CHAPTER 8 TRADE-RELATED INVESTMENT MEASURES

1. OVERVIEW OF RULES

(1) Trade-Related Investment Measures

In the late 1980s, there was a significant increase in foreign direct investment throughout the world. However, some of the countries receiving foreign investment imposed numerous restrictions on that investment, which were designed to protect and foster domestic industries and to prevent the outflow of foreign exchange reserves.

Examples of these restrictions include local content requirements (which require that locally-produced goods be purchased or used), manufacturing requirements (which require certain components be domestically manufactured), trade balancing requirements, domestic sales requirements, technology transfer requirements, export performance requirements (which require that a specified percentage of production volume be exported), local equity restrictions, foreign exchange restrictions, remittance restrictions, licensing requirements, and employment restrictions. **Some of these investment measures distort trade in violation of GATT Article III and XI, and are therefore prohibited.**

Until the completion of the Uruguay Round negotiations, which produced a well-rounded Agreement on Trade-Related Investment Measures (hereinafter the "TRIMs Agreement"), the few international agreements that provided disciplines for measures restricting foreign investment provided only limited guidance in terms of content and country coverage. The OECD Code on Liberalisation of Capital Movements, for example, requires members to liberalise restrictions on direct investment in a broad range of areas. The OECD Code's efficacy, however, is limited by the numerous reservations made by each of the Members. In addition, there are other international treaties, bilateral and multilateral, under which signatories extend most-favoured-nation treatment to direct investment. Only a few such treaties, however, provide national treatment for direct investment. Moreover, although the APEC Investment Principles adopted in November 1994 provide rules for investment as a whole, including non-discrimination and national treatment, they have no binding force.

(2) Legal Framework

GATT 1947 prohibited investment measures that violated the principles of national treatment and the general elimination of quantitative restrictions, but the extent of the prohibitions was never clear. The TRIMs Agreement, however, contains statements prohibiting any TRIMs that are inconsistent with the provisions of Articles III or XI of GATT 1994. In addition, it provides an illustrative list that explicitly prohibits local content requirements, trade balancing requirements, foreign exchange restrictions and export restrictions (domestic sales requirements) that would violate Article III:4 or XI:1 of GATT 1994. TRIMs prohibited by the Agreement include those that are mandatory or enforceable under domestic law or administrative rulings, or those with which compliance is necessary to obtain an advantage (such as subsidies or tax breaks). Figure 8-1 contains a list of measures specifically prohibited by the TRIMs Agreement. Note that this figure is not exhaustive, but simply illustrates TRIMs that are prohibited by the TRIMs Agreement. The figure, therefore, calls particular attention to several common types of TRIMs. We note that this figure identifies measures that were also inconsistent with Article III: 4 and XI: 1 of GATT 1947.

<Figure 8-1> Examples of TRIMs Explicitly Prohibited by the TRIMs Agreement

Local content requirement	Measures requiring the purchase or use by an enterprise of domestic products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. (Violation of GATT Article III:4)
Trade balancing requirements	Measures requiring that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports. (Violation of GATT Article III:4) Measures restricting the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports. (Violation of GATT Article XI:1)
Foreign exchange restrictions	Measures restricting the importation by an enterprise of products (parts and other goods) used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise. (Violation of GATT Article XI:1)
Export restrictions (Domestic sales requirements)	Measures restricting the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. (Violation of GATT Article XI:1)

Indeed, the TRIMs Agreement is not intended to impose new obligations, but to clarify the pre-existing GATT 1947 obligations. Under the WTO TRIMs Agreement, countries are required to rectify any measures inconsistent with the Agreement, within a set period of time, with a few exceptions (noted in Figure 8-2).

<Figure 8-2> Exceptional Provisions of the TRIMs Agreement

Transition period	Measures specifically prohibited by the TRIMs Agreement need not be eliminated immediately, although such measures must be notified to the WTO within 90 days after the entry into force of the TRIMs Agreement. Developed countries will have a period of two years in which to abolish such measures; in principle, developing countries will have five years and least-developed countries will have seven years.
Exceptions for developing countries	Developing countries are permitted to retain TRIMs which constitute a violation of GATT Article III or XI, provided that the measures meet the conditions of GATT Article XVIII which allows specified derogation from the GATT provisions, by virtue of the economic development needs of developing countries.
Equitable provisions	In order to avoid damaging the competitiveness of companies already subject to TRIMs, governments are allowed to apply the same TRIMs to new foreign direct investment during the transitional period described in (1) above.

Future Challenges

December 1999 marked the end of the transition period for the TRIMs Agreement. During the transition period, developing countries were allowed to retain TRIMs as long as they notified the WTO of them. With the transition period over, we will need to watch closely to ensure that TRIMs have indeed been eliminated. There have also been requests for extensions to the transition period, and these requests should be given proper consideration.

Another issue is that of export requirements (obligations for a company establishing operations in another country to export a set percentage or volume of its production). These measures were studied during the TRIM negotiations but not explicitly banned in the Agreement. We should promote further study of new disciplines for this area in the Working Group on Trade and Investment, which was established at the WTO Ministerial Meeting of December 1996.

< Box > Efforts to Establish New Rules Regarding Investment

(i) Efforts to establish a Multilateral Agreement on Investment at the OECD

Members of the OECD have been negotiating a comprehensive and legally-binding "Multilateral Agreement on Investment" (MAI) that would provide for both the liberalisation and the protection of foreign investments. The Agreement would provide 1) a high degree of discipline on investment protection; 2) broad obligations to liberalise investment; and 3) an effective dispute-settlement mechanism that would include a scheme for litigating disputes between investors and states as well as between states. It was expected that the Agreement would be open to all countries, not just OECD members. Negotiations, which began in May 1995 with a goal of presenting a draft to the OECD Ministerial Council in April 1998, were extended because of an inability to reach a compromise on liberalisation commitments, general exceptions and considerations on environment and labour. However, immediately before the resumption of the negotiations in October 1998, France withdrew from the negotiations due to the reason that the above-mentioned high degree of disciple would violate its sovereignty. Thus, it became difficult to continue the negotiations and consequently no further negotiations were conducted.

The following four points about MAI remain to be solved: whether to allow exceptions to the "standstill" clause for certain specific areas; whether exceptions to most-favoured-nation treatment should be allowed for regional economic integration organisations; whether to allow a general exception for cultural reasons; and whether to include provisions covering environment and labour issues. In addition, there are no concrete results regarding country-specific exceptions.

Currently, the OECD Committee on International Investment and Multinational Enterprise (CIME) is working on amendments to the Multinational Corporate Guidelines rather than the formulation of investment rules that seek government liberalisation. The Guidelines were first formulated in 1976 as a means of harmonising the activities of companies with the policies of the countries they moved into, thereby helping to foster trust between companies and countries. As much has changed over the intervening years, the Committee is attempting to revise the action guidelines in order to bring them into line with current international economic conditions. The Multinational Corporate Guidelines are, as their name implies, guidelines for corporate activities. They are issued jointly by member countries as an advisory to multinational companies doing business within their territories.

They do not have any legal force, however, and have not functioned as effectively as hoped. The focus of discussion is therefore on mechanisms to make them more effective and on the geographical range of application. No consensus had been reached as of this writing, although the target for completion of the Guidelines is the Ministerial Meeting scheduled for June 2000.

The revised Guidelines will cover the ten topics listed below. These topics will be added in such a manner that is consistent with both international standards formulated by other fora and with domestic law. (Content of guidelines)

1) Concepts and principles
2) General guidelines
3) Information disclosure
4) Employment and labour relations
5) Environment
6) Bribery
7) Consumer interests
8) Science and technology
9) Competition
10) Taxation

(ii) Efforts to Establish a Comprehensive Legal Framework for Investment at the WTO

WTO investment disciplines are found in the TRIMs Agreement and the GATS, but both of these deal with particular areas or particular aspects of investment. There is currently no comprehensive multilateral legal framework that covers investment disciplines.

As we have noted, the OECD was negotiating a comprehensive, legally-binding Multilateral Agreement on Investment (MAI) that would liberalize investment and provide protection for foreign investments. However, it is said that the level of commitments to be included in the agreement was too high for developing countries and there were doubts about how many developing countries would actually join.

The WTO Singapore Ministerial Conference of December 1996 therefore decided to establish a Working Group on the Relationship between Trade and Investment so that countries could examine the need for comprehensive investment rules in which the developing countries participate as well as the developed countries.

The Working Group initially had a deadline of the end of 1998, but the General Council decided to expand that so that the Group could move from basic studies of investment-related issues ("implications of the relationship between trade and investment for development and economic growth," "economic relationship between trade and investment," and "stock-taking and analysis of existing international instruments") to something closer in nature to investment rules ("merits and demerits of investment rules," and "definition of investment"). Broad-based analytical studies continue.

The third Ministerial Meeting, which was held in Seattle in November 1999, discussed initiation of investment rule negotiations as part of the new round. However, negotiations were unable to reach an agreement on starting the round itself, and consequently, there was also no conclusion on the negotiation of investment rules.

The TRIMs Agreement requires Members to notify the WTO of any TRIMs they employ that are inconsistent with the agreement. So far, 24 Members have notified the WTO of such measures. Figure 8-3 details the TRIMs that have been notified to the WTO. Most are local content requirements in the automotive and agricultural sectors.

<Figure 8-3> Outline of Notified TRIMs

	Local Content	Trade Balancing	Foreign Exchange Balancing	Export Restrictions
Argentina	*4	*4		
Bolivia				*3
Barbados	*2			
Chile	*4	*4		
Colombia	*1 *5	*1 *5		
Costa Rica	*3			
Cuba	*1 *3			
Cyprus	*2			
Dominica Republic	*3	*2 *3		
Ecuador	*1			
Indonesia	*1 *2 *3			
India	*3			*1 *2 *3
Mexico	*4			
Malaysia	*4			
Pakistan	*4 *3			
Peru	*2			
Philippines	*4		*4	
Romania	*4 *6			
Thailand	*1 *2 *3			
Uganda	*3	*3		
Uruguay			*1	
Venezuela	*1			
South Africa	*1 *2 *3			

Note: 1) TRIMs for which no extension requests were filed
Automotive *1, Agricultural *2, Other *3
2) TRIMs for which no extension requests were filed
Automotive *4, Agricultural *5, Other *6
3) Egypt and Nigeria have also informed the WTO of incentive systems for industrial promotion, but the nature and coverage of the systems is unknown.

A transition period was provided for the elimination of TRIMs employed by developing countries, as long as they notified the WTO of them. The transition period expired on 1, January 2000, at which time developing countries were obligated to remove all TRIMs. However, with less than a year remaining to the deadline, many developing countries have not advanced any specific methods or schedules for eliminating TRIMs. The TRIMs Agreement does, however, provide for an extension of the transition period should the member be able to demonstrate particular difficulties. The Council for Trade in Goods is currently reviewing requests from the Philippines (October 1999), Columbia (November 1999), Mexico, Romania, Pakistan, Argentina, Malaysia, and Chile (all December 1999).

The elimination of TRIMs is a serious issue that has close relation to the faithful implementation of the TRIMs Agreement. And Thailand, Korea, and many other developing countries have indeed eliminated their TRIMs within the allotted transition period. Some Members, however, need to reconfirm the importance of this issue and eliminate their TRIMs as promised. (Note that among the Members with TRIMs, Uganda is categorised as a least-developed country (LDC) and therefore has until 1, January 2002 for elimination.)

Brazil, Canada, and India did not notify the WTO of their automotive TRIMs, and these measures are currently being taken up in disputes settlement procedures. (The Brazilian TRIM was introduced after the TRIMs Agreement took effect, but Brazil eliminated it at the end of 1999. For details see Chapter 2 "National Treatment.")

(3) Economic Implications

Figure 8-4 shows worldwide direct investments during 1997 and 1998. During 1998 global outgoing direct investment reached a record high of $648.9 billion (up approximately 37% from the previous year), and it continues to grow. The developed countries are the driving forces in this, accounting for about 90% of the outgoing direct investment and 70% of the incoming direct investment. In the developing countries as well, both outgoing and incoming direct investments were at record high levels.

<Figure 8-4> Direct Investment around the World

(Unit: $1 billion)

	1997		1998	
	Amount of outflow	Amount of inflow	Amount of outflow	Amount of inflow
Total	4,751	4,643	6,489	6,439
Developed Countries	4,067	2.733	5,947	4,604
Developing Countries	650	1,725	523	1,659
Russia and East Europe	34	185	19	175

Source: World Investment Report 1999 UNCTAD

In the short term, TRIMs provide countries with perceived benefits. Some governments view TRIMs as a way to protect and foster domestic industry. TRIMs are also mistakenly seen as an effective remedy for a deteriorating balance of payments. These perceived benefits account for their frequent use in developing countries. In the long run, however, TRIMs may well retard economic development and weaken the economies of the countries that impose them by stifling the free flow of investment.

Local content requirements, for example, illustrate this distinction between short-term advantage and long-term disadvantage. Local content requirements may force a foreign-affiliated producer to use locally produced parts. Although this requirement results in immediate sales for the domestic parts industry, it also means that this industry is shielded from the salutary effects of competition. In the end, this industry will fail to improve its international competitiveness. Moreover, the industry using these parts is unable to procure high-quality, low-priced parts and components from other countries, and will be less able to produce internationally competitive finished products. The domestic industry can hope to achieve, at best, import substitution, but the likelihood of further development is poor. The consumer in the host country also suffers as a result of TRIMs. The consumer has no choice but to spend much more on a finished product than would be necessary under a system of liberalised imports. Since consumers placed in such a position must pay a higher price, growth of domestic demand will stagnate. This lack of demand also hinders the long-term economic development of domestic industries.

2. PROBLEMS OF TRADE POLICIES AND MEASURES OF INDIVIDUAL COUNTRIES

Under the TRIMs Agreement, member countries are required to notify the WTO Council for Trade in Goods of their existing TRIMs. Figure 8-3 shows the general breakdown of the TRIMs that have been reported to the Council, and most are from developing countries.

The transition period for elimination of notified TRIMs expired at the end of 1999. There was discussion during the third Ministerial Meeting in Seattle of granting extensions to developing countries, but no formal agreement was reached. Developing countries are therefore obligated to eliminate TRIMs as called for in the Agreement. The TRIMs Agreement does provide for extensions to the transition period for notified TRIMs should the Member demonstrate particular difficulties in implementing the provisions of the Agreement, but TRIMs were originally banned as fundamental violations of the GATT, and the transition period in the TRIMs Agreement was itself an exception. Any extension requests should therefore be subject to strict, rigorous reviews to determine necessity.

From this perspective, the moves being seen in some developing countries to introduce new TRIMs are something that cannot be ignored if the TRIMs Agreement is to be implemented faithfully. Therefore, when necessary, resolution should be sought through WTO dispute settlement procedures.

Even developing countries should realise that they must eventually break their dependence on TRIMs. Japan and other developed countries should extend whatever assistance is necessary, both technical and otherwise, to facilitate the phasing-out of TRIMs.

It goes without saying that Japanese companies investing overseas are expected to increase the amount of parts they purchase locally for contribution to the local economy. Such efforts, however, should be carried out in economically viable forms tailored to the local corporate environment, rather than enforced through TRIMs or other policy-based regulations.

Faced with the rapid internationalisation of developed countries' industrial bases, many developing countries are intensifying their efforts to attract foreign investment, hoping to draw on outside capital for their own industrial and economic development. We would note in this regard a new trend, that is particularly prominent among Asian countries, of relaxing investment restrictions to create an environment that is more attractive and inviting to prospective investors. We can say that developing countries should promote further measures in order to attract investors.

(1) Korea

Local Content Requirements

Korea's "Import Source Diversification Program" constituted a de facto ban on imports from Japan. The system designated goods for which special applications had to be filed before they could be imported. These applications needed to be accompanied either by a commitment to deliver goods or a contract, and the commitment or contracted had to be approved by the Korean Trade Agents Association. The Association ordinarily never granted approval, so imports were essentially banned. Manufacturers were exempt from submitting these contracts or delivery commitments when importing parts required for the production of finished goods that had been designated for production technology development by the Ministry of Trade and Industry, provided they met the following conditions: 1) submission of a "parts procurement plan" to a designated certification institution, 2) application to that institution for permission to import the required parts, and 3) recommendation by the head of the institution. The certification institutions only provided recommendations for companies that they had confirmed to be following the domestic production ratios specified in their parts procurement plans. The system functioned as a local content requirement by offering an exemption to the contracts and delivery commitments (which themselves effectively constituted an import ban) as an incentive for companies to adhere to domestic production ratios. Japan and other Members had repeatedly sought its elimination both as a violation of the ban on quantitative restrictions and as a violation of the TRIMs Agreement.

When it joined the OECD, Korea committed to full elimination of the program by the end of 1999. At the end of 1997, the government of Korea reached an agreement with the IMF that included elimination by the end of June 1999. Korea did indeed eliminate the program at the end of June 1999 as promised.

(2) Indonesia

Local Content Requirements

Even before the WTO came into force, Indonesia imposed local content requirements in the automotive sector, and also required set percentages of domestic soybean cake and fresh milk to be used in products based on these substances. The fresh milk requirements were eliminated in July 1999, although Indonesia had never notified the WTO of them.

The Government of Indonesia notified the measures regarding the above items to the WTO, as measures to be local content requirements falling under paragraph 1(a) of the illustrative list annexed to the TRIMs Agreement. It however announced on 31, October 1996 that it would withdraw its auto-related notification on the grounds that the local content requirements in its auto sector did not constitute a TRIM within the meaning of the Agreement. Although the measures that the WTO had been notified of were not in contravention of the Agreement, Japan still monitored them to ensure that they were not expanded and were eliminated on schedule. The automotive TRIMs appear to have been eliminated in mid-1999; Indonesia did not seek an extension under the provisions of the Agreement. However, the National Car Program introduced in 1996 does give preferential treatment in proportion to the achievement of local content requirements. (For more details on Indonesia's automotive policies, see Chapter 2, "National Treatment.")

(3) Thailand

Local Content Requirements

In the past, the Thai Minister of industry obligated domestic automotive assembly plants to meet certain local content requirements. (For example, passenger cars required a minimum of 54% Thai content, motorcycles 70%.)

The Investment Promotion Act also required the Board of Investment (BOI) to set local content requirements for milk and dairy products, motorcycles, and engines for small trucks. Thailand notified the WTO of these measures, and amended domestic laws and ordinances to eliminate them during 1999 in accordance with the TRIMs Agreement.

(4) Malaysia

Local Content Requirements

In lieu of its previous domestic content requirements, the Malaysian Government imposed new domestic content guidelines effective from 1 January 1992. According to the guidelines, domestic content requirements will rise from 20 percent in early 1992 to 60 percent for passenger cars and 45 percent for commercial vehicles by the end of 1996. (See Figure 8-6.)

<Figure 8-6> Guidelines for Local Content in Malaysia

	Category A	Category B	Category C
31 December 1992	30%	20%	Local content requirement for specified parts
31 December 1993	40%	30%	(same as above)
31 December 1994	50%	35%	(same as above)
31 December 1995	55%	40%	(same as above)
31 December 1996	60%	45%	(same as above)
After 1997	60%	45%	(same as above)

Category A: passenger cars with an engine size of less than 1,850cc;
Category B: passenger cars with an engine size of 1,850cc or more and less than 2,850cc and commercial vehicles with GVW (Gross Vehicle Weight) of less than 2,500kg;
Category C: passenger cars with an engine size of 2,850cc or more and commercial vehicles and off-road vehicles with GVW of 2,500kg or more.

Similarly, Malaysia has had local content requirements for motorcycles since 1981; requiring assemblers to use at least 60 percent locally produced parts.

Malaysia also has investment incentives that come with local content requirements. The Promotion of Investment Act of 1986 requires production plans given such privileges as “pioneer status” or “investment tax allowance” (ITAs) to meet local content standards. Companies given “pioneer status” are relieved of 70 percent of their income tax liability for a period of five years. Malaysia notified the WTO of these measures and Japan watched that they have not expanded or that they have eliminated on schedule. But, it also has not eliminated them. At the end of December 1999, it applied for an extension under the TRIMs Agreement to the end of 2001.

(5) India

Local Content Requirements, Import/Export Balancing Requirements, Export Restrictions

On December 1997, India announced a new automotive policy that requires manufacturers in the automotive industry and the Ministry of Commerce to draft and sign a memorandum of understanding (MOU) on new guidelines for the industry. The policy has the following problems in relation to the TRIMs Agreement. First, the policy requires that 50 percent local content be achieved within three years of the date on which the first imported parts (CKD, SKD) were cleared through customs, increasing to 70 percent within five years of first clearance. Second, the policy requires that export of automobiles or parts begin within three years of start-up, with the possibility of restrictions on the amount of parts (CKD, SKD) that can be imported depending on the degree to which the export requirement is met. This amounts to an export/import balancing requirement. Even prior to this policy, India had a history of making auto parts import licenses for companies setting up operations within its borders conditional upon signing MOU containing local content requirements and export/import balancing requirements--despite the lack of any legal basis for doing so. It is certain that the new automotive policy of 1997 is designed to institutionalize the previous administrative guidelines. In the TRIMs Committee held in March/September 1998, some countries – including Japan, the EU and the United States – argued that the policy would not be regarded as compatible with the WTO Agreement. Subsequently, in October 1998 the EU requested consultation – Japan and the United States participate in the consultation as third parties – and the first consultation was held in December 1998. In June 1999, the United States requested consultations, with Japan and the EU participating as third parties. The first of these consultations was held in July 1999. The government of India should eliminate the policy as soon as possible.

In addition, India has had export restrictions on agricultural products and industrial goods since 1991. It has notified the WTO of these measures and they have therefore not been in contravention of the Agreement. Nonetheless, Japan should continue to watch that they are not expanded and that they are eliminated on time.

Among the measures of which it has notified the WTO, India appeared at the time of this writing to be considering the elimination of the import-export balance requirement for foods and other consumer goods by the end of 1999 in accordance with the TRIMs Agreement. It has, however, made no changes to its automotive policies, nor has it sought an extension under the TRIMs Agreement (which it should have done in 1999). Japan should continue to monitor the status of these programs and their elimination.

(6) Philippines

Local Content Requirements, Foreign Exchange Restrictions

The Philippines has imposed local content requirements and foreign exchange restrictions as part of its passenger car, commercial vehicle, and motorcycle development plans. The local content requirements and foreign exchange restrictions differ according to engine displacement for passenger cars, according to shape and weight for commercial vehicles, and according to whether two or three wheels are used for motorcycles. And, the

Philippines imposes local content requirements in coconuts-based chemicals (soap and detergent).

The Philippines notified the WTO of these measures, and in October 1999 requested an extension under the provisions of the TRIMs Agreement until the end of December 2004, citing the Asian economic crisis as the reason it would be difficult to fulfil its Agreement obligations. The Council for Trade in Goods is currently reviewing this request. Japan should continue to watch that measures are not expanded.