The attached communication, dated 11 September 1989, has been received from the delegation of India with the request that it be circulated to members of the Group.
In order to facilitate the negotiating process, this paper sets out the views of India on the agenda before the Negotiating Group on Trade Related Investment Measures.

2. The work of the Negotiating Group is still in the analytical and exploratory phase. It is felt that the reasons behind our views, especially the macro-economic and developmental reasons that ought to receive the full consideration of the Group, should be set out as comprehensively as practicable in this written submission. Hence the length of the paper.

**PART-I**

**Negotiating Mandate and Basic Approach**

3. It is of fundamental importance that the Negotiating Group adheres to the letter and spirit of the mandate given to it by the Punta del Este Ministerial declaration and the Mid-term Review decisions. This is stressed at the outset for the reason that some of the submissions made to the Group thus far tend to take the work of the Group, in varying degrees, far beyond the Punta mandate.

4. The thrust of the Punta mandate is to avoid the trade restrictive and distorting effects of investment measures; the mandate does not extend to the creation of an "international investment regime" under the auspices of the GATT laying down prohibited and permitted investment measures. There is hardly any investment or production measure that can ultimately be divorced from one or other sort of trade implication. This does not mean that the Punta mandate has authorised the Group to examine national investment policies or to establish a GATT framework for investment. As the GATT Secretariat has pointed out in its note MTN.GNG/NG12/W/3, the intention of the Punta mandate is not to address the "broad relationship between investment, production and trade", but to focus on the "direct trade effects" of investment measures.

5. The Negotiating Group should therefore confine itself to (a) the identification of the adverse trade effects, if any, of investment measures and (b) the avoidance of the identified adverse trade effects. The focus and the emphasis should be on the adverse trade effects of the investment measures, and not on investment measures per se nor on the prohibition of the measures themselves.

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Multilateral Codes relating to foreign investment, technology transfer, and transnational corporations are under negotiation for quite sometime now in U.N. organisations, such as the "Draft UN Code of Conduct on Transnational Corporations" and the "Draft UN Code on Conduct of the Transfer of Technology". A distinguishing
6. With the focus and emphasis on adverse trade effects, the Group should address the following basic questions:

(1) What are the investment measures which have direct and significant adverse trade effects?

(2) To what extent are those adverse trade effects adequately covered by existing GATT Articles?

(3) Is it necessary to elaborate any new provisions to cope with the identified adverse trade effects?

(4) How should development aspects be integrated as an essential and inseparable part of the whole framework? And in particular, what should be the treatment accorded when development aspects outweigh the adverse trade effects?

7. The criterion for selection and examination of any investment measure should be its adverse trade effects—not alleged or assumed, but established by credible evidence. It is incompatible with the mandate to follow the all-embracing approach of the United States, and to a lesser extent of Japan, to first include all the major investment measures adopted, more particularly by the developing countries for developmental and macro-economic reasons, and then try to work out the possible permutation—combination of their direct and indirect adverse trade effects. The criterion cannot also be any extraneous factor like that the investment measure is "directed at the exports and imports of a company and its immediate objective is to influence the trading pattern of the company" as suggested in MTN/GNG/NG12/W/10; nor can it be that "it influences the business behaviour of the investor during the production process" as suggested in MTN/GNG/NG12/W/16.

8. In recent submissions to the Negotiating Group, Switzerland has proposed in document MTN/GNG/NG12/W/16 the categorisation of TRIMs into three categories, namely, prohibited, permitted and actionable investment measures, while the United States has proposed in document MTN/GNG/NG12/W/15 the categorisation of investment measures into two categories, namely, those that are prohibited in all circumstances because of their "inherently adverse trade effects" and those that are not prohibited in all circumstances, but should be subject to other disciplines under GATT. The United States has further proposed the elaboration of "illustrative lists" of TRIMs by the Group for the two categories of investment measures. Proposals that the Negotiating Group should undertake such categorisation of investment measures are totally contrary to the mandate of the Group and would only vitiate its work. The mandate of the Group feature of these Codes is that they encompass not only home and host-government policies, but also INC policies and practices and their duties and obligations. These efforts of the United Nations will be vitiated if an investment regime is sought to be established within GATT on the pretext of dealing with so-called trade-related investment measures.
does not cover rule-making on investment issues nor does it authorise the Group to create this kind of an investment framework. As pointed out earlier, the work of the Group should be strictly confined to the identification of the direct and significant adverse trade effects, if any, of trade related investment measures and means of avoiding them taking into full consideration the development aspects in the case of developing countries. Investment policies lie in the domain of national sovereign jurisdiction and the domestic policy considerations are too vital for Governments to allow a GATT committee to sit in judgement over such policies or to decide whether a particular TRIM should be prohibited or otherwise actionable.

9. Considering the fact that almost every investment and production measure will have some trade implication in the short or the long run, it is important for the Group to focus only on those investment measures whose adverse trade effects - in terms of trade restriction or distortion - are direct and significant. The "adverse effects" to be avoided should be the direct and significant adverse effects arising out of investment measures, and not those that may be indirect, incidental or peripheral to an investment measure.

10. Some industrialised countries are advocating the outright prohibition of investment measures. Even in respect of pure trade measures, the concept of prohibition is severely circumscribed in GATT. It is confined to export subsidies on manufactured products and to quantitative restrictions in principle. In respect of these two also, there are specific dispensations in favour of developing countries. They are exempted from the ban on export subsidies on manufactured products under certain terms and conditions. In the case of quantitative restrictions, developing countries can maintain them for balance-of-payments reasons. Other trade measures such as tariffs, dumping, and subsidisation of primary agricultural products are not prohibited. Therefore, any proposal to prohibit the investment measures is totally alien to the framework of rights and obligations under GATT. That would tantamount to more stringent disciplines being imposed to control the alleged adverse trade effects of investment measures than what GATT today stipulates to control the adverse trade effects of even pure trade measures.

11. Furthermore, it is not logical to assume that a performance requirement is ipso facto trade restrictive or trade distorting in all circumstances. In developing countries, a performance requirement generally lays the foundation for durable trade expansion and enhancement. This apart, a performance requirement may not be trade restrictive or distorting at all even by the approach indicated in the submissions of some of the industrialised countries. For example, suppose a phased local manufacturing programme stipulated by a Government after due techno-economic considerations requires that the imported components of the product to be manufactured should not exceed, say, fifty percent in the beginning and it should progressively be brought down to, say, fifteen per cent by the end of five to seven years, and suppose the investor himself would have followed a similar phased manufacturing programme on his own commercial judgement, how can it be argued that the performance require-
ment itself is trade restrictive or distorting? By demanding that the performance requirement should be prohibited because it is stipulated by the government, is not GATT being sought to be used to lay down a regime of investor freedom, non-government intervention and unfettered operation of market mechanisms in the garb of dealing with the avoidance of trade restrictive or distorting effects? How does the same measure become valid and non-trade distorting if followed by an investor, and objectionable and trade distorting if stipulated by the government? In this context, it must be said that there is considerable weight in the argument of the Canadian government before the FIRA panel that the stipulations made by the Canadian government in investment screening would in most cases have been followed by the investors themselves on their own commercial judgement and that government intervention served basically the purpose of ensuring harmonisation between the investment and the larger national economic interests. Therefore, it would not be appropriate for the Negotiating Group to follow the approach advocated in the submissions of some of the industrialised countries that (a) certain performance requirements are inherently trade restrictive or distorting solely because they are stipulated by the government and (b) the corresponding investment measures themselves should be banned. Rather, the Group should devote its attention to the adverse trade effects, if any, that may be caused by an investment measure in particular circumstances.

12. The prohibition of performance requirements or their rigid regulation under GATT may prove to be counter productive for liberalisation of both trade and foreign direct investment. It is a well known fact that foreign investment can be kept out of a host country but it cannot be forced into it. In the final analysis, investment is the product of both the investment climate and investment opportunities offered by a host country. Performance requirements constitute the basic mechanism for harmonising the foreign direct investment and technology flows with the national development objectives and priorities, especially in the case of developing countries. While stipulating performance requirements, each country seeks to strike a fair and equitable balance - in the light of its own circumstances - between its own interests and those of the investors. Each country follows an investment regime best suited to its own needs and conditions, and it will obviously not adopt such stringent or uneconomical performance requirements as to keep out the investment or technology required by it. On his part, the foreign investor has the choice of accepting or refusing the performance requirements on his own business considerations, and given the competitive situation in the international market place, his choice is fairly wide. Should this balance be upset and the freedom of host developing countries to negotiate or stipulate performance requirements be

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2 There are many number of instances in India where the degree of local manufacturing actually achieved by an enterprise on its own volition and commercial considerations has been much higher than the stipulated performance requirement. Economic and competitive factors, including the appreciation in the value of foreign currencies and expansion of production volumes brought about by indigenisation, have led the enterprises to accelerate their indigenisation programmes.
nullified by GATT rules and disciplines, it might lead to increasing restrictions on foreign direct investment itself. This will be unfortunate at a time when the world wide trend in developing countries is towards liberalisation of their foreign investment regimes. The Group may well miss the wood for the tree if it places prohibition or rigid regulation of performance requirements above the developmental needs of developing countries and the harmonisation of foreign direct investment and technology flows with those needs.

13. The relevance and importance of the larger development dimensions can scarcely be over emphasised in the case of developing countries when dealing with investment measures. The fundamental objective of these measures is to promote the growth and diversification of their economies, and in particular, to build up domestic industrial, technological and export capabilities. Performance requirements and investment incentives play a dual role in the task of such capabilities being built up by developing countries: on the positive side, they tend to harmonise investment and technology flows with national needs and priorities so that the contribution of these flows to national economic development is maximised; on the negative side, the performance requirements are intended to counter the varied restrictive and anti-competitive business practices followed by the transnational corporations. Two major points would, therefore, need to be stressed regarding the consideration of development aspects by the Negotiating Group:

(i) Developmental aspects should be integrated into the work of the Group as a central theme and not added as a peripheral or a subsidiary item. Therefore, it would not be logical to follow the suggestion of some of the industrialised countries that the Group should first work out disciplines and rules on TRIMs applicable alike to all countries and thereafter consider how some exceptions or time-limited derogations can be provided to developing countries. This kind of an approach is contrary to the Punta del Este mandate and the mid-term review decisions.

(ii) When the developmental implications of an investment measure, including its long run positive effects on trade, outweigh the identified adverse trade effects, developing countries should have the freedom and flexibility to maintain the investment measure and this freedom should not be curtailed by any GATT discipline. Given the enormous gap in the economic, industrial and technological strengths of developing and industrialised countries, the developmental needs of developing countries cannot be taken care of by merely giving them a limited transitional time to fall in line with disciplines that may be relevant to industrialised countries alone.
14. There is at present a serious imbalance in the negotiating process on TRIMs which is particularly unfavourable to developing countries. This is because of the exclusive focus on trade restrictive or distorting effects arising from government mandated investment measures, ignoring the more severe and wide spread restrictive and anti-competitive practices and policies followed by the transnational corporations (TNCs). The dominant role played by TNCs in world economy is well known. The biggest TNCs of the world have sales which exceed the aggregate output of most countries. The largest 56 TNCs have sales ranging between $10 billion and $100 billion. It is estimated that the largest 600 industrial companies of the world account for between one-fifth and one-fourth of the value added in the world's market economies. Their importance as exporters and importers is even greater. Nearly thirty per cent of the world trade is controlled, managed or influenced by TNCs.

15. It is an established fact that the TNCs conduct their operations according to a global strategy controlled and orchestrated from the parent company. In particular, major decisions on investment, production, expansion or diversification, imports and exports of the entities of the group operating in different host countries are controlled and directed so as to subserve the TNC's world wide strategy. The two major consequences of this phenomenon, of relevance to the work of the Negotiating Group, are that (a) while the objectives of a TNC according to its global strategy may often coincide with the interests of the host countries, they may also diverge substantially from the host country's own developmental objectives, needs or priorities; and (b) TNCs practice a wide array of restrictive and anti-competitive policies and practices in furtherance of their global strategy. These aspects of the operations of TNCs are well documented in UN and academic studies.

16. Given their unequal bargaining power, developing countries are particularly in a vulnerable position in dealing with the TNCs. As noted earlier in para 13, performance requirements are stipulated by them to ensure congruence between the operations of foreign investors and technology suppliers and their own developmental needs and priorities as well as to counter the restrictive business practices employed by them. It will, therefore, be a one-sided approach, as far as the developing countries are concerned, for the Negotiating Group to work out rules for disciplining the policies of host countries without simultaneously disciplining the restrictive business practices and policies of the TNCs themselves. To illustrate, how is it logical to proscribe export obligations stipulated by host countries without at the same time proscribing export restrictions imposed by the TNCs or the market allocation imposed by them on their affiliates, so as to carve out different markets for different entities of the group? Or how is it logical to treat local manufacturing requirement stipulated by host countries to be trade restrictive without according the same treatment to the "tied purchases" condition imposed by the TNCs.
according to which components, parts or intermediates should be purchased only from them or from sources designated by them? Or what is the rationale for calling in question the technology transfer requirements of host countries without dismantling the varied restrictive conditions imposed by the TNCs on the transfer and use of the technology by the recipient parties in the host countries? Or in terms of trade distortion, how can the abusive transfer pricing practices of TNCs be overlooked?

17. It is, therefore, imperative that the Negotiating Group deals with the adverse trade effects of not only government mandated investment measures, but also of the restrictive and anti-competitive business practices followed by foreign investors and technology suppliers. The Group's mandate is for identification and avoidance of trade restrictive and distorting effects of investment measures, and it is not confined to government measures only. Unless the Group deals with corporate measures also, its work will lack balance and the results will be particularly detrimental to the interests of the developing countries.

Part II

Specific investment measures and their trade effects

18. Before the specific investment measures and their trade effects are discussed, it would be useful to consider the setting in which performance requirements are stipulated by the developing countries. Development experience of the developing countries clearly demonstrates the larger macro-economic implications of performance requirements for their growth and development. The latest United Nations study on Transnational Corporations deals extensively with the issue of performance requirements in developing countries in various contexts, namely, host countries' development objectives, technology transfer, foreign direct investment flows, the relationship between developing countries and TNCs and the like. The following quotations from the analysis and conclusions of this important United Nations study provide a proper perspective to the whole question of performance requirements in developing countries:

(i) "Host country efforts to further their development objectives through foreign direct investment are, of course, the explanation for the new emphasis on performance criteria. The balance-of-payments crisis which has affected most developing countries means that achieving an increase in export earnings is now for most Governments of host countries a priority objective. In the manufacturing sector, TNCs are seen as having a capacity to give access to world markets through their network of corporate affiliates."

(ii) "The available empirical studies on this issue show that TNCs can help to raise the technological level of host developing countries, but that performance requirements specifically targeted at technology transfer may be needed to maximize their contribution in this area."

(iii) "Policy-makers may need to pay special attention to the creation or strengthening of those linkages, if the technological impact of FDI is to be maximized. In cases, where production capacity in supplier industries is available, or it could be fairly easily created, local sourcing requirements could play a useful role in that respect."

(iv) "In order to maximize such benefits, however, developing countries may be required to undertake deliberate policy measures, among which are efforts to channel FDI towards sectors with adequate forward or backward linkages, the development of supplier or user activities and carefully designed performance requirements."

(v) "However, the hostility in the context of overall trade issues of some industrialised economies to the imposition of performance criteria could introduce an element of uncertainty damaging to the stability of the new investment regime now emerging."

(vi) "Here the danger is that the hostility of certain developed market economies to performance criteria may upset the equilibrium which Governments and companies are beginning to achieve. Performance criteria have played an important part in diffusing some of the tension between host countries and TNCs. They are the instrument for reconciling the global strategy of the investor with the immediate interest of the host country in foreign exchange reserves, backward linkages and other developmental objectives."

19. The last of the above mentioned quotations from the United Nations study deserves the particular attention of the Negotiating Group. Performance requirements are an important policy instrument for realising the larger economic and developmental objectives of developing countries, especially their industrial and technological
development objectives. They ought to be viewed in this perspective and not as trade policy measures adopted by developing countries to deal with imports and exports of products. It is interesting to note that the UN study has viewed and analysed them not as trade distorting or restrictive measures, followed by developing countries, but as instruments necessary to be employed by them to channel foreign direct investment in consonance with their national development objectives. If fact, the UN study advocates the employment of carefully designed performance criteria to create the necessary forward and backward linkages and diffusion of technology in the national economy. More importantly, the UN study sees the performance requirements as playing the positive role of diffusing the tension between host countries and TNCs and thereby providing a conducive framework for the flow of foreign investment and technology to developing countries. The proponents of a complete prohibition or rigid regulation of performance requirements under GATT discipline would need to give serious thought to these positive facets of performance requirements.

20. Coming to the specific investment measures cited as TRIMs by the industrialised countries in their submissions to the Group, India is of the view that the following types of investment measures/performance requirements are clearly not trade-related nor can they be considered to have any direct or significant adverse trade effects, namely, local equity requirements, remittance restrictions, exchange restrictions, investment incentives, manufacturing limitations (that prohibit an investor from producing certain goods), technology transfer and licensing requirements. If the Group deals with these measures, it would really be getting involved in creating a multilateral investment regime under GATT which is beyond its mandate.

21. Of the others, performance requirements such as the domestic sales requirements (that a part of the output must be sold in the domestic market of the host country) and product mandating requirements (that the affiliated company be given the exclusive right to export specified products or that a part of the output be exported to designated countries or regions) may have some trade effects but there is hardly any evidence that they are either widely employed or that they cause trade distorting effects in any significant way, at least in the case of developing countries.

22. It would, therefore, be inconsistent with the Punta del Este mandate for the Group to consider the investment measures mentioned in paragraphs 20 and 21 above as trade related investment measures that cause adverse trade effects. As a matter of fact, if the submissions of the industrialised countries contained in documents W/6 (Nordic countries), W/10 (EEC), W/12 (Japan), W/16 (Switzerland) are taken together, it will be seen that these measures have not been regarded as trade related/trade distorting by one or more of these countries themselves. So far as the developing countries are concerned, they have consistently maintained in the discussions of the Group that investment measures of this nature cannot be regarded as trade related and are, therefore, beyond the scope of the work of the Group.
23. The performance requirements that can be regarded as having some direct trade effects are only two, namely (i) Export performance requirements and (ii) Local content/local manufacturing requirements. Trade balancing requirements that require an investor to cover all or part of his imports through exports, either by curbing his imports through local manufacturing/sourcing or by increasing his exports or by a mixture of both, are really subsumed in the two aforesaid performance requirements. In its study of "TNCs in World Development" referred to in paragraph 18 above, the United Nations (UNCTC) has also referred to only these two measures as the main performance requirements employed in developing countries.

24. These are analysed in the following paragraphs, but it should be emphasised at the outset that -

(i) these do not have trade restrictive or trade distorting adverse effects in all circumstances as has been assumed in the submissions of industrialised countries; on the contrary, they do have positive trade creating and trade enhancing effects in the case of developing countries through an expansion and diversification of their industrial production and technological base, especially in the medium and long run;

(ii) their developmental dimensions far outweigh their trade effects in the case of developing countries; as a matter of fact, these are not viewed by developing countries as trade policy instruments but as an integral part of their macro-economic developmental and technological policies. They play a key role in the harmonisation of foreign investment and technology with national developmental needs and objectives; and

(iii) they are also the instruments needed for countering the restrictive business practices widely used by the TNCs in their operations.

**EXPORT PERFORMANCE REQUIREMENTS**

25. Among the scarce economic resources that act as a major constraint to the development process of developing countries is the availability of foreign exchange. The ability of developing countries to expand and sustain their imports of capital goods, raw materials, components, intermediates, technology and technical assistance rests crucially on the expansion and diversification of their exports. The capacity to import cannot be sustained by them for long on foreign borrowing, foreign equity investment or foreign aid alone; it has to be built on export earnings if it is to be durable. It must be clearly recognised that imports could not be increased permanently by the developing countries without a corresponding increase in exports. In this context, it is important
to remember that in the 1970s, developing countries were running "financial surpluses" with which they were able to finance their "commercial deficits". But in the 1980s, there has been a drastic reversal of the situation; because of the debt crisis and other adverse factors, developing countries are now running "financial deficits". Unless therefore they are enabled to achieve "commercial surpluses" through increased exports by greater access to developed country markets, they will not be able to meet the "financial deficits" and their balance-of-payments situation will keep further deteriorating. It is, therefore, necessary to see in the larger perspective the imperative need for developing countries increasing their export earnings. Export performance requirements of developing countries should be seen as trade creating and trade stabilising measures rather than as trade restricting or trade distorting measures to be disciplined under GATT.

26. It is also necessary to take into account the differences in the objectives of transnational corporations and host developing countries in this area. The dominant objective of TNCs in investing in developing countries, especially in the case of countries with large domestic markets, is to gain access to their domestic markets. On the other hand, while host developing countries are ready to provide such access, they are anxious that the TNC participation in their national economy should lead to foreign exchange earnings by export of at least a part of the output. Given the import intensity typical of TNC operations, their penchant for inter-affiliate transactions and their remittance needs, the export of a part of the output is seen by developing countries as a necessity to meet at least a part of the foreign exchange implications of their operations. This divergence in the approach between the objectives of the TNCs and the host countries is well recognised. Export performance requirements should be seen as the instrument for bringing about an appropriate alignment between the objectives of the host developing countries and the TNCs.

27. If export performance requirements employed by the developing countries are seen as a trade distorting measure, there is no rationale or justification for viewing the export restrictions imposed by the transnational corporations in a different manner. It is a well established fact that TNCs impose a variety of export restrictions, both formal and informal, on their subsidiaries, affiliates, joint ventures and in technology licensing agreements. These are particularly rampant in the case of developing countries because of the unequal bargaining power between them and the TNCs. To illustrate, in the case of India, according to the fourth Survey Report (1985) of the Reserve Bank of India (which is the central bank of the country) on "Foreign Collaboration in Indian Industry", 354 of the 580 foreign collaboration agreements concluded in the country during the period 1977 to 1981 (i.e. 61% of the total number of agreements) contained export restrictive clauses. The number of agreements (out of the 580 agreements) which contained all types of restrictive clauses during that period was 376, and in all they had 716 restrictive clauses, of which 594 were export restrictive clauses. In other words, agreements with export
restrictive clauses formed 94% of the agreements with regulatory clauses, and more than 80% of the restrictive clauses related to exports. The survey of the Reserve Bank of India (which conducts such surveys on a regular basis since 1968 and this latest survey is its fourth in this series) has also found that the tendency to impose export restrictions has increased over the period. The tables contained in the survey regarding the classification of regulatory clauses and countrywise classification of agreements with export restrictions are shown in the Annexes to this paper. There is enough documented evidence, both from academic studies as well as the publications of the United Nations system, that such restrictive business practices are widely prevalent in the agreements between TNCs and firms in all developing countries. Instead of seeking to discipline developing countries on export performance requirements, the need is for international agreement for curbing the use of export restrictive clauses by the TNCs.

28. There is also no basis to the allegation that the export performance requirements result in every case in "dumping" in external markets. In the first place, in many cases, the investors themselves would find it profitable to undertake the exports on their own commercial judgement if only they did not resort to the restrictive business practice of export restrictions. Export performance requirements cannot therefore be regarded as trade distorting or leading to dumping ipso facto. Secondly, if in any particular case, the importing country is able to establish a case of dumping, the existing GATT rules and disciplines permit the importing country to take appropriate counter measures.

29. To sum up, therefore -

(a) export performance requirements are not necessarily trade distorting in nature; viewed in the proper perspective in the case of developing countries, they are in fact trade enhancing and trade stabilising measures;

(b) the developmental considerations far outweigh the trade distorting effects, if any, in the case of developing countries;

(c) the focus should be on the elimination of the widely prevalent export restrictions imposed by TNCs on developing countries; and

(d) export performance requirements cannot ipso facto be assumed to be a "dumping" practice; if in any particular case, an export leads to dumping, the existing remedies available under GATT are sufficient to deal with it.
LOCAL CONTENT/LOCAL MANUFACTURING REQUIREMENTS

30. The usual requirements in this regard in developing countries are that the components and parts should either be manufactured locally by the investor himself (in-house) or that they should be procured from locally manufactured sources (vendors) so that the content of locally manufactured components and parts reaches certain prescribed percentages over a period of time in terms of their c.i.f. value. This is typical in engineering goods industries and the electronics sector. In the pharmaceutical or chemical sectors, the local content requirements may take the form of the production taking place over a period of time from the basic or intermediate stage instead of its being a mere formulation or mixing activity based on imported finished or semi-finished products. It may be relevant to note here that the local content rule does not apply in many countries (for example, in India) for imported raw materials; in other words, a component or part may be manufactured locally with imported raw materials (e.g. steel, non-ferrous metals, plastics) and it will still be regarded as satisfying the local content rule although it is based on imported raw materials. The essence of these requirements in the case of developing countries is progressive local manufacturing over a reasonable period of time instead of perpetual dependence on imports of the components and the intermediates.

31. The local content/local manufacturing requirements are a key policy instrument of the developing countries to serve several important macro-economic policy objectives. Firstly, they are essential to build up the industrial production base of developing countries and thereby the diversification of their economies from predominantly an agriculture and primary commodity based economy to an economy in which industrial production also will play an important role.

32. Secondly, the building up of domestic technological capabilities is a sine qua non for the economic development of the developing countries. There will hardly be any transfer or diffusion of technology if production is based on "screw driver" operations, that is, mere assembly of imported Completely Knocked Down (CKD) or Semi-knocked Down (SKD) kits. As brought out in the quotations of the United Nations study on TNCs in para 18 above, performance requirements specifically targeted at technology transfer are essential in order to create forward and backward linkages and to maximise the technological impact of foreign direct investment. The role played by progressive local manufacturing in the case of developing countries is comparable to the difference between "giving a man some fish" and "teaching him how to fish".

33. Thirdly, it is well known that transnational corporations employ the restrictive business practices of "tied sales" (requiring that the components, parts and materials must be purchased from them or from sources designated by them) and abusive "transfer pricing" practices. Local manufacturing requirements tend to mitigate these restrictive practices employed by TNCs on a wide scale.
34. Fourthly, local content/local manufacturing requirements tend to alleviate the foreign exchange problems of developing countries. As noted earlier, foreign exchange is one of the most serious constraining factors for the economic and industrial development of developing countries. Local manufacturing contributes not only to the minimisation of perpetual dependence on imports, but also to the available foreign exchange resources being employed on a wider production base.

35. Lastly, the local content/local manufacturing requirements contribute to a number of economic gains for the national economy such as value addition in the economy through greater utilisation of domestic resources, increased employment opportunities, upgradation of the technological level of the economy and diversification of the economy as a whole.

36. Thus, in the case of the developing countries, it is important to view local content/local manufacturing requirements in the perspective of their macro-economic objectives, and not merely as trade devices targetted at the imports and exports of companies or as devices intended to coerce investors during the production process. Their development dimensions far outweigh their trade implications and, furthermore, they are essential to forge a mutually beneficial relationship between developing countries and foreign investors by harmonisation of their objectives.

37. Recognising the importance of exports as well as local manufacturing/utilisation of local resources for economic development and balance-of-payments of developing countries, the draft UN Code of Conduct of Transnational Corporations being negotiated under the auspices of the United Nations have the following specific paragraphs incorporated in it. On these paragraphs, there is a substantial consensus among the developed and developing countries as well as the industry:

"28. Transnational corporations shall carry out their operations in conformity with laws and regulations and with full regard to the policy objectives set out by the countries in which they operate, particularly developing countries, relating to balance of payments, financial transactions and other issues dealt with in the subsequent paragraphs of this section.

29. Transnational corporations should respond positively to requests for consultation on their activities from the Governments of the countries in which they operate, with a view to contributing to the alleviation of pressing problems of balance of payments and finance of such countries."
30. As required by government regulations and in furtherance of government policies, and consistent with the purpose, nature and extent of their operations, transnational corporations should contribute to the promotion of exports and the diversification of exports and, where appropriate, imports in the countries in which they operate and to an increased utilization of goods, services and other resources which are available in these countries.

38. The provisions of paragraph 30 of the draft Code mentioned above are particularly relevant for consideration of the export performance requirements and the local content/local manufacturing requirements. They are an exhortation to the TNCs that as required by government regulations and in furtherance of government policies, TNCs should contribute to the promotion and diversification of exports and to an increased utilisation of goods, services and other resources which are available in host countries. The efforts to prohibit or discipline such performance requirements are diametrically opposed to the efforts being made in other international fora to bring about a mutually beneficial relationship between host countries and TNCs on the basis of a balanced approach to the rights and obligations of TNCs and their treatment by the countries in which they operate.

39. It is also not correct to assume that in all circumstances, the local content/local manufacturing requirements are trade restrictive and trade distorting. Firstly, as pointed out in paragraph 11 of the paper, the performance requirements may be such that they would have been adopted in any event by the investor himself on his own commercial judgement and would therefore be acceptable to him. They cannot become trade distorting merely because they are mandated by the government. Secondly, they create trade in the supplier industries. For example, when a component or part is to be sourced locally, the component manufacturer goes in for the import of capital equipment, raw materials, technology, technical assistance and sub-components and parts. Thus, what may appear to be a reduction of the imports of SKD/CKD components will be more than offset by the imports made by the component manufacturer. Thirdly, by widening the production base and utilising the domestic resources, the volume of production is considerably increased and imports take place on an expanded base not only by the main manufacturer but also by the supplier industries as well. If imports were to take place only by way of SKD/CKD kits, the volume of manufacturing would tend to get restricted and there would hardly be any tangible trade activity in the supplier industries. In fact, according to the UN study cited above, one of the newer forms of TNC participation in developing country economies that is increasingly coming into the fore is "sub-contracting", namely production of components and parts not only for use in the domestic market of the developing countries, but also for sourcing for their worldwide operations. Lastly, as local content/local manufacturing diversifies the
40. It will therefore not be rational to prohibit local content/local manufacturing requirements or to regulate them in a rigid manner on the unproven assumption that they are ipso facto trade restrictive or trade distorting. Even if in a particular circumstance, they are found to create an adverse effect, their developmental aspects would far outweigh their trade effects in the case of developing countries. It would therefore be detrimental to the long term needs and interests of developing countries, as well as to the expansion of international trade, to prohibit or regulate them under GATT.

41. Thus far, the paper has dealt with local content/local manufacturing requirements from the perspective of the developing countries. But it is well to remember that these requirements are widely prevalent in developed market economies as well. For example the rules of origin requirements being followed by some of the European countries are scarcely distinguishable from the local content rules in intent and effects. As Japan has pointed out in its document MTN/GNG/NG12/W/7, rules related to the concept of origin of goods should also be studied since they have similar effects. In the automobile sector, there is at present a controversy in the EEC whether the yardstick of local content should be 60% or 80% to determine whether a car is to be regarded as "Made in Europe" or not. Whatever be the yardstick - whether it is 60% or 80% - the rationale behind it is that "screw driver" type assembly operations should be discouraged.
42. **Article I**: It has been argued that the provisions of Article I are relevant to investment measures because investment measures have discriminatory trade effects, both on imports and exports, as they are imposed on specific investors and are negotiated on a case by case basis. Article I deals with the avoidance of discriminatory trade measures and would be attracted only if a specific trade measure discriminates between goods of different origins. Furthermore, Article I applies to border measures and specifically to the items covered by it. Article I is clearly not relevant in the context of investment measures because Article I deals with discriminatory trade measures, implying discrimination between one country and another, and it does not deal with discriminatory trade effects. Moreover, investment measures are not imposed at the border; they are production measures.

43. **Article III**: Paragraphs 4 and 5 of Article III on national treatment have been cited in relation to local content/local manufacturing requirements. Article III.4 is attracted only after a product has actually been imported into a country, that is to say, only after a product has crossed the border. The obligation imposed by this provision is that once a product has actually entered a domestic market, it should be treated no less favourably than a like domestic product. This Article does not come into play when a product has not even been imported into the country. It cannot be invoked merely on the ground that had the circumstances been different, that product might have been imported into a country. If that was so, every product or its components that were previously imported, but are now indigenously manufactured, would have to be regarded as import-displacing and attracting Article III.4.

44. **In the case of local manufacturing requirements** that stipulate that a certain percentage of the product should be manufactured locally or should be obtained from locally manufactured sources, there may at best be an effect on the extent of imports, but there is no discrimination between an imported product and a like domestic product. Generally local manufacturing requirements do not stipulate that a particular component should be manufactured domestically. It would, therefore, not be correct to assume that such a requirement even places restriction on the import of any particular component, much less is there a discrimination between an imported component and a domestically manufactured component.
45. In this context, it may be pointed out that the FIRA Panel went into the question of the Canadian "purchase undertakings". It did not examine "manufacturing undertakings" at all. As clearly stated in para 5.3 of its findings, "the Panel considered that the examination of undertakings to manufacture goods, which would be imported otherwise, as requested by the United States was not covered by its terms of reference which only refer to the purchase of goods in Canada. Accordingly, the Panel did not examine this question". Again in para 6.3 under "conclusions", the Panel has reiterated: "Finally, the Panel considered that the examination of undertakings to manufacture goods which would be imported otherwise was not covered by its terms of reference". In the case of the typical local manufacturing requirement, employed in developing countries, there is no case of discrimination against "imported components" (components that have already been imported into the country and are available with stockists and which can therefore be purchased by the investor) vis-a-vis same components manufactured domestically. The obligation on the investor is to manufacture a certain percentage of the components (as required by the extent of local manufacturing requirement) either by himself or procure it from domestically manufactured sources. The local manufacturing requirement employed in developing countries is, thus, vastly different from the local purchase undertakings that the FIRA panel examined and found to be inconsistent with Article III.4.

46. Article III.5 deals with internal quantitative regulations relating to the "mixture, processing or use of products". In certain circumstances provisions of Article III.5 might get attracted by local content requirements in the case of industrialised countries. However, in the case of developing countries, totally different considerations prevail as explained below.

47. Regardless of the above, development dimensions should receive over-riding considerations in dealing with performance requirements such as local content/local manufacturing requirements. As has been explained in the preceding parts of this paper, these are key policy instruments employed by developing countries for achieving their macro-economic and developmental objectives, especially in the areas of industrialisation and technological upgradation. They are to be viewed as development policy instruments and not as trade devices. Furthermore, in most circumstances, they may not have trade restrictive or trade distorting effects. On the contrary, in the case of developing countries, they have trade creating, trade enhancing and trade stabilising effects.

48. Even if in any particular circumstance, a local content/local manufacturing requirement is found to have an adverse trade effect, then in the event of such a measure being maintained by a developing country, full account should be taken of the special situation of the developing countries. Sufficient flexibility should be provided to the developing countries to maintain their investment regimes for promoting their economic development.
49. **Article VI**: It has been argued that export performance requirements can have effects analogous to dumping and, therefore, on account of the adverse trade effects, export performance requirements should be prohibited. In the first place, it must be recognised that there is no evidence to establish a causal relationship between export performance requirements and dumping. Article VI deals with the conditions under which anti-dumping or countervailing duties may be levied against products which are exported at less than the normal value of the products, provided it causes or threatens material injury to the domestic industry of the country of importation. Therefore, if, as it is argued, export performance requirements may in certain circumstances lead to dumped exports, remedies against such dumping exist under the relevant provisions of the General Agreement. The mere possibility of dumping is an insufficient ground to demand that export performance requirements which have other basic macro-economic objectives, should be prohibited or regulated. Moreover, the GATT, and the Anti-dumping Code, do not prohibit dumping per se.

50. **Article XI**: Article XI deals with restrictions on importation and exportation of products. Some participants have argued that investment measures, and in particular performance requirements, are inconsistent with the provisions of Article XI. It should be recalled that the Canadian FIRA Panel had reached the conclusion that measures such as local purchase undertakings were not inconsistent with Article XI. The Panel noted that the General Agreement distinguishes between measures affecting the "importation of the products", which are regulated by Article XI:1, and those affecting "imported products" which are dealt with in Article III and it found no evidence in the drafting history of the General Agreement or in previous cases examined by the CONTRACTING PARTIES to justify an interpretation of Article XI:1 to cover also internal requirements. Hence, it is incorrect to cite Article XI:1 in the context of the trade effects of investment measures.

51. Furthermore, it is to be noted that there are provisions in the General Agreement that allow developing countries to maintain import restrictions for balance-of-payments reasons in relaxation of Article XI. In interpreting Article XI in relation to the trade effects of an investment measure, full consideration must be given to these provisions of the General Agreement. In other cases also, sufficient flexibility should be provided to the developing countries to maintain their investment regimes for promoting their economic development.

52. **Article XVI**: The provisions of Article XVI relate to subsidies. It cannot be presumed that investment measures constitute a form of subsidisation and lead to subsidised exports. If contracting parties are of the view that products are being subsidised, the GATT prescribes adequate remedies to deal with such cases. It is inappropriate to invoke the provisions of Article XVI in an attempt to proscribe any investment measures. In any case, even Article XVI and the Subsidies Code do not prohibit all forms of subsidies. (See para 10 of the paper).
53. **Article XVIII:** Article XVIII recognises that the attainment of the objectives of the General Agreement will be facilitated by the progressive development of the economies of those contracting parties which can only support low standards of living and are in the early stages of development. Article XVIII further recognises that it may be necessary for these contracting parties, in order to implement programmes and policies of economic development, to take protective or other measures affecting imports and that such measures are justified in so far as they facilitate the attainment of the objectives of the General Agreement.

54. **Part IV of GATT on Trade and Development.** The provisions of Part IV also reflect recognition of the development dimensions in the context of the participation of developing countries in international trade. The rapid expansion of the economies of the developing countries is a fundamental objective of Part IV. In particular the objectives embodied in Part IV such as the following are extremely relevant for the work of this Group as they relate to developing countries:

- raising of standards of living and progressive development of their economies;
- enhancing their export earnings;
- diversification of the structure of their economies; and
- use of special measures to promote their trade and development.

55. Thus, the investment measures of developing countries which are maintained in pursuance of their macro-economic and development objectives and are designed to attract capital investment and technology flows and harmonise them with those objectives, are in conformity with the spirit and philosophy of the General Agreement. It is well recognised that the provisions of the General Agreement do not apply to investment regimes. If the GATT Articles are to be extended to deal with any direct and significant adverse trade effects of an investment measure, full account must be taken of the basic recognition accorded under the General Agreement to the objective of achieving the economic development of developing countries.
## Classification of Regulatory Clauses (1977-81)

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A. Total number of agreements with regulatory clauses

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B. Total number of agreements

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<td>49</td>
<td>300</td>
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C. A as percentage of B

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## COUNTRY-WISE CLASSIFICATION OF AGREEMENTS WITH EXPORT RESTRICTIONS (1977-81)

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