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The following communication has been received from the delegation of the United States with the request that it be circulated to members of the Group at this juncture in order to allow for a full and complete discussion of it at the Group's next meeting.

GATT SECRETARIAT
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Trade Effects, TRIMs and the GATT

I. INTRODUCTION

The purpose of this paper is to consider the extent to which the GATT articles are adequate to deal with the adverse trade effects of TRIMs. The approach taken is to examine in turn the adverse trade effects produced by TRIMS; the measures responsible for those effects; the relationships among effects, measures and GATT articles; and the degree to which specific GATT articles, where applicable, provide discipline adequate to avoid the adverse effects of the TRIM in question. This discussion paper is also intended to contribute to the negotiating process by addressing an important part of the Group's mandate, that is, "...an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures...."

The coverage of GATT regarding trade effects is far reaching. The desirability of reducing and, where possible, eliminating the adverse effects associated with measures and practices such as tariffs, non-tariff trade barriers and discriminatory treatment in international commerce is recognized in the Preamble to the General Agreement. Entering into agreements to reduce and eliminate such adverse trade effects is indeed the means by which GATT's objectives regarding standards of living, employment, income, production, the full use of resources, and so on, are to be realized.

Accordingly, GATT Articles contain disciplines which address adverse trade effects and the causes of those effects. The disciplines in some articles come into play only when it can be demonstrated that adverse trade effects have caused injury; this is the case, for example, with Article VI regarding the imposition of anti-dumping and countervailing duties. The right to impose an anti-dumping duty provides both a remedy for the injury incurred, and a deterrent (hence discipline) against dumping. The disciplines in other articles, such as Articles III and XI, apply regardless of whether specific adverse trade effects can be quantified and demonstrated.

The drafters of the GATT, in other words, did more than provide remedies for trade effects that have already caused injury. Their experience made it absolutely clear that some practices were so inherently trade distorting or restrictive that they should be prohibited. Article III thus prohibits internal taxes and other measures which accord imported products less favorable treatment

than is accorded to like domestic products; Article XI generally proscribes quantitative restrictions; and so forth.

In short, the GATT deals with adverse trade effects in essentially two ways. Some articles deal with such effects by reaching to the effects and no further. Article VI, as noted, provides for remedies to counteract adverse trade effects but does not directly discipline the underlying measures. Other articles, however, deal with adverse trade effects by reaching to the root cause of those effects, disciplining the ability of contracting parties to use trade measures or practices which produce such effects. Articles III and XI, once again, are examples of this latter approach which seeks to avoid adverse trade effects rather than to provide remedies for injury after it has occurred.

The adverse trade effects caused by TRIMs generally fall into three categories:

I. artificial reduction of imports into the country applying TRIMs (generally caused by TRIMs which accord preferential treatment to domestic goods vis-a-vis imports, or which function as quantitative restrictions on imports);

II. artificial inducement or increase of exports from the country applying TRIMs, also including displacement of home and third country exports and dumping (generally caused by TRIMs which subsidize exports or require the investor to export); and

III. artificial reduction of exports from the country applying TRIMs (generally caused by TRIMs which function as quantitative restrictions on exports).

This paper examines three aspects of each of these trade effects:

A. The TRIMs associated with the trade effect

Each adverse trade effect is followed by a listing of the individual TRIMs and combinations of TRIMs which produce that effect, as well as a brief explanation of how the trade effect is produced. Certain TRIMs and combinations of TRIMs are listed under more than one adverse trade effect.

B. The extent to which present GATT articles deal with the trade effect

(1) Some adverse trade effects are produced by TRIMs or combinations of TRIMs which are clearly, inherently inconsistent with one or more articles.

(2) Other adverse trade effects are produced by TRIMs which are not clearly or in all circumstances inconsistent with present GATT articles. However, these effects are significant and should be dealt with by clarifying the circumstances in which a TRIM conflicts with an article, or by elaborating appropriate new provisions.

C. The adequacy of disciplines provided by the relevant GATT articles

Merely because a TRIM is subject to an article does not mean that the measure and its associated trade effects are adequately disciplined. Some articles provide a high degree of discipline by prohibiting the imposition of a measure, while others merely provide for remedies, and only in certain circumstances. Moreover, the discipline provided by an article may be undercut by exceptions in that or other articles.

The detailed analysis set out below can be summarized as follows. Regarding the first trade effect -- reduction of imports into the country applying TRIMs -- several TRIMs associated with this trade effect are, in the view of the U.S. Delegation, clearly inconsistent with Articles III and/or XI, and therefore involve prima facie nullification or impairment. The discipline provided by certain provisions in Articles III and XI (prohibition) is, in principle, adequate. However, a number of import reducing TRIMs do not clearly conflict with these articles, or do so only in certain circumstances.

As for the second trade effect, several TRIMs associated with artificial inducement or increase of exports and dumping appear to be inconsistent with or subject to Articles I, VI and/or XVI. In many cases, however, the disciplines provided by these articles are inadequate. As a result, one of the most basic trade distortions--an increase in exports due to an export requirement or an incentive--is not adequately dealt with by present GATT provisions.

Finally, regarding reduction of exports from the country applying TRIMs, one of the two TRIMs associated with this trade effect is clearly inconsistent with Article XI; the other TRIM, though trade distorting, is not clearly or in all circumstances inconsistent with Article XI.

I. TRADE EFFECT: ARTIFICIAL REDUCTION OF IMPORTS INTO THE COUNTRY APPLYING TRIMS

A number of TRIMs can have the effect of reducing imports into the country applying the measures. Exports from other countries are thereby reduced or displaced. As illustrated in the following list, this trade effect is the result of measures that either favor domestic products over imports, or act as a quantitative restriction on imports.

A. TRIMs associated with the reduction of imports

1. local content requirements (By obliging the investor to produce locally or purchase from local sources some percentage of the final product, imports of components and inputs are disfavored and artificially reduced.)

2. trade-balancing requirements (Imports are artificially tied to the level of export performance. If exports decline, then imports must be reduced regardless of how price or quality competitive they may be. See also export inducement.)

3. manufacturing requirements (Have effects similar to local content requirements. By requiring the investor to manufacture a product or component locally, imports of like products and components are disfavored and artificially reduced. See also export inducement.)

4. manufacturing limitations (By prohibiting an investor from manufacturing a product, a broad range of goods that might otherwise be imported in association with the project are precluded. See also export restriction.)

5. exchange restrictions (Exchange restrictions limit the investor's access to foreign currency and thereby reduce the investor's ability to import. Exchange restrictions as TRIMs are often used as a commercial policy instrument and are imposed in an ad hoc, discriminatory manner. An investor's access to foreign exchange may depend primarily on that particular investor's contribution to commercial policy goals in terms of fewer imports or more exports. See also export inducement.)

6. remittance restrictions (When a firm is not permitted to remit to the degree that it wishes, funds become bottled up in the host country. This can create an artificial increase in demand for local goods over imports as the firm seeks to make

use of available capital that cannot be remitted. In these circumstances, remittance restrictions can have effects similar to local content and manufacturing requirements. See also export inducement.)

7. technology transfer requirements (Tech transfer requirements can have import-reducing effects similar to those of local content and manufacturing requirements. By obliging the investor to incorporate a particular technology in a domestically produced good rather than import, imports are reduced. See also export inducement.)

8. licensing requirements (When an investor is obliged to provide a license to a domestic firm for local production, domestic products are favored over imports. See also export inducement.)

9. local equity requirements (Such requirements can have the effect of influencing management decisions in such a way as to alter the firm's export and import patterns, e.g. by increasing local sourcing. If local equity requirements are overly burdensome, investors may decide to forego an investment, locate elsewhere or not produce certain products in the host country that they would have in the absence of such requirements, thereby changing investment and trade flows. See also export inducement.)

10. all of the above combined with incentives (Trade distortion can be greater when performance requirements are combined with incentives. An incentive acts as a subsidy which allows the investor to overcome the added costs of performance requirements, and indeed rewards compliance with trade distorting TRIMs.)

11. all of the above in combinations which artificially reduce imports, for example:

-- a local content requirement combined with a local equity requirement whereby the investor must increase the amount of local content in return for greater equity holdings (in a sense, the investor is coerced into altering trade flows in order to maintain control over the firm);

-- a manufacturing requirement combined with remittance restrictions whereby the investor is allowed to remit a greater percentage of profits in return for a commitment to manufacture certain products locally rather than import them (here again, one TRIM is used as a lever to induce compliance with another trade restricting or distorting measure).

B. Extent to which present GATT articles deal with this trade effect

Generally speaking, Articles III and XI are relevant to circumstances where imports are artificially reduced. Article III:4 prohibits contracting parties from applying laws, regulations and requirements that have the effect of favoring domestic products over like imported products. Article III:5 prohibits regulations which require that a specified amount or proportion of a product be supplied from domestic sources, and Article XI generally prohibits the imposition of quotas and other quantitative restrictions on imports and exports.

It is important to note that the manner by which Articles III and XI deal with this trade effect is to discipline the ability of the contracting party to apply measures that produce such an effect. It is also significant that these articles cover a wide range of measures. For example, Articles III and XI refer broadly to "all laws, regulations and requirements" (Art. III:4) and "quotas, import or export licenses or other measures" (Art. XI:1). Thus, measures which have the effect of favoring domestic products over like imported products conflict with Article III and are subject to its prohibition, while TRIMs with effects comparable to quantitative restrictions on imports (or exports) contravene Article XI and are subject to its prohibition.

The relevance and adequacy of the GATT articles appear to be as follows:

(1) Import reducing TRIMs that are clearly inconsistent with Articles III and/or XI

(a) local content requirements

Article III
Inconsistent with Article III:4, as confirmed by the FIRA Panel, and with Article III:5.
(Here as elsewhere in this paper, discussions of the relationship between local content requirements and GATT Articles are included for the sake of analytical completeness, and are not intended to raise questions about the conclusions of the FIRA Panel.)

(b) trade-balancing requirements

Article XI:1
Since imports are only allowed as a function of exports, this constitutes a de facto import quota.

Article III:4
Trade-balancing requirements create a preference for domestic goods because the investor does not have to offset their purchase with export sales.

(c) manufacturing requirements

Article XI
The obligation to manufacture locally, thereby precluding the option of importing, has effects comparable to a quantitative restriction.

Articles III:4 and III:5
The requirement to manufacture a product or input on the domestic market discriminates against imports and mandates that some part or all of the product must be sourced locally.

(d) the above measures combined with incentives

Articles III:4, III:5 and XI

(e) other combinations of TRIMs which reduce imports

Articles III:4, III:5 and XI

For example, a manufacturing requirement combined with a local equity requirement whereby the investor must manufacture certain products locally in return for greater equity holdings.

(2) Import reducing TRIMs that are not clearly or in all circumstances inconsistent with existing articles, but nevertheless have significant trade effects

(a) exchange restrictions

May be inconsistent with Articles XI and XV, such as when used in a manner that frustrates the intent of the provisions of the General Agreement, notably regarding quantitative restrictions. Since a firm is able to import only to the extent that it has access to foreign exchange, exchange restrictions can have the same effects as an import quota.

(b) licensing requirements

May be inconsistent with Article III:4, such as in circumstances where the investor is obliged to provide a license to a domestic firm for local production, thereby favoring domestic products over imports and undercutting tariff concessions. (Especially relevant when accompanied by market reserve policies.)

(c) technology transfer requirements

May be inconsistent with Article III:4, such as in circumstances where the investor is obliged to incorporate a particular technology in a domestically produced good rather than import. (Especially relevant when accompanied by market reserve policies.)

(d) manufacturing limitations

May be inconsistent with Articles III:4 and/or XI:1, such as in circumstances where imports are excluded or disfavored. By prohibiting an investor from manufacturing a product, components that could have been imported in association with the project are precluded. (Especially when accompanied by market reserve policies.)

(e) remittance restrictions

While not clearly inconsistent with existing articles, can have significant trade effects. Remittance restrictions can create an artificial increase in demand for local goods over imports as a firm seeks to make use of available capital that cannot be remitted.

(f) local equity requirements

While not clearly inconsistent with existing articles, can have significant trade effects through the influencing of management decisions regarding imports and exports.

(g) the above measures combined with incentives

(h) other combinations of measures which reduce imports

For example, a technology transfer requirement combined with remittance restrictions whereby the investor is permitted to remit or remit more in return for desired technology.

C. Adequacy of discipline provided by the relevant articles

Articles III:4 and III:5 -- Adequate discipline (prohibition) where applicable. Article III:4 holds that imported products shall be accorded national treatment with respect to like domestic products. Article III:5 states that contracting parties shall not establish or maintain internal regulations which require that some amount or proportion of a product be supplied

from domestic sources. Relatively few exceptions (e.g. concerning subsidies, government procurement and cinematograph films).

Article XI:1 -- Adequate discipline (prohibition) where applicable; some limited exceptions. Article XI:1 generally prohibits quantitative restrictions, but provides exceptions for, inter alia, import restrictions on agricultural or fisheries products in certain circumstances. Articles XII and XVIII provide further, though limited, exceptions for contracting parties faced with balance-of-payments problems.

II. TRADE EFFECT: ARTIFICIAL INDUCEMENT OR INCREASE OF EXPORTS FROM THE COUNTRY APPLYING TRIMS

Various TRIMs have the effect of artificially inducing or increasing the level of exports from the country applying TRIMs, which in turn can displace exports from other countries, and/or lead to dumping.

A. TRIMs associated with this trade effect

1. export requirements (Distort trade flows by obliging investors to export according to government fiat rather than market conditions. Depending on the terms of the requirement, the additional level of exports from the host country could be large enough in volume to displace exports and domestic production from other countries. The investor may be induced to dump in order to meet required export levels.)

2. product mandate requirements (Effects similar to export requirement, with the added distortion that exports are directed at a particular market or region.)

3. trade-balancing requirements (In order to ensure its access to needed imports, a firm can be induced to increase exports regardless of market conditions.)

4. exchange restrictions (If access to foreign exchange is partly or wholly dependent on export performance, the investor can be induced to increase exports artificially and, in difficult circumstances, to dump.)

5. remittance restrictions (If the ability to remit is partly or wholly dependent on export performance, the investor may artificially increase exports and, in difficult circumstances, be induced to dump.)

6. manufacturing requirements (If a firm is obliged to manufacture a product for a market of insufficient size to permit economies of scale, the firm can be induced to export that product.)

7. technology transfer and licensing requirements (These requirements are used, often in conjunction with other measures, to move export capacity from one country to another or to create an export industry where it would otherwise not exist. While the trade effects of these TRIMs are not always immediate, ultimately they can significantly alter trade flows. These TRIMs are especially trade distorting when

technology must be transferred or licensed at an artificially low price. In these circumstances, such requirements subsidize products which can in turn be exported more easily.)

8. local equity requirements (As noted above, such requirements often have the effect of influencing management decisions in such a way as to increase artificially benefits to the host country, e.g. by increasing exports beyond a level which commercial considerations would warrant.)

9. incentives (Can induce investors to change the location of operations, thereby distorting trade flows from what they would have been in the absence of the incentive.)

10. 1-8 combined with incentives

11. the above in combinations which artificially induce or increase exports (e.g. technology transfer, export and local equity requirements; in return for greater equity holdings, the investor must transfer a specified technology to be incorporated in a product which must be exported.)

B. Extent to which present GATT articles deal with this trade effect

Generally speaking, Articles I, VI and XVI are relevant to circumstances where exports are artificially induced or increased.

Article I provides, regarding exports, that any advantage (such as an incentive or merely the right to export) granted by a contracting party to an exported product must be accorded on a non-discriminatory basis. Article I, therefore, does not prohibit measures which induce or increase the level of exports; rather, it prohibits measures which confer such advantages on a discriminatory basis.

Article VI addresses the problem of exports being dumped or subsidized. Regarding dumping, while Article VI states that dumping "is to be condemned" under certain circumstances, it does not, unlike other GATT Articles, prohibit the practices or measures which gives rise to the problem. Rather, it provides discipline through deterrence, allowing injured parties to take countermeasures in the form of anti-dumping duties. In the event of subsidization, a contracting party may levy countervailing duties equal to the subsidy.

Article XVI, together with the Subsidies Code, addresses the

use of subsidies. Regarding export subsidies, Article XVI:4, as amended, calls on its signatories to cease granting export subsidies which result in export prices for non-primary products below prices charged in the domestic market. The Subsidies Code prohibits developed countries from using export subsidies for non-primary products.

Articles I, VI and XVI deal with some but not all of the trade effects under consideration in this section.

(1) Export inducing or increasing TRIMs that are clearly inconsistent with Articles I, VI, and/or XVI

(a) export requirements (on non-primary products) combined with incentives

Conflict with Article XVI:4 of the General Agreement and Article 9 of the Subsidies Code.

(b) product mandate requirements

Conflict with Article I. If a product may be exported to to only one contracting party (or a limited number of cp's), this constitutes discrimination against other contracting parties.

(c) product mandate requirements combined with incentives

Conflict with Article I:1 because they accord advantages--the ability to export and an incentive to do so--to products destined for a particular country or group of countries.

(d) trade-balancing requirements

Conflict with Article XVI:4 of the General Agreement and Article 9 of the Subsidies Code. The right to import in return for exports constitutes a bonus on exports and is therefore an export subsidy.

(2) Export inducing or increasing TRIMs that are not clearly or in all circumstances inconsistent with existing articles, but nevertheless have significant trade effects

While the following TRIMs are not clearly or in all circumstances inconsistent with existing GATT articles, their adverse trade effects are significant and should be effectively dealt with.

(a) export requirements not linked to incentives

Regulations which compel firms to sell abroad rather

than on the domestic market are not clearly inconsistent with any existing provisions of the General Agreement (as noted by the FIRA Panel), but such government measures do alter trade patterns to the disadvantage of other countries whose markets become the targets for induced exports. It should be noted that a 1955 GATT Working Party report concluded that "contracting parties should, within the framework of their legislation, refrain from encouraging dumping ...."

(b) exchange restrictions

Conflicts with Article XVI:4 of the General Agreement and Article 9 of the Subsidies Code, in circumstances where the investor is given access to foreign exchange in return for exports; this constitutes a bonus on exports and is therefore an export subsidy.

(c) remittance restrictions

Conflicts with Article XVI:4 of the General Agreement and Article 9 of the Subsidies Code in circumstances where the investor is permitted to remit in return for exports of non-primary products; this constitutes a bonus on exports and is therefore an export subsidy.

(d) technology transfer and licensing requirements

May be subject to Article VI, notably in circumstances where technology is transferred or licensed at artificially low prices and then incorporated into a product that is exported.

(e) local equity requirements

While not clearly inconsistent with existing articles, local equity requirements can have significant trade effects through the influencing of management decisions regarding exports.

(f) incentives

Conflicts with Article XVI:4 of the General Agreement and Article 9 of the Subsidies Code if the subsidy is conditioned upon exports of non-primary products; if the subsidy is not conditioned upon exports, then subject to Article VI.

(g) all export inducing or increasing TRIMs

May be subject to the provisions of Article VI, notably in circumstances where TRIMs result in dumping.

C. Adequacy of discipline provided by the relevant articles, and exceptions

Article I: Discipline is limited in scope since it only deals with discriminatory action as between third parties.

Article VI: Inadequate discipline (remedies only in the event of material injury). Relatively few exceptions.

Article XVI: Discipline limited in scope (to date only certain developed countries have acceeded to Article XVI:4). Discipline in the Subsidies Code is also limited in scope (applies only to signatories, and includes a broad exemption for developing countries).

III. TRADE EFFECT: ARTIFICIAL REDUCTION OF EXPORTS FROM THE COUNTRY APPLYING TRIMS

Several TRIMs can have the effect of reducing exports from the country applying such measures, and thereby reduce overall trade flows.

A. Measures associated with this trade effect

1. domestic sales requirements (Obliging the investor to sell on the domestic market can distort the investor's sales decisions and have the effect of restricting the investor's ability to export.)

2. manufacturing limitations (The investor is limited or prohibited from manufacturing certain products or components. The investor is therefore denied the possibility of exporting those products or components.)

3. the above TRIMs combined with incentives

4. domestic sales requirements and manufucturing limitations in combination with other performance requirements which artificially reduce exports

   For example, a domestic sales requirement combined with a local equity requirement whereby the investor must increase domestic sales in return for greater equity holdings.

B. Extent to which present GATT Articles deal with this trade effect

As noted above, Article XI generally prohibits quantitative restrictions on exports as well as imports, whether made effective through quotas, import or export licenses or other measures.

1. Export reducing TRIMs that are clearly inconsistent with Article XI

   none

2. Export reducing TRIMs that are not clearly or in all circumstances inconsistent with existing articles, but nevertheless have significant trade effects

   (a) domestic sales requirements

   as noted above, domestic sales requirements can restrict the investor's ability to export.

(b) domestic sales requirements combined with incentives

(c) domestic sales requirements combined with other measures resulting in export reduction

(d) manufacturing limitations

Not clearly inconsistent with Article XI, but have effects comparable to an export quota.

(e) manufacturing limitations combined with incentives

(f) manufacturing limitations in combination with other measures (other than incentives) resulting in export reduction

C. Adequacy of discipline provided by Article XI

Adequate discipline (prohibition) where applicable. Article XI generally prohibits quantitative restrictions on exports (as well as imports). Exception to this general principle is made for:

-- temporary export restrictions or prohibitions necessary to prevent or relieve critical shortages of foodstuffs or other essential products; and

-- restrictions or prohibitions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade.

CONCLUSION

The preceding analysis can be summarized as follows:

A. TRIMs that are clearly inconsistent with one or more articles

1. local content requirements (alone, linked to incentives or combined with other measures)

   import reducing
   conflict with Art. III (as confirmed by FIRA Panel)

2. trade-balancing requirements (alone, linked to incentives or combined with other measures)

   import and export reducing
   conflict with Arts. III and XI

   export inducing
   conflict with Art. XVI and Subsidies Code

3. manufacturing requirements (alone, linked to incentives or combined with other measures)

   import reducing
   conflict with Arts. III and XI

4. export requirements (linked to incentives or combined with other measures)

   export inducing
   conflict with Art. XVI and Subsidies Code

5. product mandate requirements (alone, linked to incentives or combined with other measures)

   export inducing
   conflict with Arts. I, XVI and Subsidies Code

B. TRIMs that are not clearly or in all circumstances inconsistent with existing articles, but nevertheless have significant adverse trade effects

1. export requirements that do not result in dumping

   export inducing
   do not clearly conflict with existing articles

2. exchange restrictions

   import reducing
   may conflict with Arts. XI and XV

export inducing
may conflict with Art. XVI and Subsidies Code

3. licensing requirements

import reducing
may conflict with Art. III

export inducing
may conflict with Art. XVI and Subsidies Code

4. technology transfer requirements

import reducing
may conflict with Art. III

5. remittance restrictions

export inducing
may conflict with Art. XVI and Subsidies Code

6. incentives

export inducing
may conflict with Art. XVI and Subsidies Code

7. TRIMs that result in dumping (such as export and technology transfer requirements in certain circumstances)

export inducing
may be subject to Art. VI

8. manufacturing limitations

import reducing
may conflict with Arts. III and XI

export inducing
may conflict with Art. XI

9. local equity requirements

import reducing and export inducing
do not clearly conflict with existing articles

10. domestic sales requirements (alone, linked to incentives or combined with other measures)

export reducing
may conflict with Art. XI

11. the above TRIMs combined with incentives

12. the above TRIMs in other combinations

The above analysis suggests that existing GATT articles are adequate to deal with the adverse trade effects of some but not all TRIMs. In this regard, the GATT already provides certain disciplines, principally in Articles I, III and XI, which would appear to prohibit the use of certain TRIMs and combinations of TRIMs. However, the analysis also shows that existing GATT articles are in many respects inadequate, and the relationships among articles, trade effects and certain TRIMs unclear.

This analysis is offered as a contribution to the Group's examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures. In the U.S. view, a discussion of this paper and contributions by other delegations would prepare the Group to consider specific steps for dealing with TRIMs.