus its discussion on those measures with visibly direct trade effects. In response, another participant commented that the difficulty of separating the effects of individual TRIMs should be viewed as a demonstration of the complex trade effects involved and not used as a reason to distinguish direct from indirect trade effects and to focus only on direct effects. The indirect effects for one country might be the direct effects for another and it seemed doubtful that a clear distinction could be made on this basis.

13. Another said that there were often complex reasons for the application of TRIMs. In some cases they were used in conjunction with trade measures as part of a strategy to provide positive assistance and create more efficient industry rather than as part of an attempt to gain trade or economic advantages. The Group should concentrate on TRIMs with likely longer-term, restrictive effects on trade rather than on those with only short-term effects that were essentially positive in nature. It was worth noting also that the trade effects of some TRIMs were very small and did not represent a major disruption to international trade. The Group should avoid focusing only on the most easily identifiable TRIMs which were implemented by highly visible means and were the most transparent, and consider also less obvious measures that might have more significant trade distorting effects. In response to a comment that drawing distinctions on the basis of short or longer-term trade effects might not be helpful if the objective being sought was to ensure that investment measures were as trade-neutral as possible, this participant stated that it was not yet his intention to exclude any TRIMs but rather to ensure that there was adequate discussion of the less visible ones.

14. Another participant stated that the empirical evidence provided on individual TRIMs, which had concerned mainly local content, local procurement and export performance requirements, had shown clearly and

convincingly that these could have very restrictive trade effects. It should not be necessary to examine TRIMs on a case-by-case basis and show that they always had trade restrictive and distorting effects before drawing the conclusion that they ought to be subject to GATT disciplines. It was sufficient to show that they could have such trade effects, as was the case with quantitative restrictions, for example, to which GATT disciplines were generally applicable whatever their trade effects in individual circumstances. It might be theoretically conceivable to pursue the matter case-by-case for TRIMs by developing disciplines similar to those contained in Article VI of the GATT, but in his view this would not be appropriate. Certain TRIMs invariably had trade restrictive and distorting effects which called for multilateral disciplines rather than remedies, and in any case TRIMs were too complex to be dealt with through case investigations and dumping margins or some equivalent practices.

15. A shortcoming of the empirical evidence that had been provided concerned those examples where several TRIMs were applied at the same time. These did not provide conclusive guidance on the potential trade effects of individual TRIMs nor, therefore, on which TRIMs it was worth considering with a view to elaborating possible, additional GATT disciplines. One example had involved the use of an export performance requirement in conjunction with an investment incentive and it was possible to conclude that the trade effect would have been the same even without the export performance requirement since the local market had been too small to justify efficient domestic production. Nevertheless, it remained the view of his delegation that certain core TRIMs clearly caused trade restrictive and distorting effects by influencing the trading behaviour of the investor. These were domestic sales, local content, manufacturing and trade-balancing requirements as well as export performance requirements which forced companies into dumping practices.

16. In the context of mutually reinforcing trade and investment policies which had been pointed out in the empirical case studies, it seemed that a number of TRIMs could only achieve their apparent objectives of setting up domestic industries if applied in conjunction with restrictive trade policies. This was so for licensing requirements and manufacturing limitations, for example, and there was need for further reflection on these measures. Clearer definitions were needed for some of the TRIMs and their trade effects mentioned in MTN.GNG/NG12/W/9. This was the case for local equity requirements, licensing requirements, remittance restrictions and technology transfer requirements. Local equity requirements were cited always in combination with other TRIMs and it might be sufficient to deal only with these others. The trade effects of licensing requirements needed clarification when an investor manufacturing one product was required to license the manufacture of another product. Remittance restrictions could cause an investor to modify the type of investment made, in which case they would appear to be only indirectly trade-related, or force the investor to purchase more local inputs but without legally excluding further imports, in which case it was not clear that the effects were trade restrictive or distorting. Technology transfer requirements could take the form of requiring that certain components be incorporated into a product in the

host country or that certain technological processes be used. Trade effects could clearly occur where the investor was required also to produce the components or processes locally, but these could probably be captured adequately by disciplining manufacturing requirements and it was not clear that technology transfer requirements were justified as a separate category of TRIMs.

17. In response to this and other comments on the trade effects of technology transfer requirements, one participant stated that these requirements illustrated the complexity of the trade effects of TRIMs. A simple undertaking by an investor that a particular technology would be used might or might not have trade effects and be relevant to the Group's discussions. However, such an undertaking could be accompanied by a commitment to licence technology to local firms and by a specification of the return that the investor could obtain from that technology over the period he retained proprietary control. Apart from raising commercial policy issues connected with the protection of intellectual property, the technology transfer could then affect the operations of domestic producers and so alter trade patterns. Combined with an export performance or product mandating requirement it could produce an export platform for a whole region and result in trade effects for third countries. In general, it was difficult to separate the trade effects of individual TRIMs since several measures were often used in combination and, in the view of this participant, the Group should concern itself with the trade effects of combinations of measures as well as individual measures. His delegation was not prepared to accept that any TRIMs be excluded from the discussion, at least until the negotiations were much farther along. In response to another question, he stressed that his delegation was concerned about the use of TRIMs in both developed and developing countries.

18. Several other participants expressed their appreciation for the empirical studies that had been provided and some asked for them to be summarized in written form to permit more careful study and reflection. They gave their initial reactions to them.

19. One considered the case studies were helpful in improving understanding of the issues but not convincing when it came to attributing general adverse trade effects to TRIMs. TRIMs were part of investment policies and the objective of investment was to increase economic growth and to create new trade flows. He could not subscribe to the theory that the overall effects of investment and TRIMs were trade restrictive or distorting. As long as countries had sufficient comparative production advantages to overcome the supposed disadvantages of TRIMs, foreign investors would still make profits and there would be gains to the host economy since investment created trade. No investor would put money into a venture or continue operating if there were not profits to be made, yet in only one of the case studies provided had it been claimed that an investor went out of business because of the application of TRIMs. If TRIMs really were such an imposition in terms of raising production costs and lowering competitiveness and profits as was stated by some participants, then investors would decide to go elsewhere.

20. Nor could this participant accept the argument that there was a direct link between TRIMs and trade distortion. The gains in trade for a host country were not necessarily made at the expense of third countries. Incentives could encourage new investment in an industry that would not otherwise have taken place at all in any neighbouring countries. This could create new trade flows in raw materials and components as well as raise national income, so that an investment incentive could definitely result in a net gain as long as the resulting investment could compete internationally. Additional performance requirements imposed on a foreign investor might diminish, but would not offset, this trade gain as long as the investor continued to make profits.

21. The proper guideline for the Group to adopt was the GATT itself when considering whether the effects of investment measures were restrictive or distorting. This was the only approach that was consistent with the negotiating mandate. The FIRA panel had found that local content requirements were illegal under the GATT and the trade effects of other TRIMs might also be found to be in violation of it. The Group should examine them against GATT norms and, in the light of the trade effects, decide whether new disciplines were necessary.

22. Another participant said that it was not possible to generalize about the adverse trade effects of TRIMs on the basis of the empirical studies provided since these often had concerned combinations of TRIMs from which it was hard to isolate the trade effects of individual measures. Also, other factors such as exchange rate changes could influence the analysis of which effects were attributable directly to the TRIMs. Although no evidence had been provided in these studies that TRIMs had pure trade creating or expanding effects, the possibility could not be ruled out. He enquired to what extent the case studies had been based on foreign investors complaining about the imposition of TRIMs because their operations were not successful and whether other surveys had been made of investors subject to TRIMs with successful operations. He received the reply that the case studies had not been chosen on the basis of complaints by investors and that they covered both successful and unsuccessful companies.

23. Other approaches aimed at deducing the trade restrictive and distorting effects of TRIMs by examining how the measures worked and likening their effects to those of trade measures should be based strictly on the question of whether or not they were consistent with existing GATT disciplines. This was a fundamental premise of the GATT. Although tariffs could have trade restrictive and distorting effects they were fully consistent with the GATT Articles. Quantitative restrictions were in general prohibited but in exceptional circumstances they were permitted. By analogy, the Group should not accept the argument that the trade effects of TRIMs were inherently inconsistent with the GATT. Each country had a sovereign right to determine its investment policies and these policies should not be questioned unless they could be shown to have trade effects that were inconsistent with the country's GATT obligations.

24. Another participant stated that notwithstanding the empirical studies provided, the Group did not have sufficiently clear proof yet that the trade effects of TRIMs were of a general nature. It was difficult to measure the trade effects of TRIMs in isolation from the influence of other factors. Also, these effects might be viewed as adverse in the short-term but beneficial in the longer-term. Comments by other participants that the micro-level effects might be positive but the macro-level effects on the international trading system negative required further reflection, since what was important was the effect on countries participating in the negotiations. It should be borne in mind that the empirical studies had covered multinational enterprises whose vested interest lay in having as much freedom of action for their operations as possible. They would not wish to be subject to TRIMs any more than they might wish to pay taxes. Yet these studies had shown that, with only limited exceptions, the enterprises could still make profits even with the imposition of TRIMs. TRIMs were known about at the time an investment was made and were not normally imposed ex post facto.

25. Care was needed in attributing particular trade effects to specific TRIMs. It had been stated that remittance restrictions could cause an increase in export prices, which presumably reflected transfer pricing practices on the part of foreign investors. These practices were used widely to avoid taxes and were not only a result of the imposition of remittance or exchange restrictions. It had been claimed that export performance requirements led more or less automatically to dumping, but no empirical evidence had been provided for this and the claim seemed of doubtful validity. It was unlikely that investors would accept such requirements if it forced them to dump over the longer-term. In any case, anti-dumping remedies were available in the GATT.

26. Another participant stated that the Group should not overlook the fact that the empirical studies had been based on the operations of multinational corporations and therefore reflected a particular point of view about the meaning of trade distortion. They had shown the trade restrictive and distorting effects of TRIMs to be no more than a possibility. Also, the trade effects attributed to TRIMs in these cases could have been due to other factors, including trade policies. It was necessary, therefore, to adopt a case-by-case approach to TRIMs since it was not reasonable to subordinate the design of national investment policies to multilateral principles and disciplines when it was no more than a possibility that particular measures might result in trade distortion. It was true that the GATT was built on general principles for trade measures and did not required case-by-case confirmation of their trade effects, but measures such as quantitative restrictions were recognized as leading certainly to trade distortion and the same causality had not been established for TRIMs. The need to approach TRIMs on a case-by-case basis was reinforced by comments made that certain TRIMs required accompanying trade restrictions in order to attain their objectives, since it would seem obvious in such instances to address in GATT the need for discipline over the trade measures rather than the TRIMs.

27. It was necessary to reach a common understanding in the Group on the meaning of trade distortion. If it was used too loosely to mean a loss of trade opportunity, then investments themselves could be considered to be trade distorting since they could displace trade flows. If it was used to mean any changes in trade flows, then trade creation could occur only through the expansion of markets to accommodate new entrants. Usually, however, it was competition that determined trade shares and a new trade share was gained at least partly at the expense of another producer. This was a perfectly healthy process, and it underlined the difficulty of differentiating clearly trade distortion and creation.

28. It was also necessary to clarify exactly what it was being claimed were the trade distorting effects of individual measures. It had been stated, for example, that a manufacturing requirement operated like a quantitative import restriction since it reduced imports and created a loss of trade for third countries and it led to the artificial development of domestic production capacity. The analogy was not clear because a manufacturing requirement had the same effect on trade as the development of any new production capacity, whether achieved artificially or not.

29. It appeared that some participants were adopting an approach aimed at achieving liberalization in the area of investment. The negotiating mandate required the Group explicitly to examine and remedy only the trade effects of investment measures. For this reason the effect of TRIMs on investors' profits was not relevant to the Group's work. However, with respect to whether an investor was content to be subjected to TRIMs or not, it was worth bearing in mind that investors and producers were apparently content to enter into voluntary export restraints and yet it had not been possible to agree on their legality under the GATT. Also, although the Group was not dealing with investment per se, it should be recognized that disciplining the use of TRIMs might result in governments exercising stricter sovereign control over foreigners' rights to invest at all, thereby reducing flows of direct foreign investment.

30. Finally, the observation made on the empirical studies that trade and investment measures were frequently reinforcing reflected a natural aspect of domestic policy coordination and was not something to be regarded negatively.

31. Another participant stated that the Group should not focus only on the use of investment measures by developing countries but should consider also the trade practices of multinational corporations. Many of the investment measures that had been mentioned were employed by developing countries to attract foreign capital as part of domestic industrial policy with the aim of development and technological progress. In adopting such measures, developing countries claimed to be able to improve their level of competitiveness and technological ability so as to meet development imbalances. From the standpoint of development, it was these imbalances which distorted trade and not the measures themselves. To challenge the use of some of the measures mentioned was equivalent to challenging the technological progress of sovereign countries. If this was to be

discussed, so also should policies to protect obsolete industries of the developed countries since these distorted international trade. Licensing and technology transfer requirements were often imposed to prevent restrictive business practices of multinational corporations in connection with the manufacture of products using contractual technology. It would be useful if the Secretariat could circulate studies prepared by UNCTAD some years ago on restrictive business practices. Another participant said it would be useful for the Group to have this material in order to see whether it was relevant or not.

32. Another participant stated that, while he was not dismissing the efforts that had been made to present empirical studies, his delegation could not accept them as evidence of the trade effects of investment measures. Such an assessment of potential trade effects could only be subjective, speculative and hypothetical. The studies were replete with examples of foreign investors who considered they had suffered potential trade loss or disadvantage. However, the point of view of multinational corporations was based on how they could maximize their trade and investment opportunities. National governments did not share this point of view and it was necessary in the Group to examine the matter from the standpoint of the contracting parties.

33. Before proceeding much further, therefore, it would be necessary to agree on what was meant by trade restriction and distortion. The Group should not attempt to define these terms, but rather should recognize from the negotiating mandate that they could be interpreted only in relation to GATT Articles. The GATT allowed countries to restrict trade in many ways and just because an investment measure might be claimed in certain circumstances to have trade restrictive effects did not mean that it was necessarily in violation of the GATT. The yardstick on which to determine trade restriction and distortion had to be the operation of GATT Articles and legality or illegality under the GATT. This is what his delegation meant by a panel-like approach. In this respect his delegation was concerned about the attempt to draw conclusions on the trade effects of investment measures on the basis of empirical studies and without relating the exercise explicitly to the operation of GATT Articles. Furthermore, he could not accept that participants were required to justify investment measures in terms of the GATT or to establish whether they were in conformity with GATT objectives. The Group's examination should be not whether investment measures were trade restrictive but whether the perceived trade restrictive effects of the measures were GATT-consistent or not.

34. A related point concerned the conclusions that had been drawn from the empirical studies on the effects of investment measures on the domestic economy of the home country. These were irrelevant to the purposes and functions of the GATT. The GATT applied only at the border and there was corresponding autonomy of action for governments within their borders. This was recognized, for example, in the Subsidies Code. It was not the business of other contracting parties if a government applied measures that did not result in efficient and competitive domestic industries. This

might not contribute to the efficient allocation of resources worldwide but there were many existing examples, such as textiles and agriculture, where it nevertheless occurred and where it could be claimed equally that the allocation of resources would become more coherent if the GATT were applied.

35. Nor was it relevant for the Group to discuss whether a government had achieved its objectives by imposing an investment measure. Governments had a sovereign right to determine their investment policies and his delegation did not share the perspective on how the GATT operated of other participants who wanted to apply the general principles of the GATT to investment per se. The right of governments to impose investment measures for domestic investment purposes could not be challenged under the GATT. In this regard the emphasis placed by some participants on the mutually reinforcing nature of trade and investment regimes was puzzling. If what was meant was simply that governments coordinated their trade and investment régimes in order to achieve certain objectives it was acceptable, but it should not be used to imply that it could result in negative trade effects. Not all governments took investment decisions on the basis of trade objectives. His delegation was on record as having said that trade and investment were basically competitive in nature. Setting up a domestic import-substitution industry would reduce trade flows but this should not be regarded as trade restrictive or distortive. It was natural for a country such as his own, which did not have a very liberal trade regime but which maintained its trade restrictions in conformity with the GATT, to maintain restrictions with regard to its investment regime. This might give rise to trade effects which could be viewed by others as trade restrictive or distorting. Hence, the test of trade restriction or distortion had to be whether the country had a basis for maintaining them under the GATT. This had been the thrust of the submission that developing countries had made to the FIRA Panel.

36. His summary of the discussion so far was that investment policy may or may not be related to trade, the trade effects of investment measures may or may not be adverse, and the adverse trade effects of investment measures may or may not be GATT-consistent.

37. Another participant felt that the empirical studies had shown only that the potential trade effects of investment measures were of relatively minor significance in comparison which other problems facing world trade and the trading system.

38. Another stated that governments had sovereign rights over investment policies and it was still not clear how the line could realistically be drawn between these and the objective of some participants to subject the trade effects of investment measures to GATT disciplines. All investment affected trade.

39. There were exchanges of views on a number of points from the statements that had been made.

40. It was acknowledged that the response in GATT to dumping was built on remedies rather than disciplines but this was because a distinction existed between dumping that resulted from marginal cost pricing practices and predatory dumping. The first, it could be argued, was not bad since it resulted only in the provision of cheaper goods to consumers but the second resulted in injury to other producers. In the case of export performance requirements there was per se evidence of predatory behaviour, since in the event an investor could sell competitively on export markets the requirements would be redundant, so that these measures fell squarely into the kind of practice that Article VI was designed to catch. It was felt by some that for this reason disciplines might be more appropriate than case-by-case remedies. Others denied there was any proven relationship between export performance requirements and dumping and that as a result a case-by-case approach was indispensable. One asked if any provisions in investment agreements were known about which obliged an investor to sell exports at less than fair value.

41. With respect to the point that some investment measures could have trade creating effects, several participants stated that trade creation at a micro, or national economy level might result in trade distortion at a macro, or global economy level. Dumping was one example. In this regard it was not relevant to the exercise to focus on the fact that a foreign investor might have accepted the imposition of TRIMs in his negotiations with a host government since the TRIMs could nevertheless cause trade distortion for third countries. Another participant said that his remark had not been intended to deny that increased investment led to increased trade; on the contrary, one of the objectives of his delegation in these negotiations was to create better conditions for investment since it believed that investment was essentially trade-creating and not trade-restricting or distorting. He certainly did not subscribe to the view that trade and investment were essentially competitive or substitutive. It might be possible to defend the use of investment incentives where these were applied non-discriminatorily to all industries so as to lower the marginal cost of capital, although in his view this was probably a wasteful use of domestic resources in particular when countries competed in this way to attract investment. Nevertheless, it had to be recognized that the practice of offering investment incentives was widespread and that much of the cost was borne domestically. The problem of trade restriction and distortion arose mainly when incentives were applied discriminatorily among investors and a government attempted to offset their cost by imposing performance requirements, etc. which passed at least part of the cost on to foreign exporters. He would welcome evidence in such cases from other participants to support their argument that the trade-creating effects could outweigh the trade restrictive and distorting effects. Another participant suggested that investment incentives might be more a problem of subsidies than of TRIMs, and that the TRIMs problem concerned the conditions that went with an investment rather than the investment itself.

42. With respect to the point that the trade restrictive and distorting effects of investment measures had to be gauged in terms of violation of

existing GATT Articles, one participant said that this wrongly mixed up the issue of trade restriction and distortion with the separate issue of whether the GATT was applicable. It was necessary to adopt a common sense approach to the identification of the trade effects of TRIMs. Another stated that it was not the rôle of the Group to give definitive findings on whether TRIMs violated GATT Articles, but rather to examine whether existing Articles were adequate to take care of the trade effects of TRIMs and, if not, to elaborate further provisions. One participant drew attention to the mandate which required the Group, if necessary, to elaborate new disciplines and stated that it would be necessary to think about new provisions for TRIMs that appeared to have only a marginal relationship to existing GATT Articles. Another disagreed with this interpretation of the mandate and said that the Group should limit its examination to only those trade effects of TRIMs that were inconsistent with existing Articles and see whether, and if so what, further provisions might be necessary to deal with them. One participant considered that further panel findings on the trade effects of investment measures along the lines of the FIRA panel would have been helpful to the Group in this respect.

43. Several participants stated that they did not want to call into question the sovereign right of governments to determine their investment policies nor the existence of such policies. The purpose of the negotiations was to curb the trade restrictive and distorting effects of measures taken in this regard. For this reason it was not relevant to measure the effects of TRIMs in terms of company profitability or how many investments were made, although in this context it was noted that TRIMs were not imposed only at the time an investment was made but also afterwards. One participant noted a potential link between lower profits, lower competitiveness and lower exports. Another noted that governments equally had a sovereign right to determine their commercial policies but it had been a function of the GATT to search for multilateral commitments that submitted trade measures to appropriate disciplines. Multilateral disciplines over investment measures would involve no more of a loss of sovereign control than was involved for tariffs or quantitative restrictions. In any event, multilateral negotiations in GATT were conducted always in a way that respected national sovereignty and each contracting party would be free to determine its position regarding final agreements that were reached.

Continuation of the identification and examination of the operation of GATT Articles related to the trade restrictive and distortive effects of investment measures

44. One participant presented his delegation's views on the operation of GATT Articles for each of the TRIMs cited in MTN.GNG/NG12/W/9. By way of a summary, he stated that although many Articles had been found to be relevant to TRIMs, there was a certain convergence of the argument on the particular relevance of Articles I, III and XVI, as well as XXIII which reached all TRIMs in certain circumstances but did not impose any disciplines on them.

45. The relevant GATT Articles for each TRIM were, in his view, as follows:

TRIM	Articles
Local content requirements:	I, II, III, X, XI, XVII and XXIII
Export requirements:	I, VI, X, XVI, XVII, XXIII and Subsidies Code
Trade-balancing requirements:	I, II, III, VI, VIII, X, XI, XIII, XVII and XXIII
Manufacturing limitations:	I, II, III, X, XI, XIII, XVII and XXIII
Manufacturing requirements:	I, II, III, X, XI, XIII, XVII and XXIII
Product mandate requirements:	I, VI, X, XI, XIII, XVII and XXIII
Remittance restrictions:	I, II, III, VI, VIII, XI, XIII, XV, XVII and XXIII
Technology transfer requirements:	I, II, III, VI, VIII, X, XI, XIII, XVII and XXIII
Licensing requirements:	I, II, III, X, XI, XIII, XVII and XXIII
Local equity requirements:	I, II, III, VI, X, XI, XIII, XVII and XXIII
Incentives:	I, III, X, XVI, XVII and Subsidies Code

46. His observations on the relationship between individual Articles and individual TRIMs were:

47. Article III virtually bans all local content rules. The 1983 GATT panel was unequivocal in its conclusion that contracting parties are precluded by Article III:4 from requiring foreign investors to purchase goods of local origin in preference to imported goods.

48. A local content requirement may contravene Article II:1 by adding a layer of protection to domestic products above and beyond that provided for in countries' tariff schedules and thereby undercutting the value of negotiated tariff concessions obtained by countries under GATT.

49. In the FIRA case the United States Government argued unsuccessfully that local content requirements have the same effect on imports as quotas and therefore violate Article XI:1. The panel decided that internal requirements (local content) are not restrictions on the "importation" of products per Article XI:1 but restrictions affecting "imported products" per Article III. In the panel's view, if Article XI were interpreted to cover internal requirements then Article III would be "partly superfluous". The panel's reading of Article XI may be excessively narrow which justifies raising the relevance of Article XI.

50. In the FIRA case the United States Government argued unsuccessfully that local content requirements violate Article XVII provisions since they oblige investors to give less favourable treatment to imported products than to domestic products and thus prevent investors from acting in accordance with "commercial considerations" when making purchases.

However, the panel did not definitively answer the question of whether Article XVII:1(a) embraces the national treatment as well as MFN principle. Whether Article XVII does (or ought to) embrace national treatment and whether investors must (or should) be allowed to act in accordance with commercial considerations are still questions in need of answers. If one accepts the FIRA panel view that the treatment provision of Article XVII is only an MFN provision and that the MFN provision must be violated before "non-commercial" actions ensue, then to the extent that local content requirements are applied discriminatorily between two foreign investors, as happens in case-by-case application (a potential violation of Article I), investors may be prevented from adhering to the MFN principle and thereby undertake actions on "non-commercial" grounds in violation of Article XVII:1(b) as interpreted by the FIRA panel.

51. Non-transparent local content requirements may contravene the provisions of Article X, though the Article specifies only that "laws, regulations, judicial decisions, and administrative rulings of general application" must be known to market actors. This raises the issue whether case-by-case local content requirements violate Article X.

52. Supposedly, export requirements are only effective, and therefore trade distortion only arises, when they are combined with some fiscal, financial or trade-related incentive which offsets their additional costs. If this is true, one need only be concerned with those instances in which export requirements and incentives are combined, ignoring export requirements imposed in isolation.

53. The self-regulation argument simplifies the world too much. Countertrade and offset commitments demonstrate that firms agree to all manner of conditions in order to close deals: investors probably do the same with respect to export requirements. Though export requirements raise costs for investors, especially if the investor is not an exporter, this does not, ipso facto, doom a potential investment. It may diminish a firm's expected rate of return, but the investment so affected may, nonetheless, reflect the investor's best opportunity or fit well within his global strategy. Available evidence shows that export requirements are imposed in isolation, particularly in cases in which firms have already invested to serve local markets.

54. Export requirements, in isolation, may violate the terms of Article VI if such requirements lead to dumping in the home country and, possibly, third-country markets as well. The language is a little unclear on third-countries as it refers only to dumping of products by "one country" in the "commerce of another country". In any event, Article VI is only a remedy for the effects of export requirements and does not constitute a constraint on their use. The FIRA Panel observed that there is no provision in GATT which forbids export requirements, per se, and that contracting parties are under no obligation to prevent enterprises from dumping. However, the 1955 Working Party report concluded that "contracting parties should, within the framework of their legislation,

refrain from encouraging dumping ... by private commercial enterprises". This may be a perfect example of a GATT Article in need of repair.

55. Governments use what may be termed "perverse incentives" in order to obtain export commitments from foreign investors; that is, export measures and other TRIMs are combined such that the latter are waived or modified if the investor agrees to the export obligation. Clearly, the waiver of performance conditions contingent upon export may artificially induce exports. Dumping is a conceivable outcome, in which case the provisions of Article VI may be applicable. Impairment of tariff concessions is another outcome, in which case remedies are possible under Article XXIII. Export requirements linked to perverse incentives are not prohibited by the terms of Article XVI nor the Subsidies Code although perhaps they ought to be.

56. A host government may offer a foreign investor the advantage of serving the internal market behind a high tariff wall in exchange for an export commitment. This incentive confers the obvious benefits of protection to the investor; in exchange, the investor is taxed -- he commits to export some of his output. The host government, in effect, mandates dumping. Remedies are available under Article VI, but, again, the export commitment itself is not covered.

57. Export requirements (except on primary products and developing countries' exports) which are linked to prohibited government subsidies violate the GATT Subsidies Code.

58. In the FIRA case, the United States requested the panel to find Canada's export requirements in violation of Article XVII:2(c), arguing that the exports which result do so because of non-commercial decision-making. The FIRA panel held, with respect to Canada's local content requirements, that Article XVII:1(b), which obligates governments to allow enterprises to act in accordance with commercial considerations, cannot be read apart from XVII:1(a), which is the MFN obligation, and export requirements do not violate the MFN obligation. However, as with local content requirements, export requirements imposed case-by-case, particularly when associated with some advantage or incentive, may be discriminatory in their effects and thus violate the MFN obligation of XVII:1(a) and of Article I.

59. Article X is potentially applicable to non-transparent export requirements, with the same caveats as for local content requirements.

60. A <u>trade balancing requirement</u> may run counter to the terms of Article I, the most-favoured-nation principle, if the requirement is imposed differentially on different foreign investors.

61. A trade balancing requirement introduces an additional charge on imports -- the need to export -- and therefore adds a layer of protection above and beyond that provided for in a country's tariff and undercuts negotiated tariff concessions. Article II may reach this requirement.

62. Such requirements potentially violate the national treatment standard of Article III:4 by introducing a discriminatory charge on imports.

63. A trade balancing requirement could induce dumping by foreign investors. If so, the requirement is potentially actionable but not disciplinable under Article VI.

64. One might argue that a trade balancing requirement is a "charge" on imports which amounts to indirect protection of domestic producers and thus is GATT inconsistent by virtue of Article VIII:1(a).

65. Non-transparency of a trade balancing requirement may violate Article X, which requires the publication of trade regulations, etc.

66. A trade balancing measure may also violate Article XI:1, if imports are limited to some proportion of the amount (volume or value) exported, effectively establishing an import quota.

67. Article XIII attempts to establish an MFN standard for the imposition of quantitative restrictions on imports and exports. An import restriction in the form of a trade balancing measure may be reachable under this Article, if imposed discriminatorily.

68. If local content or export measures are reachable under Article XVII, then so are trade-balancing measures.

69. Article XXIII may cover these measures through non-violation nullification.

70. To the extent a manufacturing limitation is applied in a discriminatory manner between the investors of different countries, a possible violation of Article I exists. The limitation, differentially applied, will likely have discriminatory effects on imports, if not on exports, and thus may contravene the MFN principle of Article I.

71. If the host country imposes a manufacturing limitation or market reserve on the investor's product line, then the established trade flows associated with the investment, including imports from the investor's home market or imports from third countries, are affected. The effect of the market reserve may be to impair the benefits the investor (trader) is entitled to and had reasonably anticipated from negotiated tariff concessions. As such, this measure may violate Article II.

72. If a foreign company assembles a product from components imported from his home market, and the host country decides to prohibit the assembly of these products because domestic companies can produce a like product from indigenous components, then imports of all components which comprised the products are discriminated against. In effect, the market reserve simply creates an arbitrary preference for domestic goods over foreign goods, which is a violation of Article III:4.

73. In addition, Article III:1 obligates contracting parties not to apply "laws, regulations and requirements affecting internal sale" on "imported or domestic products so as to afford protection to domestic production". A manufacturing limitation is inherently protectionist; its sole purpose is to grant monopoly protection to domestic producers.

74. A manufacturing limitation may be covered by Article XIII if the limitation violates the Article's MFN standard established for quantitative restrictions excepted from Article XI, for instance, by Article XII.

75. The provisions of Article XVII may not preclude the imposition of market reserve and associated manufacturing limitations on investors, nor ensure observance of national treatment by the government-created firms which result from these policies. Some authorities argue, however, that state-trading companies by Article III:4, at least with respect to imports, must observe national treatment. If this is correct, then the discrimination between foreign and domestic suppliers which undergirds market reserve and manufacturing limitations is inconsistent with III:4 and, by extension, XVII:1(a). Thus the results of market reserve, if not the policy itself, may be actionable under Article XVII.

76. If XVII:1(b) can be read as a separate obligation on the part of contracting parties to allow firms to purchase and sell solely on the basis of commercial considerations, then a manufacturing limitation violates this provision, for it induces the arbitrary cessation of importing and exporting on the part of private foreign firms. This cessation is induced by fiat not commercial considerations. If it cannot be read as a separate obligation, then the debate returns to the treatment provision of XVII:1(a).

77. Articles X, XI and XXIII may also be relevant for reasons already given.

78. The MFN principle of Article I aims to ensure that products and traders of contracting parties have an equal opportunity to compete and sell into each other's markets and vis-à-vis each other in third markets. If associated with some advantage or incentive, for instance the exclusive right to market a product locally, a manufacturing requirement may serve to discriminate among foreign suppliers, say of specialized intermediate inputs, because the firm to which the advantage is conferred may act as a monopsonist in the domestic market for such inputs. The exercise of market power on the buying side -- discrimination -- is in conflict with the provisions of Article I. However, a manufacturing requirement alone may not necessarily violate Article I.

79. Under a manufacturing requirement, a foreign firm is committed to produce a given product or input, and may be constrained from importing a like product or input. If so, this may constitute, effectively, an additional charge on the imports of such like product or input in contravention of Article II.

80. A manufacturing requirement, which may confer the exclusive right to sell a given good domestically, affords protection to domestic production in possible conflict with Article III:1. Article III:1 states that "requirements affecting the international sale" of products "should not be applied ... so as to afford protection to domestic production". If a foreign company is required to manufacture a given good, to the exclusion of imports of the same, the requirement conflicts with the national treatment clause of Article III:4. By itself, the mere requirement to manufacture a good may not constitute a violation of Article III.

81. A non-transparent manufacturing requirement may violate the provisions of Article X.

82. Under a manufacturing requirement a company more than likely cannot import a like product. In so far as this measure acts as a quantitative restriction on imports, it may conflict with Article XI:1.

83. Manufacturing requirements which are excepted from the obligations of Article XI must still adhere to the MFN standard of Article XIII. That is, if the importation of a like product is prohibited under a manufacturing requirement the prohibition cannot be selectively relaxed for certain foreign suppliers.

84. If a firm, "formally or in effect", is given the "exclusive privilege" of serving the domestic market, it is for the purposes of XVII:1(a), a state-trading enterprise. Thus, its purchases and sales must be consistent with the "general principles of non-discriminatory treatment", whatever that may mean. Assuming it is an MFN standard, if by monopsony power the firm permits imports at lower prices from some foreign sellers than from others, it violates the MFN standard. Its import purchases are thus not consistent with commercial considerations. Assuming it is a national treatment standard, the exclusion of <u>like imports</u> in favour of the required domestic product violates national treatment. If not under the obligation of XVII:1(a), as in the case in which all foreign manufacturers are under the same manufacturing requirement -- i.e., no exclusive privilege is extended -- the firm, under XVII:1(c), still cannot be <u>prevented</u> from operating consistently with XVII:1(a) by the manufacturing requirement.

85. Article XXIII may also be relevant for reasons already given.

86. If a <u>product mandate requirement</u> obliges the investor to service a given export market from the host country, it targets exports to particular markets. It could work to stimulate exports to some GATT members, but not others. The latter countries would be discriminated against. Article I aims, in part, at ending practices which discriminate between export markets. Hence, this measure may conflict with the intent of Article I. Also, it may induce price discrimination among export markets. If the product mandate requirement also confers some degree of monopsony power to the foreign firm, it may result in discrimination among foreign sources of supply. This could violate Article I.

87. A product mandate requirement mandates exports. It is not inconceivable, therefore, that this requirement could lead to mandated dumping in foreign markets. If so, then the provisions of Article VI may provide a remedy if there is material injury.

88. A non-transparent product mandate requirement may violate Article X.

89. Article XI:1 limits prohibitions or restrictions on the "exportation of any product destined for the territory of any other contracting party". Does this clause cover restrictions on exports from countries other than the one imposing the restriction?

90. If the requirement restricts exports from home or third-country locations, and is understood to be a quantitative restriction per Article XI, then, to the extent an exception is found for it under Article XII, all contracting parties' exports of the product must be equally affected. The inability of other contracting parties to realize the additional export capacity from foreign investment because it is bound to a host country imposing the requirement represents an opportunity cost to those countries which is likely to be felt more by some than others.

91. Under a product mandate requirement, a foreign company may be constrained to target particular export markets. Hence, the foreign firm may be prevented from observing the MFN principle with respect to sales in foreign markets, which would violate Article XVII:1(c).

92. A product mandate requirement may arguably nullify or impair benefits, direct or indirect, which members derive through GATT and thus be actionable under Article XXIII.

93. A <u>remittance restriction</u> can be likened to a tax on imports, for example when it is so structured that in order to import an investor must restrict his profit remittances and incur an opportunity cost. A remittance restriction such as this which is differentially applied to foreign investors may discriminatorily tax imports from some GATT countries more than others. This may contradict Article I, which, in part seeks to end discrimination linked to the country of origin.

94. The remittance restriction described above places a tax on imports. As such, it may afford the imposing country a level of protection beyond that called for in its tariff schedules, contravening Article II.

95. If the remittance restriction as described above operates as an additional tax or tariff on imports, then Article III:1 and III:4 are violated. The tax is one that domestic products do not face and thus discriminates against imports.

96. A remittance restriction may allow an investor to remit a higher percentage of his profits, or perhaps all his profits, if he exports a given percentage of his production. Assume that this investor sells his output to a domestic market protected by a high tariff wall but is

uncompetitive in export markets. If the investor, to remit more profits from local sales, sells abroad at the world price, the profit remittance limitation acts as an inducement to dumping in export markets. This dumping may be actionable under Article VI.

97. A remittance restriction may be inconsistent with the terms of Article VIII if the restriction represents an "indirect protection to domestic products or a taxation of imports ...", notwithstanding that Article VIII appears more directly related to customs formalities and fees.

98. If a government imposes a measure on a foreign investor such that allowable imports are a negative function of profits remitted, this in effect establishes a quota on imports in possible violation of Article XI:1. The restriction is made effective through "other measures".

99. The government's aim in this case may not necessarily be to control imports but rather to conserve foreign exchange for balance-of-payments reasons. As such the measure may be acceptable under Article XII, but it must still be applied on an MFN basis. If it is not, then the measure may be inconsistent with Article XIII.

100. Private enterprises subject to remittance restrictions are prevented from acting in a manner consistent with the "general principles of non-discriminatory treatment" in importing or exporting under Article XVII if this standard embraces the national treatment principle: foreign suppliers from whatever country are discriminated against when supplying the affected companies. The same is true if this standard is MFN and if differential application of the restriction induces discrimination between foreign sources of supply.

101. Article XXIII may also be relevant for reasons already given.

102. All of the foregoing points with respect to GATT coverage of remittance restrictions must be interpreted in light of Article XV. In general, Article XV obligates the contracting parties to cooperate and consult with the IMF and states that the GATT and IMF may pursue a coordinated policy with regard to exchange questions within the IMF's jurisdiction and quantitative restrictions and "other trade measures" within GATT's jurisdiction.

103. Article XV:4 appears to provide a means of examining how remittance restrictions may "frustrate the intent" of GATT. There is very little in the drafting history or interpretive notes which fleshes out XV:4, but XV:9 states that nothing in the Agreement precludes a member from: (a) using exchange controls or restrictions in compliance with IMF obligations; <u>or</u> (b) using restrictions or controls on imports or exports, the sole effect of which, additional to effects permitted by Articles XI, XII, XIII and XIV, is to make effective said controls or restrictions.

Whatever additional obligations may be assumed by XV:4 appear to be offset by XV:9.

104. In essence, Fund provisions govern exchange matters related to current account transactions, including remittance restrictions. Current transactions come under the provisions of Article VIII of the Fund Agreement, which bind the developed countries from imposing current account remittance restrictions, and Article XIV, which basically allow developing countries to continue their restrictions and "adapt them" over a "transitional period".

105. It is, therefore, justifiable to raise the issue of the trade effects of remittance restrictions as a TRIM in GATT per the discussion above, and if warranted, to call for greater IMF/GATT policy coordination on transfer issues generally, and conceivably to cite particular remittance restrictions IMF surveillance may neglect. One potential example is the linkage of profit remittances by countries to trade performance, either import or export. In this case, countries may use the remittance carrot to achieve trade goals, which are the GATT's domain. GATT should have a special concern then for remittance restrictions applied on a discriminatory, case-by-case, firm-by-firm basis.

106. The trade effects born of restrictions on capital transfers can also be raised. The IMF is silent on capital account restrictions. However, increased discipline, if feasible, is best left to the IMF.

107. A <u>technology transfer requirement</u>, discriminatorily applied to various investors, may be discriminatory in its effects on imports from countries. This may contravene Article I, which is supposed to extend the right of sale in the host country equally to all contracting parties once tariffs are applied.

108. A technology transfer requirement may be likened to a tax and result in treatment of countries' imports less favourable than that provided for in tariff schedules by adding an extra layer of protection above tariffs. Article II may thus be violated.

109. Technology transfer requirements may be used to protect domestic producers, much like other non-tariff barriers to trade. Forcing use of one technology over another may arbitrarily constrain the investor to use local inputs, cost-efficient with the mandated technology, rather than foreign inputs, cost-efficient with desired technology. This is a hidden barrier to trade, which by the terms of Article III:1 should be disciplined. Under technology transfer requirements - government regulation - the products of other contracting parties may not receive treatment equivalent to like products of domestic origin. This is potentially inconsistent with Article III:4. Technology transfer requirements may effectively induce domestic sourcing, which may be inconsistent with Article III:5.

110. Technology transfer requirements, if used as "charges" on imports, amount to indirect protection to domestic producers and may be inconsistent with Article XIII:1(a). While this TRIM may not involve a "charge" as commonly understood by the GATT, the prohibition against indirect protection reflected in this Article, as a principle, is still applicable.

111. Requirements which effectively preclude the importation of goods or inputs associated with foregone desired technology may constitute the equivalent of quantitative restrictions inconsistent with Article XI.

112. Technology transfer requirements, as Article XI restrictions excused by Article XII, are still subject to the MFN standard of Article XIII.

113. Technology transfer requirements may certainly prevent firms from acting in accordance with commercial considerations with respect to their exports and imports. It is less certain whether the commercial considerations obligation of Article XVII is under an MFN or national treatment banner.

114. Articles VI, X and XXIII may also be relevant for reasons already given.

115. With regard to licensing requirements, under Article I concessions, including bound tariffs, granted to one contracting party must be granted to all contracting parties. Thus the Article attempts to eliminate, for instance, discrimination in import trade. As the price of entering a given market with one product and sourcing as desired, an investor may be obliged to confer production rights for another product to local producers. Absent this licensing requirement, the investor might have established his own production facility and supplied that facility from home. He may, instead, forego exports under the licensing arrangement, an opportunity cost to him. In any case, the imports for production are effectively taxed by the requirement. Investors from other countries selling like products in the host market may not be subject to licensing requirements. Thus the requirement may operate to discriminate between different countries' imports.

116. Licensing requirements in the above example can possibly be viewed as additional charges on imports which impair the value of tariff concessions.

117. Licensing requirements may be viewed as "requirements affecting internal sale" applied to imported products which potentially afford protection to domestic production, inconsistently with Article III:1. If requirements effectively impose taxes on imported goods, this violates the national treatment clause of Article III:4.

118. Licensing requirements as quantitative restrictions per Article XI, which are excepted by Article XII, must comply with Article XIII's MFN standard (except where Article XIV is applicable).

119. Articles X, XI, XVII and XXIII may also be relevant for reasons already given.

120. Local equity requirements might violate Article I. As an example: an investor wishes to establish a manufacturing facility, import components and produce for local sale. However, to establish this facility majority control must be ceded to host country nationals. From the point of view of the investor, loss of control of his foreign subsidiary may represent an additional cost of production which theoretically taxes each component imported. Viewed in this fashion, a local equity requirement, which is differentially, or even equally, applied to different foreign investors may represent differential rates of taxation on foreign suppliers.

121. An equity requirement which stipulates that foreign investors cannot supply technology to joint ventures might also contradict the terms of Article I. Foreign investors are limited to less than controlling equity in these ventures, but the equity contribution itself cannot be in the form of technology. This "specified" local equity requirement would seem to hold the potential for establishing an arbitrary bias against foreign goods associated with a given technology. The bias may be differentially felt by different contracting parties, in part depending upon the manner in which the specified equity requirement is imposed on different investors.

122. If local equity requirements potentially represent additional taxes on imported goods as described above, then they may afford protection above and beyond that provided for in a country's tariff schedule. Specified local equity requirements, by effectively restricting the use of given technologies in manufacturing, may represent hidden protection to domestic production and nullify tariff concessions in violation of Article II.

123. If a local equity requirement is waived or modified if the investor agrees to an export commitment, the juxtaposition of the two TRIMs could encourage dumping by the investor. The act of dumping is potentially actionable under Article VI, but the combination of the local equity waiver and the export commitment does not itself contradict this Article.

124. Local equity requirements may be covered by Article XI:1. If under such a requirement a foreign investor is required to deposit his capital contribution (foreign exchange) with a country's central bank and his deposits, which are limited by the terms of the equity restriction, comprise the joint venture's trade account from which imports will be paid then such a measure may contravene the provisions of Article XI:1. In effect, an import quota is fixed according to the value of the deposited equity.

125. Local equity requirements involve involuntary mixing of foreign and local equity. The joint ventures which are created are state-created enterprises. Are they then state enterprises within the meaning of Article XVII:1(a)? Such an enterprise would be of or like a state enterprise within the meaning of XVII:1(a), if granted an "exclusive or special privilege" by the state. If the local equity required in the joint

venture is owned or controlled by the state, then the enterprise is a state enterprise. This is important, because an enterprise within the meaning of XVII:1(a) must act consistently with either MFN or national treatment (or both) when making purchases and sales externally.

126. Articles III, X, XIII and XXIII may also be relevant for reasons already given.

127. Incentives on their own may be of less concern because they are subject to fiscal disciplines. But packages of incentives and TRIMs should concern the Group, because the distortion which results from their use in combination may be greater than the sum of the distortions caused by their use in isolation, and the motivation behind such packages is more obviously to effect desired trade results.

128. Concluding his observations, the participant whose views are recorded in the preceding paragraphs said that Articles I, III, X, XVI, XVII and the Subsidies code were relevant when incentives are imposed with other TRIMs, and particularly with performance requirements. The arguments had been made already.

129. Another participant stated that his delegation's views so far on how GATT Articles were related to the TRIMs cited in MTN.GNG/NG12/W/7 were mostly contained already in the informal compilation prepared by the Secretariat. In summary, local content requirements needed to be examined against Article III:4 and 5 and Article XI:1; trade balancing requirements against Articles III, VI and XI; domestic sales and technology transfer requirements against Article XI; and export performance requirements against Articles VI and XI. If Article XI was found not to be related to the trade effects of export performance requirements then a new discipline should be negotiated since this was a core TRIM.

130. Another participant stated that local content requirements were clearly in breach of Article III:4, as the FIRA panel had confirmed, and they could be equated with domestic quantitative restrictions in the sense of Article III:5. They could also be compared to an extra tariff since the tariff itself could be termed a local content preference. They could have effects equivalent to import restrictions and contravene the provisions of Article XI on "prohibitions or restrictions other than duties, taxes or other charges". Export performance requirements could lead to dumped sales which undercut normal commercial pricing policies, particularly where a certain proportion of imports had to be financed through exports or where components were expensive because of high border protection. In such cases Article VI was relevant, and it was noted that a Working Party report on other barriers to trade, adopted in 1955, stated that "it follows from paragraph 1 of Article VI that contracting parties should, within the framework of their legislation, refrain from encouraging dumping, as defined in that paragraph, by private commercial enterprises". Export performance requirements could increase exports over and above a level that would otherwise have occurred in the sense of Article XVI:1 and they could have subsidizing effects, in particular where border protection was high

and profits on domestic markets were used to cover losses from sales of exports which were not competitive on world markets. Regulations that artificially increased production would, in the absence of offsetting measures such as a consumption subsidy, either increase exports or reduce imports and a subsidy covered not only the actual disbursement of money to producers but also measures which had an equivalent effect. This had been recognized by contracting parties when the Working Party report on anti-dumping and countervailing duties was adopted in 1960. Since a similarity with subsidies could be seen, the transparency provisions of Article XVI:1 would seem to be applicable to investment measures which operated directly or indirectly to increase exports or decrease imports.

131. One participant, referring to a comment made in the discussion (see paragraph 34), disagreed that the GATT was intended to apply only to border measures and that there was corresponding autonomy of action within borders. This was not the case with subsidies covered by Article XVI. Nor with internal regulations covered by Article III:4. One other participant said that even if TRIMs were not imposed at the border their trade effects were felt at the border. Another stated that past discussions on subsidies had, no doubt, supported the sovereign right of countries to maintain industrial policies and this applied equally to TRIMs, but they had gone one step further and said that the trade effects of some subsidies, certainly export subsidies, could be adverse in certain circumstances for third countries and should therefore be subject to multilateral discipline. In response, another participant stressed the importance of not glossing over the difference of the treatment in GATT between export and other subsidies. He stated that the Subsidies Code did not recognize export subsidies as a legitimate policy measure but it did not discipline subsidies that were used to pursue domestic objectives. Article III:4 covered the non-discriminatory application of internal taxes and the provision of national treatment to imported products. He was concerned at the way this was being related to the trade restrictive and distorting effects of investment measures since some participants appeared to be applying the principle of non-discrimination to the policy instruments of investment or to the perceived trade effects of investment measures without first establishing that these were inconsistent with the GATT.

132. One participant stated that the proposition that Article I was relevant in the case of the selective application of TRIMs seemed to be based on the idea that GATT rules could apply to investment and investment opportunities should be treated as trade opportunities. This was not acceptable, since Article I was relevant only to trade opportunities. He saw no possible relevance of Article XI to export performance requirements since Article XI dealt only with export restrictions. Also, he did not agree that the transparency provisions of Article XVI:1 should apply to TRIMs since these did not fall within the definition of which subsidies should be notified.

133. One participant stated that it was fallacious to argue that an investor which had obtained the right to invest in a host country should demand the application of GATT provisions to his operations. Applying the

GATT to the effects of an investment overlooked the fact that the right to invest or establish was not based on any GATT provision whatsoever. It was therefore not feasible nor appropriate to apply the non-discriminatory MFN provisions of Article I to the effects of TRIMs, whether trade-distorting or not, since direct foreign investment and investment policy did not conform to Article I in the first place. With respect to local content requirements, the FIRA Panel had left no doubt that Article XVII did not extend to national treatment but only to non-discriminatory MFN. He enquired what was the relevance of Articles XII, XV and XVIII to the Group's exercise. He stated that the proposition that every TRIM was potentially subject to action under Article XXIII begged the question of whether the measure was trade-related or not, which was the yardstick for action in GATT. He enquired whether it would be considered actionable under Article XXIII if a trade concession, that had been negotiated with a trading partner on the implicit understanding of a particular market size for a product, was subsequently undermined by a bilateral investment agreement entered into by a foreign investor and that trading partner to establish import substitution operations for that product, since in his view the trade effect was the same whether the investment was accompanied by TRIMs or not.

134. One participant said that the net was being cast very wide in relating GATT Articles to TRIMs and he was unsure of the legality of the linkages that were being made.

Further work required in terms of the Negotiating Plan

135. The Chairman recalled the Plan for the subsequent negotiating stages and enquired whether participants were yet in a position to make proposals on which TRIMs had trade restrictive and distorting effects, which Articles these were related to and whether any adverse trade effects required the elaboration of further provisions. Such proposals could help to deepen understanding and move the work along, although it was clear that there was no consensus yet in the Group on the answers to any of these questions.

136. Several participants stated that the Group had examined in some detail the trade effects of investment measures and the operation of GATT Articles which some members had cited. The Group should now move forward. One way to do so was to put these two elements together schematically. Two participants hoped that they would be in a position to put forward proposals along these lines for the next meeting, one of them aiming to try to focus the discussion more clearly.

137. One participant considered the Group should not move hastily to the subsequent negotiating stages. The Group had not yet reached the point where it could single out particular investment measures that it felt it was necessary to deal with. Another felt an attempt was being made to force the pace by asking for proposals. Some participants had stated that they needed to reflect further on the perceived trade effects of investment measures and on the views put forward at this meeting. In his view, the Group was not at the stage of making further progress beyond the work

already underway. At its next meeting the Group should aim to have a more focussed discussion on the relationship of the trade effects of investment measures with the operation of GATT Articles.

Other matters

138. It was decided the Group would meet again in the week of 13-17 June 1988.