CHAPTER 9

TRADE-RELATED INVESTMENT MEASURES

OVERVIEW OF RULES

1. BACKGROUND OF THE RULES

After the late 1980s, a significant increase in foreign direct investment took place throughout the world. However, some countries, especially developing countries, receiving the foreign investment imposed numerous restrictions 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 that 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 restrictions distort trade in violation of GATT Articles III and XI, and are therefore prohibited.

Prior to the Uruguay Round negotiations, which resulted in a well-rounded Agreement on Trade-Related Investment Measures ("TRIMs Agreement"), only a few international agreements provided disciplines for measures restricting foreign investment and provided limited guidance in terms of content and country coverage. The OECD Code on Liberalisation of Capital Movements, for example, requires Members to liberalize 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; the extent of the prohibitions, though, was never clear. However, the TRIMs Agreement, which was agreed as part of Annex 1A: Multilateral Agreement on Trade in Goods of the WTO Agreements, specifically prohibits investment measures that are inconsistent with the provisions of Articles III or XI of GATT 1994. In addition, the Agreement 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 Articles III:4 or XI:1 of GATT 1994. The TRIMs Agreement prohibited those measures 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 II-9-1 contains a list of measures specifically prohibited by the TRIMs Agreement. Figure II-9-1 is not comprehensive; it simply illustrates TRIMs that are prohibited by the TRIMs Agreement and calls particular attention to several common types of TRIMs. The figure also identifies measures that are inconsistent with Articles III: 4 and XI:1 of GATT 1947.

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 measures inconsistent with the Agreement within a set period of time, with a few exceptions. The exceptions are detailed in Figure II-9-2.

Figure II-9-1 Examples of Measures Explicitly Prohibited by the TRIMs Agreement

Local content requirements	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); and 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).

Figure II-9-2 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 within 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 generally would violate GATT Articles III or XI, provided that the measures meet the conditions of GATT Article XVIII which, by virtue of the economic development needs of developing countries, allows specified derogation from the GATT provisions.
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 above.

3. *EXTENSION OF TRANSITION PERIOD*

Under the TRIMs Agreement, Member countries are required to notify the WTO Council for Trade in Goods of their existing TRIMs that are inconsistent with the TRIMs Agreement within 90 days from the date of entry into force of the WTO Agreement (Article 5.1). To date, 27 Members have notified the WTO of such measures (notification of TRIMs by Members that acceded to the WTO after its foundation will be described below).

Each country is obliged to eliminate TRIMs notified under Article 5.1 within the specified transition period (Article 5.2); the transition period for the above-mentioned notifying countries expired at the end of 1999, except for the cases where the extension of the transition period was approved by the Council for Trade in Goods (explained below).

The Council for Trade in Goods, however, can extend the transition period at the request of the notifying developing Member countries (including least developed countries) if they can demonstrate that circumstances prevent them from eliminating the TRIMs in a timely manner (Article 5.3). In November 2001, an extension of the transition period for eliminating the notified TRIMs was granted until the end of May 2003 for Romania; until the end of June 2003 for the Philippines; and until the end of December 2003 for Chile, Argentina, Colombia, Mexico, Malaysia, Pakistan, and Thailand). (See the same section of the 2014 Report on Compliance by Major Trading Partners with Trade Agreements for the details of the background to the extension of the transition period.)

Of the countries for which the transition period was extended in November 2001, Argentina, Chile, Colombia, Thailand, Mexico, Malaysia and Romania eliminated their TRIMs measures by the end of 2003 as scheduled. The Philippines eliminated local-content requirements and foreign exchange restrictions in the automotive sector on July 1, 2003. However, the Philippines still maintains 60% local content requirements in some sectors. Although these measures are suspended, the Philippines has not committed to eliminate them. In December 2003 Pakistan requested another extension until the end of December 2006, but then expressed its intention to officially withdraw the extension request (and to eliminate the remaining TRIMs) at the Council for Trade in Goods meeting in March 2006. In July 2006, the “Deletion Program” at issue was abolished. In its place, the Tariff Based System was introduced. However, provisions of this system promote localization by, for example, levying a 35% tariff on CKD parts for local automakers but a 50% tariff on others. For all intents and purposes then, the measure may constitute a demand for local content. As noted above, TRIMs notified under Article 5.1 immediately after the establishment of the WTO Agreement in principle have been eliminated. However, whether the elimination of all these measures has been done is not clearly confirmed.

The Hong Kong WTO Ministerial Declaration, made in December 2005, provided that the existing TRIMs measures of least developed countries notified within two years from 30 days after the date of the Declaration could be maintained until December 18, 2012, and newly introduced measures notified within six months after the introduction could be maintained for up to five years. However, none of the measures had to be eliminated by 2020 (even if extension were granted by the Council for Trade in Goods). To date, no TRIMs have been notified under this Declaration.

As an example of notifications of TRIMs made in accordance with Accession Protocols by countries that acceded to the WTO in recent years, at the time of its accession to the WTO in January 2013, Russia notified its regulations on investment for the “industrial assembly” in the automobile industry as TRIMs that were inconsistent with the Agreement. Russia retained these TRIMs and committed in its Accession Protocol to eliminate them by July 1, 2018. In November 2015, Kazakhstan notified TRIMs that were incompatible with the agreements in the sectors of oil, gas, and mining and the automobile sector when it acceded to the WTO. The country committed to the abolishment of these TRIMs by January 1, 2021, and July 1, 2018, respectively (extension is possible).

4. TRIMs Committee

A committee on TRIMs (TRIMs Committee) was established under the TRIMs Agreement (Article 7) to afford Members the opportunity to consult on matters relating to the operation and implementation of the Agreement. Committee meetings have been held regularly twice a year to carry out responsibilities assigned to it by the Council for Trade in Goods[1] (Article 7.2) and report annually to the Council for Trade in Goods (Article 7.3). The Committee is also utilized as a place for Members to exchange opinions on their specific individual measures that are suspected of being inconsistent with the TRIMs Agreement, etc.

5. Economic Aspects and Significance

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 can 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 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. Consumers in the host country also suffer as a result of TRIMs because they must spend much more on a finished product than would be necessary under a system of liberalized imports. Since consumers placed in such a position must pay a higher price, domestic demand will stagnate. This lack of demand also stifles the long-term economic development of domestic industries.

Major Case

(1) India - Measures Affecting the Automotive Sector – (DS146 & DS175)

December 1997, India announced a new automotive policy that requires manufacturers in the automotive industry and the Ministry of Commerce and Industry to draft and sign a memorandum of understanding (MOU) on new guidelines for the industry. The policy has the following TRIMs Agreement-related problems: First, the policy requires that 50 per cent local content be achieved within three years of the date on which the first imported parts (CKD, SKD) are cleared through customs; the requirement increases 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; restrictions

[1] The responsibilities assigned to the TRIMs Committee by the Council for Trade in Goods in the past include the discussion of a proposal on specific and differential (S&D) treatment for developing countries relating to Articles 4 and 5.3 of the TRIMs Agreement, which were implemented for the period 2002-2007.

on the amount of parts (CKD, SKD) that can be imported depend on the degree to which the export requirement is met. This policy amounts to an export/import balancing requirement. Even prior to this policy, India made auto parts import licenses for companies setting up operations within its borders conditional upon signing an MOU containing local content requirements and export/import balancing requirements - despite the lack of any legal basis for doing so. It is clear that the new automotive policy of 1997 is designed to institutionalize the previous administrative guidelines.

In October 1998, the EU requested WTO consultations (in which Japan and the United States participated as third parties). The first consultations were held in December 1998, but were unsuccessful. A WTO panel was established in November 2000 at the request of the EU; Japan participated as a third party. In June 1999, the United States requested separate consultations that were held in July 1999. Japan and the EU participated as third parties. These consultations were also unsuccessful. A panel was subsequently established at the request of the United States in July 2000, and Japan, the EU, and the Republic of Korea participated as third parties. At the end of November 2000, the two panels were consolidated into a single panel.

Prior to this dispute, India had already lost before the WTO Appellate Body a complaint brought by the United States over import restrictions on specific items, including automobiles. India reached an agreement with the United States to eliminate import restrictions by April 2001. Consequently, quantitative restrictions on 714 items were eliminated on April 1, 2000, and an additional 715 items on April 1, 2001. Consequently, Department of Commerce and Industry Notice No. 60 was abolished in September 2001. However, the export obligations continued and, thus, the measures cannot be regarded as having been fully eliminated. Indeed, the WTO panel subsequently examined Commerce and Industry Department Notice No. 60 and found that the MOU based on it violated GATT Articles III and XI. India, which was dissatisfied with the Panel Report, appealed to the Appellate Body on January 31, 2002, but withdrew the appeal on March 14. Subsequently, in August 2002, the Indian Government abolished the export obligations and, accordingly, the automotive policy was fully eliminated.

(2) Local content requirements (domestic-product preferential subsidies) on solar power panels made in Ontario, Canada (DS412 & DS426)

See pages 439-440 of the 2017 Report on Compliance by Major Trading Partners with Trade Agreements - WTO, EPA/FTA and IIA -.

(3) Brazil –Measures concerning discriminatory taxation and charges for automobiles, etc. (domestic-product preferential subsidies) (DS472 & DS497)

See Part I, Chapter 11.