PAST DISCUSSIONS IN GATT ON
TRADE-RELATED INVESTMENT MEASURES

Note by the Secretariat

Background

At its first meeting on 2 April 1987, the Negotiating Group on Trade-Related Investment Measures requested the Secretariat to prepare a note on past discussions in GATT relevant to the question of the trade restrictive or distorting effects of investment measures. In preparing the note, the Secretariat has been guided by the exchange of views at that meeting, particularly with respect to the kind of trade effects involved and what is to be understood by the term "investment measures".

The Secretariat has not attempted to provide comprehensive accounts of past GATT discussions on the subject, some of which, particularly in the case of dispute panel proceedings, included complex argumentation for which reference should be made to the relevant GATT documents cited in each case. Rather, it has reported the main issues that have been raised with the aim of assisting delegations to identify and examine the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures.

The subject of trade-related investment measures was first discussed in GATT in the Consultative Group of Eighteen in 1981 (CG.18/14), as a result of which the Secretariat prepared a background paper (CG.18/W/64) which described work done in other international organizations on the question of export requirements and requirements regarding import substitution, and listed relevant provisions of the General Agreement. The subject was also discussed in the preparatory phase of the 1982 Ministerial Meeting (L/5395), but it was not included in the Ministerial Work Programme. Finally, discussions at meetings of the Senior Officials' Group and the Preparatory Committee preceded the inclusion of the subject in the Punta del Este Declaration. These are summarized respectively in SR.SOG/10 and in PREP.COM(86)SR/4, SR/6 and SR/8. A large part of these discussions was concerned with issues resolved by the adoption of the Punta del Este Declaration. This note reports only on the points raised that bear directly on the impact of investment measures on trade flows.
Certain reports by Panels may be relevant to the Group's discussions. Many delegations have drawn particular attention to the recent Panel report which examined local content and export performance requirements within the specific context of Canada's Foreign Investment Review Act (L/5504 and BISD 30S/140). The report is summarized in this note.

Past discussions in the Consultative Group of Eighteen, the Senior Officials' Group and the Preparatory Committee

At a meeting of the Consultative Group of Eighteen in 1981 (CG.18/14), one member felt that even though investment performance requirements and incentives might serve legitimate national purposes, they could also affect other countries' trading interests, even to the point of impairing benefits negotiated under the GATT. For instance, requiring domestic procurement for items bound in GATT or their re-export in such a way as to deny access to the domestic market could have a direct and adverse effect on the rights of contracting parties.

Some members considered that the two measures most directly related to trade were local content and export performance requirements. One was concerned also about the effects on trade of processing or value-added requirements and funding arrangements. However, some members felt that while it was true that many of these measures could have trade effects, that in itself was not sufficient ground for action in GATT unless damage to the trade interests of contracting parties could be proved, in which case Articles XXII and XXIII provided remedies. One member doubted that such measures had significant trade effects. Another expressed interest in the effects on trade of the activities of transnational corporations, particularly their purchasing policies and product mandating and transfer pricing.

1It should be noted that there could be a question as to whether the application of certain conditions to the purchase or use of capital or investment goods would be regarded in particular circumstances as an investment measure. In this connection, the findings of the Panel report dealing with special credit facilities offered by the Italian Government to farmers for the purchase of agricultural machinery of domestic, but not of foreign, origin could be of interest (L/833 and BISD 7S/60). Panel reports dealing with United States Tax Legislation (DISC) (L/4422 and BISD 23S/98) and with Income Tax Practices maintained by France, Belgium and the Netherlands (L/4423, 4424 and 4425 and BISD 23S/115, 127 and 137) may also have some bearing on the subject of trade-related investment measures, but are not specifically concerned with investment.
In the Senior Officials' Group, the matter was brought up from two aspects. One concerned the direct effects on trade flows of performance requirements that influenced where an investor purchased inputs, for which reference was made to the findings of the Panel report on Canada's Foreign Investment Review Act. One participant considered that trade-related performance requirements could be seen as a type of non-tariff barrier.

The other aspect concerned the indirect effects of investment measures on trade flows via their effects on investment flows and the international allocation of production. One participant drew attention to a positive link between increased investment flows and increased trade flows based on the creation of production and trading opportunities through new investment, and on the beneficial effects of increased direct foreign investment on international financial flows, particularly for the indebted developing countries. Other participants doubted that solutions to the debt problems of developing countries should be sought from the international trading system, in part because the net effect on the balance of payments of direct foreign investment was not evidently positive. One participant considered also that the link between investment flows and trade flows was complex, and that a positive correlation could not be clearly established; in some circumstances, increased international investment flows could result in reduced trade flows.

During the Preparatory Committee discussions which led up to the adoption of the Punta del Este Declaration, the subject of trade-related investment measures was again examined at the two levels of the direct and the indirect effects of investment measures on trade.

Several participants considered that certain investment measures, particularly local content and export performance requirements, could have important direct, distorting effects on trade flows in a manner identical to measures already covered by specific Articles of the General Agreement. Minimum export requirements, for example, could result in export subsidization. In the view of one participant, however, local content performance requirements could be used to promote the more intensive use of locally-manufactured goods with the aim of increasing manufacturing activity, industrialization, and therefore trade.

With respect to the indirect trade effects of investment measures via their influence on international investment flows, one participant recalled that, in 1955, the CONTRACTING PARTIES had adopted a Resolution on International Investment for Economic Development (BISD 38/49). The Resolution recognized, *inter alia*, that increased foreign capital flows, in particular to less-developed countries, would facilitate the objectives of the General Agreement by stimulating economic development whilst rendering it less necessary for countries to resort to import restrictions. The CONTRACTING PARTIES had also recommended using their best endeavours to create conditions calculated to stimulate the international flow of capital. In the view of this participant, this Resolution had recognized that there was a real link between broader investment-related issues and
the overall objectives of the GATT. Broader investment issues, such as rights of establishment, national treatment in all respects, financial transfers, etc., had effects on the ability of countries to expand capacity for the production of tradeable goods. Rights of establishment also provided access to important distribution channels vital to international trade in goods, which in turn had an effect on the capacity for the growth of world trade.

Some other participants considered that the relationship between trade flows and investment flows should be recognized, and that direct foreign investment was linked to the development of international trade patterns. Others questioned the assertion that investment flows and trade flows were necessarily correlated positively, and suggested that as often as not the relation between investment and trade was competitive rather than complementary.

The language of the Punta del Este Declaration on Trade-Related Investment Measures would appear to represent a decision to focus on the direct trade effects of investment measures and the extent to which they are addressed by GATT Articles rather than on the broad relationship between investment, production and trade.

**Canada - Administration of the Foreign Investment Review Act**

At its meeting on 31 March 1982, the Council agreed to establish a Panel to examine a complaint by the United States about the administration of Canada's Foreign Investment Review Act (C/M/156). The Panel's terms of reference, which were announced at the Council meeting on 2 November 1982, were the following: "To examine, in the light of the relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by the United States concerning the administration of the Foreign Investment Review Act of Canada with respect to the purchase of goods in Canada and/or export of goods from Canada by certain firms subject to that Act." At the Council meeting, a number of delegations expressed doubts whether the dispute was one for which the GATT had competence since it involved investment legislation, a subject not covered by the GATT, and they reserved their position on the terms of reference (C/M/162).

Under Canada's Foreign Investment Review Act of 1973, acquisitions of control of a Canadian business or establishments of a new business by non-Canadians were to be allowed to proceed only if the Government had determined that they were, or were likely to be, of significant benefit to Canada. The Act listed five factors to be taken into account by the Government in making this determination, among them the effect on the level and nature of economic activity in Canada including on the utilization of parts, components, and services produced in Canada and on exports from Canada.
The Act provided that investors could submit written undertakings on the conduct of the business they were proposing to acquire or establish, and these undertakings became legally binding on the investor if the investment was allowed. There were no pre-set formulas or prescriptions for the undertakings, which included purchase, manufacturing, and export undertakings in a variety of forms. All undertakings were monitored by the Government, and although at the time the Panel conducted its examination the Minister responsible for the administration of the Act had not applied to the courts to enforce any investor's written undertaking, cases of unfulfilled undertakings had arisen and had been dealt with either through postponement or a waiver, or the undertakings had been revised.

The United States requested the Panel to find that the written undertakings obtained by the Government of Canada under the Act which obliged foreign investors subject to the Act

(a) to purchase goods of Canadian origin in preference to imported goods or in specified amounts or proportions, or to purchase goods from Canadian sources;

(b) to manufacture in Canada goods which would be imported otherwise

were inconsistent with Articles III:4, III:5, XI and XVII:1(c) of the General Agreement, and that the undertakings which obliged foreign investors

(c) to export specified quantities or proportions of their production

were inconsistent with Article XVII:(c).

Canada requested the Panel to find that the purchase and export undertakings given by foreign investors were not inconsistent with the provisions of these Articles and that, were they found to fall within the provisions of one or more of these Articles, they would constitute measures within the provisions of Article XX(d). As to the manufacturing undertakings, Canada asked the Panel to find that these did not fall under its terms of reference.

Both the United States and Canada agreed that the issue before the Panel was not the Foreign Investment Review Act itself, nor Canada's right to regulate the entry and expansion of foreign direct investments, but rather the consistency with the General Agreement of the purchase and export undertakings given by investors subject to the Foreign Investment Review Act.

The Panel report (L/5504 and BISD 30S/140) was adopted on 7 February 1984 (C/M/174). It noted that in view of the fact that the General Agreement does not prevent Canada from exercising its sovereign right to regulate foreign direct investments, the Panel examined the purchase and export undertakings by investors subject to the Foreign
Investment Review Act of Canada solely in the light of Canada's trade obligations under the General Agreement.

It also noted that in a statement before the Panel, Argentina had pointed out that the provisions and arguments invoked against Canada were not necessarily those which could be invoked legitimately against less-developed contracting parties, given rights to protect national industries which these contracting parties enjoyed under the General Agreement. The Panel recognized that in disputes involving less-developed contracting parties full account should be taken of the special provisions in the General Agreement relating to these countries (such as Article XVIII:C). The Panel did not examine the issues before it in the light of these provisions since the dispute only involved developed contracting parties.

The Panel did not examine undertakings to manufacture goods which would be imported otherwise, since it considered that this question was not covered by its terms of reference.

The Panel concluded that the practice of Canada to allow investments subject to the Act conditional upon written undertakings by investors to purchase goods of Canadian origin or goods from Canadian sources accorded less favourable treatment to imported products than that accorded to like products of Canadian origin and was inconsistent with Article III:A. In this respect it found that the purchase undertakings entered into by investors under the Act could be properly described by the word "requirements" as used in Article III:A. Although both the United States and Canada agreed that the Act did not make the submission of these undertakings obligatory, the Panel noted that, once they were accepted, the undertakings became part of the conditions under which the investment proposals were approved, in which case compliance could be legally enforced. It considered the Canadian view that the word "requirements" in Article III:A should be interpreted in the light of Article 12 of the Havana Charter which, inter alia, gave a member the right "... to determine whether and to what extent and upon what terms it will allow future foreign investments, to prescribe and give effect on just terms to requirements as to the ownership of existing and future investments and to prescribe and give effect to other reasonable requirements with respect to existing and future investments". However, the Panel could not subscribe to the assumption that the drafters of Article III of the General Agreement had intended the term "requirements" to exclude requirements connected with the regulation of international investments, and it did not find anything in the negotiating history, the wording, the objectives and the subsequent application of Article III which would support such an interpretation.

With regard to the consistency of purchase undertakings with paragraph 5 of Article III, the Panel noted that the conditions of purchase were not at issue in Article III:5 but rather the existence of internal quantitative regulations relating to the mixture, processing or use of products. On the basis of the presentations made, the Panel did not find
sufficient grounds to consider the purchase undertakings in the light of Article III:5.

The Panel reached the conclusion that purchase undertakings were not inconsistent with Article XI. It noted that the General Agreement distinguishes between measures affecting the "importation" of 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.

Having reached a decision on the purchase undertakings in relation to Article III:4, the Panel did not consider it necessary to make a specific finding on the interpretation of Article XVII:1(c) in the context of this case, and did not reach a separate conclusion, therefore, regarding the consistency of purchase requirements with this provision.

Finally with respect to the purchase undertakings, the Panel did not subscribe to Canada's contention that, although the Panel had found them to be inconsistent with Article III:4, they fell within the exception provided for in Article XX(d) because the Act constituted "a law which is not inconsistent with the provisions of the General Agreement" and the purchase undertakings were "measures necessary to secure compliance" with that law. The Panel was not convinced, in particular, that a detailed review of investment proposals, without investors being bound to purchasing practices having the effect of giving preference to domestic products, would not be sufficient to enable the Canadian Government to determine whether the proposed investments were or were likely to be of significant benefit to Canada within the meaning of the Act.

As regards the undertakings by investors to export specified quantities or proportions of their production the Panel concluded that Article XVII:1(c) was not applicable. It found that there is no provision in the General Agreement which forbids requirements to sell goods in foreign markets in preference to the domestic market, and, in particular, that the General Agreement does not impose on contracting parties the obligation to prevent enterprises from dumping. As a result, the Panel's view was that Canada was not acting inconsistently with any of the principles of non-discriminatory treatment prescribed by the General Agreement in accepting investment proposals on the condition that the investor export a certain quantity or proportion of production, and that it was not therefore necessary to proceed a step further and examine the export undertakings in the light of the commercial considerations criterion of sub-paragraph (b) of Article XVII:1.

At the Council meeting when the Panel report was adopted, several contracting parties supported the view that the Panel report could not be taken to provide an opening for the introduction of new themes, such as investments, in the GATT. They also supported the view that adoption of
the Panel report could not in any way contribute to the evolution of case law applying to less-developed contracting parties, and recalled that the report had acknowledged that, in disputes involving less-developed contracting parties, full account should be taken of the special provisions in the General Agreement and dispensations relating to these countries, such as Article XVIII:C.