MEETING OF 26 NOVEMBER 1987

Note by the Secretariat

1. The Group held its fifth meeting on 26 November 1987 under the chairmanship of Ambassador T. Kobayashi (Japan). The agenda set out in GATT/AIR/2517 was adopted.

Identification and examination of the operation of GATT Articles on the basis of national submissions

2. The Chairman invited participants to make further comments on the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures.

3. One participant identified Article XIX as being related to the trade restrictive and distorting effects of investment measures. In her view, a host country government should be permitted to take safeguard action if domestic producers suffered negative trade effects from investment measures applied by foreign companies investing in that country or by the home country governments of those companies.

4. One participant expressed the view that, in respect of the trade effects of local content requirements, the provisions of Article III:4 and Article XI:1 should be examined in the Group as being applicable in a complementary way, not in a cumulative way. It was the view of his delegation that Article XI:1 was not applicable to the trade effects of local content requirements. This had been confirmed by the FIRA Panel report, but the Panel had not excluded the application of Article XI:1 to the trade effects of other internal measures such as manufacturing requirements and it remained the view of his delegation that Article XI:1 did not require the existence of border measures in order to be applicable.

5. One participant, in illustrating the need for further discussion in the Group to concentrate on the examination of the operation of GATT Articles that related directly to the adverse trade effects of investment measures, stated that the provisions of Article XI had been mentioned in relation to the trade effects of exchange restrictions and that the Group might find that these fell within the competence of the IMF rather than the GATT. Another participant saw a clear division of responsibilities between the Fund and the GATT. The Group should focus on company-specific exchange
restrictions that were more instruments of trade policy than of exchange rate policy in order to clarify the extent to which these needed to be covered by the GATT Articles.

6. One participant disagreed with the argument that the provisions of Article XXIII might be sufficient to avoid the adverse trade effects of investment measures. The same line of argumentation could equally have been used to exclude any need to negotiate the Tokyo Round Codes, which would not have been convincing.

7. One participant considered that a statement made at an earlier meeting relating the provisions of Article XXIII to the trade effects of all investment measures appeared to imply that it was an obligation of contracting parties not to apply trade-related investment measures. This could render the balance of rights and obligations under the GATT meaningless. A country that permitted no foreign investment to take place would have no use for trade-related investment measures, but another country that was opening up its economy to direct foreign investment might need to apply certain trade-related investment measures and should not be penalized under the GATT for its efforts in liberalizing investment flows. Another participant stated that a country with a liberal policy towards outward investment could reasonably expect that host countries would not apply trade-related investment measures that nullified or impaired its rights under the GATT.

8. Several participants stated that the provisions of Article XXIX were not relevant to the work of the Group. The approach to the issue of international investment in the Havana Charter was not the same as that in the Punta del Este Declaration, which dealt uniquely with the trade restricting and distorting effects of investment measures and not with investment itself. Furthermore, as had been stated in the report of the FIRA Panel, Article XXIX referred to an instrument that had never been implemented and the acceptance of which was no longer pending, as was assumed in the Article. For both substantive and legal reasons, therefore, these participants doubted the usefulness of the Group undertaking an examination of the operation of Article XXIX.

9. One participant repeated some statements he had made at earlier meetings. He emphasized the importance of the transparency provisions of Article X for trade-related investment measures, but stated that these were not sufficient in themselves; substantive provisions covering the trade effects of investment measures were also needed. He stated that the operation of Article XI should be examined in regard to the restrictive effects of export performance requirements on the free flow of trade even though these requirements did not appear to violate the provisions of Article XI directly. Also, he emphasized the importance of ensuring procedures for dispute settlement in respect of the trade effects of investment measures under Articles XXII and XXIII.
10. Some participants stated that the Group had undertaken, in a useful and fairly comprehensive manner, the identification and examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures. One pointed out that from the discussions which had taken place it was possible to list, for individual investment measures, those Articles that had been cited as being related to the trade effects of the measures along with supporting argumentation. Some of the supporting arguments needed to be refined further, but the work of the Group was well underway. Another expressed the view that some participants had been adopting too narrow an interpretation of the objectives of the Group and it should be kept in mind that subsequently it would be necessary to go beyond the examination of existing GATT Articles and consider what further provisions were necessary. Another participant felt there was not much more to say in terms of interpretation of the various Articles that had been cited and that now it would be necessary to consider what to do in such circumstances where it had been noted, for example, that Article X was limited in scope or that the operation of Articles VI and XVI should be examined to determine whether it is appropriate for governments to be taking actions which encourage unfair trading practices. Such issues as these could not be discussed much further in a purely analytical fashion.

11. Some other participants considered that the Group had undertaken only a preliminary examination of the operation of GATT Articles. A wide range of views had been expressed and there were few areas yet of agreement. Counter-arguments had been put forward to most, if not all, of the proposals made on the relationship of GATT Articles to the adverse trade effects of investment measures. Far more precision was needed on what the trade effects of investment measures were, whether these effects were sufficiently direct, significant, restrictive and distorting to warrant consideration, and whether they could be related directly to the operation of GATT Articles. For this reason, the Group should not close the door on the further identification and examination of GATT Articles.

12. One of these participants suggested that the Group should undertake a more detailed examination of the operation of GATT Articles on the basis of a panel-like approach, focusing on the extent to which the trade effects of individual investment measures nullified or impaired GATT benefits. This did not mean that the Group should look only at specific Panel reports that had addressed the question of the trade effects of investment measures, although a more detailed examination of the FiRA Panel findings could be useful. It meant examining the problem in the light of specific GATT provisions. Such an approach would allow the Group to clear up ambiguities in the interpretation of its negotiating mandate and to narrow down the scope of its work to only those Articles that were related directly to the trade effects of investment measures.

13. Another participant stated that it would be too limited for the Group to restrict its examination of the operation of GATT Articles to only those instances where a case history existed or to only those Articles that appeared to apply so rigidly to the trade effects of investment measures.
that they could be taken care of through dispute panel-type procedures. It was necessary for the Group to adopt a broad approach to its work and identify, inter alia, where there were deficiencies in the GATT Articles in respect of these trade effects.

14. Several participants supported the idea that the Group needed to go into greater depth and detail on the trade effects of investment measures, and felt that this would constitute a useful start to the Group's work in 1988. It was recalled from earlier meetings that there had been requests for empirical evidence of the trade effects of investment measures to substantiate the claims of those participants making written submissions that investment measures did have trade restrictive and distorting effects. The Group needed hard evidence of the magnitude and significance of these effects. This should include evidence of the incidence of investment measures and the number of companies complaining repeatedly and regularly about the effects of the measures on their trade, as well as evidence of the extent to which the measures restricted and distorted trade. One of these participants cited data on companies affected by certain trade-related investment measures which suggested that the incidence of these measures was relatively limited. Another stated that he was not in favour of the Group carrying out a notification exercise but he would welcome whatever empirical evidence could be provided. Some other participants emphasized that the Group should keep in view also the trade-creating effects of investment measures, since the purpose of investment measures was to increase economic activity and this resulted in trade expansion.

15. Some participants provided indications of the incidence and trade effects of investment measures. One cited some instances which in his view indicated that the application of trade-related investment measures had contributed to reducing inflows of direct foreign investment to certain countries. In the view of these participants, there was sufficient evidence to show that trade-related investment measures were applied widely and constituted a real problem, and that their trade restrictive and distorting effects could be substantial. It was noted that trade-creating effects were not exclusive of trade distortion. Efforts could be made to improve upon this empirical evidence, but certain difficulties might arise in this regard if it were to involve the identification of individual countries and affected companies.

16. In any case, it was not clear that it was indispensable for the Group to have such specific empirical evidence, and in particular not on the trade effects of each investment measure. The potential trade effects that investment measures could cause had been described in written submissions. The FIRA Panel findings had implied that local content requirements did have trade restrictive and distorting effects. The threat to other countries' trade of a major trading nation imposing local content requirements on a key industry should be self-evident. It ought, therefore, to be sufficient for the Group's examination of the operation of GATT Articles to be based on the general proposition that investment
measures could have trade restrictive and distorting effects without the need for specific proof in each case. There was a parallel with the effects of trade restrictions: quantitative restrictions were illegal under Article XI even if a specific import quota was not filled so that there was no demonstrable trade restrictive effect of the quota. Requests for empirical evidence of companies complaining about the trade effects of investment measures, which it was felt were related to earlier statements that no problem existed where investors agreed to the conditions imposed upon them in the form of investment measures, were not considered to be relevant since what was at issue was the trade effects of the measures on third countries. The FIRA Panel had felt that private contractual obligations entered into by investors should not adversely affect the rights of contracting parties under the General Agreement.

17. Some other participants stated that evidence of the number of countries applying investment measures or even aggregate estimates of the trade effects of investment measures were not sufficient to remove the uncertainties that they had about the magnitude and importance of these effects when measured against the balance of GATT rights and obligations. The Group had to focus on the examination of GATT Articles related to the direct and significant, trade restrictive and distorting effects of investment measures, and to do this it would need clear background evidence of which specific investment measures could and did produce such effects. It was not sufficient to show that investment measures could, in hypothetical circumstances, produce such effects. A more detailed examination of the actual trade effects of local content requirements, export performance requirements, and so on was required to substantiate the argument that these effects should be addressed more adequately by the GATT Articles. These participants were not convinced that most of the investment measures cited in written submissions did have direct and significant, trade restrictive and distorting effects which ought to be addressed by the GATT Articles. The reference made to the fact that quantitative restrictions were not permitted under Article XI even if they had no trade restrictive effects was not relevant since the GATT Articles did not deal with investment measures per se; it was only the trade effects of these measures that the Group was called on to discuss.

18. It was stated by some participants that empirical evidence relating the application of investment measures to diminished flows of direct foreign investment was neither convincing nor of concern to the Group's negotiating mandate which was restricted to the trade effects and not the investment effects of investment measures.

19. One participant said that not all of the investment measures cited had a direct and significant, negative impact on trade, and not all of the GATT Articles that had been mentioned were directly related to the trade restrictive and distorting effects of investment measures. Those that warranted analysis by the Group were: domestic sales requirements, which directly restricted export opportunities for third countries and for which Articles XI and XVI were relevant; exchange restrictions, which distorted
trade flows by requiring companies to export and/or limit imports and for which Article XI and XV were relevant; export performance requirements, which distorted trade flows by forcing a higher level of exports or limiting imports when these were tied to export performance and for which Articles VI, XI and XVI were relevant; local content requirements, which restricted imports and for which Articles III, XI and, in certain cases, also XVII were relevant; manufacturing requirements, which restricted imports and for which Article XI was relevant; and trade-balancing requirements, which restricted imports and for which Articles XI and XII were relevant. More generally, Articles III, X, XXII, and XXIV:12 were also related to the trade effects of these measures.

20. In her view, other investment measures were not covered by the Group's negotiating mandate for one or more of several reasons. Measures such as local equity and technology transfer requirements had only indirect negative effects on trade that were difficult to identify. Measures such as remittance restrictions, technology transfer requirements, product mandating requirements, local equity requirements and licensing requirements were only tangentially related to GATT Articles. Measures such as remittance restrictions, technology transfer requirements, local equity requirements and licensing requirements related, in concept and in practical effect, to the investment and development policies of individual countries and did not present a challenge to the negotiating mandate agreed on for trade liberalization in the Uruguay Round. Investment incentives were a legitimate tool of development and trade policies to attract direct foreign investment and they did not have important trade-distorting effects. Finally, it was necessary to balance the analysis of the trade restrictive and distorting effects of investment measures with consideration of the objectives of national development policies. Only when investment measures had clear negative trade effects and when they clearly contravened GATT Articles should they be given priority over national development policies.

21. Another participant considered that it was important not to focus on the negative effects of individual investment measures to the exclusion of their other effects. The objective of measures such as manufacturing requirements and technology transfer requirements was to promote industrialization, in much the same way as investment incentives, and this had trade effects but not, on balance, that were necessarily negative. His government wanted to attract direct foreign investment and it did not want its efforts in this regard limited by the GATT.

22. One participant stated that the Group's exercise, if it was to be balanced and comprehensive, should include the trade effects of measures applied by private companies as well as those applied by governments. It might be necessary for capital-exporting countries to agree to GATT obligations that would ensure that their companies followed the same rules in a host country that they followed in their home country with respect, for example, to rules on competition.
Consideration of the Group's future work programme, including documentation requirements

23. One participant expressed satisfaction with the discussion that had taken place, even if it could not be considered to have been exhaustive. The Group should move forward through an examination of the trade effects of investment measures and aim to establish areas of convergence of view and eventually agreement. It should be left open to any participant to identify additional GATT Articles or investment measures that had trade restrictive or distorting effects. The issues raised in this Group were entirely relevant to fulfillment of the basic objective of the Uruguay Round, which was the expansion and liberalization of trade as a whole.

24. It was agreed that the draft of the informal compilation of views that had been prepared by the Secretariat would be revised on the basis of comments received from participants and updated to take account of the views expressed at this meeting on the operation of GATT Articles. Participants would have the opportunity at the next meeting to decide what further should be done with the compilation.

25. The Chairman noted that this year, the Group had been working towards a common appreciation of how its negotiating objective might be effectively understood and applied. Discussion in the Group had been structured around an examination of the operation of eighteen GATT Articles that certain participants had cited as being related to the trade restrictive and distorting effects of investment measures. The Group would continue its discussion with a view to exploring further how GATT Articles address the trade restrictive and distorting effects of investment measures and whether further provisions may be necessary to avoid adverse effects on trade.

26. Drawing on the discussions at this meeting, the Chairman proposed that, as a next step, the Group should focus on an examination of the trade effects of investment measures that had been cited by participants in written submissions or oral statements, benefitting whenever possible from concrete evidence of these trade effects, and examine how these effects were, or were not, covered by GATT Articles. He invited participants that were in a position to do so to provide evidence of the trade effects of investment measures.

27. A participant stated that the Chairman had provided sufficient guidance for the future work of the Group. It would be necessary to build on the work that had been done this year, but discussions were still at an exploratory stage and all participants should have the opportunity to contribute in substance at future meetings.

Other business

28. The Chairman indicated a tentative schedule for the next meeting, and suggested that the Group might find it convenient in future to have longer but less frequent meetings.