The following communication, dated 12 June 1987, has been received from the delegation of the European Communities with the request that it be circulated to members of the Group.

Trade-Related Investment Measures

The objectives of the initial phase of the negotiating plan are the identification of those investment measures which have trade restrictive and distorting effects and an examination of these measures in the light of existing GATT Articles. The European Communities submit herewith their preliminary views on this subject matter and suggest that the following types of investment measures be examined by the Negotiating Group, with the above objectives in mind:

1. Measures related to local content:
   a) local content requirements
   b) manufacturing requirements

2. Measures related to export performance:
   a) export performance requirements
   b) product mandating requirements

3. Measures related to local content and/or export performance:
   a) trade balancing requirements
   b) exchange restrictions

Obviously such measures can be applied by governments to any company, foreign or domestically owned. They should be examined under the heading of "investment measures", because such measures are frequently applied in connection with the authorization of foreign direct investment, i.e. investments made to establish, extend or acquire a wholly owned foreign undertaking or to acquire a share in a newly established or existing foreign undertaking for the purpose of the production or distribution of
goods. The conclusions reached in this examination with regard to trade effects and the operation of GATT Articles would also extend to such measures which are indiscriminately applied to domestic and foreign investment or to domestic investment only.

A. Description of Investment Measures

1. The practices falling under each of the 6 types of measures can take different forms which can be illustrated as follows:

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

   b) **manufacturing requirements** can require the company to manufacture locally certain products or components of products used or sold by it.

   c) **export performance requirements** typically require that a specified proportion of the output or a specific minimum quantity or value of the goods produced are exported. A more indirect form of export performance requirement are restrictions on the establishment of an adequate local distribution system which would limit opportunities of marketing the products locally.

   d) **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.

   e) **trade balancing requirements** can 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.

   f) **exchange restrictions** can link or limit the availability of foreign currency to the company's export earnings.

2. Obvious similarities exist between these types of measures.

   For example, a manufacturing requirement is a sort of local content requirement to the extent that certain components of the products sold by the company must be of local origin or at least produced locally. They could be distinguished from a "classical" local content requirement in that they impose an obligation to manufacture and not to purchase and focus on specific products or components and not on a proportion of total sales or on a specified volume.

   Moreover, both product mandate and export performance requirements are export undertakings, the latter unlike the former fixing specific export targets. Depending on the structure and local availability of the required inputs, trade balancing requirements can operate as export undertakings, or
in the absence of export markets as limitations to import. Similar considerations apply to exchange restrictions.

3. Since the above description could be no more than an illustration of the multitude of measures, often specifically designed to fit the circumstances of individual cases, the Negotiating Group may wish to add further examples to each of these types with a view to arriving at a more comprehensive description and an operationally relevant typology of measures.

B. Trade effects

All of the investment measures listed above directly relate to purchases and sales of the company and are, therefore, trade related. In the Communities' view all of them may have trade distorting or restrictive effects, because they involve an obligation to make procurement and/or marketing decisions which are potentially different from what they would have been in the absence of the TRIM. This can be illustrated as follows:

a) Local content requirements can restrict trade in so far as they oblige the company to purchase products of local origin which, in the absence of such requirement and based on purely economic reasons, it might have imported. Thus imports from the company's home country and other third countries are displaced by goods of local origin. Even where the company is not obliged to purchase goods of local origin but from local sources only, and where, consequently, it cannot purchase the goods directly from the foreign producer, trade will tend to be distorted in favour of domestic products because it will be more difficult for imported goods to be competitive.

b) Manufacturing requirements can lead to import substitution irrespective of cheaper availability on world markets and thus restrict trade, since the company is obliged to produce certain goods locally which it might otherwise have imported.

c) In the absence of government intervention a company will decide on what to export on the basis of a number of complex factors, including the competitiveness of its products on the various markets and the cost structure of its various production facilities. An export performance requirement obliging a company to export irrespective of these factors can distort trade by artificially creating trade flows which are prejudicial to the trading interests of other contracting parties.

d) Product mandating requirements can distort competition and restrict trade by limiting a company's ability to determine the export activities of its subsidiaries on the basis of its own economic assessment and by obliging it (exclusively) to export the product in question from the host country.
e) Trade balancing requirements can operate in a manner similar to export performance requirements. A company which must import certain components which are not available at equivalent quality or price on the local market would be compelled to export at whatever price and condition and thus to distort trade. Conversely, where the company cannot export a sufficient amount, the trade balancing requirement operates like an outright prohibition to import and thus restricts trade.

f) Exchange restrictions linking the availability of foreign exchange to the realization of export earnings can restrict and distort trade in a way similar to trade balancing and export performance requirements.

C. Operation of GATT Articles

1. The operation of GATT Articles in relation to certain trade distorting or restrictive investment measures has been examined by a panel which was established to investigate certain issues raised in connection with the Foreign Investment Review Act (FIRA) of Canada. In 1983 this panel reached conclusions with respect to local content and export performance requirements, but it did not consider any of the other measures mentioned above.

The following paragraphs present the Communities' preliminary assessment of the operation of GATT Articles on the six types of TRIMs described above, limited to those provisions which seem to be generally applicable to these kind of measures. There are other provisions which may apply under the particular circumstances of individual cases and thus justify a different assessment. These are addressed subsequently.

(i) Article III:4 sets out the national treatment obligation and stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin.

The FIRA panel found with regard to local content requirements that an obligation to purchase goods of local origin or from local sources was not consistent with this provision, because in both cases there was discrimination against imported products.

In addition, Article III:5 would seem to apply where a local content requirement obliges a company to obtain components of its products from domestic sources and where this requirement is embodied in quantitative regulations.

Although manufacturing requirements are similar to local content requirements because they too require that a product used or sold by the company is of local origin, provided that where materials from another country are concerned these undergo a substantial
transformation so as to confer on the final product the origin of the processing country, Article III:4 would not necessarily appear to be applicable. At the time when an obligation to manufacture certain goods in the host country becomes effective and influences the behaviour of the company, the "like product of national origin", to which Article III:4 refers, does not yet exist but is still to be produced. A strict interpretation of Article III:4 could, therefore, lead to the conclusion that manufacturing requirements do not violate the national treatment principle.

(ii) Article XI:1 bans any restrictions other than duties, taxes or other charges, on the importation or on the exportation or sale for export of any product.

The FIRA panel determined that the local content requirements under consideration did not prevent the importation of goods as such and were not inconsistent, therefore, with this Article. It based its determination on the distinction between "imported products" falling under Article III:4 and the "importation" of products being regulated by Article XI:1, resulting in a narrow interpretation of Article XI:1 which consequently did not cover internal requirements. This interpretation would deserve further examination.

A manufacturing requirement which obliges a company to produce locally the components or products used or sold by it, effectively bars this company from importing like products. In this regard it differs from local content requirements where the company concerned would still be free to import. It would appear, therefore, that manufacturing requirements are inconsistent with Article XI:1.

The same consideration applies with regard to trade balancing requirements and exchange restrictions which limit or eliminate a company's capacity to import.

Product mandate requirements which oblige a company to assign exclusive rights to export specified products to a specific subsidiary limit the ability of the company to export like products from other countries including its home country. Hence, it would appear that such requirement also violates Article XI:1. Nothing in this provision suggests that it only applies to restrictions on the exportation of goods from the country imposing such restrictions and not to restrictions on exports from third countries.

(iii) Article XVII:1(c) obligates contracting parties not to prevent an enterprise from acting in accordance with commercial
considerations. At first glance this provision would seem to cover and prohibit all of the TRIMs mentioned above.

The FIRA panel considered this provision in the context of its discussion of local content requirements. It indicated that it saw great force in the argument that the "general principles of non-discriminatory treatment", in the light of which the term "commercial considerations" had to be interpreted, only meant the most-favoured-nation and not the national treatment principle. If this view was confirmed, local content requirements as well as the other TRIMs mentioned above would not be in conflict with this provision. The panel noted, however, that its reasoning was based to a large extent on the drafting history of Article XVII:1. While this is a recognized method of legal interpretation, it is uncertain that the tentative conclusions of the panel - it needed not to decide this issue with regard to local content requirements - would be confirmed if a different (e.g. semantic or systematic) methodological approach was chosen. A reading of sub-paragraphs (a) and (b) does not necessarily suggest, for example, that there is a hierarchy between the terms of "general principles of non-discriminatory treatment" and "commercial considerations" which inevitably leads to a restrictive interpretation of the latter. It could be examined, for example, whether the term "commercial considerations" could also be taken at its face value and thus encompass local content requirements.

The FIRA panel also looked at export performance requirements. It noted that there was no provision in the GATT which forbade requirements to sell goods in foreign markets in preference to the domestic market, or which imposed on contracting parties the obligation to prevent enterprises from dumping. Therefore, it concluded, export performance requirements were not inconsistent with any of the principles of non-discriminatory treatment prescribed by the GATT for governmental measures affecting exports by private traders, and Article XVII:1(c) did not apply.

It should be noted that in respect of export performance requirements the panel seems to have attributed a meaning to the "general principles of non-discrimination" which differs from what it has said in the context of local content requirements. This underlines the necessity further to clarify the meaning of this provision.

These considerations in respect of export performance requirements would also seem to apply to trade balancing requirements and exchange restrictions which, as has been argued above, can operate like export performance requirements.
(iv) Article X:1 stipulates that "laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, ... shall be published promptly and in such a manner as to enable governments and traders to become acquainted with them". All of the above-mentioned TRIMs, to the extent that they are generally applicable, are covered by this transparency requirement.

(v) Article XXIV:12 stipulates that contracting parties shall take such reasonable measures as may be available to them to ensure observance of the provisions of the General Agreement by the regional and local governments and authorities within their territory. This provision also applies with regard to TRIMs adopted by such sub-national entities.

2. There are other GATT Articles which may also be applicable such as Articles XII, XV, XVIII:B and C and XXIII. Articles XII, XV and XVIII provide for exceptions to the generally applicable rules and Article XXIII can apply to any situation leading to nullification and impairment of benefits. While these provisions may be of relevance in individual cases, they are subsidiary to the principal question posed to the Negotiating Group, namely the identification of the operation of GATT Articles on TRIMs in general. Only after the Group has identified those provisions which restrict or prohibit the use of TRIMs can the question of exceptions be examined. The Communities suggest, therefore, that in its consideration of the operation of GATT Articles the Group concentrate first on provisions which, like those discussed under C 1 above, possibly restrict or prohibit the use of TRIMs. In this context it could be helpful if the Secretariat would prepare background documents based on GATT history and precedent with a view to clarifying questions of interpretation such as those relating to Articles XI:1 and XVII:1.

3. The preliminary examination of the operation and applicability of GATT Articles under C 1 above leads to the tentative conclusion that the use of many of the TRIMs selected by the Communities could be considered to be restricted or prohibited by the GATT. Some uncertainties remain, however, and certain measures, such as export performance requirements, may not be covered by existing GATT disciplines. It should also be understood that the list of TRIMs selected by the Communities and discussed in this paper is of a preliminary character and subject to revision.