SUBMISSION BY THE EUROPEAN COMMUNITIES

The following communication, dated 17 May 1988, has been received from the delegation of the European Communities with the request that it be circulated to members of the Group.
1. In pursuance of the negotiating objectives as spelt out in the Ministerial Declaration of Punta del Este, in accordance with the negotiating plan and in the light of the discussions in the Negotiating Group the European Community is putting forward its views on those areas where it considers that negotiations to elaborate further provisions may be required with a view to avoiding restrictive and distorting effects of investment measures on trade.

2. These views are being submitted with the understanding that the present negotiations are not intended to call into question the existence of national investment policies as such. What is at issue are the trade distorting and restrictive effects of certain investment measures which should be brought under effective GATT discipline where necessary.

3. The Negotiating Group has done a substantial amount of work, contributing to a better understanding of the functioning of TRIMs, their effects on trade and the operation of existing GATT Articles. Until now 14 measures have been introduced into the discussion. These measures have not always been defined in an unequivocal manner. In order to facilitate further discussions all the investment measures tabled so far are described below. It should be understood, however, that these descriptions are not necessarily exhaustive and may, as work proceeds, need further refinement.

(i) **Domestic sales requirements** stipulate that a specified proportion of the output or a specific minimum quantity or value of the goods produced are sold on the market of the host country.

(ii) **Exchange restrictions** limit the investor's access to foreign currency and thereby his capacity to import products or components used or sold by him, or link it to his export earnings and thus would be a specific form of a trade balancing requirement.

(iii) **Export performance requirements** require that a specified proportion of the output or a specific minimum quantity or value of the goods produced are exported.

(iv) **Investment incentives** have been defined as benefits granted in conjunction with an investment.

(v) **Licensing requirements** compel the investor to allow the production, use or sale of a specific product or technology to other companies in the host country.

(vi) **Local content requirements** require that a given percentage of the value of the final output must be either of local origin, or purchased from local sources.

(vii) **Local equity requirements** specify a certain percentage of the equity of a company which must be held or controlled by local investors, or a ceiling on foreign equity.
(viii) **Manufacturing limitations** prohibit an investor from producing certain goods.

(ix) **Manufacturing requirements** require the company to manufacture locally certain products or components of products used or sold by it.

(x) **Product mandating requirements** can require a commitment to assign to the affiliated company concerned the exclusive right to export specified products worldwide or to certain regional markets.

Another form of **product mandating** would oblige the investor to export a certain amount or percentage of production to a designated market.

(xi) **Remittance restrictions** place limits on the ability of the foreign investor to remit profits, capital and other funds associated with the investment.

(xii) **Technology transfer requirements** require the foreign investor to adopt production or processing techniques that incorporate specific technology into the product or to conduct a specific minimum amount of R & D in the host country.

(xiii) **Trade balancing requirements** require a company to export an amount equivalent to a certain proportion of imports, or tie the import of certain product components to exports of other products.

What has been called "import substitution requirement" appears to be equivalent to a local content requirement and no separate category should be created therefore. The second type of **product mandate requirement** which was described as an obligation to export would appear to be equivalent to an export performance requirement and should be subsumed under this latter category.

4. The first question with regard to all of these measures has been whether and to what extent they were **trade related** in the sense of being trade distorting and restrictive. Several participants considered that only those measures were relevant which had a direct impact on trade. Behind these questions and considerations lies the fact that in principle each investment measure, i.e. each measure relating to the establishment or operation of an investment, can and probably will have an influence on trade even if it is taken for reasons entirely unrelated to trade. Since it is obvious that measures taken, for example, for fiscal, environmental or consumer protection purposes should not be the subject of these negotiations, although they can have a significant impact on the type of investment permitted and consequently on trade flows, the need arises to distinguish between investment measures in general and those of them which are relevant in the light of the negotiating objectives.

In the Community's view those measures are relevant which are **directly related** to trade and which, therefore, deserve being called **trade related** investment measures. These are all measures which are directed at the exports and imports of a company and the immediate objective of which is to influence its trading patterns. Among the measures discussed so far by the Group the following ones appear to be in this sense clearly trade related:
(i) local content requirements;
(ii) manufacturing requirements
(iii) export performance requirements
(iv) product mandating requirements
(v) trade balancing requirements
(vi) exchange restrictions
(vii) domestic sales requirements
(viii) manufacturing limitations concerning components of the final product”.

All of these measures limit directly the investor's capacity either to import or export goods or to sell them on the domestic market. Conversely, they oblige the investor to export goods or to purchase them on the domestic market. In other words, the investor is no longer free to sell or to buy as much to whom and from which sources he considers appropriate on a competitive price, quality and delivery basis. In this sense, these measures are trade restrictive.

There is a basic difference between these measures and others, such as measures regulating the production of certain goods for reasons of the protection of the consumer or the environment. The latter measures undoubtedly can have an impact on the kind of investment, e.g. on the quality of the production technology employed in order to reduce the release of toxic waste, but do not direct trade flows resulting from a given investment.

The inclusion of trade balancing requirements and exchange restrictions is without prejudice to the possibility to adopt the measures necessary to safeguard a Contracting Party's external financial position and balance of payments, as provided for in the GATT and the Agreement of the IMF.

5. Where trade is restricted, trade is distorted, because restricted trade will inevitably be complemented by other trade or domestic production and no longer be determined by factors such as competitiveness of the products and comparative advantage of the producers.

It has been said that the question of what was distorting or restrictive had to be decided in the light of the GATT. The GATT does not define these terms. It uses, however, for example in Article XI et seq., the term "restrictions" on the importation or exportation of any product. There is no basis for assuming that an import restriction imposed on the investor by way of a manufacturing requirement should in GATT terms be considered any less restrictive than an import quota allocated to the same company. The GATT (Article XVI) is also concerned with the problem of an increase of exports due to government intervention. It follows that, for example, export requirements are a problem appropriately dealt with by the GATT.
All this is further evidence of the fact that trade related investment measures as defined under 4, basically are nothing else than trade policy measures which are linked, individually or generally, to the authorization of the establishment, expansion or continued operation of an investment. These measures are, therefore, undeniably such which fall under the purview of the GATT. Where they are unlike most other trade policy measures is the fact that they are not applied at the border but addressed directly to the individual investor. The FIRA-case has clearly shown, however, that measures of this kind can be covered by the disciplines of the GATT. Anything else would indeed leave the door wide open to a circumvention of almost any GATT rule.

In the Community's view an agreement by the investor to the TRI Ms imposed on him does not resolve the issue either, since such an agreement cannot eliminate nor justify the adverse effects of such measures on the trade of other countries and companies.

6. With regard to the other measures listed under 3, the Community considers that they have not yet been demonstrated to fall within the same category of narrowly defined trade related investment measures as those mentioned under 4. While it is true that measures such as remittance restrictions or technology transfer requirements probably have an impact on the decision of the investor whether to invest in the country concerned, and on the type of investment considered appropriate by him, for example with respect to characteristics such as volume or depth of production, this in itself cannot qualify these measures as being directly trade related.

Other measures, such as licensing requirements, may put the investor at a competitive disadvantage, for example, if he is obliged to license a local producer on non-commercial terms to produce and sell a product which would be competing with the product line he intends to open in the host country himself. Other measures, which in the Community's view clearly go beyond the mandate of the Group and which are not mentioned in the catalogue under 3 above, such as the tax regime applied, may have similar effects on the investor's competitive position. Such measures would not appear to influence the trading behaviour of the investor in the same direct manner, and would, therefore, not be considered as being trade related in the same sense.

Finally, certain measures such as equity requirements, may frequently be applied in combination with other measures, for example in order to provide an incentive to the investor to reach certain performance standards in respect of exports or local content. Used in this context, they may contribute to the creation of trade restrictive or distorting effects, but, of themselves, would not seem to be directly trade related.

7. While the Community remains open for further examination of measures not listed under 4 above, some of which might also be of interest to other Negotiating Groups, it considers that, in the light of the discussions held so far and of the analysis set out above, the investment measures listed under 4 are directly trade related, typically restrict and distort trade and should be subject, therefore, to appropriate disciplines.
It has been stated that these measures do not necessarily in every case cause such adverse effects, and that consequently it should be established case by case whether they do. While it is true that a TRIM may not be trade restrictive and distorting in each individual case, the same holds true, for example, with regard to import quotas, if real imports are less than the quota. Nevertheless the GATT with good reason includes a general rule prohibiting such import restrictions.

TRIMs could appear not to be trade restrictive because the (trade) performance required might be less than what had been planned by the investor. For example, a local content requirement imposed on an investor in the food processing industry might be irrelevant if the investor had planned to buy the raw material in the local market in any event.

In all other cases listed under 4 above—the TRIMs would tend to restrict trade. Moreover, it should be borne in mind that governments impose TRIMs precisely because, in pursuance of social, economic and development objectives, they intend to influence the trade of the investor or to avoid that a planned trading pattern, which is acceptable to them, is subsequently changed in a way they consider undesirable.

The fact that in individual cases a TRIM may have no effect is irrelevant, therefore, and should not lead to the conclusion that generally applicable disciplines would be inappropriate.

8. The Community proposes, therefore, that the group agree that the investment measures listed under 4 above, which typically distort and restrict trade, should be subjected to appropriate disciplines with a view to avoiding restrictive and distorting effects on trade, and to enter into negotiations on this basis.

It is possible that some of these measures are already partly covered by existing GATT Articles and thus may be subject to rules considered sufficient for the purpose of avoiding adverse trade-effects. There has been no agreement yet on the extent to which this is the case. In the Community's view the Group, mindful of the desirability of appropriate disciplines on the above measures, should, on the basis of proposals by participants, pursue its work aiming at agreed interpretations of existing GATT Articles and at the elaboration of appropriate further provisions where this is necessary to achieve the objective of avoiding restrictive and distorting effects of TRIMs on trade.