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Investment Measures

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The following communication, dated 25 May 1988, has been received from the delegation of the United States with the request that it be circulated to members of the Group.

Applying Trade Policy Concepts to TRIMs

I. Introduction

1. In past sessions, the Negotiating Group on Trade-Related Investment Measures has addressed a number of basic, important issues concerning TRIMs. Beginning with the Group's first meeting in April 1987, it has compiled information about investment measures that should be considered TRIMs, and has discussed the characteristics of those measures. The Group has also examined in some detail the relationships between TRIMs and GATT Articles, and at the February meeting there was an extensive presentation of actual cases demonstrating the trade effects of TRIMs.

2. Against this background, the United States believes that it is appropriate for the Group to consider the applicability of some familiar trade policy concepts to TRIMs. Part II proposes several general considerations which, in the view of the United States, should be taken into account as the Group proceeds in its work. In Part III, three broad GATT concepts related to discipline are examined: most-favoured-nation treatment, national treatment and prohibition. Part IV discusses several issues associated with applying trade policy concepts to TRIMs.

3. Several points stand out in the analysis. First, the trade concepts examined are reflected in existing GATT provisions. In the cases of m.f.n. and national treatment, there are specific articles devoted to the concept; as for prohibition, the concept is implicit in various articles where there is an obligation not to maintain a certain measure or practice.

4. Second, while the concepts are examined separately, they are in many respects interdependent. For example, national treatment and m.f.n. each reflect the concept of prohibition: the former prohibits discrimination between domestic and imported products, and the latter prohibits discrimination between foreign products on the basis of nationality.

5. Third, the concepts examined can contribute to the objective of avoiding the trade-restrictive and distorting effects of TRIMs, but existing GATT disciplines will have to be complemented by further provisions if such adverse effects are to be fully avoided. The precise form of such provisions should be determined in the course of negotiations, but additional provisions will be necessary to ensure that the trade-restrictive and distorting effects of TRIMs are avoided.

## II. General considerations

6. The United States believes that the following general considerations should give orientation to the Group's work:

- (1) The Group should proceed with a view towards achieving agreement on specific steps to avoid and eliminate the trade-distorting and restricting effects of TRIMs among GATT contracting parties.
- (2) Any agreement on TRIMs should recognize the sovereign right of every country, subject to its international obligations, to establish its own investment policy. At the same time, as countries have agreed in the GATT to accept disciplines on trade-distorting commercial policies, countries should ensure that there are comprehensive and effective disciplines that address TRIMs.
- (3) The Group should deal with all identified TRIMs, but be flexible in its approach. Rather than arbitrarily limit the number of TRIMs under consideration, the Group should explore various ways to deal with these measures consistent with the objective of avoiding trade restriction and distortion.
- (4) TRIMs should be disciplined in a manner that takes into account their adverse trade effects on host, home and third countries.

## III. Disciplines

7. A basic premise of the GATT system is that trade barriers on imports are to take the form of duties, which are to be reduced in trade negotiations and applied on a non-discriminatory basis. Measures other than duties which discriminate against imports are prohibited or subjected to disciplines which limit their use. Other trade practices are also subject to particular disciplines.

8. There are a number of disciplines that could be applied - in some cases are already applicable - to TRIMs. Three disciplines are examined in turn below.

### A. Non-discrimination

9. A basic trade concept, and one enshrined in the GATT system is non-discrimination. The two GATT principles dealing with non-discrimination are Most-Favoured-Nation (m.f.n.) and national treatment. While both m.f.n. and national treatment are familiar trade concepts, their possible application to TRIMs raises several questions:

- What are the GATT concepts related to m.f.n. or national treatment that are applied or could be applied to TRIMs?
- What may be the shortcomings of applying m.f.n. or national treatment to TRIMs?

(1) Most-favoured nation

10. Several GATT Articles include m.f.n.-type commitments, primarily Article I which provides that "... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." The key elements in the Article I m.f.n. commitment are the accordance of advantages on like products, and non-discrimination between countries of origin or destination in the accordance of advantages. For example, a tax rebate on exported products (where not proscribed by Article XVI or the Subsidies Code) that is granted to one or more contracting parties must be accorded to like products destined for all contracting parties.

11. An application of the GATT m.f.n. principle to TRIMs would mean that host governments could not impose investment measures that would have the effect of according advantages on like products destined for or originating in a limited number of contracting parties. However, of the TRIMs identified by the Group thus far, the only one that seems to fit these criteria is a regional product mandate requirement linked to an incentive that directs exports to particular countries. It would run afoul of Article I because it accords an advantage (the incentive) to products destined for a particular country or set of countries. If, however, the requirement to export were generalized and did not specify any particular destinations - an export requirement linked to an incentive rather than a product mandate requirement - it does not appear that m.f.n. would be violated. Moreover, TRIMs not linked to an incentive or benefitting from some other advantage, would apparently not be precluded by Article I. Thus, this application of m.f.n. provides discipline to only a limited range of TRIMs.

12. The adverse trade effects of TRIMs could be reduced somewhat further if m.f.n. were understood to preclude discrimination between foreign-controlled firms from different countries producing like products. For example, if any foreign-controlled producer of a like product is not subjected to a product mandate requirement, then all other foreign producers of like products should similarly be freed of such requirements. To give another example, the least onerous manufacturing requirement imposed on a foreign investor (including the absence of such a requirement) would automatically become the standard for all such requirements imposed on foreign producers of like products.

13. Yet even an m.f.n. standard applied to TRIMs in this manner would be inadequate to avoid their adverse trade effects. For example, if there were only one foreign-controlled firm in the host country, there would be no basis for m.f.n. treatment. Or if all foreign-controlled producers of a particular product were subject to a TRIM, the m.f.n. standard would be met, but serious trade distortion would persist. In addition, if the foreign investors manufacture different products, more favourable treatment applied to one would not apply to the others.

14. In summary, while the m.f.n. principle can be useful in certain circumstances to discipline the use of TRIMs, its application does not provide discipline in a comprehensive manner.

(2) National treatment

15. The broad principle of non-discrimination is taken a step further by national treatment, which, in the GATT, precludes discrimination between domestic products and imported foreign products of any contracting party. In paragraphs 1, 2 and 4 of Article III, the GATT provides that imported goods will be accorded the same treatment as like or competitive local goods with respect to matters under government control, such as laws, regulations, taxes, etc.

16. In the context of TRIMs, GATT national treatment would require that trade-related investment measures not be imposed so as to afford protection to domestic products vis-à-vis like or competitive imported products. For example, and as the FIRA case made clear, a local content requirement contravenes the national treatment principle set out in Article III, paragraph 4 because it accords a preference to domestic products over imported foreign products.

17. As with m.f.n., however, GATT national treatment has serious shortcomings as a means for avoiding the adverse trade effects of TRIMs. As indicated above, national treatment in the GATT is concerned with discrimination against imported products. However, a number of TRIMs, such as export and product mandate requirements, have effects primarily on exports rather than imports.

18. The adverse trade effects of TRIMs could be reduced somewhat further if national treatment were understood to mean that foreign-controlled firms shall be treated no less favourably than domestic producers as concerns exports and imports of like or competitive products. If, for example, a domestic firm is not required to export a percentage of its final product, foreign-controlled firms should not be required to export like or competitive products either.

19. Yet even this understanding of national treatment would not fully avoid the adverse trade effects of TRIMs. If national firms are subjected to TRIMs, foreign-controlled firms could be accorded the same treatment, and undesirable trade effects would persist. Moreover, there may be no basis for national treatment if there are no domestic firms in the host country producing like or competitive goods.

20. In sum, national treatment, like m.f.n., could contribute to the objective of avoiding the trade-distorting effects of TRIMs, but by itself is insufficient as a comprehensive discipline for TRIMs.

#### B. Prohibition

21. Another basic trade policy concept in the GATT is prohibition. While prohibition is the most straightforward form of discipline, its application to TRIMs raises several questions.

- How is the concept of prohibition treated in GATT principles and practices?
- Does prohibition, as it is applied in the GATT, have any shortcomings for avoiding the adverse trade effects of TRIMs?

22. The concept of prohibition is implicit in numerous GATT Articles. For example, Article I prohibits a contracting party from according advantages in a discriminatory manner. Article III prohibits contracting parties from treating imported products less favourably than like domestic products, and Article XI generally prohibits the imposition of quotas and other quantitative restrictions on imports and exports. Under Article VIII, contracting parties are not permitted to impose taxes on imports for fiscal purposes, and Article XVI prohibits signatories from granting export subsidies on exports of non-primary products.

23. A number of TRIMs conflict with GATT Articles that contain the concept of prohibition. The FIRA Panel confirmed that Article III:4 enjoins contracting parties from employing local content requirements; other TRIMs as well run afoul of Article III's prohibition against favouring domestic products over foreign ones. In addition, TRIMs that function as quotas, such as trade-balancing requirements, are contrary to Article XI's prohibition against quantitative restrictions. To give another example, tying incentives to the export of manufactured goods contravenes Article XVI's prohibition of subsidizing the export of non-primary products.

24. Thus, a number of TRIMs are already subject to GATT Articles that incorporate prohibition. However, because of the qualifications attached to prohibition, even this discipline as provided for in the GATT Articles is not sufficient to avoid fully the trade-restrictive and distorting effects of all TRIMs. Prohibitions set out in the General Agreement are qualified by specific or broad provisions defining areas where prohibition does not apply. For example, the Article XI prohibition against quantitative restrictions also sets out specific cases in which the general principle does not apply. Contracting parties may, for instance, maintain temporary export restrictions on "essential" products, and import restrictions on agricultural or fisheries products in certain circumstances. Articles XII and XVIII provide further exceptions to the prohibition on quantitative restrictions for contracting parties seeking to alleviate balance-of-payments problems.

25. Some GATT Articles stop short of prohibition but provide for specific, unilateral remedies against the use of certain trade practices. This approach is used, for example, in the context of dumping and subsidies (Article VI), which are actionable in certain circumstances. Those circumstances constitute restraints on dumping and the bestowal of subsidies or bounties, backed up by the ability of contracting parties to take countermeasures.

26. It is difficult, however, to see how this approach could be effective for TRIMs; it would be difficult to implement and of minimal value as a means of avoiding the trade-distorting effects of TRIMs in home and third-country markets. Moreover, any rules developed under such an approach would have to be so extensive and elaborate that monitoring compliance would be impractical.

27. In summary, while the concept of prohibition has far fewer shortcomings than other disciplines, its practical application, based on existing GATT Articles, would not deal with all of the trade distortions caused by TRIMs. This suggests that the Group should consider how prohibition, as provided in the GATT, may be reinforced so that the adverse trade effects of TRIMs are fully avoided.

28. The United States believes that the foregoing analysis of m.f.n., national treatment and prohibition should be borne in mind as the Group proceeds in its work. In particular, the Group should address the need for further provisions so as to ensure that the trade-restrictive and distorting effects of TRIMs are fully avoided. The United States is also prepared to consider other forms of discipline on TRIMs which other delegations may propose.

### III. Associated issues

29. Consideration should also be given to a number of other trade policy concepts and issues that have implications for all of the above disciplines.

#### A. Transitional arrangements

30. The effective application of disciplines would involve important adjustments for all parties affected by TRIMs. While it would be premature to decide on transitional arrangements before disciplines have been determined, one possible approach is to phase disciplines in progressively in appropriate circumstances. These issues will require thorough analysis by the Group. Transitional arrangements may be appropriate in some instances, but they should not erode or abrogate existing disciplines or new disciplines that can otherwise be agreed upon.

## B. Transparency

- What information about the use of TRIMs is necessary for disciplines to be effective?
- What other benefits would transparency provide?

31. Clear and reliable information about the conditions for investment in contracting parties is necessary for disciplines to be effective. In addition to serving as a tool for compliance, transparency would, in a positive sense, assist countries interested in attracting investment by contributing to more predictable operating conditions.

32. Article X of the GATT sets a standard for transparency by requiring contracting parties: (1) to publish promptly trade laws, regulations, judicial decisions, administrative rulings and international trade agreements; and (2) to administer trade laws, regulations, etc. in an "impartial and reasonable manner", and to maintain tribunals for this purpose.

33. In the context of TRIMs, there may need to be a higher standard of transparency. Transparency should mean, at a minimum, that governments be required to notify and periodically update which TRIMs are provided for in laws, regulations and policies. Contracting parties should also be required to report on progress in conforming to agreed-upon disciplines. In the context of enforcement and dispute settlement (see below), there may also be a need for basic information about individual transactions, consistent with legitimate concerns about confidentiality between the investor and the host government.

## C. Enforcement and dispute settlement

- Are existing GATT provisions adequate for the enforcement of agreed-upon disciplines, and the settlement of disputes?
- What special problems do TRIMs pose for enforcement and dispute settlement?

34. If disciplines on TRIMs are to be effective, and the adverse trade effects of TRIMs avoided, there must be adequate mechanisms to (a) enforce disciplines and (b) resolve disputes.

35. In general, the GATT approach to enforcement and dispute settlement is based on transparency, notification, consultations among concerned parties, attempts at conciliation, panel investigations, reports and recommendations, and if a settlement has not been reached, re-establishment of the balance of concessions through compensation or retaliation.

36. Various GATT Articles contain provisions related to enforcement and/or dispute settlement. For example, Article XXIII sets out procedures that seek to both ensure compliance and resolve disputes. Provisions in

Articles XII and XVIII also support enforcement and dispute settlement by requiring periodic review and consultation with contracting parties invoking the balance-of-payment exception to the prohibition on quantitative restrictions.

37. Experience with these provisions, however, has shown that they have shortcomings. For example, quantitative restrictions maintained for balance-of-payment reasons are not always reported. Moreover, TRIMs pose special problems for enforcement and dispute settlement. For example, if an investor is faced with a measure that he believes is a prohibited TRIM, the mechanism for resolving any resulting dispute should be expeditious because of the need for investors to make timely investment decisions. Effective enforcement and dispute settlement mechanisms for TRIMs will also need to take into account the work of other GATT Negotiating Groups in this area.

#### D. Development considerations

38. Bearing in mind that the Group's first order of business is to deal with the adverse trade effects of TRIMs, it is noted that considerations relating to development have been raised by a number of delegations. The United States believes that discussion of these considerations should follow the establishment of appropriate disciplines on TRIMs, and should be in the context of precisely delineated obligations for all contracting parties.

#### IV. Conclusions

39. The preceeding analysis suggests a number of conclusions which should be borne in mind as the Group proceeds with its work.

- (1) A number of familiar trade policy concepts related to disciplines are applicable to TRIMs. These include, for example, non-discrimination (m.f.n., national treatment), prohibition, transparency, effective dispute settlement and enforcement mechanisms, and appropriate transitional arrangements.
- (2) These concepts are already reflected in the GATT system. Indeed, they make up the principal elements of the GATT and the related Tokyo Round Agreements. In each case there are provisions in the GATT that support the application of these trade policy concepts to TRIMs.
- (3) While the GATT already has provisions that incorporate these concepts, additional provisions will be necessary to ensure that the trade-distorting effects of TRIMs are avoided.
- (4) Given the linkages between these concepts, we must take a systematic approach to dealing with TRIMs.
- (5) The application of new disciplines to TRIMs may require appropriate transitional arrangements.
- (6) Enforcement and dispute settlement mechanisms should be effective and expeditious.