

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

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Group of Negotiations on Goods (GATT)

Negotiating Group on Trade-Related
Investment Measures

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SUBMISSION BY THE EUROPEAN COMMUNITIES

The attached communication, dated 13 November 1989, has been received from the delegation of the European Communities with the request that it be circulated to members of the Group.

A. INTRODUCTION

1. In its submission to the Negotiating group on TRIMs of 24 May 1988 the Community has put forward a list of investment measures which it considers as being directly trade related and in respect of which the Group should undertake negotiations with a view to establishing, where appropriate, further provisions which may be necessary to avoid adverse effects on trade. The present submission is designed to complement that earlier submission in describing in greater detail the Community's views on the application of existing GATT Articles to TRIMs, on areas where further provisions are necessary, including certain parameters of a procedural nature which appear necessary to achieve the objectives of the negotiations.

2. In the Community's view the discussion and negotiation of multilateral disciplines within the GATT concerning the use of TRIMs should be based on two fundamental premises :

- (i) the objective of any such discipline should be the avoidance or elimination of trade distortions or restrictions caused by TRIMs; and
- (ii) these disciplines should, to the largest extent possible, be built on existing GATT Articles and principles.

3. Negotiations on TRIMs should not call into question the existence of national investment policies as such. Governments conduct investment policies with a view to achieving what they consider as being important economic, industrial, social, cultural and development objectives. Investment measures may be an integral part of these policies. These policies should not be carried out, however, at the expense of other countries' legitimate trade interests. Certain disciplines in the use of investment measures are, therefore, necessary, in order to avoid distortions or restrictions to international trade. However, government incentives, including subsidies, are being addressed in the Negotiating Group on Subsidies; such incentives are, therefore, not the subject of the current negotiations on TRIMs.

Any investment measures can have some impact on trade. Investment measures do, however, differ in respect of the intensity with which they affect trade flows. There are, as pointed out in the Community's previous submissions, those investment measures which are directly trade related in that they directly regulate imports and exports of an investor. Other investment measures can have a more indirect effect on trade flows. The

Community suggests, therefore, that the type of discipline imposed should vary according to the type of investment measure in question.

4. The core of any GATT agreement related to TRIMs should in the Community's view consist of two elements. First, the disciplines concerning the trade distorting or restrictive effects of those investment measures which the Community has described in its previous submission as being directly trade related. Second, the disciplines concerning trade distorting and restrictive effects caused by any other investment measures.

B. DISCIPLINES REGARDING THE EFFECTS OF DIRECTLY TRADE RELATED INVESTMENT MEASURES

5. The characteristic feature of directly trade related investment measures as compared to other investment measures is the fact that their effect on trade is not incidental, but direct and intentional. In regulating the trading patterns of the investor they are so intimately linked to trade that it appears to be practically impossible to eliminate their adverse trade effects without prohibiting or eliminating the measures in question.

Where the trade distortions and restrictions caused by such measures are adequately addressed by existing GATT Articles, it does not seem necessary to elaborate further provisions. This would in principle also apply where the GATT provides for exceptions to general rules, such as in Articles XI:2, XX, XXI or XII, XV or XVIII:C. The Community has proposed in other Negotiating Groups that some of these Articles be strengthened. It is not suggesting to reduce the scope of these exceptions because trade distortions or restrictions are caused by TRIMs and not by other types of trade policy measures. Where, however, certain of these Articles are subject to review in the GATT, account will have to be taken of the results of this review.

Where, on the other hand, such TRIMs are causing trade distortions or restrictions not adequately dealt with by existing GATT Articles, further provisions would be necessary with a view to avoiding such adverse effects on trade.

6. The following paragraphs set out the Community's views concerning the application of existing GATT Articles with regard to the trade distorting or restrictive effects of these investment measures.

(1) Local content requirements

As confirmed by the FIRA panel, a requirement to purchase goods of local origin in preference to imported goods, or to purchase goods from local sources discriminates against imported products and is contrary to the national treatment principle of the GATT as set out in Article III paragraph 4 thereof.

However, the national treatment principle only requires that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin. It thus calls for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting their internal sale, offering for sale, purchase, distribution or use. Consequently a requirement which would stipulate that goods should be purchased on a competitive price, quality and delivery basis, without the requirement of a specific origin of these goods, would appear to be in conformity with the national treatment principle.

(ii) Manufacturing requirements

A requirement to manufacture goods locally with the purpose of substituting such goods for imported goods in the context of a company's production or sales has the same effect as a requirement to purchase goods of local origin (see above) and should therefore be subject to equivalent disciplines.

(iii) Domestic sales requirements

A domestic sales requirement restricts the investor's freedom to export his products. It constitutes an export restriction and appears to be contrary to Article XI:1 of the GATT. Given its trade restrictive effect, such requirement should in any case be subject to equivalent disciplines.

However, where such a requirement is imposed to prevent or relieve critical shortages of products essential to the exporting party, the exception of Article XI:2(a) could apply.

(iv) Trade balancing requirements

A trade balancing requirement limits the imports of the investor to an amount which is established according to the company's export performance. It constitutes an import restriction and appears to be contrary to Article XI:1 of the GATT. Given its trade restrictive effect, such requirement should in any case be subject to equivalent disciplines.

(v) Exchange restrictions

An exchange restriction limits the investor's access to foreign exchange and thus his capacity to import, either in absolute terms or in relation to his export earnings. It constitutes an import restriction and appears to be contrary to Article XI:1 of the GATT, unless it can be justified by reference to Articles XII and XV of the GATT. Given their trade restrictive effect, such exchange restrictions should in any case be subject to equivalent disciplines.

(vi) Product mandating requirements

A product mandate requirement limits the ability of the investor to export specific products from other countries including his home country. It constitutes an export restriction and appears to be contrary to Article XI:1 of the GATT. Given its trade restrictive effect, such requirement should in any case be subject to equivalent disciplines:

(vii) Manufacturing limitations with regard to components

Manufacturing limitations concerning components of the final product, in order to be operationally relevant, would have to be linked to a restriction of the importation of such components, and this would be contrary to Article XI:1 of the GATT.

(viii) Export performance requirements

Export performance requirements oblige the investor to export irrespective of the competitiveness of his products. While it should not be excluded, therefore, that export performance requirements are covered by Article XVII:1(c) of the GATT, in that they prevent an investor from acting in accordance with commercial considerations, this interpretation is not uncontroversial. Indeed, the panel examining the FIRA-case reached the opposite conclusion.

Export performance requirements distort and may also restrict trade. Where an investor produces a product which is competitive on export markets he will quite naturally exploit these competitive opportunities and export. There is no need for an export requirement. Obliging an investor to export uncompetitive products at competitive prices to third markets will, on the other hand, often lead to distortions in these markets by displacing more competitive exports from other countries or sales of the domestic producers in these markets, thus causing injury to industries in other countries. In the Community's view, an agreement related to TRIMs should include provisions which would eliminate these distortions.

Although it can be argued that (having regard to existing GATT Articles, and in particular Article VI) export performance requirements the effects of which cause or threaten to cause material injury to the industry of a contracting party or materially retard the establishment of a domestic industry, are contrary to GATT obligations, the Community considers that an Agreement on TRIMs should establish an explicit discipline which would oblige signatories to forego the use of export performance requirements.

C. DISCIPLINES REGARDING THE EFFECTS OF OTHER INVESTMENT MEASURES

7. Investment measures other than those listed in section B, paragraph 6 do not have the same direct impact on trade. Although they are likely to have some effect on trade, just as every direct investment has such effects, these measures are not prohibited per se by existing GATT Articles, nor should they be prohibited in the framework of the current

negotiations. It is, however, perfectly possible that these measures distort or restrict trade and thus cause injury to a third party, be it the foreign investor's home country or a third country.

A GATT agreement related to TRIMs should take account of this fact. Signatories of such an agreement should, therefore, undertake a commitment to avoid causing such trade distorting or restrictive effects on trade through the use of investment measures.

It is only by establishing a general discipline concerning the avoidance of trade restriction and distortion that the risk of circumvention of the strict GATT disciplines concerning the measures listed under point 6 above can be substantially reduced. Such a general obligation, the respect of which would be subject to international surveillance through appropriate notification, consultation and dispute settlement proceedings, would also make it more difficult to apply trade distorting and restrictive investment measures designed to achieve the objectives of the directly trade-related measures enumerated in Section B through the use of alternative formulae.

The Community considers that it would be appropriate to transpose the general commitment to avoid causing trade distorting or restrictive effects into more operational terms by reference to the following trade policy concepts used by the GATT :

- (i) Signatories should avoid causing through the use of investment measures nullification or impairment of any benefit accruing directly or indirectly to another signatory under the General Agreement.

This concept, taken from Article XXIII of the GATT, would include, for example, benefits of tariff concessions bound under Article II of the GATT.

- (ii) Signatories should avoid causing through the use of investment measures serious prejudice to the interests of another signatory.

The notion of serious prejudice to the interests of another signatory would appear to be appropriate to cover those cases where investment measures do significant harm to the trade of a signatory but where there is no nullification or impairment of benefits under the Agreement. Such prejudice could result, for example, from investment measures which have the effect of displacing the exports of like products of another signatory from a third country market, of displacing or impeding the imports of like products into the market of the country having adopted the measure, or of causing injury to an industry in the domestic market of the importing signatory.

D. GENERAL CONSIDERATIONS WITH REGARD TO DISCIPLINES

8. Since investment measures have the same trade distorting or restrictive effects, irrespective of whether they are applied to foreign direct investment or domestic investment, the above considerations also apply with regard to measures applied to domestic investors. For example, local content requirements infringe upon the national treatment principle even where it is a domestic investor who is obliged to buy products of local origin; a manufacturing requirement is as restrictive on imports if applied to a domestic firm as it is when applied to a foreign-owned firm. It follows, that a GATT Agreement related to TRIMs should apply to all investment measures, not only those applied to foreign investors.

9. Participants should apply investment measures which are subject to existing GATT disciplines or to disciplines to be agreed upon in these negotiations on a non-discriminatory basis. They should not discriminate between national investors and investors of foreign origin, nor between foreign investors of different national origin. This latter aspect is of particular relevance where investment measures by their very nature are only applicable to foreign investors (e.g. local equity or transfer of technology requirements).

10. The application of existing GATT disciplines is unconditional and not subject to the agreement of the private operators concerned. An import quota remains contrary to Article XI:1 even where all the importers have agreed to its introduction. Likewise, a TRIM which contravenes existing GATT Articles cannot be justified by the agreement of the investor.

This general principle, that GATT rules cannot be derogated from with the consent of private parties but only if Contracting Parties agree, remains valid even where a government has extended an investment incentive to the investor under the condition that he undertakes to observe certain performance requirements. Such incentive does in no way eliminate the trade distorting or restrictive effects of the performance requirement concerned. Consequently, trade distorting or restrictive requirements cannot be legitimised by the fact that a government has "paid" for the investor's

commitment to conduct trade in a particular way, or that it was the investor who had taken the initiative and requested the incentive, offering at the same time commitments which would fall into the category of TRIMs.

11. Investment policies are often decided upon, and investment measures are often taken at sub-federal, state, provincial or local level. International rules governing the use of such measures would, therefore, only be effective to the extent that they are fully respected by all authorities responsible for investment policies, including those at subnational level. Consequently the obligations assumed by signatories of a GATT Agreement on TRIMs should cover the actions of all public authorities, and signatories should be held responsible for the full implementation of the Agreement by any authority in their territory.

E. TRANSPARENCY

12. Transparency is an important element to ensure the respect of any agreement related to TRIMs. The Community has pointed out in its previous submission, that the directly trade related investment measures "are nothing else than trade policy measures linked, individually or generally, to the authorization of the establishment, expansion or continued operation of an investment," but that unlike most other trade policy measures "they are not applied at the border but addressed directly to the individual investor." This entails an intrinsic lack of transparency since any reduction of imports cannot be easily ascertained to be the result of government imposed import restrictions. This lack of transparency is further emphasized by the fact that foreign investors will only rarely complain to their home governments after having made their arrangements with the host country, and that overall trade balances are of little concern to them. Domestic investors, to the extent they are affected by TRIMs, are even less likely to complain.

13. The GATT provides in Article X:1 for a certain, but insufficient, degree of transparency. It stipulates that "laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to ... requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefore, ... shall be published promptly and in such a manner as to enable governments and traders to become acquainted with them" (emphasis added). This obligation appears to be applicable only to those investment measures which are directly trade related. Moreover, investment measures are often taken on an ad hoc basis or are discretionary decisions adopted by the authorities on the basis of a more or less wide enabling clause in the national legislation.

14. The Community considers, therefore, that there should be an obligation of signatories to notify the GATT of those investment measures which are susceptible of having a significant impact on trade in that they operate directly or indirectly to increase or to reduce exports of any

product from or reduce imports of any product into their territory. Signatories should also have the opportunity to make a written request for information on the nature and extent of any investment measure introduced or maintained which is susceptible of having such effects.

F. CONSULTATION

15. It has been rightly pointed out that Articles XXII:1 and XXIII:1 of the GATT can apply with regard to investment measures where these measures distort or restrict trade.

It would be appropriate to be more specific in relation to investment measures with a view, on the one hand, to arriving expeditiously at a clarification of the situation and a mutually acceptable solution, thus reducing the period of uncertainty for the investor, and, on the other hand, excluding frivolous requests for consultations. Bearing in mind this twofold objective, consultations should be entered into as quickly as possible where a signatory has reason to believe that another signatory has introduced or maintains an investment measure which causes nullification or impairment of benefits accruing to it under the General Agreement, or serious prejudice to its trade.

Such a request for consultation should include a statement of available evidence with regard to the existence and nature of the investment measure in question and the adverse effects on the interests of the requesting signatory.

Where it is established in the course of these consultations that the investment measure in question has any of the effects set out in paragraph 7 above, the party which has introduced the measure would be expected to remedy the situation, preferably by revoking or modifying the measure so as to eliminate the restrictive or distorting trade effects. Any such remedial action should be implemented without causing discrimination among signatories of the agreement.

G. DISPUTE SETTLEMENT

16. Since such consultations do not always result in a mutually acceptable solution, signatories might have to resort to GATT dispute settlement procedures which ultimately could imply the withdrawal of concessions or the suspension of other obligations under the General Agreement.

H. DEVELOPING COUNTRIES

17. The Community considers desirable that in principle the same disciplines be accepted by all participants irrespective of their level of development. It recognizes, however, that developing countries consider that their investment policies are of particular relevance for the achievement of their economic, social and technological development objectives. Although the disciplines set out above do not call into question these investment policies as such, and lay down rules only with regard to the trade distorting and restrictive effects of particular investment measures, the Community is ready to consider the possibility of reasonably defined special transitional provisions, except for those developing countries which have reached a high level of international competitiveness. They would allow developing countries to adjust their investment policies accordingly, and to cope with possible structural adjustment.
