CHAPTER V

WORLD TRADE ORGANIZATION
AND INDIAN INVESTMENT
MEASURES
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SECTION A

PROVISIONS ON TRADE RELATED INVESTMENT MEASURES

INTRODUCTION

The Trade Related Investment Measures (TRIMs) Agreement contains rules on certain investment measures that have a distorting effect on trade in goods. In particular, the TRIMs Agreement provides that such trade-related investment measures are subject to the disciplines of GATT Article III (National Treatment on internal taxation and regulation) and GATT Article XI (general elimination of quantitative restrictions). In short, the TRIMS Agreement does not regulate Foreign Direct Investment (FDI) as such but only addresses measures resulting in discriminatory treatment of imports & exports by foreign firms of other WTO Members.

BACKGROUND

Prior to the Uruguay Round negotiations, the linkage between trade and investment received little attention in the framework of the GATT. But

1FDI is generally defined (by the IMF, OECD, others) as "ownership by a foreign firm or individual of 10% or more of the shares or voting power of an incorporated entity or the right to 10% or more of the profits of an unincorporated entity."
there were several efforts to develop a multilateral, enforceable Code of Conduct Regulating Cross-Border Investment:

HAVANA CHARTER

The Charter for an International Trade Organization (1948) contained provisions on the treatment of foreign investment as part of a chapter on economic development. This Charter was never ratified and only its provisions on commercial policy were incorporated into the General Agreement on Tariffs and Trade (GATT).

1955 RESOLUTION ON INTERNATIONAL INVESTMENT FOR ECONOMIC DEVELOPMENT

In 1955, the GATT contracting parties adopted a resolution on International Investment for Economic Development in which they, inter alia, urged countries to conclude bilateral agreements to provide protection and security for foreign investment.


THE FOREIGN INVESTMENT REVIEW ACT PANEL

Perhaps the most significant development with respect to investment in the period before the Uruguay Round was a ruling by a panel in a dispute
settlement proceeding between the United States and Canada. In Canada Administration of the Foreign Investment Review Act (FIRA), GATT Dispute Settlement Panel considered a complaint by the United States regarding certain types of undertakings which were required from foreign investors by the Canadian authorities as conditions for the approval of investment projects. These undertakings pertained to the purchase of certain products from domestic sources (local content requirements) and to the export of a certain amount or percentage of output (export performance requirements). The Panel concluded that, the local content requirements were inconsistent with the National Treatment obligation of Article III: 4 of the GATT but that the export performance requirements were not inconsistent with GATT obligations. The Panel emphasized that, at issue in the dispute before it was the consistency with the GATT of specific trade-related measures taken by Canada under its foreign investment legislation and not Canada's right to regulate foreign investment per se.

The Panel decision in the FIRA case was significant in that, it confirmed that existing obligations under the GATT were applicable to performance requirements imposed by Governments in an investment context in so far as such requirements involve trade-distorting measures. At the same time, the Panel's conclusion that export performance requirements were not covered by the GATT also underscored the limited scope of existing GATT disciplines with respect to such trade-related performance requirements.

URUGUAY ROUND NEGOTIATIONS ON TRADE-RELATED INVESTMENT MEASURES

The Punta del Este Ministerial Declaration which launched the Uruguay Round included the subject of trade-related investment measures as a subject for the new round through a carefully drafted compromise: "Following an examination of the operation of GATT Articles related to the trade-restrictive

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2BISD 30S/140, 1984

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and trade-distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade."

The emphasis placed in this mandate on trade effects made it clear that the negotiations were not intended to deal with the regulation of investment as such.

The Uruguay Round negotiations on trade-related investment measures were marked by strong disagreement among participants over the coverage and nature of possible new disciplines.

While the TRIMs were negotiated under the Group of Negotiations on Goods (GNG) two basic issues cropped up, i.e.

(i) whether the disciplines developed in this area should be limited by existing GATT Articles especially Article III and XI of GATT or expanded to develop an investment regime, and

(ii) whether all or some of the TRIMs should be prohibited or should be dealt with on a case-by-case basis demonstration of direct and significant restrictive and adverse effects on trade.

In the TRIMs negotiations, certain developed countries such as Japan and United States were interested to negotiate new rules with respect to various aspects of investment policy, notably incentives and performance requirements. The proposals of United States and Japan were to the effect that not only legal regime on international investment should be established but also allow Multinational Corporations, a freedom to investment in full climate of freedom and least restrictions.
The United States enumerated the effects of TRIMs under categories which:

(a) prevent, reduce or divert imports by limiting the sale, purchase and use of imported products;

(b) restrict the ability to export by home and third country producers; and,

(c) artificially inflate exports from a host country thereby distorting trade flows in world markets.  

Therefore, the TRIMs had adverse trade effects and this was a sufficient reason to make a case for applying general principles and disciplines to control them, e.g. requirements adopted Governments of host countries have trade distorting and inhibiting effects, such as, requirements for local content, export performance, trade balancing, domestic sales, manufacturing, product mandating, remittance restrictions, technology transfers, licensing and local equity.

The EC Proposals* focused on measures that, had a direct and significant restrictive impact and link to GATT rules identifying TRIMs that met the criterion of being directed at the exports and imports of a company with immediate objective of influencing its trading patterns, (local content, manufacturing, export performance, product mandating, trade balancing, exchange restrictions, domestic sales, and manufacturing limitations concerning components of the final product).

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*See submission by the EC, Documents MTN. GNG/NG 12.
The developing countries position in the negotiations was little ambivalent. On the one hand, the developing countries asked for strict adherence to the mandate and for limiting the negotiations exercise to the effects of investment measures that had a direct and significant effect on trade and the other to maintain maximum flexibility in respect to investment policies including remittance restrictions, technology transfer requirements, local equity requirements, licensing requirements, incentives to achieve economic growth, trade expansion, industrial, social and development objectives.

The developing countries proposals went further by asking for effects test where in evidence based on case-by-case examination of investment measures should be established to establish whether a direct and significant adverse effect on trade existed. In other words clear causal link would need to be demonstrated between the measure and the alleged effect; and if such a link was established, the nature and impact on the interests of the affected party would need to be assessed and appropriate ways and means would have to be found to deal with the demonstrated effects, including in relation to the treatment accorded when development aspects outweigh the adverse trade effects.

The rationale for the above proposals by the developing countries lies in the fact that, they use a combination of investment incentives and performance requirements to pursue a variety of development objectives such as; to orient resource allocations to sectors considered to have a particular growth potential; to build up a viable domestic private sector; to promote vertical integration, to attract foreign technologies or export oriented investment, or to improve access to major markets and export marketing capacities. In many cases, since policy instruments to ensure free domestic competition are not sufficiently effective or enforceable vis-à-vis Multinational

"Doc. MTN. GNG/NG12/4. p.11-12
6See Submission by Malaysia, Singapore, India, Mexico and Bangladesh – MTN. GNG/NG12/W13, 17, 18, 19 and 21

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Corporations, investment measures are relied upon to correct market distortions created by these multinationals. In the present climate of globalization, in which international competitiveness and liberal foreign direct investment are *sine-qua-non* for any development effort of the developing countries, and in absence of sufficient official aid, the developing countries are continuously in need of private investment which *per se* is in the hands of Multinational Corporations. The Multinational Corporations obviously favour investment in the countries with the least number of restrictions.

Whatever the differences might be, the compromise that eventually emerged from the negotiations is essentially limited to an interpretation and clarification of the application to trade-related investment measures of GATT provisions on National Treatment for Imported Goods (Article III) and on Quantitative Restrictions on Imports or Exports (Article XI). Thus, the TRIMs Agreement does not cover many of the measures that were discussed in the Uruguay Round negotiations, such as export performance and transfer of technology requirements.

**TRIMS: MAIN PROVISIONS**

**OBJECTIVES**

The objectives of the Agreement, as defined in its Preamble, include "the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country Members, while ensuring free competition". 
LIMITATION OF COVERAGE TO TRADE IN GOODS

The coverage of the Agreement is defined in Article 1, which states that, the Agreement applies to investment measures related to trade in goods only. Thus, the TRIMs Agreement does not apply to services.

NO GENERIC DEFINITION OF WHAT IS A "TRIM"

The term "Trade Related Investment Measures" (TRIMs) is not defined in the Agreement. However, the Agreement contains in an Annex, an Illustrative List of Measures that are inconsistent with GATT Article III: 4 or Article XI: 1 of GATT 1994.

THE TRIMS AGREEMENT AND REGULATION OF FOREIGN INVESTMENT

The disciplines of the TRIMs Agreement focus on discriminatory treatment of imported and exported products and do not govern the issue of entry and treatment of foreign investment. For example, a local content requirement imposed in a non-discriminatory manner on domestic and foreign enterprises is inconsistent with the TRIMs Agreement because it involves discriminatory treatment of imported products in favour of domestic products. The fact that, there is no discrimination between domestic and foreign investors in the imposition of the requirement is irrelevant under the TRIMs Agreement.

BASIC SUBSTANTIVE OBLIGATIONS: ARTICLE 2 AND THE ILLUSTRATIVE LIST

Article 2.1 of the TRIMs Agreement requires Members not to apply any TRIM that is inconsistent with the Provisions of Article III (National Treatment of imported products) or Article XI (prohibition of Quantitative Restrictions on
imports or exports) of GATT 1994. An Illustrative List annexed to the TRIMs Agreement lists measures that are inconsistent with Paragraph 4 of Article III and Paragraph 1 of Article XI.

MANDATORY AND NON-MANDATORY MEASURES

The Illustrative List covers both TRIMs which are mandatory or enforceable under domestic law or under administrative rulings and TRIMs compliance with which is necessary to obtain an advantage. The list includes:

• Local Content – impose some certain amount or value of domestic inputs
• Trade Balancing – volume or value of imports tied to levels of exports
• Foreign Exchange Balancing – requires that foreign exchange made available for imports must be a certain proportion of the value of foreign exchange realized from exports
• Foreign Exchange Restrictions – restricts access to foreign exchange in order to constrain the volume of imported inputs
• Manufacturing Requirements – requires certain products to be produced locally
• Manufacturing Limitations – prevents firms from manufacturing certain products or product lines in the host country
• Technology Transfer – requires specified technology to be transferred to host country for use locally or certain types of R&D to be conducted locally
• Licensing of Technology – requires investor to license technology for use in the host country
• Domestic Sales – requires an investor to sell a certain proportion of its output in the host country
• Export Performance – requires that a minimum proportion or value of production in host country be exported
• Export Controls – certain products may not be exported
• Product Mandating – requires investor to supply certain markets with designated products or products manufactured in a specified facility or operation or some products may be exported only from host country
• Remittance Restrictions – restricts the right of the investor to repatriate returns from its investment
• Local Equity – requires that a certain percentage of a firm's equity must be held by local investors in the host country.
• Market Reserve Policy – some markets reserved for local production

DISTINCTION BETWEEN PARAGRAPHS 1 AND 2 OF THE ILLUSTRATIVE LIST

TRIMs identified in Paragraph 1 of the Illustrative List as being inconsistent with Article III: 4 concern the purchase or use of products by an enterprise, while the TRIMs listed in Paragraph 2 as inconsistent with Article XI: 1 of GATT 1994 concern the importation or exportation of products by an enterprise.

TRIMs which are inconsistent with the National Treatment obligation of Article III: 4 of GATT 1994 Paragraph 1(a) of the Illustrative List covers TRIMs, which require the purchase or use by an enterprise of products of domestic origin or domestic source (local content requirements) while Paragraph 1(b) covers trade-balancing TRIMs, which limit the purchase or use of imported products by an enterprise to an amount related to the volume or value of local products that it exports. In both cases, the inconsistency with Article III: 4 of GATT 1994 results from the fact that the measure subjects the purchase or use by an enterprise of imported products to less favourable conditions than the purchase or use of domestic products.

TRIMs which are inconsistent with the prohibition on imposition of quantitative restrictions of Article XI: 1 of GATT 1994 Paragraph 2(a) of the Illustrative List covers measures which limit the importation by an enterprise of products used in its local production in general terms or to an amount related
to the volume or value of local production exported by the enterprise. There is a conceptual similarity between this Paragraph and Paragraph 1(a) in that they both cover trade-balancing measures. The difference is that, Paragraph 1(b) deals with internal measures affecting the purchase or use of products after they have been imported, while Paragraph 2(a) deals with border measures affecting the importation of products.

Measures identified in Paragraph 2(b) of the list involve a restriction of imports in the form of a foreign exchange balancing requirement, whereby the ability to import products used in or related to local production is limited by restricting the enterprise's access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise.

Finally, Paragraph 2(c) covers measures involving restrictions on the exportation of or sale for export by an enterprise, whether specified in terms of particular products, volume or value of products or in terms of a proportion of volume or value of its local production. Since Paragraph 2 applies the provisions of Article XI: 1 of GATT 1994, it deals only with measures that restrict exports. Other measures relating to exports, such as export incentives and export performance requirements, are therefore not covered by the TRIMs Agreement.

Moreover, the phrase 'investment measures' as reflected in Agreement indicates that, the TRIMs Agreement is not limited to measures taken specifically in regard to foreign investment. Nothing in the TRIMs Agreement suggests that, the nationality of the ownership of enterprise subject to a particular measure is an element in deciding whether that measure is covered by the Agreement. Since TRIMs Agreement is basically design to govern and provide a level playing field for foreign investment measures relating to internal taxes or subsidies cannot be construed to be a trade related investment measure. Internal taxes or advantages are only one of the many types of the advantages, which may be tied to a local content requirement, which is a principal focus of TRIMs Agreement. TRIMs
Agreement is not concerned with subsidies and internal taxes as such but rather with local content requirements, compliance with which may be encouraged through providing any type of advantage. Nor in any case, internal measure would necessarily govern the treatment of foreign investment. 7

In examining whether the measures in question are investment measures, the Panel on Indonesia-Autos 8 reviewed the legislative provisions relating to the measures. The Panel concluded that, the measures were 'aimed at encouraging the development of local manufacturing capability for finished motor vehicles and parts and components in Indonesia and that there is nothing in the text of the TRIMs Agreement to suggest that a measure is not an investment measure simply on the ground that a Member does not characterize the measure as such, or on the grounds that the measure is not explicitly adopted as an investment regulation.'

In examining whether the measures at issue in the dispute were trade-related, the Panel on Indonesia-Autos held that, the local content requirements were necessarily trade-related. If these measures are local content requirements, they would necessarily be 'trade-related' because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade. An examination whether these measures are covered by Item (1) of the Illustrative list of TRIMs annexed to the TRIMs Agreement, which refers among other situations to measures with local content requirements, will not only indicate whether they are trade related but also whether they are inconsistent with Article III: 4 and thus in violation of Article 2.1 of the TRIMs Agreement. 9
Article 3 of the TRIMs Agreement provides that all exceptions under GATT 1994 shall apply, as appropriate, to the provisions of the TRIMs Agreement. TRIMs Agreement is a full-fledged Agreement in the WTO system. The TRIMs Agreement and Article III: 4 of GATT 1994 prohibit local content requirements that are TRIMs and therefore cover the same subject. But when the TRIMs Agreement refers to 'the provisions of Article III', it refers to the substantive aspects of Article III' i.e., ten Paragraphs of Article III are referred to in Article 2.1 of the TRIMs and not the application of Article III in the WTO context as such. Thus if Article III is not applicable for any reason not related to the disciplines of Article III itself, the provisions of Article III remain applicable for the purposes of TRIMs Agreement. This view is reinforced by the fact that, Article 3 of the TRIMs Agreement contains a distinct and explicit reference to the general exceptions to GATT. If the purpose of the TRIMs Agreement were to refer to Article III as applied in the light of other GATT rules, there would have been no need to refer to general exceptions. Moreover, it has to be recognized that the TRIMs Agreement, in addition to interpreting and clarifying the provisions of Article III where trade-related investment measures are concerned, has introduced special transitional provisions including notification requirements. This reinforces the conclusion that the TRIMs Agreement has an autonomous legal existence, independent from that of Article III. Consequently, since the TRIMs Agreement and Article III remain two legally distinct and independent sets of provisions of the WTO Agreement, we find that even if either of the two sets of provisions were not applicable, the other one would remain applicable. The Panel on Indonesia-Autos found that, the tax and tariff benefits contingent on meeting local requirements under the Indonesian car programmes constituted 'advantages'
within the meaning of the Chapeau of Paragraph I of the illustrative list of TRIMs and as a result were inconsistent with Article 2.1 of the TRIMs Agreement.

EXCEPTIONS FOR DEVELOPING COUNTRIES

Article 4 allows developing countries to deviate temporarily from the obligations of the TRIMs Agreement, as provided for in Article XVIII of GATT 1994, the understanding on the Balance-of-Payments provisions of GATT 1994 and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November, 1979 permit the Member to deviate from the provisions of Article III and XI of GATT 1994.

TRIMS: NOTIFICATIONS AND TRANSITIONAL ARRANGEMENTS

NOTIFICATION REQUIREMENTS

Under Article 5.1, Members were required to notify to the Council for Trade in Goods, within 90 days after the date of entry into force of the WTO Agreement, any TRIMs that are not in conformity with the Agreement. A decision adopted by the WTO General Council in April 1995 provided that Governments that were not Members of the WTO on 1 January 1995, but were entitled to become original Members within a period of two years after 1 January 1995, should make notifications under Article 5.1 within 90 days after the date of their acceptance of the WTO Agreement.

11ibid. 14.91-14.92
12BISD 265/205-209
TRANSITIONAL PERIOD FOR THE ELIMINATION OF TRIMS WHICH ARE INCONSISTENT WITH THE AGREEMENT

Members are obliged under Article 5.2 of the TRIMs Agreement to eliminate TRIMs which have been notified under Article 5.1. Such elimination is to take place within two years after the date of the entry into force of the WTO Agreement in the case of a developed country Member, within five years in the case of developing countries and within seven years in the case of a least developed country Member.

LIMITATION OF THE BENEFITS OF THE TRANSITIONAL PERIOD TO EXISTING MEASURES

TRIMs introduced less than 180 days before the date of the entry into force of the WTO Agreement do not benefit from these transitional periods. Thus, the transitional provisions of the TRIMs Agreement do not permit the introduction of new TRIMs that are inconsistent with the Agreement.

"STANDSTILL" REQUIREMENT DURING THE TRANSITIONAL PERIOD

The Agreement precludes Members from changing measures notified under Article 5.1 in a manner, which would increase their inconsistency with the Agreement (Article 5.4). However, if a Member has notified a TRIM under Article 5.1, it may during the transitional period apply the same TRIM to a new investment in order to avoid a distortion of competition between the new investment and existing investments (Article 5.5).
POSSIBLE EXTENSION OF THE TRANSITIONAL PERIOD

Under Article 5.3, the Council for Trade in Goods may, on request, extend the transitional period for the elimination of TRIMs in the case of a developing country which demonstrates particular difficulties in implementing the provisions of the Agreement. Requests for such an extension have been submitted by Argentina, Colombia, Chile, Malaysia, Mexico, Romania, Pakistan, the Philippines and Thailand. These requests are currently the subject of consultations in the Council for Trade in Goods.

TRANSPARENCY

Provisions designed to ensure transparency with respect to the application of TRIMs are contained in Article 6 of the TRIMs Agreement. This Article provides in particular for the notification to the WTO Secretariat of lists of publications in which TRIMs may be found. Notifications received under these provisions are listed in document G/TRIMS/N/2/Rev.8.

COMMITTEE ON TRADE-RELATED INVESTMENT MEASURES

Article 7 of the TRIMs Agreement establishes a Committee on Trade-Related Investment Measures as a forum to examine the operation and implementation of the Agreement. The Committee usually meets twice a year. Much of the work of the Committee to date has focused on the notifications received under Article 5.1 of the Agreement.
The consultation and disputes arising out of TRIMs Agreement are to be decided in accordance with the provisions of Article XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding of the WTO.

The Panel in EC-Bananas III case examined the import licensing procedures of the European Communities under GATT Licensing Agreement and the TRIMs Agreement. The Panel found that, the allocation of import licences to a particular category of operators was inconsistent with Article III: 4 of GATT 1994.¹⁵

In Indonesia-Autos case, the European Communities and the United States claimed that, the Indonesian 1993 car programme, by providing for tax benefits for finished cars incorporating a certain percentage value of domestic parts and components, and for customs duty benefits for imported parts and components used in cars incorporating a certain percentage of value of domestic products, violated the provisions of Article 2 of the TRIMs Agreement and Article III: 4 of GATT 1994. The Panel on Indonesia-Autos found that, the tax and tariff benefits contingent on meeting local requirements under the Indonesian car programmes constituted 'advantages' within the meaning of Chapeau of Paragraph I of the illustrative list of TRIMs and as a result were inconsistent with Article 2.1 of the TRIMs Agreement.¹⁰

In Canada-Autos case, the complainant raised claims pertaining to conditions concerning the levels of Canadian value added and the maintenance of certain ration between the net sales value of vehicles sold for

¹⁴Article 8
consumption in Canada. Those claims were based upon both Article III: 4 of the GATT 1994 and the TRIMs Agreement. The Panel found that, certain requirements concerning domestic value added were inconsistent with Article III: 4 of GATT 1994.\(^{17}\)

In the India, measures affecting Automotive Sector, Complaint by the European Communities and the United States,\(^{18}\) it was contended that, India applied certain measures by way of local content and export-balancing requirements were violative of Articles III, XI of GATT and Article 2 of the TRIMs Agreement. The Panel held that, India's Auto Policy, 1997 was inconsistent with its obligations under TRIMs. Consequently, India has eliminated all such inconsistencies in its new Auto-Policy.

**REVIEW OF THE OPERATION OF THE TRIMS AGREEMENT**

Article 9 stipulates that, not later than five years after the date of entry into force of the Agreement, the Council for Trade in Goods shall review the operation of the TRIMs Agreement. The review was formally launched by the Council in October 1999. While Article 9 provides that in this review, consideration is to be given as to whether the Agreement should be supplemented with provisions on investment policy and competition policy, it should be noted that the first WTO Ministerial Conference held in Singapore in 1996, established working groups on trade and investment and on trade and competition "having regard to the existing WTO provisions on matters related to investment and competition policy and the built-in agenda in these areas, including under the TRIMs Agreement".

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MONITORING BODIES

SURVEILLANCE AND MONITORING

Under Article 7 of the Agreement, the Committee on TRIMs was established with the following terms of reference: "The Committee shall carry out responsibilities assigned to it by the Council for Trade in Goods and shall afford Members the opportunity to consult on any matters relating to the operation and implementation of this Agreement (TRIMs Agreement)."

CONCLUSION

TRIMs has a built-in agenda under Article 9 of the Agreement, wherein the Members may recommend further policy measures on both investment policy and competition policy. At the 1st Ministerial Conference of the WTO at Singapore in December 1996, the Members decided to set up two study groups to examine the necessity of further accords on investment policy and competition policy. The two groups are yet to come to any conclusion if such additions are desirable.

PROPOSAL FOR A MULTILATERAL INVESTMENT AGREEMENT

Following that study process, a Multilateral Investment Agreement (MIA) at the WTO is being proposed by a number of countries including the EU, Korea and Japan. It is being vigorously opposed by India, Malaysia, Egypt and others, while the US has said that it will not stand in the way of such an Agreement but nor will it be an active proponent.

Considering the real politics of the WTO, which involves trade-offs, some developing countries may be tempted to compromise on the issue in
order to move forward in implementation or agriculture, or other bilateral issues of their interest. Both EU and Japan see the push for such an Agreement to fend off protests on the further liberalization of their highly protectionist agricultural policy. However, it is not in the interest of developing countries to go along with an MIA proposal.

There is no evidence that, an international investment Agreement would increase the flow of investment to developing countries and it would tie the hands of Governments trying to channel investment flows according to their national developmental needs and strategies. Investment flows to developing countries have actually gone down as a proportion of total FDI since the implementation of TRIMs.

TRIMs REVIEW

Even if countries do not agree to discussions on an MIA, investment issues will still be discussed as the TRIMs is mandated for review. During the review, developing countries should resist attempts to extend the scope of the treaty to include any of the following:

• A broader definition of investment
• Pre-establishment rights
• Restrictions on non-trade related performance requirements

Developing countries should take the opportunity to press for amendment of the treaty on the following lines:

THE DEVELOPMENTAL DIMENSION

The current Agreement fails to take into account the vast differences between countries in their needs from investment.
Introduce flexibility for developing countries to use local content requirements. Local content requirements can contribute to the development of domestic industry and have been used successfully by OECD and the newly industrialized economies in the past. The current TRIMs treaty requires developing countries to phase these out within the time limits for implementation (2000 for developing and 2002 for Least Developed Countries). These time limits are arbitrary and already expired and should introduce a new time limit with an indicator of developmental benchmark. Until countries reach this level, they should be able to introduce or retain local content requirements.

Flexibility to impose restrictions on Balance of Payments, grounds should be retained.

BALANCING THE AGREEMENT

The current Agreement imposes onerous obligations on the Governments of the poorer capital-importing countries. These need to be balanced against obligations for developed countries and businesses.

Regulate the use of investment incentives, or 'positive TRIMs'. Incentives have the same distorting effects on investment flows as the limits and conditions imposed by negative TRIMs. Limits should be set on the levels of all incentives and a schedule imposed to reduce these further over time. Incentives that are not justified on developmental grounds should be banned under the revised Agreement.

REGULATING INVESTORS

• Code of Conduct: Build a binding code of conduct for investors and countries into the Agreement. Existing international Agreements should be
integrated and expanded into a comprehensive set of treaty provisions. This would prevent the exploitation of developing countries' resources by powerful Trans National Corporations (TNCs) and the 'race to the bottom' phenomenon (lowering domestic regulatory standards to try to attract FDI). The Agreement could include provisions on corruption, accounting and reporting, transfer pricing, technology transfer, information disclosure, environmental and labour standards, dispute settlement, etc.

- **Competition Policy and Law:** Any further liberalization of investment should only take place after national and international competition regimes are strengthened. TNCs enjoy advantages over domestic firms in developing countries through economies of scale and monopolistic ownership of intellectual property such as brands and proprietary technology. Without competition law, foreign companies may abuse market dominance to the detriment of local firms and consumers, with long-term implications for the development of domestic production capabilities.

- **Home Country Obligations:** Impose obligations on capital-exporting countries to regulate the behaviour of their TNCs according to their national standards. Some developed countries apply their anti-corruption laws to the activities of firms outside the domestic economy. The same extra-territorial jurisdiction should be applied to corporate standards in other areas.
SECTION B

INDIAN INVESTMENT

INTRODUCTION

TRIMs Agreement was meant to address investment measures that were trade related and violated Article III (National Treatment) or Article XI (general elimination of Quantitative Restrictions). Notably, this Agreement is biased in favour of developed countries so much that, it is the developing countries that have to make policy changes that are in compliance to it. At this juncture of the 21st millennium, it is quiet important to look at the linkages between trade, FDI and development of developing countries like India. Although the Agreement foreshadowed a direct link with GATT, there was still some confusion regarding whether or not a policy that violated GATT Articles automatically meant that it violated the TRIMs Agreement. As indicated before, the problem here is that, the TRIMs Agreement did not introduce new language in the context of disciplining policies – instead it only referred to the GATT Articles. Therefore, this raises a question of how the TRIMs Agreement actually fits into the set of Multilateral Trade Agreements (MTAs) and whether it allows or prevents a measure directly targeted to a foreign enterprise.

In many ways, the WTO Agreement on Trade-Related Investment Measures (TRIMs) is less significant than the WTO Agreements on services, Intellectual Property Rights, and agriculture. The TRIMs Agreement does not involve any new rules or disciplines, referring only to the existing provisions under the GATT. In fact, the whole text of the TRIMs Agreement is only 5 pages long. However, by enforcing GATT provisions on 'National Treatment', this short and simple Agreement has had far-reaching effects on everything from fresh milk to auto parts.
INDIA’S NOTIFIED TRIMs

As per the provisions of Article 5.1 of the TRIMs Agreement, India had notified three trade related investment measures as inconsistent with the provisions of the Agreement:

- Local content (mixing) requirements in the production of News Print,
- Local content requirement in the production of Rifampicin and Penicillin – G, and
- Dividend balancing requirement in the case of investment in 22 categories of consumer goods.

Such notified TRIMs were already eliminated on 31st December, 1999. None of these measures is in force at present. Therefore, India does not have any outstanding obligations under the TRIMs Agreement as far as notified TRIMs are concerned.

POSITIVE IMPLICATIONS OF TRIMs ON INDIA

However, the domestic content is an extremely useful and necessary tool from the point of view of developing countries like India. Such a requirement is often necessary for:

(i) encouraging domestic economic activities in raw material and intermediate input sectors;
(ii) up-gradation of input production;
(iii) prevention of wastage of foreign exchange in the import of raw material and intermediate inputs;
(iv) ensuring linkages of FDI with domestic economic activities;
(v) encouraging indigenization in case of FDI; and
(vi) acting in several other ways as an important instrument in the developmental process.

Similarly, India also finds export performance requirements to be useful and necessary from the point of view of balanced economic growth and national development. Local content requirements stipulate that a minimum share of inputs be obtained from local sources; 'laws of similar' are often used to define appropriate local inputs. Import and foreign exchange restrictions have the same effect as both limit the amount of inputs that can be imported. The trade effect is to reduce imports (that are displaced by local supplies) TRIMs reduce imports and also contribute to increasing potential Balance of Payments benefits from FDI. Export requirements are aimed to increase the proportion of output exported. TRIMs designed to reduce competition with domestic producers, that may be import-substituting, have the same effect. These include manufacturing requirements, market reserve and domestic sales limitations on what can be sold on the local market. Some TRIMs aim to ensure that Multinational Enterprises (MNEs), on balance, do not import more in value than they export, e.g. trade or foreign exchange balancing.

In short, under the Agreement, India can continue to deploy measures such as import balancing requirements on the grounds of Balance of Payments difficulties. There is no implicit or explicit reference to obligation regarding entry on quantities of foreign direct investment. The waivers provided in TRIMS are adequate. On balance the proposal meets India’s demand more than half way. The GATT rules are not restricting the freedom of developing countries like India, to frame and implement economic policy as per their requirements.

NEGATIVE IMPLICATIONS OF TRIMs ON INDIA

Broadly speaking, FDI has not yielded the benefits anticipated by hosts in terms of technology transfer, local linkages or having a net positive impact.
on the Balance of Payments. There are a range of MNE practices, restrictive or not, that reduce the benefits of FDI to hosts. Thus, the hosts try to impose restrictions on the activities of MNEs so as to capture more of the benefits. The most prevalent of such TRIMs are local content requirements, import restrictions and export requirements. In the TRIMs Agreement, "investment measures" such as local content (obliging foreign firms to use at least a specified minimal amount of local inputs) is prohibited for most developing countries. India needs policies because of the low level of development of the local sector, which would not be able to withstand free competition. Thus, by implementing TRIMs, developing countries like India is losing some important policy options to pursue their industrialization. But notably, Governments are still free under the WTO to have their own investment policy to decide what kind of foreign investors to permit, and what conditions to impose. This kind of authority can be undermined since these MNEs have the supremacy drive for most economies in LDCs. The prohibition of "local content" requirement (i.e. that firms or projects make use of a certain minimum amount of local materials) will seriously hinder the efforts of India to promote local industry, save on foreign exchange, and upgrade local technological capacity. There is also a prohibition on investment measures that limit the import of inputs by firms to a certain percentage of their exports. Such measures had been introduced to protect the country's Balance of Payments. The prohibition of these two investment measures will make the attainment of developmental goals much more difficult. In any case of nonconformity, the decision goes against the defending party requiring them to bring their laws into conformity with the TRIMs Agreement. Suppose the defendant is indicated rules of the game apply despite the claim in the WTO of Special and Differential treatment. If a developed or developing country lodges its complaint on any violations, cases are treated on equal basis.

However the Agreement, as it is biased towards the interests of MNEs rather than those of host countries, restricts the ability of hosts to constrain the activities of MNEs. This may have undesirable social impacts (in terms of labour standards) and environmental impacts (such as excessive pollution).
No liberalization implies adverse sustainability impact. 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 in developing country like India, it also means that the 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. At best, the domestic industry can hope to achieve import substitution, but the likelihood of further development is poor.

In general, therefore, the record for implementation for the TRIMs Agreement is not too bad but approximately a third of the Members that notified policies did not comply with the TRIMs Agreement. This, however, does not mean that, serious implementation problems do not exist. There are serious problems, but they differ substantially from the type of implementation problems in such Agreement as the Trade Related Aspects of Intellectual Property Rights (TRIPs). Basically capacity constraints affect the transitional periods.

MULTINATIONAL ENTERPRISES (MNEs) Vs. SMALL- MEDIUM ENTERPRISES (SMEs) AND SMALL SCALE INDUSTRIES (SSIs)

Once investment and trade is liberalized progressively to "facilitate investment across frontiers...", the nagging question that rings into one's mind is whether developing countries like India and LDCs are able to embrace competition from developed countries. Liberalization between two unequal partners is least likely to result in a win-win situation. It is more of a zero-sum game where one loses what the other get or vice versa. Rural economy of India is characterized by SMEs and Small Scale Industries (SSIs) while in developed countries; MNEs thrive to penetrate rural India frontiers to seek
investment prospects. This penetration is viewed as FDI in economic terms and is associated with at its best short term benefits and at worst long term domestic industrial shrunken ness. SMEs and SSIs characterized by high strategic risks such as competitor moves (in most cases MNEs), changing markets, demand fluctuations, obsolete technology, price distortions/controls, diseconomies of scale, semi and unskilled labour export constraints, limited access to raw materials and competitiveness, etc. face serious challenges from MNEs which force them to scale down and ultimately terminate business. It is clear that the TRIMs Agreement fail to realize these ramifications if it does then it one can safely conclude that "...free competition..." will not promote economic growth envisaged in the Agreement.

The TRIMs Agreement prevents the Indian Government from ensuring that foreign investment promotes national objectives or encourages domestic industry. India will no longer have the power to prevent multinationals from merely extracting resources from India and dumping imported goods in the domestic market by requiring them to use locally produced goods as production inputs or limiting imports of an enterprise to an amount related to its exports. India will be prohibited from protecting its national interests despite the fact that foreign investment has historically increased imports and reduced exports.

The TRIMs Agreement prevents any discriminatory investment measures which favour goods produced by Indian companies over imports. However, Indian companies will be unable to complete on a completely equal basis with transnational corporations due to the great disparities in financial and technological power. The future will be that foreign companies will take over control of most of the Indian market and deprive Indian companies of a fair opportunity to engage in trade.

A month prior to the Seattle WTO talks the Indian Government circulated a set of proposals on behalf of Cuba, the Dominican Republic, Egypt, El Salvador, Honduras, Indonesia, Malaysia, Nigeria, Pakistan, Sri
Lanka and Uganda. In these proposals it was argued that, the TRIMs Agreement should be substantially revised: “There is a need to review provisions in the Agreement on TRIMs which come in the way of acceleration of economic growth in developing countries and deny these countries the means to maintain Balance of Payments stability.”

Specifically it was proposed that: “Developing countries should be exempted from the disciplines on the application of domestic-content requirement by providing for an enabling provision in Article 2 or Article 4 to this effect.” These proposals are important because they challenge the existing WTO -TRIMs mechanism and its restriction of developing countries' capacity for national development. The 'national development' issue also highlights the fact that, the ban on local content policies means that developing countries are prevented from adopting industrialization strategies used by the US, Japan, France, Germany, the UK, etc, in the past.

At present it is tactically important to support the call for revision of the TRIMs Agreement to allow the use of local content policies. Regarding the review of the operation of the Agreement on Trade-Related Investment Measures, Brazil reiterated a joint proposal with India for a WTO Secretariat study on TRIMs, pointing to two positive developments in Hong Kong in this area: the mandate (Paragraph 39) to consult further on implementation issues; and granting additional flexibility on TRIMs to LDCs. It is said that these two developments showed that the existing Agreement was inadequate to deal with the needs of developing countries - Argentina, India and China supported the proposal.

CONCLUSION

The Agreement poses problems both with respect to the limited transitional period available for removing TRIMS and the denial of freedom to countries to channelize investments in such a manner that fulfils their
developmental needs. There is therefore a need to review provisions in the Agreement relating to local-content requirements as the existing provisions come in the way of accelerating the industrialization process in developing countries and deny these countries the means to maintain Balance-of-Payments stability. With a view to ensuring that these instruments may be maintained by developing countries like India, till such time that their developmental needs demand, the transitional period mentioned in Article 5, Paragraph 2 needs to be revised.

Article 5:3, which recognizes the importance of taking account of the development, financial and trade needs of developing countries while dealing with trade related investment measures, has remained inoperative and ineffectual. The provisions of this Article must therefore be suitably amended and made mandatory.

The TRIMs Agreement should be modified to provide developing countries another opportunity to notify existing TRIMs measures which they would be then allowed to maintain till the end of the revised transitional period.

Developing countries should be exempted from the disciplines on the application of domestic-content requirement by providing for an enabling provision in Article 2 or Article 4 to this effect.

Yet the real significance of the TRIMs Agreement lies in what it was supposed to be not what it is. Originally, it was proposed that, a comprehensive Agreement on investment be included under the WTO regime. This would guarantee National Treatment for foreign investors and ban any kind of governmental regulation on foreign investment such as: technology transfer requirements, restrictions on the transfer of profits overseas, controls on foreign exchange flows, Government reviews of foreign investment performance, nationalization, expropriation, etc. The Governments of the EC,
US, Japan and Canada tried to push this proposal through, but faced strong resistance from the Governments of developing countries like India. So a watered-down TRIMs Agreement was the result. However, we have already seen the original plan resurface in the form of the Multilateral Agreement on Investment (MIA) proposal and its realization in NAFTA’s Chapter 11. So, there is still pressure for an expanded, more powerful TRIMs Agreement that would act as a bill of rights for transnational corporations. Another possibility is that a new investment Agreement in the WTO will be introduced, superceding the current TRIMs Agreement.

MULTILATERAL INVESTMENT AGREEMENT

If an MIA is included, in future in any forum of WTO developing countries can best safeguard their interests by participating actively in the negotiations on the Agreement, whether or not they choose to sign on to the final outcome. They should insist on the following points:

• Definition: The definition of investment should cover only foreign direct investment. Other capital flows are notoriously volatile and shocks to the domestic economy from short-term capital market movements can reverse long-term developmental gains. Furthermore, there is no conceptual justification for linking these flows with trade.

• Screening: National Treatment should apply only to the post-establishment phase, and not to pre-establishment. It is essential for developing countries to be able to screen investments to ensure that, they meet with their developmental needs. Domestic ownership may have an important long-run effect on the development of the indigenous industrial capability of the country.
• **Performance Requirements**: There should be no further restrictions on performance requirements e.g. local employment, technology transfer, etc.

• **GATS Type Approach**: The Agreement should adopt the same approach to liberalization as the General Agreement on Trade in Services (GATS). Countries would offer to liberalize in sectors of their choice. Having liberalized a sector, countries should be allowed to re-impose restrictions if justified on developmental grounds.

• **Dispute Settlement**: Investor-state dispute settlement should not be allowed. This mechanism has generated damaging results under NAFTA and would lead to even more serious consequences in the broader international environment.

• **Code of Conduct**: A binding code of conduct for TNCs and countries as part of the Agreement.19

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