NEGOTIATIONS FOR TRADE RELATED INVESTMENT MEASURES (TRIMs) : IMPLICATIONS FOR THE SOUTH

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CERTIFICATE

This is to certify that this dissertation entitled "**NEGOTIATIONS FOR TRADE RELATED INVESTMENT MEASURES (TRIMs) : IMPLICATIONS FOR THE SOUTH**" submitted by **SANJAY SRIVASTAVA** in partial fulfilment of six credits out of a total requirement of twenty four credits for the award of degree of **MASTER OF PHILOSOPHY** of this University is his original work and maybe placed before the examiners for evaluation.

This dissertation has not been submitted for the award of any other degree of this University or any other University to the best of our knowledge.

DR.K.D.KAPOOR
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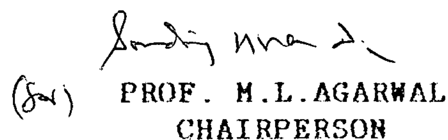

PROF. M.L.AGARWAL
CHAIRPERSON

DEDICATED TO MY

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CONTENTS

		Page No.
	ACKNOWLEDGEMENTS	
	PREFACE	
	ABBREVIATIONS	
Chapter I	INTRODUCTION	1-51
	Trade Related Investment Measures: Historical Background	1-11
	TRIMs: What It Means	11-19
	Characteristics of TRIMs	19-25
	Political Economy of TRIMs: Challenges & Stakes	25-34
	GATT As An Instrument of Diplomacy	34-45
	Uruguay Round : A Diplomatic Offensive of the North	45-51
Chapter II	DIPLOMACY OF THE NORTH IN THE URUGUAY ROUND WITH SPECIAL REFERENCE TO THE UNITED STATES	52-115
	Pre-Uruguay Round Negotiating Positions of the United States	52-64
	Negotiating Positions and Approaches in Uruguay Round	65-82
	Dunkel Draft: Proposals for TRIMs	82-86
	Transnational Corporations as Engines of Growth	87-115
Chapter III	IMPLICATIONS FOR THE SOUTH AND ITS STRATEGIES	116-174
	Negotiation in the Uruguay Round	116-126
	Rejoinder to US Argument that GATT Articles are Applicable to TRIMs	126-149
	National Socio-Economic Consequences of	

Page No.

	TNCs/FDI	149-165
	Failure to Pursue Global Coalitional Strategy	165-174
Chapter IV	INDIA'S POLICY TOWARDS FOREIGN DIRECT INVESTMENT	175-226
	Introduction	175-176
	General Background: Economic Development and the Role of the State	176-183
	Evolution of Foreign Investment Policy	183-214
	Implications of Policy for FDI	214-223
	Outlook for Future	223-226
Chapter V	CONCLUSION	227-245
	ANNEXURE	246-254
	Annexure I	246-254
	BIBLIOGRAPHY	255-260

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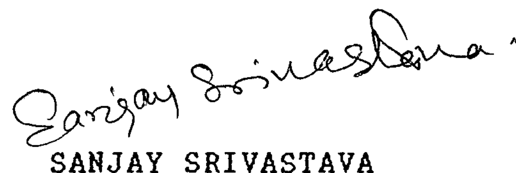

NEW DELHI

SANJAY SRIVASTAVA

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PREFACE

Contemporary international investment system is a issue of dispute between North and South. The performance requirement measures put up by developing countries on Trans-national Corporations (TNCs), have raised eyebrows in the North, which is home of TNCs. These performance requirements on TNCs are imperative for planned development of the developing countries, but have been regarded by North as trade distortive and trade restrictive.

In the present environment, particularly after the attenuation of Cold War, liberalisation in foreign trade has taken place. Most of the developing countries have either liberalised or in the process of doing so, thus creating congenial environment for foreign investment, still clash of interest exists, industrialised countries (ICs) are fighting for more liberalisation of investment policies of developing countries, and protection of foreign investors rights there. Again developing countries find it must to put performance requirements on TNCs for their planned development. Thus on one hand economic interests of TNCs are at stake, on the other hand socio-economic development of poor countries, who need foreign investment but according to their priority, is endangered.

This conflicting situation, had led to negotiations on TRIMs. It was actually the declining trade competitiveness of the US and economic crisis of 1980s which impelled it to bring the issue to GATT. In the Uruguay Round and outside also, US is keen for the establishment of international investment regime with rules and principles that will restrict and limit host country policies and laws in relations with foreign investors. Dunkel Draft is a step further in this direction. However this is seen in the South, as a covert hegemonic design of the North, to create unlimited rights for TNCs. The study of negotiations on TRIMs are crucial as on its outcome hinges the pace of planned development of the countries of the South in forthcoming decades.

The study will examine the hypothesis that the diplomacy of the North (under overall leadership of US), to create a TRIMs regime, is a covert strategy, which by means of self-suited investment regime, intends to maintain permanent hegemony of the North over the South. Failure of the South across the negotiating table on TRIMs will lead to undermining of economic sovereignty and ability to counter restrictive business practices of the TNCs. The study also shows the fact that during GATT negotiation on TRIMs, the strategies of the South have been defensive in nature, and success

of any strategy depend overwhelmingly on the 'unity' and `coordination'.

The first chapter contains the meaning, nature, characteristics and political economy of TRIMs, stakes and challenges of North and South. It also deals with the history of negotiations of TRIMs. It also contains the political economy of GATT and Uruguay Round negotiations to show the hegemonic designs of North.

The second chapter deals with diplomacy of the North, led by the US. It also looks into the proposals and motives of Nordic countries Japan and EEC.Chapter discusses,claims of US that GATT articles are individually applicable to TRIMs. it also analyses proposals of Dunkel Draft regarding TRIMs. It seeks to analyse US view that TNCs are engines of growth in developing countries. Overall, chapter deals with US efforts to create international investment regime to ensure the interests of TNCs, on the cost of development of developing countries.

The Third chapter deals with the diplomacy of South, its proposals and negotiating strategy. It also examines the socio-economic impact of TNCs on the developing countries and the necessity of TRIMs, as instrument for planned development of economy. It also seeks to refute to the claims of

US that certain GATT articles are applicable to TRIMs. The chapter shows the failure of South to pursue global coalitional diplomacy.

Chapter four takes up India's Policy towards Foreign Direct Investments (FDI). It traces the industrial and investment policies since 1948, with emphasis on 1991 Industrial Policy and aftermath. It also analyses the technology transfer to India and overall future perspective.

The last chapter deals with what is needed to be done by the South. It includes a few concluding suggestions and observations about the issue as it stands today. As no agreement has been arrived on Dunkel Draft till date and everything is still fluid, this dissertation merely represents an effort at analysing the present and the past with a few tentative indications of the future.

ABBREVIATIONS

ASEAN	-	Association of South East Asian Nations
CBI	-	Caribbean Basin Initiative
DCs	-	Developed Countries
EC	-	European Community
EEC	-	European Economic Community
EFTA	-	European Free Trade Association
GATT	-	General Agreement on Tariffs and Trade
GDP	-	Gross Domestic Product
GNG	-	Group of Negotiations of Goods
GNS	-	Group of Negotiations on Services
GSP	-	Generalised System of Preferences
IMF	-	International Monetary Fund
IP	-	Intellectual Property
IPRs	-	Intellectual Property Rights
MFA	-	Multi-fiber Arrangement
MFN	-	Most Favoured Nation
MNCs	-	Multi National Corporations
MTN	-	Multilateral Trade Negotiations
NAM	-	Non Aligned Movement
NGOs	-	Non Governmental Organisations
NICs	-	Newly Industrialised Countries
NIEO	-	New International Economic Order

OECD	-	Organisation for Economic Cooperation and Development
SUNS	-	Special United Nations Service
TNC	-	Trade Negotiations Committee
TRIMs	-	Trade Related Investment Measures
TRIPs	-	Trade Related Aspects of Intellectual Property Rights
UN	-	United Nations
UNCTAD	-	UN Conference on Trade and Development
UNESCO	-	UN Educational, Scientific and Cultural Organisation
USITC	-	US International Trade Commission
USTR	-	US Trade Representative
WIPO	-	World Intellectual Property Organisation

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CHAPTER – I

Chapter -1

INTRODUCTION

TRADE RELATED INVESTMENT MEASURES: HISTORICAL BACKGROUND

History of negotiations on TRIMs can be traced back to the efforts of the United States (US) for the evolution of international regime on property rights of the foreigners in the eighteenth and nineteenth century.[1] Actually the standard for treatment of foreigners and their property evolved in the seventeenth and eighteenth centuries (treaty of Westphalia 1648 and treaty of Paris 1745). Arising out of their extensive and ongoing economic ties with each other, all the European powers had reciprocal economic interests of their nationals in each other countries. These norms included the concept that the property of foreigners can not be expropriated except for recognised public purpose and on payment of compensation according to international standards and subject to international arbitration. After its own independence, US accepted these norms,and from early part of this century tried to enforce them on the Caribbean and

1. Chakravarti Raghvan : Recolonization (Penong Malaysia: Third World Network,1990). p.143

Central American States.[2]

Until World War I these rules were largely unchallenged. At the 1909 The Hague Peace Conference,the Latin American States challenged only the right of unilateral enforcement. But the situation changed after World War I At the series of economic conferences convened by the League of Nations, these norms about property and other rights of foreigners came under increasing challenge,and failed to be incorporated into the new international treaties.[3]

The US, like the Europeans,through the interwar period had continued to assert the validity of the 19th century international standards, and tried to do so forcefully for example against Mexico after its revolution in 1930s. Even earlier the interventions in the Dominican Republic (under Theodore Roosevelt) and so-called Roosevelt corollary to the Monroe doctrine, sought to establish the European-US international property norms and enforce their observance by Latin American Nations.[4]

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2. ibid . p-143

3. ibid . p-143

4. ibid p-144

After the World War II, the US took the lead in fashioning a new post-war system of political and economic relationships and institutions governing Trade; Money and finance (Havana Charter and the Bretton Woods agreements). The US revived the efforts to incorporate into them international norms and standards relating to the property right of foreigners. But the US did not succeed.

After World War II, multilateral efforts to deal with the issue of foreign direct investments (FDI) were initiated in the United Nations Conference on Trade and Employment, held at Havana in 1948. The Final Act of the conference included the encouragement of the international flow of capital for productive investment as one of the objectives of the proposed International Trade Organisation.[5] Recognition was given in Article 12:1 (a) of ITO to the fact that international investment "can be of great value in promoting economic development".[6] While the Act suggested that member

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5. For Details see UN conference on Trade and Employment, Held at Havana, Cuba from November 21,1947 to March 24,1948: Final Act and Related Documents (Lake Success,N.Y. Interim Commission for the International Trade Organisation,1948), p.5. cited in The impact of Trade Related Investment measures on Trade and Development Theory Evidence and Policy implications. (New York 1991), UNCTC, ST/CTC/120 Sales No. E.91.II. A.19. p.79.

6. ibid. p.79

states should "give due regard to the desirability of avoiding discrimination as between foreign investment",it was recognised that any state may decide, in so far as other agreement may permit, "whether and to what extent and upon what terms it will allow foreign direct investment",and that "it might take any appropriate safeguards necessary to ensure that foreign investment is not used as a basis for interference in its internal affairs or national policies"; it was also recognised that States may "prescribe and give effect on just terms to requirement as to the ownership of existing and future investment" and to "other reasonable requirement" with respect to such investments.[7]

The history of negotiations of Havana Charter demonstrated the unwillingness of governments to subject their investment policies-and,indeed,the whole range of their trade policies-to international rules and disciplines. Despite the absence of accepted international norms,the US sought to get them accepted through bilateral commerce and friendship treatise. US also sought to use bilateral aid (and its control of multilateral aid through the World Bank and other international and regional financial institutions) to get Third World countries to accept these norms. But by

7. ibid. p.79

and large these proved counterproductive. Third World countries have developed a strongly nationalist attitude to foreign capital,to some extent due to their realisation that the state has to play an important role in the economic transformation of their countries and also as a reaction to deep-seated historical memories of the way foreign capital came and established itself in their countries. Foreigners received with hospitality, invariably abused the privilege to acquire political control and enforce colonialism.[8] The GATT itself became a permanent institution, primarily because of the unwillingness of major economic powers to adopt the Havana charter. Since then,an informal consensus has prevailed with regard to the regulation of foreign direct investment,with sovereign discretion being virtually under no restraints,pending the adoption of an international framework work on foreign direct investment as negotiated by the UN Commission on Transnational Corporations.

Investment issues were never a major focus in the GATT before the launching of Uruguay Round. However,some countries have previously invoked the General Agreement in respect of some investment measures,arguing that measures pertaining to local content,export performance, etc. were

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8. ibid. p.80

trade-related and that they required detailed examination in light of GATT articles. Efforts to extend the coverage of the General Agreement to take into account such considerations began soon after the conclusion of the Tokyo Round in 1978. A significant development in this direction was the dispute brought by the US against Canada on the latter's administration of the Foreign Investment Review Act (FIRA) in 1982. A number of delegations, however, expressed doubts about the competence of GATT to settle that dispute, as investment legislation was not covered by the General Agreement.[9] The GATT council finally allowed the dispute settlement Panel to proceed with its work on the presumption that Panel would be limited in its activities and findings to issues falling within the boundaries of the General Agreement.[10]

In its report,the FIRA Panel found that Canada's practice of allowing certain foreign direct investment under FIRA on the condition that the investor provide written undertakings to purchase goods of Canadian origin or goods

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9. For record of the Statements and reservations made by delegations,see General Agreement on Tariffs and Trade,Basic Instruments and Selected Documents, (Geneva,March 1984), 30th Supplement pp.141-42. cited in n.8. p.80

10. ibid. p.80

from Canadian sources,was inconsistent with Article III:4 of the General Agreement which stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of requirements affecting their internal sale, purchase, transportation, distribution or use. However, the Panel also found that the undertakings to purchase Canadian goods did not prevent the importation of goods as such and were therefore not inconsistent with Article X1:1 of the General Agreement (on prohibition of quantitative restrictions). Similarly,the Panel concluded that Canada did not act in violation of Article XV11:1 (c) of the General Agreement (which are argued by the United States,required that business decisions should be made only on the basis of commercial considerations), by requiring investors under FIRA to provide written undertakings that they would export a specified amount or production of their production.[11]

Argentina, in a submission before the Panel,had argued that the dispute involved two developed contracting parties and that the agreements invoked against developing countries,given the exception that the General Agreement accords

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11. No.9, pp. 165-166, cited in The impact of TRIMs on Trade and Development, (New York 1991). UNCTC, Sales No. E.91.II.A.19.

developing countries in order to promote the establishment at particular industry. In response to this agreement,the Panel recognised,that in any dispute involving less developed contracting parties,full account should be taken of the special provision of the General Agreement relating to these countries (such as Article XVIII C). The Panel did not examine the issues before it in the light of these provisions since the dispute only involved developed contracting parties.[12]

Even though the question of investment was informally discussed in the GATT in the early 1980s at the request of some countries which expressed concern at increases in the use to trade-related investment measures,it was during the preparatory phase of the Uruguay Round that the attempts to place investment measures on the GATT agenda gathered momentum. A proposal by the US to the Preparatory Committee in June 1986 called upon Governments to agree that the Uruguay Round negotiations should address the means to increase discipline over government investment measures which should be controlled and reduced in the light of specific articles and overall objectives of the General Agreement. The draft

12. UNCTC n.9, p. 158-166, cited in The impact of TRIMs on Trade and Development, (New York 1991). UNCTC, Sales No. E.91.II.A.19.

text for the Ministerial Declaration entitled "Investment" suggested by the United States specified that the negotiations should address,inter alia,government investment measures that direct investment flows and distort trade flows, thereby reducing that contribution of trade liberalisation to expanding World trade and economic growth. However, this attempt met with resistance from some developed countries. The mandate of the Round,as it was eventually formulated in the Punta del Este Ministerial declaration, reflects a balance between the interests of the various parties. The aim of the negotiations on TRIMs were specified in the mandate as follows:

> "Following an examination of the operation of GATT Articles related to trade-restrictive and distorting effects of investment measures, negotiations should elaborate,as appropriate, further provisions that may be necessary to avoid such adverse effect on Trade."[13]

The Mid-Term Review Decision of the Trade Negotiations Committee,held at Montreal in December 1988, articulated this negotiating objective in a procedural fashion,in the form of a series of elements:

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13. "Ministerial Declaration on the Uruguay Round" in <u>Uruguay Round: Papers on Selected Issues</u> (UNCTAD/ITP/10), P.369.

* Further identification of the trade restrictive and distorting effects of investment measures that are or may be covered by GATT Articles,specifying those articles.

* Identification of other trade restrictive and distorting effects of investment measures they may not be covered adequately by existing GATT Articles but are relevant to the mandate of the Group given by the Punta del Este Ministerial Declaration.

* Development aspect that would require consideration.

* Means of avoiding the identified adverse trade effects of trade-related investment measures including,as appropriate,new provisions to be elaborated where existing GATT Articles may not cover them adequately.

* Other relevant issues,such as the modalities and implementations.[14]

The mandate specified in the ministerial Declaration gave rise to two different interpretations in the negotiating process. On the one hand,the developing countries have

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14. "Mid-term review agreements", News of the Uruguay Round, (Geneva, 24 April 1989), p.23.

argued that the aim of the negotiations is to elaborate appropriate provisions for the avoidance of adverse effects on trade caused by investment measures,and not the disciplining of investment measures per se. Such effects would need to be identified through a case-by-case examination of investment measures. The developed countries, on the other hand,have argued that the effects often cannot be isolated from the measures and consequently any serious attempt to tackle the trade-distorting effects of investment measures would have to deal with the measures themselves. The major divergence in the negotiations on TRIMs can be seen as emerging from these two interpretations.[15]

TRIMS: WHAT IT MEANS

Any investment resulting in production is bound to have an effect on trade and is thus "trade-related". Trade-related investment measures are measures adopted by host-country governments[16] to attract and regulate foreign direct

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15. ibid. p.24

16. Home countries also apply two kinds of TRIMs -

a) "Export limitation on Foreign Affiliates", this has possible economic impact of restricting trade.

b) "Preferential taxes for income on Investments",this will subsidize investment. Cited in UNCTC, New Issues in the Uruguay Round of Multilateral Trade Negotiations, UNCTC Current studies,series A, No.19 (U.N publication, sates No. E.90.II. A.15)

investment in their territories. They are mainly of two kinds. The first kind consists of a series of incentives designed to attract investment,such as fiscal incentives, loans, tax rebates,provision of services on preferential terms etc. The second kind, a series of requirements or conditions, which are designed to encourage the use of investment according to national priorities. They can take the form of local content requirements,manufacturing requirements, export performance requirements, technology transfer or licensing requirements.,etc. The use of these two kinds of measures may constitute the terms and conditions for the entry of investment into the host country.

Many developed and most developing countries resort to both these kinds of measures.[17] Since third World countries need foreign investment,they feel impelled to provide incentives to attract the investor,particularly at a time of scarce capital in the World. But even while doing so,many countries also stipulate conditions for a number of reasons. The chief among these relate the their need and desire to ensure:

...Continued...

a) That the investment, are in accordance with their development needs.

b) That the net outflows (on their current and capital accounts) whether by way of profit remittance or payments for goods and services etc. do not cause strains on their balance of payments, that the restrictive business practices of the TNCs are kept under control and their adverse effects on their local economies reduced, if not eliminated.[18]

The following is a brief explanation of some investment measures by host countries to regulate the behavior of TNCs in their country with particular reference to the link between these measures and RBPs and their role in countering the effects of such practices.

1. Export Requirements :

Such requirements typically oblige an investor to export a fixed percentage of production, a minimum quantity or value of goods, or (like a trade-balancing requirement) some portion of the investments import balance. Foreign investments necessarily involve obligations for repayments. Hence countries with balance-of-payments difficulties like

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18. C.Raghvan. no.1, PP.147-148.

to reduce the net outflow of foreign exchange by insisting on export requirements in relation to such investment. Beside such requirements may stem from an effort by governments to counter international market allocation by foreign enterprises. Restrictive Business Practices such as international market allocation by foreign enterprises. Restrictive business practices such as international cartels, for example, can artificially distort-trade and,among other things, allocate international markets and restrain or block exports from a given country. Similarly, TNCs might allocate markets among their subsidiaries with the sole aim of securing access to a given host-country market through the opening of a local production subsidiary, with no intention of exporting form their new manufacturing base. Sometimes export requirements are imposed in return for special treatment accorded to foreign investors in the domestic market,such as through fiscal incentives. Export requirements are, therefore, a means for host-country governments to curb export prohibitions at the enterprises level,and they can also help to ensure proper quality for the products,as these will have to compete in the World market.[19]

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19. <u>Papers on Selected Issues : Uruguay Round</u> (New York 1990), UNCTAD/1TP/10, PP.113-114.

2. Local Content requirements :

Such requirements typically oblige an investor to produce or purchase form local sources some percentage or absolute amount of the value of the investor's production. This measure can thus be another effective way of reducing the net foreign exchange outflow. It can also be a response by the host-country government to vertically integrated TNCs holding a dominant position of market power which might otherwise never seek to purchase intermediate inputs from a local source. Local content requirement also introduce imports of intermediate inputs,thus limiting the scope for transfer pricing and differential or predatory pricing by the foreign enterprise. They may also induce foreign firms to envisage extending the range of products manufactured locally,thus contributing to the process of industrialisation and helping to improve product quality. Moreover, they may be imposed in order to provide an additional margin of protection to domestic producers of particular intermediate goods. Finally, they can also strengthen the countervailing market power of producers of domestic inputs in as much as they offer protection against differential or predatory pricing by foreign supplier aimed at eliminating local

production.[20]

3. Trade-balancing requirements

Trade balancing requirements typically restrain an investor from importing more than an equivalent amount or some proportion of exports. The investor may be obliged to earn through exports all foreign exchange necessary for the purchase of imported goods or components. As for local content and export requirement,trade balancing requirements aim at limiting the net foreign exchange outflow. They also strengthen the position of domestic producers vis-a-vis suppliers of imported intermediate inputs,there by enabling them to combat international market allocation arrangement among foreign firms, long-term exclusively contract or tied selling arrangement.[21]

4. Technology transfer and licensing requirements

The basic objective of such measures is to acquire the advanced technology that is so important for development. They are also used to strengthen the bargaining position of the host countries in international contract negotiation. Requests for a technology unrelated to the proposed project but of licensing requirements are part of the bargaining

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20. ibid. p.214

21. 21. ibid. PP.213-214

process of the host country aimed at strengthening the position of domestic firms in contact negotiations with foreign corporation.[22]

5. Domestic Sale requirements :

These requirements impose on the foreign investor an obligation to sell in the domestic market at prices those below in the World market. A host government employs such measures to ensure that certain products are available in sufficient for the needs of local entities. They might constitute the counter measure to refusal to deal or unfair (cartel) pricing on the part of foreign exporters. Such requirements may be necessary in certain sectors for local entities which would otherwise be forced to import such products at exorbitantly high prices.[23]

6. Investment incentives :

These are used to attract foreign investments in areas in accord with national development priorities. These are used not only by developing countries but a large number of ICs too, for attracting investment or persuading investors

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22. ibid. PP.214-215

23. ibid. p.215.

to open production in backward areas.[24]

7. Limitation on remittance and other foreign exchange restrictions.

Limitations of the outflow of profits and other remittances is mainly aimed at reducing pressures on the balance of payments of host countries.

8. Product mandate requirements or export requirements :

such requirements typically oblige the investor to earmark a specific product for export. As a government-imposed market allocation, this requirement counters enterprise-to-enterprise market allocation or exclusively contracts. Apart from countering a restrictive business practice, it may be helpful also for balance-of-payments reasons.[25]

9. Manufacturing requirements and imitators :

This TRIM reserves certain markets to local firms and is designed to counter international market allocation by TNCs by assuring "countervailing market-power" for local producers who might otherwise be eliminated by foreign competition. They can be used by the host-country govern-

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24. No.17......,p.150

25. ibid. p.151

ments either to avoid abusive pricing practices by TNCs (eg. pharmaceuticals) or to protect local firms from predatory practices.[26]

10. Local equity requirements :

Local equity requirements typically specify that a certain percentage of the equity of a company created by foreign investment be held or controlled by local investors. This measure is aimed at ensuring for local management a degree of control over the local subsidiary.[27]

CHARACTERISTICS OF TRIMs[28]

This study of characteristics of TRIMs are based on seven major empirical attempts to gather information about TRIMs characteristics. They are as following[29]

(1) The US Department of Commerce Benchmark surveys (1977 & 1982).

(2) The US International Trade Commission study (1982).

(3) World Bank study (1985)

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26. ibid. p.152

27. ibid. p.153

28. The Impact of TRIMs on Trade and Development (A UN Publication, New York 1991 Sales No-ST/CTC/120, E.91.II.A.19

29. For details see no.28

(4) The 1985 United States Trade Representative dater (1986)

(5) The Overseas Private Investment Corporation Study (1987)

(6) The 1989 US Trade Representative survey. (TRIMs)

(7) The 1989 US Trade Representative survey (by Indesly)

On the basis of above mentioned surveys and reports, following characteristics of TRIMs may be spell out-

1. Categories of Industry: There appears to be a wide difference among industries in the incidence of specifically designated TRIMs requirements. In all studies the automotive industry appears to be a prime target (27 percent of united States overseas automotive affiliates surveyed in the Department of commerce Benchmark survey, 75 percent of the World Bank automotive sample, more than 80 percent of automotive subsidiaries in the ITC samp). For food processing, the World Bank study found 48 per cent of the projects subject to TRIMs. In chemicals and petrochemicals, the World Bank study found a large number (no prices figure given) with TRIM requirements;the ITC survey found 12 per cent. In computers and office equipments, the ITC study discovered 19 per cent of the projects with TRIM requirement;

the Gusinger study suggested TRIMs were infrequent and unimportant. Complicating the findings, however, the USTR lists 42 to 51 countries as having TRIM regulations applying to "all industries.

2. Categories of TRIM requirements : In automobiles and chemicals, local content TRIMs are generally more prevalent than export minimums. In computers and office equipment, export minimums are more prevalent (ITC study). In chemicals and petrochemicals, both local content and export content and export performance TRIMs are used. The sample of OPIC cases suggests that, when TRIMs are used,export and import requirements are frequently combined and export and import balancing is frequent. The OPIC sample also suggests that local content requirement are often required only if inputs of comparable price and quality are available. Finally, the OPIC sample showed that when TRIMs are required, they are often compensated for by other types of favorable treatment (63 per cent).

3. Coverage of Investors : In contrast to the raw data on numbers of countries with TRIMs on the books,the data on coverage of investors suggests that developed country regulations cover move breadth of investment. Using the USTR information on United States direct investment

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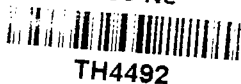

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in each country (in 1987) as a proxy to measure the extent of investment potentially touched by TRIMs, the amount of United States investment covered by local content and trade-balancing TRIMs is $ 24 billion in the "middle income developing countries". The corresponding figures for United States investments potentially affected by export TRIMs are $ 17 billion in the former $ 72 billion the latter. United States investments potentially affected by incentives amount to $ 195 billion in "middle income developing countries". For those countries where there is a listing of TRIMs applied to "all industries", the comparative figures are $ 38 billion in the "middle income developing countries" and $212 billion the "developed countries". Finally, the amount of US investment in the countries with the most extensive presence of TRIM regulations is $ 30 billion in the top 20 "middle income developing countries", versus $ 230 billion in the top 20 developed countries.

4. Categories of countries : TRIMs are found in both developed and developing countries. TRIMs are more likely to the found in developing countries than in the developed countries,and these is a greater number of former with TRIMs than the latter. Nevertheless,there

may be "implicit" TRIMs which are not widely recorded in conventional studies. Debates about "rules of origin" in European community (and elsewhere) are essentially negotiations about local value-added requirements. The controversy about whether the Government of France would count Bluebird cars imported from Nissan plant in the United Kingdom as part of parent company non-European import quota into France,or alternatively as a European built can for example, revolved around whether the 70 per cent United Kingdom local content of the Bluebird would satiety the French minimum of 80 per cent.[30]

5. Incidence : It is a challenge to determine the actual incidence of TRIMs. There is a wide disparity among studies which report,or infer,the frequency of TRIM usage. In the case of developing countries, for example,the more comprehensive surveys (1977 and 1982 United States Department of Commerce benchmarks) found a total of no more than 6 per cent of United States foreign affiliates subject to TRIM requirements (taking overlap into account). The much

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30. For details see Trade-related aspects of intellectual property rights and trade-related investment measures UNCTC (New York 1990), E/C.10/1990/13,7, P.16.

narrower OPIC survey, however, discovered 40 per cent of the small sample subject to TRIMs. The World Bank study recorded 51 per cent on an even smaller number of cases subject to TRIM requirements.

From above two complementary explanation suggest themselves. They are First: the majority of the TRIMs by pathetically in force in various countries may be discretionary and negotiable,with firms not having to comply it the terms are too onerous (or if they are in a strong enough bargaining position to rarest). This would reconcile the otherwise conflicting evidence that a large number of countries with a great deal of foreign direct investment within their borders have TRIMs on the books, while most of the investors do not report that their subsidiaries are governed by TRIMs. This explanation is consistent with data released by the USTR in 1985, where 58 per cent of the TRIMs in 91 countries were reported to be discretionary and negotiable.[31]

Second : The majority of the TRIMs may not require the investor to undertake actions the parent firm finds up economic and/or is not planing to undertake anyway (such TRIMs are redundant). This would explain why even the large number

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31. For details see United States Trade representative, Office of investment Policy Inventory of investment barriers, 22 October 1985.

of firms operating in countries where TRIMs were actually in force did not consider themselves "subject to TRIM requirements". This interpretation of the evidence finds support in the OPIC study, in which 83 per cent project subjects to TRIMs merely required the investors to carry out activities (local sourcing,exporting) which they planned to do their own. Similarly,in the World Bank study, corporate officers reported in several of the 38 cases subject to TRIMs that their subsidiaries would eventually have achieved the specified levels of exports or domestic content; the TRIMs merely accelerate the firms' plans to develop local suppliers and enter export markets.

POLITICAL ECONOMY OF TRIMs : CHALLENGES & STAKES

The Third World countries who got independence after World War II are characterised with mass poverty and underdevelopment. For the overall development of society, in these countries, foreign capital investment is one of the most important factor, highlighting this point, Mr.R.N.Malhotra ex-governor of the Reserve Bank of India, said -"The Third World countries do require substantial external resource to maintain the tempo of investment growth. Along with official development assistance and commercial borrowing, private foreign investment can make an

important contribution to the rates of growth of these countries. Foreign resources, facilitates import of capital goods and technology which are not domestically available, and thus help to promote the diversification of the economic structure and its efficiency."[32] Thus developing countries have been looking for direct foreign investment from ICs (industrial countries) of the North, from both governmental and non-governmental agencies, i.e. TNCs.

The absolute level of flows of foreign direct investment going to developing countries has been increasing since the early 1980s. The size of the annual flows more than doubling since 1984, and reaching $25 billion in 1988. Shifts in its distribution suggest that significant competition exists among potential host countries, to avail the opportunity of Foreign Direct Investment (hereafter referred as FDI) to their countries. Developing countries also tend to change their polices and make liberalisation e.g in People Republic of China, following the adoption of a new foreign investment policy in 1979, inflows of FDI increased markedly during 1980, and reached $3.2 billion in 1988, 12 per cent of all inflows to developing countries in that

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32. Cited in Foreign Direct Investment and Technology Transfer in India, (UNCTC publication), sales no. SC/STc/117 p.9.

years,... however transnational corporations found that the administrative apparatus continued to be cumbersome and time consuming, thus FDI declined in China".[33]

But the Third World countries, since decolonisation have brought to bear to their development an element of planning, and through incentives and regulations have sought to channelise FDI in line with developmental objectives, national priorities and to subside the restrictive business practices of the TNCs".[34] To regulate investment usually developing countries apply following investment measures" (TRIMs).

* Local content requirements (the foreign company must use a specified minimum ratio of local materials in its production.
* Export requirements (obliging an investor to be part a fixed percentage of production);
* Trade-balancing requirements (restraining an investor from importing more than an equivalent amount or some proportions of exports);

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33. ibid. p.36

34. ibid. p.40

* Local equity requirements (specifying that a certain percentage of the company's equity be held by local investors);
* Limitation on remittance of profits and other foreign exchange restrictions; and
* Manufacturing limitations (reserving certain markets to local firms to protect them from being eliminated by foreign competition)[35]

Developing Countries have argued that these measures are needed to protect their countries' balance of payment position, to prevent unethical TNC practices such as transfer pricing or monopolistic market allocation, to ensure the survival and development of local industries or to ensure a certain degree of economic sovereignty or to counter restrictive business practices of the TNCs.

The developed countries, however, want the Third World to remove most of the existing TRIMs. They argue that TRIMs distort free trade because they have an influence over conditions of production and thus over costs and prices. They also insist on national treatment' that foreign investors be treated the same as local investors.

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35. For details see pp. 13-19, of this disertation.

While the Third World countries are willing to negotiate on the trade-distortive effects of investment measure, the industrial countries want to prohibit the measures themselves. If the US proposals are accepted, Third World government would no longer be able to require foreign firms to have local equity participation or to transfer technology, to have local content in its output or to limit foreign exchange outflows.

The rights of the foreign investors are also to be safeguarded by providing that the government of the investors's home country can take up the purported violation with the host government. Failing a satisfactory outcome, the company's government can negotiate against the trade and property of the host country. Thus the right to retaliation will give 'bite' and ensure enforcement of the foreign investor's right.

Moreover, the proposals would enable cross-linkages and retaliation, enabling home countries of foreign investors to retaliate against the goods exported by an offending country.

The EEC and Nordic countries take the argument even a step further, by proposing that the removal of restrictions

on investments be applied not only to foreign investors but also to domestic investments. They argue that since any investment measures could have a trade distorting effect (an the affect trade of other countries in third markets) the GATT rules should apply to both foreign and domestic investments.

Since the local investors may be unable to defend themselves against their own governments, regulations, the GATT regime should make all offending measures as "GATT illegal". A foreign government could even intervene on behalf of a local company against its won government if it were to raise a complaint about being affected by a TRIM.

These proposals go far beyond the curbing of distortive effects on trade in goods and far beyond the present GATT mandate. They amount to the establishment of a full-fledged system to regulate both foreign and domestic investments, to spell out and enforce the rights of investors by forbiding governments from imposing many inevitable existing conditions and restrictions on investors.

According to C.Raghvan, a senior Indian journalist and GATT observer in Geneva. "The scope and sweep of the US proposals go even beyond the claimed property rights of foreigners, rights backed by gunboat diplomacy and military

occupation, that prevailed in colonial era, and now sought to be reinstated and backed by trade sections". In this envisaged new investment system, GATT is seen to be the world policing agency.

These proposals are being fought by Third World countries. In March 1990, A GROUP OF 14 Third World countries (including Argentina, Brazil, China, Cameron, Egypt, India, Nigeria, Tanzania and Yugoslavia) submitted their own proposals, opposing the use of the Uruguay Round to create rights for investors or to prohibit investment measures. Instead, the negotiations should be confined to tackling adverse trade effects of investment measures and within the existing GATT framework.

They argued that investment measures were used by governments to fulfill social and development objectives and to counter corporate behavior that threatened these objectives. Investment measures such as local equity, remittance and other foreign exchange restrictions, technology transfer and licensing, were used to promote development and had no impact on trade. Some other measures, though trade-related, did not significantly affect trade and the trade effects were beneficial to the Third World countries and thus justified for development considerations.

These countries in their proposal stated that the clear intention of the Uruguay Round mandate was to focus on trade restrictive and distorting effects of investment measure-and not to establish an international investment regime nor to circumscribe the capacity of governments to employ investment measures per se.

Investment measures were used to fulfill social and economic policy objectives. Thus the countries rejected any a priori presumption that investment measures were inherently trade restrictive and distorting. If it can be shown that an investment measure had a direct, significant adverse trade effect, a clear causal link would have to be established between the measure and the alleged effect. If such a link is established then appropriate ways would have to be found to deal with the adverse effects, and not to measure themselves.

They also argued that investment measures are legitimately and justifiably used by the Third World to promote development, enhance employment and also to offset trade restrictive and distorting effects of corporate practices. They defended the use of many investment measures which the industrial countries seek to outlaw. For example :

* Local content requirements are important to encourage the use of locally available inputs and promote local industrialisation; as well as to prevent foreign firms form importing parts from their parent companies even if comparable local inputs were available.
* Domestic sale requirements (obliging foreign forms to sell in the local market) were intended to ensure that some products were available locally in sufficient quantity atappropriate prices.
* Local equity requirements were aimed at ensuring a degree of control for local management, encouraging, local savings and technology transfer, and for national security reasons.
* Remittance and other exchange restrictions were used to reduce balance of payments pressures on host countries.
* Export requirements were also used to improve a host countries foreign exchange position and to counter the possibility of foreign firm blocking exports due to international market allocation strategies.

The Third World viewpoint is that the prohibition of such investment measures would tantamount to establishing a world investment regime that grants tremendous freedoms to TNCs whilst prohibiting governments from taking legitimate

measures to protect their countries from unethical corporate practices or to promote growth of locally controlled economic activities. Any country that broke the new laws would face retaliatory sanctions. this tremendous widening of the powers of GATT was unacceptable to the Third World.

Although the Third World views were submitted to the chairman of the TRIMs negotiating groups at his request, third World delegates were generally disappointed when in May 1990 he presented a draft text of an agreement on an international investment regime that reflected the viewpoint of the US, Japan and the EC whilst completely ignoring the views into and official submissions of the Third World countries.

GATT AS AN INSTRUMENT OF DIPLOMACY

The GATT (General Agreement on Tariffs and Trade) is a multilateral treaty which has been signed by over 100 governments at present.[36] Over 30 other countries apply GATT rules de facto. GATT is not an organisation and its signatories are not known as members but contracting parties. It is a forum where the contracting parties meet from time to time to discuss and solve their trade problems. The GATT

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36. In September 1990 Venezuela, Bolivia and Tunisia joined GATT. The same year Costa Rica because 100th contracting party after ratification.

rules provide for the settlement of trade disputes, call for consultations, waive trade obligations and even authorised retaliatory measures. This treaty now covers over 74% of the world trade.[37]

The GATT stands with the World Bank and the IMF as one of three institutions established at Bretton Woods that have meant so much to the Western world. Although the Bank and the Fund have always been firmly based, GATT started off as the ailing sibling.[38] As the Allied powers thought of having a liberal world trading system after second World War, the International Conference on Trade and Employment was held in Havana in the winter of 1947-48. But the US Congress did not ratify the Havana charter.[39] As a result, a GATT, which was intended to form ITO (International Trade Organization) emerged alone from the ashes of Havana charter

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37. Benno Engles, "GATT and the Developing Countries", Economics (Tubingen West Germany) Vol. 39, pp.28-29.

38. Dennis Thompson, "GATT's Fortieth Birthday", Journal of World Trade Law, Vol. 22(1), 1988, p.5.

39. The US Congress refused to ratify the Charter because it would have meant ceding to the ITO (International Trade Organization) some part of US sovereignty and agreeing to forego some rights of the Congress and the US government in the area of trade policy.

as a provisional treaty without any organization.[40]

In spite of its troubled start, the makers of GATT have contrived to prove it a success.[41] It served to guide the growth of international trade but this, along with its goals[42] and objectives,[43] is being questioned in recent years.

Chakravarthi Raghavan writes,

> "One of the myths surrounding the GATT is that its seven trade rounds brought about the liberalisation of trade

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40. 53 nations had drew up and signed Havana Charter. The GATT was signed by 23 nations on 30 October, 1947 and came into force on January 1, 1948, when other nations had also signed it.

41. "GATT was a less ambitious organization....It would serve as a sort of clearing house between nations." Bo Sodersten, International Economics (London, 1985), P.233.

42. The ultimate goal of the GATT is "to raise living standards ensure full employment through a steadily growing effective demand and real income develop fully the resources of the world, and expand the production and exchange of goods on a global level". M. Jhingan, International Economics, (New Delhi, 1988). p.414.

43. The objectives of the GATT are based on a few fundamental principles contained in the code of International Trade Conduct:

    1) To follow unconditional most-favoured-nation(MFN) principle.

    2) To carry on Trade on the principle of nondiscrimination, reciprocity and transparency.

    3) To grant protection to domestic industry through tariffs only.

    4) To liberalise tariff and non-tariff measures through multilateral negotiations.

and the expansion of the world economy since 1945. It will perhaps be more correct to say that the post-war expansion of the world economy, the so-called Golden Age of the industrial world, has been the result of the operation of a number of macro-economic processes intervention to promote expansion. The expansion of trade was an effect rather than the cause of world economic expansion".[44]

The GATT process was instrumental in satisfying the demand for space for the MNCs. All the tariff cuts in the past rounds echoed this purpose, and dealt essentially with issue of 'market access'. It is true that Europe and Japan benefited by the GATT Rounds and their exports expended. However, the post-war reconstruction and expansion of production in Europe was essentially the result of the massive US Marshall Plan aid. The GATT modality of negotiating and extending concession, tariff and non/tariff, meant that the DCs in successive negotiations reduced their mutual tariff and non-tariff barriers, but not those in respect of exports of Third World countries. Thus Third World countries did not benefit, by and large, from these trade liberalisation measures. They did derive some indirect benefits because of the trickle down effects of global economic expansion and the exchange of trade concessions among the major DCs in industrial products where the Third World countries were minor supplier.

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44. Raghavan, n.1, pp.49-50.

Side by side with these tendencies for trade liberalisation, there were also contrary trends. When the cotton producing Third World countries began exporting cotton textiles,[45] the protectionist counterforces began asserting themselves. These have since been institutionalised in the Multi-fiber Agreement (MFA) and its successive protocols of extension.[46] All such discriminatory and 'managed trade' arrangements represent the price paid by the Third World countries for the launch and conclusion of successive GATT MTNs (Multilateral Trade Negotiations) or rounds for trade liberalisation.[47]

After the initial flush of independence,and hopes that with independence economic prosperity would be automatic,

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45. Some like India, Pakistan and Egypt were GATT contracting parties from the outset. It is also interesting to note that Japan was allowed to join the GATT only after it had agreed to bilateral restraints on exports of textile to the US.

46. Recently, during Uruguay Round an agreement has been arrived at to phase out MFA, in a period of ten years.

47. The concessions exchanged among DCs would normally have had to be extended to Third World countries under Article 1 of the GATT for most-floured-nation treatment.

disillusionment set in by the early 1960's.[48] The GATT theories and the actualities of the trade negotiations, with the Third World having no voice and deriving no substantive benefits, were additional factors in their disillusionment. In GATT, The Heberler Committee's report and on GATT recommendations led, at the 1963 GATT Ministerial meeting to the adoption of conclusions and recommendations on a Programme of Action [49] for measures for expansion of trade of Third World counties. But these have remained largely unimplemented, though figuring on the agenda of successive rounds. In 1964, the GATT sought to accommodate the Third World by incorporating special provisions relating to 'Trade and Development' in Part IV. Essentially a best endeavor framework involving no commitments, these provisions came into

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48. Of the original 23 signatories, 11 were less developed contracting parties. Two of them (Lebanon and Syria) dropped out and the third, China (Taiwan) withdrew in 1951. In the first phase of decolonization, the newly independent countries all joined the UN, and most of them the IMF and the World Bank. But very few rushed in to GATT. Later they slowly joined it. Today, out of around 100 contracting parties, 70 are 'less developed' (Almost all from the Group - 77 countries, who now number 128).

49. These, among others, called for standstill on new barriers to export trade of these countries, removal of quantitative restrictions inconsistent with GATT, duty-free entry for tropical products, elimination of tariffs on primary products and reduction and elimination of barriers on semi processed and processed exports of the Third World, and progressive reduction of internal charges on products wholly or mainly produced by Third World countries.

force the next year. But they have remained previous exhortations, and have not been translated into commitments or obligations like the other parts of the GATT. So, GATT has been used in the past by the DCs for their own ends, because of following reasons and weakness of South.

Firstly, trade (with communication) is the biggest interface of nations with others. The Third World nations, struggling to sell abroad and earn foreign exchange to import necessities and investment goods and intermediate inputs, are most vulnerable at this front. A country can, by not seeking their resources, at least for a while, defy the IMF and the World Bank, and escape their influence and conditionalities. But it is difficult for any country to shut itself off from trade with the outside world. Although World Bank is able to hold out a carrot, it is unable to wield the stick, which the trading system and its retaliation provisions (Section 301 etc.) provide. One of the efforts in the Uruguay Round is to enable the three to combine forces in influencing trade and economic policies of the South.

Secondly, among the foras dealing with such issues, the Third World countries are at the weakest inside GATT in terms of collective organisation and bargaining. They do not

negotiate or bargain collectively inside GATT. They seem to have accepted the dogma that GATT is a 'contract' among individual 'contracting parties' with varying interests and that there are no North-South difference but only differing trading interests.[50] Unlike in UNCTAD, UN or other agencies of the UN system, inside GATT there is only a tenuous informal group of 'less developed contracting parties'[51] that meets from time to time to exchange information, and occasionally present a joint paper or statement. Helped by the 'non-transparent' (hidden and lack of openness) processes of GATT, the representatives of some of the Third World countries take positions inside GATT that are contrary to what they take in NAM or UNCTAD. It is a result of the internal contradictions of the South. But the major trading nations, despite their mutual differences and trade quarrels, have always been aware of their general common interest against

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50. At one stage, in the preparations for the 1982 GATT Ministerial meeting, the US had talked of a new North-South trade round, of the DCs exchanging trade concessions with the NICs, and in return for their own concessions to the NICs forcing them to open up their markets to other Third World countries. But very soon this North-South dimension dropped out of the US terminology.

51. It is the GATT term for Third World countries. The informal group includes Israel and Turkey (an OECD member). Until their accession to the EFC, Greece and Spain also formed part of the group.

the South and have been concerting together.[52]

Thirdly, unlike in other fora where the South can muster at least the verbal and rhetorical support of the Socialists, in GATT, the Socialists' support cannot be counted on. In the current state of East-West relations, there are even doubts as whether the East could any longer be counted on to support the South. For their own reasons, including their primary aim of reducing or eliminating the built-in discrimination against them on the ground of the role of their state enterprises and trading entities, the East European socialist countries inside GATT (Hungary, Poland, Czechoslovakia) take a low profile, and sometimes take positions closer to that of the West.[53]

Fourthly, negotiating process inside GATT is another reason for insistence of the DCs for TRIMs talks in it.

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52. The US, EFC, Japan and Canada meet regularly on trade issues, at so-called quadrilateral meetings and overall economic co-ordination is done at the meetings of G-5, G-7, G-10, and at annual Ministerial sessions at the OECD. They do no break ranks among themselves, as the behaviour of Australia, Canada and New Zealand (in the Cairns group) at the Montreal midterm review meeting of the Uruguay Round in 1988 showed.

53. China is trying to resume its status as a GATT contracting party and is negotiating the terms of its resumption, and thus taking a relatively low profile. Bulgaria has applied to join. From 1983-84, The USSR had been making unofficial soundings about joining GATT. In March 1986 they expressed the desire of becoming on `observer'.

While all inter-governmental negotiations are in private the GATT processes are the least transparent. With very rare exceptions for ceremonial purposes, all GATT meetings are behind closed doors, without the obtrusive presence of the media[54] or non-governmental organisations (NGOs) of consumers and other public interest groups. Major MNCs are often around such meetings as `advisors' to their delegations. GATT documentation are all `restricted', except when there are specific decisions to be made public, often long after the event. There is no group or representational system of negotiations in GATT, as in UNCTAD and other UN agencies, but only the informal `green room consultations,.[55] This makes it easier to forge and strike deals which may be against the public interest before the public is fully aware of what is happening. Participation in these consultations is by `invitation' and those invited are selected by a non-

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54. The media reportage of GATT activities, and of the Uruguay Round, is mostly based on what the GATT spokesmen reveal to the Press (copious on viewpoints of the industrial world but very sparse on that of Third World countries), or what any interested delegation chooses to reveal often in unattributable background briefings. Coupled with the US domination of information channels, this makes manipulation of the media and management of news easier in GATT.

55. The `green room consultations' is the code name for GATT's decision-making process, and is so named after the wall-paper decor of the GATT Director General's conference room in Geneva, where these consultation take place. The understandings reached in these consultations are presented formally to others, often with only a few hours notice, and rammed through.

transparent process. Third world invites vary (with some invited because their diplomats if excluded could be a nuisance at the formal meetings) in these consultations.

Another factor is the negotiating environment. The very atmosphere and makeup is intended to overawe anyone opposing the viewpoints of the DCs. There is a fetish about participation at level of ambassadors. Third World countries, who cannot always field ambassadors (who in Geneva are often delegates to several UN agencies) are often represented by their junior officials, who are expected to take notes and are discouraged from active participation. Moreover, although in their, all contracting parties are equal; and GATT's consensus decision-making process is the most democratic with the big and the small having the same equal voice. But, in practice, when ever the small have tried to assert themselves, they have been ignored or sought to be overawed by the arguments that the countries with the largest share of the world trade have more at stake. This was openly stated during the preparatory stages of the Uruguay Round when repeatedly the US spoke of the `trade weight' of the US, EEC, Japan and the OECD countries that supported the Round and its new themes as against the low `trade-weight' of the few who opposed it and whose voice should hence b

ignored. This concept is practiced even more widely in GATT's actual decision-making. In the full meetings of its bodies the adoption of decisions is only a formality. Real decisions are taken in the green room consultations and other informal channels of negotiations.

These are the reasons behind bringing the issue of TRIMs by the Dcs on the agenda of GATT. They will be using GATT, as in past, as an instrument in their diplomacy towards achieving the desired ends. So, GATT appears to be hamstrung by born-again protectionism on both sides of the Atlantic. Despite their genuflections to free trade and 'outward-oriented' strategies of development, the DCs are increasingly unwilling to play by GATT's 'Rules of the Game'. In a world of paradoxes it is China and the USSR which are knocking on GATT's door for entry into the world market and it is the US and the EC which are raising barriers to trade.[56]

URUGUAY ROUND : A DIPLOMATIC OFFENSIVE OF THE NORTH

The GATT has completed seven rounds of multilateral

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56. Sanjay Baru, "GATT: Winter of Discontent", Economic and Political Weekly, Jan. 7, 1989, p. 15.

trade negotiations (MTN).[57] An eighth round was launched in September 1986 at the Uruguan resort of Punta del este. It was scheduled to end in 1990 but now assent on Dunket Draff is awaited'. In charge of the overall negotiations is a Trade Negotiations Committee. Reporting to the Committee there is a Group of Negotiations on Goods (GNG) and a group of Negotiations on Services (GNG).[58] Overall there are 15 negotiating groups,[59] three of which consider issues never before examined in multilateral trade talks. These are TRIPs, TRIMs and Services.

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57. The first conference was held at Geneva in 1947, the Second at Annecy (France) in 1949, the third at Torquary (England) in 1950-51, the fourth at Geneva in 1955-56, and fifth at Geneva (Dillon Round) between 1954-62, the sixth at Geneva (Kennedy Round) between 1963-67 and the seventh at Tokyo between 1973-79.

58. The GNS is separate from GNG because developing countries would not participate in the negotiations on services as GATT Contracting Parties. Hence, Punta del Este meeting had a separate section on services, which referred to `interested parties' rather than `contracting parties'. Murray Gibbs and Mina Mashayakhi, "Services: Cooperation for Development". Journal of World Trade, Vol. 22(2), 1988, p.81.

59. Within the GNG there are 14 sub-groups, each of which examines particular issues :(A) General Trade Liberalisation Measures -- 1. Tariffs 2. Non-tariff Measures, (B) Sector Specific Trade Liberlisation Measures -- 3. Natural resource Based Product 4. Textile and clothing 5. Agriculture 6. Tropical Products, (C) Improvement of GATT legal framework - 7. GATT Articles 8. Agreements and Arrangement 9. Safeguards 10. Subsidies and Countervailing Measures 11. TRIPs 12. TRIMs (D) Improvement of GATT as an institution -- 13. Dispute Settlement 145. Functioning of the GATT System.

The primary and overall objective of the round is to strengthen and broaden the GATT system. The Ministerial Declaration, which launched the round drew a link between trade, growth and development.[60] In response to developing country concerns and aspirations, it explicitly states that trade is seen as a means of promoting growth and development rather than as an end in itself.[61] This Round is the most challenging undertaking in GATT history, not only because of the worsening of the world trading conditions, but also due to its complex and diversified agenda. In a trading environment characterized by increasing bilateral measures, the Round can function correctively by reaffirming non-discrimination and genuine multilateralism, thus preventing welfare losses to weaker trading partners. Furthermore, the Uruguay Round presents an opportunity for decisively incorporating the 'development dimension' into the multilateral trading system.[62] The South Commission has stressed that in a number of respects the outcome of Uruguay Round may vitally affect the domestic development and future options of the

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60. Phedon Nicolaides, "GATT at the Crossroads". European trends, No. 1, 1989, p. 49.

61. Uruguay Round: Further Papers on Selected Issues, (New York: UNCTAD. UNDP. 1990), P. XIII.

62. South Commission's statement at third meeting at Mexico, 5-8 August, 1988. Cited by Raghavan, n.1, p.26.

developing countries.[63]

However the progress of the negotiations in the Uruguay Round has been uneven from the perspective of the points mentioned above. On the new issues like TRIMs, the pace of negotiations has continued to accelerate, while negotiations on traditional market access issues have been rather slow. Th GATT has been associated in the past with a fair amount of success in reducing trade barriers. Average tariffs in industrial countries have fallen from 40% in 1947 to 15% in 1962 to 5% by the beginning of the Uruguay Round.[64] But the stress in this round is definitely on new issues like TRIPs, TRIMs and Services.[65] Given the potential impact of some DCs proposals and the intensity of bilateral pressures, it is becoming increasingly difficult to visage the emergence of a package which will prove adequate to the actual needs of developing countries. The Tokyo Round, with far fewer items on its agenda, took seven years and left behind much unfinished business, mostly of concern to the Third World.

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63. Baru, n. 56, p.15.

64. The EC's chief spokesman in GATT, Amb. Tran Van-Thinh, for example, told newsman in February 1987 that the new round is not about technical GATT issues like tariff and non-tariff measures, but about wider economic issues and trade policy. Cited in Raghavan, n.1, pp. 36-37.

65. Diplomacy preceding the Uruguay Round is discussed in Chapter 2.

This round is also similarly being manipulated by the DCs through their intense diplomatic endeavors.

The wisdom of launching the new round and its contents had been the subject of acrimonious debate between the DCs and the Third World countries. It is no exaggeration to say that the Third World countries were virtually dragged into the negotiations, much against their will and better judgment.[66] From the viewpoint of the Third World the Uruguay Round is an exercise with very far-reaching implications as under the new trade regime (that would emerge) the autonomy of developing countries in pursuing their development may seriously get compromised. The new round for the DCs is essentially for reorganising the international economy as per their needs. It has also to be seen in the wider geopolitical context of the efforts of the US to maintain its position as a global superpower because it finds its power under challenge not only militarily but also in terms of lits post-1945 status as the dominant centre in the capitalist world.[67] Through the Uruguay Round, the US is attempting

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66. See Paul Kennedy, <u>The Rise and Fall of the Great Pow ers'</u> (New York : Random House, 1987).

67. B.S.Chimi, "Political Economy of Uruguay Round of Negotiations : A perspective" <u>International Studies</u> Vol.29, No.2, 1992, PP. 136-37.

to incorporate into the GATT framework areas of economic activity and relations that are not strictly 'trade' issues - intellectual property rights,services and investment rights - and whose legitimacy for inclusion in the Uruguay Round has been sought by prefixing the words 'trade', 'trade in' or 'trade-related' before them. In reality,the DCs are using the Uruguay Round to continue their diplomatic offensive for setting up a new international regime, in the face of crumbling of the Bretton woods system,so that their economic, and thereby political, hegemony over the Third World countries may continue unperturbed and uninterrupted.

In December 1991, Arthur Dunkel, Director-General of GATT and chairman of the TNC, presented a set of proposals for consideration by the 108 participating states. The 436 page Dunket Draft Text (DDT) was offered as a single undertaking.

Dunkel proposals seeks, through the medium of GATT, to restructure international legal and institutional rules governing the areas of goods, intellectual properly rights, foreign investment and services in order to further the interests of global capitalism in a period of profound economic transformation brought about by rapid technological developments. The essence of this restructuring is to free

transnational capital from spatial and temporal constraints and obligation through an effective system of sanctions. From the perspective of the developing countries the DDT seeks to inaugurate a "new world order" in which the peoples of developing world are required to surrender their economic independence to international institutions in favour of transnational capital in the name of interdependence and free markets "------ This secession of economic territory to an international institution drastically reduces the possibilities of pursuing an independent path of development. DDT seeks to legitimise the invasion of the national economic space of the developing countries, decline selfdefence (i.e. independent economic development) GATT illegal, and insist on a policy of economic disarrangement (reverse policies of self reliance). The spatial relocation of the of national policy making process would thus deny any serious choice to the peoples of the developing world to shape their own future. On the other hand the content with which the DDT hopes to fill the empty concept of interdependence would ensure that it would never add up to justice for the already marginalised peoples of the world".[68]

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68. ibid. p.137

CHAPTER II

Chapter II

DIPLOMACY OF THE NORTH IN THE URUGUAY ROUND WITH SPECIAL REFERENCE TO THE UNITED STATES

PRE-URUGUAY ROUND NEGOTIATING POSITION OF THE UNITED STATES:

The U.S. believes that an open international trading system is in its best interest and has supported efforts to liberalize trade. International rules for regulating the two major deterrents to trade, tariff and non-tariff barriers have been established by the General Agreement on Tariffs and Trade (GATT) and the Tokyo Round of the Multilateral Trade Negotiations (MTN). But as some barriers to trade are lowered other appears to be rising. Some of the U.S. groups consider trade-related investment policies to be one of the key emerging barriers because these policies are relatively free of international regulation.

These investment policies, which are often intended primarily to attract and control foreign investment, can

also act as a barrier to trade. This happens when a foreign investor agrees to alter his trading or investing patterns in exchange for some incentive such as tax concessions or domestic market access.

Many developing countries feel justified in using such policies to encourage foreign investment, which stimulates domestic development, and minimise trade deficits. But concern in US is growing. There is the belief that these policies restrict trade and may cause production to be shifted from U.S plants and/or foreign markets may be closed to US exports. However, hard evidence to support these beliefs is not yet available.

There are two types of trade-related investment policies - performance requirements and investment incentives which may include subsidies, tariff concessions, tax forgiveness, preferential domestic market access and protection from other foreign competition.[1]

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1. For details see Table No.2.1, cited in President Excutive Council,"A Report To The President From The President's Export Council", April 1982. A White House Publication, (Washington. US.1982).

These policies by the developing countries are supposed to serve their national goals, and sometimes result in a form of protectionism. The 1977 Mexican Auto Decree, for development of Automative industry, is an example. It has as its stated objectives accelerating the growth of the Mexican automotive industry and assisting the industry to become a net exporter within five or ten years. To accomplish this goal, the Decree includes an array of performance requirements and investment incentives. Many US officials and groups such as the Labour-Industry Coalition for International Trade (LICIT) maintain that this policy is protectionist. They believe it will result in significant damage to US trade, production and jobs. On the other hand Mexican government views the Decree as a part of its overall development plan, and as a national policy not subject to foreign review.[2]

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2. See Table No.2.1 and 2.2

Table No. 2.1

TRADE-RELATED INVESTMENT POLICIES

INVESTMENT POLICY	DESCRIPTION	EXAMPLE
1. PERFORMANCE REQUIREMENTS Local Content Requirement Minimum Local Material Minimum Local Labor Minimum Local Equity Export/Import Requirements Minimum Export Maximum Import	A performance requirement is any requirement placed by a host government on a foreign investor and is often the condition under which various incentives are provided.	1. PERFORMANCE REQUIREMENTS Local Content Requirements - BRAZIL: 50% local value-added is required for special financing for minerals development. - CANADA: Investment approvals and Federal Incentives linked to local sourcing commitments. Export/Import Requirements - TAIWAN: Tax incentives tied to minimum export volume. - KOREA: Specific export requirements for export-import link system.
2. INVESTMENT INCENTIVES Tax Concessions Tariff Concessions Subsidies Domestic Market Access/ Protection	An investment incentive is a government action or policy which increase the net cash flow of a business over what would have been expected without the government intervention. An incentive may simply be access to the foreign market.	2. INVESTMENT INCENTIVES - MALAYSIA: Tax incentives conditioned on high local content. - INDONESIA: Exemption from duties and tax on certain imports tied to priority of activity. - FRANCE: Regional development grants up to 25% of the amount invested are based on the number of jobs created. - MEXICO: Computer companies wanting to tap the domestic market must manufacture locally.

Sources: Performance Requirements, LICIT, March 1981, Investment Policies in Seventy-Three Countries, Price Waterhouse, September 1981.

Table No.2.2

SELECTED TRADE-RELATED INVESTMENT POLICIES OF SEVERAL U.S. TRADING PARTNERS AND THEIR APPARENT IMPACT ON U.S. TRADE

COUNTRY	INVESTMENT POLICY	SECTOR AFFECTED	APPARENT IMPACT ON U.S.TRADE
AUSTRALIA	Foreign Investment Review Board Performance requirements negotiated Foreign Takeovers Act Local content required.	All	
BRAZIL	Export Fiscal Benefits Program (Befiex) Incentives tied to minimum export levesl.	Automotive High Technology	o In 1980, performance requirements resulted in an estimated $ 243 million of automotive imports to the U.S. which reduced employment in the U.S. auto industry by about 1,500 (Drousslang, Labor Dept., 11/81)
CANADA	National Energy Program (not yet law) Incentives tied to local equity.	Energy	
	Foreign Investment Review Act (1974) Performance requirements linked to approval of new new investment and acquisitions.	All	o FIRA approved proposals from the period 1975-1979 resulted in 50,000 Canadian jobs and $4 billion investment. If <u>all</u> of the jobs represent displaced U.S. production mandated by performance 5 years (assumes productivity of $100,000/worker). (FIRA Five Year Annual Report, 1975-1979 (1980)). - <u>Apple Computer</u>: To obtain FIRA approval (Sept. 1981), agreed to 801 local value added after 1st year, and to sell 80% of its product through Canadian retailers. - <u>Brown Boveri</u> (Canada): A Swiss-owned company which gave its Canadian subsidiary exclusive rights to manufacture Brown Boveri motors and controls for sale in North America thereby preempting investment in the U.S. - <u>Hauserman Ltd.</u>: Agreement to increase its Canadian subsidiary's exports to the U.S. (Nov. 1979). - <u>Micheline Tire</u>: Incentives to operate in Nova Scotia. - <u>Renault</u>: In taking control of American Motora, must apply to FIRA for approval of its takeover of AMC's Canadian subsidiary and therefore must demonstrate the benefits it's bringing to Canada.

COUNTRY	INVESTMENT POLICY	SECTOR AFFECTED	APPARENT IMPACT ON U.S.TRADE
FRANCE	Nationalization and Economic Renewal Plans In return for accepting "Voluntary guidelines" for local sourcing and import reduction, incentives and export aids are provided.	All Special focus on Machine Tools Textiles Furniture Leather Footwear	-U.S. Quaker Oats: Incentives provided for each new job completion in October 1982.
JAPAN	Foreign Investment Law (1980) Foreign direct Investment approval is dependent upon information administration guidance.	All	-Black and Decker: To obtain approval for its wholly owned manufacturing venture, the company agreed to 50% local content.
MEXICO	Mexican Auto Decree (1977) Performance requirements linked to incentives.	Automotive	o Performance requirements resulted in an estimated $364 million of U.S. automotive imports and caused a loss of about 2,300 jobs in 1980. (DRousslang, Labor Dept., Nov 1981) If the Decree is fully implemented and it exports of Mexican autos and parts to the U.S. rise to $3 billion by 1985, a cumulative loss of 86,000 - 115,000 jobs in the U.S. auto and auto parts industries will result during the period 1979-85. (LICTT, March 1981) -Chysler de Mexico: Presumably because of the Decree, the company is building an engine plant with an annual production of 200,000 4-cylinder engines in Mexico. 75% of production is scheduled for export to the U.S. -Ford:A $375 million engine plant with annual capacity of 400,000 4-cylinder engines is scheduled for completion in 1984. The engines are primarily for export.
	Mexican Computer Decree (not yet law) Performance requirements linked to incentives.	Computer	o U.S. computer exports to Mexico expected to drop. -Radio Shack: "We aren't going to get as much as we do not by exporting to Mexico, but 49% of something is a whole lot better than nothing." (Wall St.Journal, (1/29/82))

The performance requirements and investment incentives result in trade restrictions. Some countries using these policies may be violating their international trading obligations. For example Canada is a signatory to the General Agreement on Tariffs and Trade (GATT) and therefore subject to its regulations. One of these regulations, under Article III, rules out the discrimination between imported and domestically produced products. Canada's Foreign Investment Review Agency (FIRA), is assumed to be violating Article III when it reviews applications for FDI and accepts or rejects the application on the basis of "significant benefit to Canada". Acceptance by FIRA is often based on local sourcing of supplies, of goods and national benefits, an apparent violation of Article III of the GATT.[3]

The US opposition to trade-related-investment policies, may be enumerated under following points[4]:

US groups e.g. Computer and Business Equipment, Manufacturers Associations, Corning Glass Work Exxon Group etc., agree that foreign countries using these TRIMs can restrict

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3. "Canada's Foreign Investment Procedures", The Wall St. Journal, February 16, 1982, p.5. In January 1982, the US asked for consultation with Canada concerning the FIRA within the dispute settlement mechanism of the GATT.

4. President Executive Council, n.1, p.58

US trade and may be violating trading obligations. But there is no agreement on how much damage is done to US trade or how important the issue is.

- Economic theory suggests that trade-related investment policies may cause distortions in international trade and investment flows.
- Investment incentives can change international investment and trade patterns by shifting the location of investment in productive capacity from one country to another. As a result jobs and exports may be shifted.
- Performance requirements can distort trade by forcing the use of local labour or material and there by restricting imports. They may also distort trade more directly by setting maximum import limits and minimum export levels. One country's import restrictions directly limit another country's export. Artificially high export levels in a regulated economy may mean that manufacturers in a unregulated economy are losing exports or production.
- In the US, opposition to foreign trade-related investment policies takes two forms. Some see the policies as a serious threat to the US economy and assign the issue high priority. Others view the policies as less of a danger and therefore give lower priority to the issue.

Labour groups suspect US jobs have been and will be lost because of these policies. A report, by the LICIT, in 1981 pointed out that 86,000 to 115,000 jobs in the US auto and auto parts industries would be lost between 1979 and 1985 as a result of Mexican Decree[5]. A Labour Department study in the same year calculated that 2,300 US automotive job opportunities were lost in 1980 because of the Decree[6].

- These US companies usually are of two types. Some are suppliers to America's foreign direct investors. They see their business suffering because of mandate restrictions. Others are companies which can not or do not wish to invest abroad and are thereby denied access to foreign markets.
- Despite of above mentioned conviction, forming a cohesive US policy towards foreign trade-related investment policies is further complicated by the support for these types of policies in the US. Particularly companies with foreign investment give low priority to performance requirement, because of the fact that host country may retaliate if US protests sharply, labour organisations support local content requirement. In abroad also, investment policies are often considered legitimate development tools.

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5. Performance Requirements, LICIT. 1981, (Wahington 1981) p.6. The calculation assumes that Mexican exports of autos and auto parts to the US will reach $ 3 billion in 1985.

6. Don Rousslang, The Effects of Performance Requirements on US Auto Trade with Brazil and Mexico, (U.S. Labor Department Wanshington, 1981), P.6.

- Moreover incentives are recognised as trade distortive every state offers some type of investment incentive[7]. Any international effort to eliminate investment incentives would logically have to include those in the US as well.

The developing countries tend to view trade-related investment policies as legitimate efforts to industrialise without incurring severe trade deficits. Many countries have opted for paying the temporary costs hike of developing an infant industry (often automotive) using trade-related investment policies in exchange, perhaps, for longer run improvement in both domestic and international efficiency and welfare. Japan was successful in building an automotive industry using the infant industry approach which provides protection to infant industry from imported products. Australia, Chile, and Peru found that the cost of their policies was too high and have revised their efforts to develop a motor vehicle industry through the use of performance requirements[8].

US has also implemented unilateral remedies[9]. e.g. Trade Act of 1974, Countervailing Duty (Tariff Act of 1930), Anti-dumping Act 1920.

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7. "The Fifty Legislative Climates," Industrial Development, (Washington, January/February 1980), p.7.

8. V. J. Adduci, President, Motor Vehicles Manufacturers Association, in a letter to the USTR dated December 15, 1981.

9. For details see Table No. 2.3.

Table No.2.3

TRADE-RELATED INVESTMENT POLICIES:
PROPOSED BILATERAL FEMEDIES

PROPOSED REMEDY	DESCRIPTION	STAUS
Trade Act of 1974	Section 301 permits the President to retaliate when U.S. trade is damaged. Investment issues not specifically covered.	No investment-related cased to date.Proposals to amend the Act to cover investment are now before Congress.(S.2071/S.2094/II.R.4407)
Countervailing Duty (Tariff Act of 1930)	Any subsidy on the production, manufacture, or export of a product which damages U.S. industry is subject to a countervailing duty. Investment incentives must be shown to be a subsidy.	No action.
Antidumping Act (1920)	Imposes a dumping duty on imports if they are sold at less than fair market value in the U.S. procedures must be injured. Investment not specifically covered. Would be necessary to show that incentives were a subsidy.	No action.
Generalized System of Performance (GSP)	Deny GSP benefits to developing countries which impose performance requirements. (GSP allows developing countries imports to enter duty-free.)	S.1150, sponsored by Senators Heinz and Moynihan, now in Committee, would accomplish.
Foreign Aid Bill of 1981	Overseas Private Investmenr Corporation (OPIC) must refuse to finance or insure any investment subject to performance requirements where U.S. trade would be "substantially damaged."	No insurance denied to date due to performance requirements.
Export-Import Bank	Instruct Directors not to finance investment projects linked with performance requirements.	Proposals, no action.
IMF/World Bank	Instruct Directors to discourage performance requirements when reviewing investment policies of developing countries. (U.S. holds 22% of the Bank Vote.)	Proposal, no action.
Foreign Investment Screening	Screen foreign investment in the U.S. to insure overall U.S. interest isn't jeopardized.	Proposal, no action.
U.S. Performance Requirements	Impose performance requirements to protect U.S. trade, jobs, and production.	Douglas Fraser of UAW supporting a local content bill for autos.
Disclosures	Legislation mandatory disclosure of performance requirements agreements.	Proposal, no action.
Inaction	Do nothing and lost the market forces work them selves out.	

TRADE-RELATED INVESTMENT POLICIES:
PROPOSED BILATERAL FEMEDIES

PROPOSED REMEDY	DESCRIPTION	STATUS
Bilateral Investment Treaty	The new model bilateral investment treaty outlaws performance requirements which restrict U.S. trade.	None currently exist. Negotiations with Panama and Egypt in progress.
Friendship, Commerce	National treatment required for U.S. firms matters of exportation, taxation, sale, distribution, storages, and use of goods produced. Therefore, possible violation if certain requirements or incentives are not applied to domestic firms, but are applied to foreign firms.	U.S. has 40 treaties with several nations but investments are not specifically addressed.
Consultations	Initiative bilateral talks with the objective of obtaining an agreement to limit or eliminate performance requirements and/or investment incentives.	Consultations with Mexico concerning their Auto Decree are in progress. Bilateral talks with Canada over the use of investment incentives in the auto industry are in progress. Consultations also with France and Japan regarding investment policies.
GATT 1/ Article 3	Art. 3 (national treatment) prohibits internal discrimination between imported and domestically produced products. Local sourcing requirements and investment incentives appear to be violations.	Test case initiated by U.S., Jan., 1982: USTR claims Canada's FIRA violates Art. 3 and Art. 17, and has initiated consultations.
Article 11	Art. 11 (quantitative restrictions) prohibits quantitive restrictions other than duties, taxes, or other charges. Local content requirements appear to be violations.	
Article 16	Art. 16 (subsidies) bans export subsidies which are aimed at foreign investors. Investment incentives linked to performance requirements appear to be violations.	
Article 17	Art. 17 (state trading enterprises) requires that firms which recieve special privileges from the state must be allowed to procure in a nondiscriminatory way. Investment incentive linked to local sourcing appear to violations.	

1/ The General Agreement of Tariffs and Trade (GATT) does not address trade-related investment policies directly.

2/ Any contracting party can submit a dispute to the GATT for settlement if it feels its right have been violated. The GATT Dispute Settlement Procedure involves consultation (Art. 22). If an agreement is not reached, the issue is submitted to board of arbiters (Art. 23) who decide the case.

TRADE-RELATED INVESTMENT POLICIES:
PROPOSED BILATERAL FEMEDIES

PROPOSED REMEDY	DESCRIPTION	STATUS
MTN 3/ Subsidies Code (Art. 9)	Art. 9 prohibits exports subsidies on products other than certain primary prodicts. Investment incentives tied to export requirements appear to be violations.	No test case, no action.
OECD 1976 Declaration on Internatlional Investment and Multinational Enterprises	Declaration consists of voluntary guidelines for MIE conduct in host countries. Consultations are available for member countries adversely affected by investment incentives or disincentives.	USTR pressing for OECD concensus condemning performance requirements, March 1981 - formal consultation procedures used re:Canada's National Enegry Program.
GATT for Investment	A proposed multilateral agreement covering investment and trade which might involve negotiating a standstill and then a roll back on trade distroting investment policies.	Proposal, no action.

3/ The multilateral Trade Negotiations (MTN) did not address trade-related investment policies directly.

NEGOTIATING POSITIONS AND APPROACHES IN URUGUAY ROUND :

Written submissions have been made almost exclusively by developed countries viz. United States, European Economic Community (EEC), Japan and the Nordic Countries. The position of United States of America is and Japan similar, and vary only in emphasis. Developed countries have so far identified 14 TRIMS under both performance requirements and investment incentives[10]. They appear to propose an international investment regime which would establish rights for foreign investors and reduce constraints on Transnational Corporation (TNCs). The submissions by these two countries cite a number of regulatory performance requirements adopted by governments of host countries which are alleged to have trade distorting and inhibiting effects, such as requirements for local content, export performance, trade balancing, manufacturing, product mandating, remittance restrictions, technology transfer, licensing and local equity. In a separate category, incentives granted by governments have been included because they allegedly lead to distortion of trade flows - for example, when they result in creation of trade or subsidized standard flows.

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10. See Chapter No.1, of this dissertation, pp.13-19

Under local content requirements, the US has tried to attack several production and sales arrangements; trade-balancing equity shares; technology commercialisation practices, various licensing arrangements; balance of payment issues, and remittance restrictions etc. The argument for all these has been that such requirements, directly or indirectly, or even potentially, can limit imported products being sold or used in a country and hence it is trade-restrictive and distortive.

The US has also sought to criticise production and sales requirements which restrict ability of other countries to export to a host country of specific foreign investment or technology undertakings. Requirements relating to trade, technology and licensing, various production equity and remittance, as well as incentive policies of various countries on exports have also been sought to be attacked on the ground that they 'force' exports and distort trade.

For each of the TRIMs mentioned above, a large number of GATT articles are cited as being of relevance, and it is suggested that these GATT articles be reviewed in depth in order to asses their relevance and establish, where necessary. The position of the United States is that GATT already covers trade-related investment measures but these should be

addressed more explicitly through the elaboration of additional discipline.

Basically following GATT articles are sought by US as being applicable to TRIMs which should prevent developing countries from applying discriminatory measures on FDI.[11]

For the US article 1 contains the key i.e., general most-favoured-nation (MFN) principle which stipulates that with respect to customs duties and charges, rules and formalities in connection with importation and exportation, and internal taxes and other internal regulations, any advantage, favour, privilege or immunity granted by contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties. Clearly, article 1 deals with the avoidance of discriminatory trade measures that discriminate between goods on the basis of country origin.

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11. "TRIMs, Development Aspects And The General Agreement" by - Hardeep Puri and Delfino Bondad in Uruguay Round: Papers on Selected Issues (U.N Publication, UNCTAD/ITP/42), pp.66-76.

According to US, articles II contains both general and specific provisions aimed at protecting the value of tariff concession. It requires each contracting party to accord to the commerce of the other contracting parties treatment no less favourable than that provided for in tariff schedule. It has been argued that different kinds of TRIMs could increase the cost of importation. For instance, it has been alleged that trade-balancing requirements which require a particular level of exports before import licences are granted can impose an additional cost on imports, thus undermining the value of a tariff concession.

Another article sought by US to claim that GATTA articles are applicable to TRIMs, is article III. It contains the national treatment principle. Article III:4 stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of regulations affecting their internal sale, offering for sale, purchase, transportation, distribution or use. Article III:5 provides the use of internal quantitative regulations which directly or indirectly require the supply of products from domestic sources.

US argues that article VI[12] deals with and describes conditions under which counter-measures (antidumping and countervailing duties) can be amplified if dumping or subsidization causes or threatens material injury to an established industry or materially retards the establishment of a domestic industry.

Article VI has been cited as being relevant to several TRIMs. Some illustrative examples are:

- Investment incentives that reward the attainment of export targets; and
- Requirements that increase exports.

Article VIII also strengthen claims of US, it limits fees and formalities to the costs of services rendered in respect of imports. This article bans "fees and charges of whatever character" (other than those imposed consistently with articles II and III) to the extent that they exceed the approximate cost of services rendered. Such fees and charges are not to represent indirect protection to domestic products.

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12. The provisions of article VI of the General Agreement have been amplified in the Tokyo Round Anti-Dumping Code - which replaced the earlier 1967 Instrument - and Tokyo Round Subsidies and Countervailing Measures Code.

The central "transparency" clause of the General Agreement (article X), contains provisions requiring prompt publication of laws, regulations, judicial decisions and administrative ruling of general application. This is to enable governments and traders to become acquainted with administration of trade regulations.

Provisions on the application of quantitative import and export restrictions and requires the general elimination of quantitative restrictions on importation or exportation of products are contained in Article XI, the provisions according to US rules out TRIMs used by developing countries.

Article XVI[13] : This article contains provisions on the use of subsidies. The US proposes to classify TRIMs as outrightly prohibited, permitted yet actionable etc, along the lines of the Mid-Term Review Decision on subsidies, presumes that all TRIMs have effects equivalent to subsidies.

State trading enterprises are dealt under article XVII, it contains according to US, a number of principles which

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13. Article XVI is already under consideration in the negotiating group on subsidies and countervailing measures.

creates rights in the General Agreement that are directly relevant to the trade restricting and distorting effects of investment measures.

Article XVIII, deals with government assistance to economic development. It has been listed for review in the negotiating group on GATT articles where US attempt, in particular, is to recast the provision of section B of this article and tighten the procedures for its invocation. The attempt appears to be to encourage countries to more from invocation of article XVIII: B to article XVIII C dealing specifically with protection of infant industries which would involve prior approval of contracting parties and provision for compensation.

A GATT article XXIII according to US, article provides remedies when a party considers that any benefit accuring to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the agreement is being impeded as a result of the application by another contracting party of any measures whether or not it conflicts with the provision of this agreement. Thus US views that all trade-related investment measures would ipso facto fall under the provisions of article XXIII.

While some of the US demands could be claimed to relate to existing GATT articles, others (such as those relating to equity holdings, remittance practices or licensing provisions) are very difficult to relate to the GATT provisions or said to be directly trade related, except on the thesis that anything that results in production or investment has trade effects and thus trade-related[14].

US has also called for arrangements to facilitate transition to a stage when effective disciplines against TRIMs are established, possibly through progressive phasing in of disciplines, effective and expeditious enforcement, and a dispute settlement mechanism. Noting that considerations should follow the establishment of appropriate disciplines on TRIMs and should be in the context of precisely delineated obligations for all contracting parties. In other words, all contracting parties, including developing countries, should assume these clearly defined obligations or exceptions should be considered only after the appropriate disciplines on TRIMs have been established.

In relation to question of development US submission agrees that compliance with a TRIMs agreement would involve

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14. For Details of Developing Country's Refutation of US claims; See Chapter 3, pp.126-143, of this dissertation.

significant adjustment on the part of countries which apply such measures and of firms subject to them. The draft agreement proposed by the United States suggests a scheme for the progressive adjustment of the agreement. However, the submission stresses that the agreement should not indefinitely postpone disciplines and that there are strong arguments for brief transition periods. The argument is that if transition periods are long, important economic adjustments could be delayed and that this could disadvantage established companies in relation to new entrants[15].

While the US is pushing the interests of its TNCs in outward investment, and in reducing the power of host states to bargain, there is also the growing concern within the US about the takeover of industrial and other sectors by foreign investors. Much of the debates and media attention has been on Japanese investments. But European investment is still far ahead. At the end of 1987 European investment in the US amounted to $ 785 billins while that of Japan was only $ 194 billions.[16]

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15. 'The Impact of TRIMS on Trade and Development', UN Publication, New York, 1991, ST/CTC/120, (Sales No. E.91. II.A 19); p.84.

16. Raghvan, Recolonisation (Penang Malaysia) p.153.

According to Japan following TRIMs should be given priority :

(i) local content requirements;

(ii) export performance requirements;

(iii) trade balancing requirements;

(iv) domestic sale requirements;

(v) technology transfer requirements;

(vi) manufacturing requirements; and

(vii) product mandating requirements[17];

In this connection, it suggested that articles III, X, XI, XII and XVIII of GATT should be examined with regard to the measures having the effect of import restrictions. Japan, like the US believes that negotiations should result in the establishment of a new agreement in GATT on investment measures. An important feature of the Japanese proposal is that it draws attention to the need for the inclusion of both national and local government measures, apparently in order to cover policies introduced at the level of state, rather than at the federal level, in the United States. Japan has also presented a methodology to facilitate the

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17. "TRIMs : Issues For Developing Countries in the Uruguay Round" by Hardeep Puri and Philippe Brusick, in Uruguay Round Papers on Selected Issues (UN Publication, UNCTAD/ITP/10). p. 207.

examination of the effects of TRIMs by classifying them into those which are not but are relevant to its provisions. It would like participants to agree to prohibit both types of measure in principle, and to lay down specific procedures to reduce or to abolish all such measures. With respect to the second type of measure, it suggests that it is necessary to elaborate further provisions in order to avoid their trade-restricting and distorting effects.

An important ingredient of the Japanese submission, like that of the United States, is that rules on non-discrimination, transparency, consultation and dispute settlement should be applied to all TRIMs which have trade-restrictive and distorting effects.

The Japanese proposals make it clear that the intention is to create a new international investment regime centered in GATT. In its paper of June 12, 1987 noting that direct investments are increasing (both in volume and number) while government measures on these investments, with effects on trade, are 'multiplying'. Japanese submission pointed out that - "It is important to establish within the GATT a new system to regulate these measures ... to assure free flow of trade .... The Government of Japan thinks it necessary to prohibit or limit these measures in principle and if neces-

sary establish new international rules[18]".

As their statements and papers to the negotiating group show, the US and Japan want to use the multilateral negotiations as a starting point for putting into place an international investment regime with rules and principles that will restrict and limit host country policies and laws and administrative measures in relation with foreign investors and technology suppliers. A broad range of issues are involved - social and development policy, financing, employment and industrial relations, regional development and fiscal policy, international capital flows, competition policy, control of restrictive business practices, transfer of technology etc. The aim clearly is to create rights for TNCs and make illegal restrictions or obligations imposed on them by host countries.

The second important group among the developed countries in the negotiations is that of European Community (EC) and the Nordic Countries. They have adopted a more nuanced position than that of the United States and Japan, in that they focus on investment measures that have a direct and significant restrictive impact on trade and a direct link to the existing GATT rules. In one of its later submissions,

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18. Cited in C.Raghvan: Recolonisation, p. 154.

the European Community stated that the negotiations should not call into question the existence of national investment policies as such, and that the objective of any discipline in the area should be the avoidance or elimination of trade distortions caused by TRIMs. Such disciplines should, to the largest extent possible, be built on existing GATT articles and principles. The EC submission recognised that in principles all investment measures can and probably will have an influence on trade, even when they are taken for reasons entirely unrelated to trade. However, as it was important that measures taken for example, for fiscal, environmental or consumer protection purposes should not be subject to negotiations, it was necessary to distinguish between investment measures in general, and those that are relevant to the Uruguay Round negotiating objectives. The EC considered those measures to be relevant which have a direct relation to trade measures directed at the exports and imports of company, with the immediate objective of influencing its trade patterns. Among the 14 measures discussed in the Negotiating Groups the EC identified eight measures as directly trade-related. They are local content requirements; manufacturing requirements; export-performance requirements; product-mandating requirements; trade-balancing requirements; exchange restrictions; domestic sales require-

ments; and manufacturing limitations concerning the components of the final product.

In the EC's view, technology transfer and licensing requirements do not qualify as relevant for the negotiations, even though they may have an impact on investors' decision to invest or on their choice of a specific kind of investment. Similarly, licensing requirements and the tax regime applied may disadvantage the investor's competitive position, but do not appear to influence the investor's trading behavior in a direct manner and can not be considered as trade related. Equity measures too, in themselves, are not directly trade related, according to EC positions[19]. However, in a later submission, the EC had suggested that a TRIMs agreement should recognise the fact that it was perfectly possible that these measures distort or restrict trade and thus caused injury to a third party, be it the foreign investor's home country or a third party. The EC has proposed that signatories to the TRIMs agreement should, therefore, undertake, a commitment to avoid causing such trade distorting and restrictive effects on trade through the use of investment measures. The EC has suggested that such a general commitment can be transposed to more opera-

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19. For Details See MTN.GNG/NG12/W/10, UN Publication.

tional terms by using trade policy concepts taken from Article XVIII and Article II of the General Agreement. The EC as well as the Nordic countries oppose the inclusion of right of establishment and of transfer of resources in the negotiations[20].

In spite of EC's insistence on directly trade-related investment measures as the proper subject of the negotiations, it does not agree with the developing country proposal that the adverse trade effects need to be determined on a case by case basis, and argues for generally applicable disciplines. It has cited Articles III:4 (national treatment), XI:1(provision on quantitive restrictions on exports & imports), XVII:1 (C)(state trading enterprises) and X:1 (central transparency clause) as requiring examination. In the EC's view, the question exceptions can be addressed only after the provisions which prohibit or restrict the use of TRIMs have been identified by the Negotiating Group. This view implies that Article XXIII (remedy provisions) can apply to any situation leading to the nullification and impairment of benefits.

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20. See MTN/GNG/NG 12/W/23.

The Nordic countries, on the other hand, argue that the trade effects of investment measures cited in the Negotiating Group vary from one TRIM to another TRIM and sometimes from case to case[21]. Thgerefore, it would not be appropriate to cover all TRIMs within the same discipline. The Nordic countries suggest that both comprehensive and case-by-case approaches be used. They consider only two TRIMs-local content requirements and export-performance requirements to be sufficiently clear-cut in their trade-distorting effects, to be subject to a comprehensive discipline. In these cases, elimination should be the goal, but a gradual approach is needed so as to allow governments and investors, time to adjust. The phasing out of these measures should be based on, notification, binding and elimination within an adjustment period. The Nordic countries suggest three years as the adjustment period for developed countries, five years for developing countries and 10 years for the least developed countries. For TRIMs that are not covered by the comprehensive discipline, the Nordic countries propose the application of a second level of discipline directly linked to national treatment and non-discrimination, and action on a case-by-case basis by the GATT dispute settlement mechanism.

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21. See MTN/GNG/NG 12/W/23.

In relation to exceptions, Nordic countries favour a strong link to the GATT Agreement, and argue that Article[22] XI;2, XII, XVIII;B and C, XX AND XXI should be examined for their relevance when negotiating a discipline, attitude and stand of the European communities appears to be conditioned by its considerable outward investments as well as its community, wide integration[23] (with liberalisation of rules for all TNCs established already in the community) to be achieved by 1992. It is thus, interested in assuring its investors similar rights in countries, including the US and Japan.

At the same time, the EC has also an interest, through outward investment, in Japan to gain access to that market and in US to obtain access to high technology. Foreign investors, EC and Japanese, are attempting in the US to take over existing enterprise in high technology areas and thus gain access to technology. The EC members have also considerable overseas investment in extractive and manufacturing sectors in the Third World and are interested in expanding them. In regard to inward foreign direct investment, and the Japanese efforts in this direction, the EC and its states are trying to use their regulatory powers to ensure access

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22. For details of these articles see pp.67-73, of this dissertation.

23. Fate of the Maastricht Treaty is yet to be decided.

to, and genuine transfers of new technologies that would enable them to leapfrog and catchup with the US and Japan. These regulatory powers which EC is trying to use, are no different in objective and purpose of the Tird World countries providing for local content and export performance requirements.

DUNKEL DRAFT : PROPOSALS FOR TRIMs

The Uruguay Round Negotiations were to be concluded within a period of four years. A mid-term review took place at Montreal, Qubec, in December 1988. The Round could not be concluded within the stipulated time; the Ministreal meeting held in Brussels from 3 to 8 December 1990, which collapsed over the farm, subsidy issue, itdeeply, divided US and European Community (EC). In the next phase of negotiations, which ended in December 1991, Arthur Dunkel, Director General of GATT and Chairman of TNC, presented a set of proposals of considerations by 108 participating states. The 436 page Dunket Draft Text (hereafter referred as DDT) was offered as a single undertaking. Dunkel gave states time till 13 January 1992 to respond to the text. The negotiations, though stated to conclude by April 1992, are not likely to do so; for, from all accounts, they have been proceeding at a slow

pace and developing countries are highly critical of it (till date 1st July 1993, no agreement has taken place on Dunkel Draft and entire issue is in the state of flux).

DDT wants to restructure global economic system. The essence of this restructuring is to free transnational capital from spatial and temporal constraints the obligations through an effective system of sanctions. From the perspective of the developing countries. DDT seeks to inaugurate a "new world order" in which the people of developing world are required to surrender their economic independence to international institutions in favour of transnational capital in the name of interdependence and free markets. It secures this goal first through redefining the concept of national economic space what has always been considered sovereign economic space is now the subject of globalization. Both the formulation and the implementation of economic policies are brought under international surveillance. This secession of economic territory to an international institution drastically reduces the possibility of pursuing an independent path of development. Thus DDT legitimise the invasion of national economic space of the developing countries.

DDT also redefines the concept of national economic time. Present time is not same for all countries, it had different meaning for developed and developing countries. This fact has manifested itself, in the unexceptationable principle of special and differential treatment of developed countries. However DDT proceeds to dilute the principle of special treatment at a time when it is most needed by dev-loping countries. Considered, for example, Article XVIII : B (provisions of governments assistence to economic develop-ment) of GATT. It allows the developing countries to impose quantitative restrictions in the face of "balance-of-pay-ments difficulties" arising from efforts to expand their internal markets and from the instability of the terms of trade. The DDT water down this article by prohibiting discriminatin between domestic and foreign products.

The DDT is oblivious of both past and the existential history of the developing world. The rejection of the notion of relative historic time reveals the absence of any concern about the future of the peoples of the developing world. National economic space and time are being appropriated to serve the needs of global capitalising, which is today

facing a crisis, even as socialism has collapsed[24]

The DDT on TRIMs is by way of an elaboration of Articles III: 4 and Article XI: 1 of the GATT. Article III is on national treatment and Article XI on general elimination of quantitative restrictions. The text in its Annexure lists out TRIMs which are inconsistent with Article III:4 and XI:1

These are:-

a) Inconsistent with III: 4- (i) Requiring the investor to purchase or use product of domestic origin, (ii) Limiting purchase or use of imported product to an amount related to the volume or value of local product that the investor exports.

b) TRIMs inconsistent with Article XI-1 (i) Limiting import of products used in or related to its local production, generally or to an amount related to the volume or value of local production it exports; (ii) Restricting import of products used in or related to the investors local production by restricting its access to foreign exchange to an amount related to the foreign exchange to an amount related to the foreign

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24. "Political Economy of Uruguay Round of Negotiations:" A Perspective" by B.S. Chimni in International Studies', Vol.no.29, Sage Publication, (New Delhi, 1992), p.p 138.

exchange inflows attributable to the enterprise; (iii) Restricting exports specified in certain terms.

By adopting this text, developing countries will undertake not to apply the above TRIMs. This would mean (a) developing countries not be able to confine imports by the foreign investor to technology, equipment and raw material not available in India. this might affect adversely the use of our local products and raw material; (b) Developing Countries will have no means to ensure the foreign exchange neutrality of the foreign investment or make it foreign exchange positive.

These provisions will, therefore - (a) Undermine the efforts of the developing countries to pursue a self - reliant growth based on the technology, capital good and raw material available in the country; (b) Prove to be big drain on the foreign exchange reserve, with consequent adverse effect on the balance of payments position and hence on the capacity to repay out debts by the developing countries; (c) Be against the developing countries, current industrial and foreign investment policies even after the introduction of the recent reforms in these policies.

TRANSNATIONAL CORPORATIONS AS ENGINES OF GROWTH

Most of the developed countries while arguing for reduction of regulatory measures on TNCs opines that transnational corporations (TNCs) play a larger role in the world economy to day then they had in the past. Flows and stocks of FDI (foreign direct investment) are larger in absolute terms and in relation to key economic indicators, such as GDP. exports and domestic capital formation, than they have been in the past for the world economy as a whole and for most of the host countries, both developed and developing countries. In addition, world-wide foreign sales of TNC are larger than exports as a means of delivering goods and services to markets. According to US, TNCs which invest in the developing countries, are helpful in the development process of host countries, thus hostile view towards TNCs (FDI) should be omitted, TNCs should be left free (unregulated) and TRIMs used by developing countries should be abandoned to facilitate free flow of FDI.

These quantitative measures of TNC activities are indicators of both the growing economic importance of TNCs and their potential for shaping world development. There is also a qualitative dimension to the expansion of TNCs, which integrates within themselves the principal modes of international economic activity, namely, investment, trade in goods and services, technology of resource allocation on a wide scale and a channel for transmitting a variety of economic imuleses, such as production technology and labour skills.

The increasing importance of TNCs in the World economy is not only an outcome of recent growth of FDI. In addition, changing perceptions concerning TNCs- particularly, among the developing countries, but also among many developed ones ensure that their impact is more significant regardless of cyclical swings in the amounts of FDI. Because of those changing perceptions, fundamental shift in policy-making has occurred in that area. The principal aim is no longer to control and contain the activities of TNCs, but rather to encourage FDI in order to reap its benefits.

Several concurrent factors that operate in an interrelated manner on the international, regional and national levels, are behind the shift in attitude vis-a-vis TNCs. On the international level, new and changing technologies, the global expansion of key industries and the ascendancy of the service sector are changing the nature of production and the ways in which developing countries participate in the international division of labour. On the regional level, emerging trends point to a concentration of world economic activity in the three main regions, Asia, North America and Western Europe, with growth and integration in those region driven by Triad members - Japan the US and European Community respectively[25]. On the national level, recent years have witnessed the opening up of most of the world to private

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25. UNCTC, World Investment Report 1991: The Triad in Foreign Direct Investment (United Nations Publications, Sales No. E-91, II A 12) pp. 44.

enterprises and some form of market system such that there are now few countries and industries into which international capital may not go.

The developed countries have called TNCs as engines at growth and are playing central role in present day international economic system. An understanding of their contribution to economic growth and development particularly in developing countries becomes important. It needs to take into account not only the quantitative impact at TNCs, but also their importance in shaping the emerging international economic system.

1. TNCs As Instrument of Capital Formation And Economic Growth.

Transnational corporations are important contributors to world-wide savings and investment. They generate savings through retained earnings and, since TNCs are among the largest firms in their home economies, their contribution is likely to be substantial. In addition, they are themselves investors, utilizing both their internally-generated savings and the savings of others, which they obtain through borrowing and the issue of equity.

Most savings are generated domestically, but savings can also be generated by business firms and from foreign sources, and can be affected by Government policies. The primary determinants of household savings patterns and demographic variables, such institutional factors as the

effectiveness of the financial system, macroeconomic conditions and policies.

There are few ways in which TNCs would have a direct impact upon household savings. To the extent TNCs add to domestic employment, there would probably also be an increase in savings. In addition, the wages and salaries paid by TNCs and the income earned by local suppliers of TNCs undoubtedly alter the distribution of income in favour of savers, although such effects are likely to be limited. As employers, TNCs can encourage savings by, for instance, establishing pension plans, instituting direct deposit into savings accounts and offering payroll deductions for purchasing insurance.

Corporations, can also contribute to savings in host countries through retained earnings. Information from balance-of-payments accounts for Brazil and Mexico,, shows substantial annual fluctuations in the share of FDI inflows accounted for by reinvested earnings. Over a 23-year period (1967-1989), reinvested earnings by TNCs accounted for between 15 and 90 per cent of annual inflows of FDI for these two large developing countries [26] For the United States, approximately third, and in 1990 almost a half, of flows of FDI to developing countries took the form of rein-

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26. Data from International Monetary Fund Balance-of-Payments tape, retrieved in January 1992.

vested earnings during the period 1982-1990.[27]

Developing countries have long sought foreign savings as an important contributor to capital formation. Since the onset of the debt crisis, they have placed renewed emphasis on attracting FDI to augment domestic savings. The importance of TNCs in generating savings and as sources of investment spending in host developing countries appears to have been growing, especially in the second half of the 1980s. Thus, for a number of host developing countries, FDI may be filling an important gap.

Many governments have been incurring large budget deficits and their savings rates have been declining. Transnational corporations can contribute to government revenues directly via tax payments, contractual fees, etc., and indirectly through taxes paid by their employees and suppliers. Direct tax payments by the foreign affiliates of United States-based TNCs to foreign governments amounted to approximately $100 billions in 1989, or about 10 per cent of their foreign sales.[28]

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27. U.S. directinvestment abroad: detail for historical-costposition and balance of payments flows, 1990", Survey of Current Business, vol. 71, No.8(August 1991), table 4, and earlier annual articles.

28. See Table No. 2.4

Table No. 2.4. Tax payments by foreign affiliates of United States translational corporations, as a percentage of total government revenue of the host country, 1989

(Millions of dollars)

Country	Tax payment	Government revenues	percentage	Unites states FDI as share of total inward stock of FDI
Chile	192	8500	2.3	49[a]
China	16	62428	-	16[b]
Ecuador	18	1288	1.4	54[b]
Egypt	6	20547	-	
Guatemala	78	504	15.5	22[c]
India	98	39671	0.2	21
Indonesia	866	16190	5.3	6[a]
Korea, Republic of	138	38202	0.4	28[a]
Malaysia	619	9141	6.8	6[b]
Mexico	1266	27448	4.6	64
Peru	174	1425	12.2	29
Philippines	362	3716	5.4	56
Thailand	910	12321	7.4	24[b]
Trinidad and Tobago	151	1168	12.9	
Total	4894	245549	2.0	

Sources: United States, Department of Commerce, US. Direct Investment

Abroad: 1989 Benchmark Survey (Washington, D.C., United State Government Printing Office, 1991); International Monetary Fund, International Financial Statistics Yearbook, 1991 (Washington, DC., International Monetary Fund, 1992).

a 1988, b 1987, c 1985.

2. TNCs And The transfer of technology to the Developing Countries.

Technology development by TNCs mostly takes place in the home countries of these firms or in other developed host countries. Therefore, access to technologies for developing countries is largely a matter of acquiring technologies from TNCs in developed countries. The impact of technology transfer from TNCs on the growth of the host economy, however, depends on how the various modes of technology transfer interact with the local technological capabilities, incentive structure and institutional arrangements.

The principal sources of technology acquisition are scientific and technical publications; trade (through the import of machinery and equipment); FDI (through both wholly-owned foreign affiliates or join ventures); and non-equity links with TNCs through mechanisms such as patents, licenses, technical assistance agreements and other contractual arrangements as well as strategic alliances. transnational corporations play a major role in all these modes of transferring technology, particularly so in the latter three.

Transnational corporations generally transfer their most recent technology to their affiliates, while selling or licensing older technology to local-owned firms and joint ventures.[29] Hence, FDI may be the only way for many developing countries to gain access to the latest technology and especially to certain key technologies. It has both direct and indirect effects on the technology of host country.

(a) Direct effects

(i) Transnational corporations and factor productivity :

An important contribution of technology to growth is through increased factor productivity.

There are case studies, that provide some evidence of the relative efficiency of the use of factors of production, as between foreign affiliates and domestic enterprises. A study on Thailand found that foreign firms had higher average productivity of both capital and labour in the manufacturing sector compared with domestic firms, and the difference was owing to the higher efficiency of foreign firms as

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29. Magnus Blomstrom, "Host country benefits of foreign investment", Working Paper No. 3615 (Cambridge, National Bureau of Economic Research, 1991), mimco.

measured by a technology co-efficient derived from production-function estimations. [30] Similarly, a study on the Republic of Korea observed that the marginal product of both capital and labour was higher in foreign firms compared with domestic firms, but the differential was much greater for capital than labour.[31]

All these studies, therefore, support the view that foreign firms can contribute to growth through the provision of technologies that made more efficient use of capital and labour.

(ii) Transnational corporations and product composition

The introduction of new products or qualitatively superior old products is one of the ways by which technology promotes growth. transnational corporations can play a role in this process. One way of assessing the role is to examine the performance of TNCs in the production of relatively more research-intensive products (table 2.5). The

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30. Somsak Tambunletchai and Eric D. Ramstetter, "Foreign firms in promoted industries and structural change in Thailand", in Eric D.Ramstetter, ed., Diorect Foreign Investment in Asia's Developing Economies and Structural Change in the Asia-Pacific Region (Boulder, Colorado, Westview Press, 1991), pp.65-102.

31. Chung H. Lee and Eric D. Ramstetter, "Direct investment and structureal change in Korean munufacturing". in ibid, pp. 105-141.

table shows that, for the United States TNCs the expansion of the share of sales of high and medium research-intensive industries primarily occurred in Asia and the Pacific. In this region, the United States affiliates also had the largest increase of R&D expenditure as percentage of sales. There has been an increase in the share of sales of high and medium research-intensive industries in manufacturing sales in Asia and the Pacific as well as Latin America, with a slightly more pronounced growth in the latter region in terms of the share of manufacturing sales.

The creation of production facilities by TNCs in high and medium research-intensive industries can imply technology transfer not merely through the changing product composition, but also through the training of host country personnel in new technical skills and the introduction of new management methods and new ways of organizing the production process.

Table No. 2.5 Shares of high and medium research-intensive industries [a] In total sales and manufacturing sales of foreign affiliates, 1982 and 1989.

(Percentage)

	1982		1989	
Developing region	Share in total sales	Share in manufacturing sales total	Share in total sales	Share in manufacturing sales
United States majority-owned affiliates				
Africa	3.5[b]	59.2[b]	3.1[b]	32.0[b]
Asia and the Pacific	15.7	-	50.7[b]	-
Latin America	21.8	57.3	33.1	60.9
Japanese affiliates				
Africa [c]	17.1	42.4	10.8	40.9
Asia and the Pacific[d]	29.0	74.5	25.9	79.8
Latin America	20.1	66.0	19.4	74.3

Sources: United States, Department of Commerce, U.S.Direct Investment Abroad: 1982 Benchmark Survey, (Washington, Dc.C., United States Government Printing Office, 1985), table III. D.3, and 1989 Benchmark Survey, Preliminary Results (Washington, D.C., United States Government Printing Office, 1991), table 32; Japan, Ministry of International Trade and Industry, The Fourth Basic Survey on Japanese Business Activities Abroad (Tokyo, Okurasho Insatsu-Kyoku, 1990), q.12, and Survey on the Overseas Activities of Japanese Companies, No. 12-13 (Toyo, Toyo Hoki Shuppan, 1984).p.43.

a High and medium research-intensive industries Include chemicals, machinery (except electrical), electrical machinery and domestic equipment, and transportation equipment.

b Part of data are suppressed by the sources to avoid disclosure.

c Includes South Africa.

d Includes Australia and New Zealand.

(iii) Transnational corporations and export composition

The technological content of exports can be an important determination of growth performance. It is well known that R&D intensive exports generally have higher income elasticities; therefore, the growth of these exports is more sustainable over the long run. Besides, a rising share of such exports also carries the implication that the country concerned is in a position to take advantage of shifts in international demand (manifested in the growth of internationally competitive R&D intensive industries), rather then to rely exclusively on traditional exports based on natural-resource endowments to low labour costs. The role of TNCs in the export of R&D intensive products, therefore, deserves scrutiny.

The relevant data are presented in table 2.6. They show that, in the case of Japanese affiliates, the share of R&D intensive exports in total manufactured exports increased between 1982 and 1989 in Latin America and Asia, but declined in Africa, where an absolute decline of R&D intensive

exports also occurred. In the case of the United States affiliates, the share of R&D intensive exports increased somewhat in Latin America, declined slightly in Asia (though the share is still much higher than in Latin America and remained very small in Africa. On the whole, affiliates have significantly increased R&D intensive exports.

It is difficult to estimate the local value-added in the host country from export-oriented production. It should also be noted that the performance of TNCs in respect of R&D intensive exports is not necessarily better than that of local enterprises. In particular, local enterprises in certain Asian countries have clearly outperformed foreign affiliates. Total R&D intensive exports from Asia in 1989 were more than four times those recorded in 1982.

Table 2.6 Manufactured exports and research and-development intensive exports of foreign affiliates, 1982 and 1989

(Millions of dollars)

	United States majority-owned affiliates		Japanese affiliates [b]	
Developing region	manufactured exports	R&D intensive exports	Manufactured exports	R&D intensive exports
Latin America				
1982	4692	2908	971	84
1989	10176	6794	815	165
Percentage increase	117	184	-19	96
Asia				
1982	5954c	5453c	5950	3027
1989	13861	12176	11560	7230
Percentage increase	13	123	94	139
Africa				
1982	069c	3c	23	9
1989	566	9c	30	5
Percentage increase	235	200	30	-44

Sources: United States, Department of Commerce, U.S.Direct Investment Abroad: 1982 Benchmark Survey, op. cit. table III.E.4. and III.E.5. and 1989 Benchmark Survey table 42 and 44; Japan, Ministry of International Trade and Industry, Survey on the Overseas Activities of Japanese Companies, No. 12-13, op. cit., pp. 90, 91 and 95 and No. 18-19, (Tokyo, Okurasho Insatsu-kyoku, March 1990). 00. 74-75, 78-79 and 82-83.

a The values may be substantially understated because of incomplete coverage of firms in the surveys.

b part of the data is suppressed by the source to avoid disclosure.

(iv) Research and development by affiliates

The evidence that an overwhelming proportion of the foreign R&D of TNCs is located in developed countries does not necessarily imply that such R&D is insignificant from a host-country perspective. In countries such as India, the Republic of Korea and Singapore, share of aggregate R&D expenditure attributable to foreign firms exceeded 15 per cent in the 1970s. [32] Moreover some evidence indicates that foreign affiliates may now be devoting more of their resources than before to R&D. In the case of the majority-owned foreign affiliates of the Unites States TNCs, there has been a noticeable increase in their R&D expenditures as a proportion of sales in a number of developing countries. But there are some noticeable regional differences. Research- and- development expenditure by the United States affiliates as a percentage of sales increased four times between 1982 and 1989 in Asia and the Pacific, while it stagnated in Latin America and remained insignificant for the developing countries in Africa.

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32. John H. Dunning, "Multinational enterprises", op.cit., p.16.

(v) Organizational innovation and management practices

Organizational innovation and improved managerial practices are being increasingly viewed as a major aspect of technological development for enhancing productivity and accelerating growth. The principal components of these aspects that have evolved over the last two decades or so can be summarized as follows.[33]

* The underlying philosophy of production has been altered: instead of producing to stock, goods are produced to order. That necessitates a demand-driven system capable of producing a variety of product types in much smaller volumes. Hence, lot sizes have been reduced dramatically.
* The efficient production of different products in small lot sizes requires minimizing downtime. That, in turn, requires quick line changeovers and tool setups. Machinery redesign becomes necessary but, more importantly, production-line workers must be trained to do

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33. UNCTC, New Approaches to Best-Practice Manufacturing: The Role of Transnational Corporations and Implications for Developing Countries (United Nations publication, Sales No. E.90.II.A.13.

changeovers rather than having them done by separate terms as in mass production.

* Production layouts need to be destructed, and changes made on the use and management of machines in order to create a smooth flow of smaller lot sizes.

* Inventories have to be reduced to a minimum "just-in-time" level rather than being stocked "just-in-case", so that the increased number of different product types can be accommodated without large carrying costs.

* Maintaining a smooth flow of production without inventories requires that components have zero defects or be of perfect quality, whether they come from suppliers or from in-house sources further back in the production line.

* Skill and craft demarcations among workers are eliminated and workers are trained to be multi-skilled. They are paid according to their skill level and the quality of their work.

The organizational changes involved extend throughout the firm: from design to marketing to production: from senior management to the shop floor; and from management's relations with its work force to the firms' relations with its suppliers.

Transnational corporations from Japan, particularly those in the automobile industry, have been the pioneers of these developments. It was during the 1980s that these organizational techniques began to be introduced outside of Japan. In some cases this was a direct result of the operations of the Japanese affiliates themselves, especially in the electronics, automobiles, component and machine tool industries that had been established in North America and Europe. In other cases, non-Japanese supplies of these Japanese foreign investors began to restructure to incorporate new patterns of organization in order to meet the requirements of their Japanese customers. A third source of innovation was the practice of those firms that had subsidiaries or joint ventures in Japan and which were learning through the operations of these subsidiaries - Bendix's production of auto components and Xerox's restructuring of the mid 1980s are case in point. By the late 1990s the central tenets of the new organizational paradigm had filtered through to the major non-Japanese TNCs and were being implemented at the plant level in various industrialized countries.

More recently, TNCs from Japan and elsewhere have shared implementing organizational changes in developing

countries. No systematic data are as yet available to document the extent of such technology transfer. However, available case studies show that some developing country firms have adopted these changes either as joint venture partners of TNCs or under licensing agreements, in order cases, similar changes have been introduced in TNC affiliates or subsidiaries in developing countries. Examples of the adoption of these technological changes can be found in such diverse countries as Brazil, the Dominican Republic, India, Mexico and Zimbabwe.[34]

(b) Indirect effects

Foreign direct investment can promote growth through several indirect mechanisms of technology transfer. For example, backward linkages to local firms, in the form of subcontracting the supply of parts, components and services, create additional demand for intermediate products. A supplier firm in a developing country that is in a subcontracting relationship with a foreign subsidiary can receive technical assistance to improve its product quality and production process or to undertake new product development.

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34. Transnational Corporations and Management Division, Transnational Corporations and the Transfer of New Management Practices of Developing Countries (New York, United Nations, forthcoming).

When upgrading the technological level of supplier industries, FDI often increase the local value-added and generates growth. The presence of foreign affiliates can increase competition and thereby force domestic enterprises to improve productive efficiency, which is growth-enhancing.

TNCs may increase their use of inputs from local sources. Local sourcing of inputs, particularly when done under subcontracting arrangement, is often associated with technological assistance to the local suppliers by TNCs. In a survey of the largest foreign affiliates operating in Mexico, for example, it was found that almost two thirds of them had local subcontracting relationships. Almost all of the foreign affiliates that subcontracted locally imparted some kind of training to their national subcontractors. 87 per cent provided training in quality control, 68 per cent gave technical assistance and 22 per cent offered financial assistance to their subcontractors.[35]

As to the spillover impact of TNCs on the technological capacity and productive efficiency of indigenous enterprises, several studies on developed countries provided

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35. UNCTC, Foreign Direct Investment and Industrial Restructuring in Mexico (United Nations publication, Sales No. E.92.II.A.9).

mixed evidence. The same is true of developing countries. A recent study on Mexico showed that the rate of productivity growth of local firms and their ability to reach the productivity standards of TNCs were positively related to the degree of foreign ownership of an industry.[36] That estimate was interpreted to imply that competition from foreign affiliates forced Mexican firms to increase productivity by investing in human capital and new technology. Thus improving the average productivity performance of Mexican firms. In contrast, a study on Morocco did not provide any evidence that the presence of foreign firms resulted in increased productivity of domestically-owned firms.[37] Although foreign firms had higher levels of productivity, domestic firms showed faster productivity growth; but that could not be attributed to dynamic externalities from FDI.

In some cases, TNCs stimulate technology development by local R&D institutions. In India, for example, one TNC

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36. Magnus Blomstrom and Edward N.Wolf, "Maltinational corporations and productivity covergence in Mexico" (1989), mimeo.

37. Mona Haqddad and Ann Harrison, Are there dynamic externalities from foreign direct investment? Evidence from Marocco", in R.Newfarmer and C.Frischtak, eds., Transnational Corporations, Market Structure and Industrial Performace. United Nations Library on Transnation Corporations (London, Routledge, forthcoming).

recently signed a letter of intent with a Government-funded telecommunications R&D facility-the Centre for the Development of Telematics-to use switches designed by the Centre in a new open-architecture cellular system. In addition, the TNC intends to sponsor research at nine leading engineering colleges.[38]

3. TNCs And Human Resources Development.

(a) Impact on Health and Nutrition :-

Transnational corporations in pharmaceutical, health-care, agricultural, biotechnology and food products industries potentially influence health and nutrition levels in both developed and developing countries through major breakthroughs in health and medical research and the introduction of new food products and food-production technology. While most of the actual effects of the innovations in developing countries are the result of local government or private-sector action, TNCs can play some role through their production and trade activities in host countries.

In response to developing-country needs, many pharmaceutical TNCs have expressed interest in supplying essential

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38. Busines Asia, vol. XXIII No. 46(18 November 1991), p.14.

drugs for public health-service use in poor countries at lower cost. Transnational drug manufacturers can also contribute by becoming actively involved in providing consulting services to advice on improvements in national drug policies and the logistics of supply. One example is the Burundi Pilot Project, the result of a collaboration between the Ministry of Health of Burundi, the World Health Organization and three Swiss pharmaceutical TNCs: Hoffmann-La Reche, Ciba-Geigy and Sandoz.[39]

Transnational corporations may also engage in R&D in health-related fields within the developing countries in which they operate. Such activity can contribute to the professional development of indigenous researchers, and it can generate relevant knowledge locally about health issues. Although localization of R&D by large research-intensive TNCs takes places only rarely,[40] Some exceptions to this trend have been noted. Four laboratories dedicated to research in developing new drugs to treat tropical diseases

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39. Marjan Svetlicic and Matiga Rojhhec, "Export-orignted industrial collaboration in Yugoslavia" (Geneva, UNCTAD, 1991), mimeo.

40. See United Nations Centres on Transnational Corporations, Transnational Corporations and the electronic Industries of ASEAN Economies (United Nations publication, Sales No. E.87.II.A.13), and Alden M.Hayashi, "The new shell game", Electronic Business, vol.14,No.5 (1 March 1988), pp. 36-40.

have been set up in developing countries by Wellcome, a British drug manufacturer.[41]

Where no new technology or innovation is involved, TNCs in the health-care industry may internationalize operations. Several health-care enterprises based in the United States and other industrialized countries have established affiliates in developing countries. [42]

Another area of health on which TNCs have a potential impact relates to nutrition. Affiliates of TNCs produce approximately 12 per cent of the processed food in developing countries; in the more advanced developing countries, with a heavier investment in the food industry, the percentage can rise to over 25 per cent.[43]

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41. See Machalel Westlake, "Aviation and aerospace'88: China-Joint ventures and join opportunjities", Far Eastern Economic Review, vol. 139, No.5 (4February 1988). PP. 50-56.

42. For a discussion of marketing barrers faced by developing countries, see, Sanjaya Lall, "Marketing barrers facing developing country manufactured exports: a concemal note", The Journal of Development Studies, vol 27, No. 4 (July 1991), pp. 137-150.

43. United States, Department of Commerce, U.S.Direct Investment Abroad: 1989 Benchmark Survey (Washington, D.C. United States Government Printing Office, 1991), table2,4 and 5.

(b) The impact of TNCs on primary or secondary education in host countries, through direct investment of financial contributions, is minimal. education is an area that is typically and entirely the domain of the host governments. It has been observed, however, that some TNCs include training in basic educational skills in their training programmes when local circumstances make it necessary; for example, Unitever and Mobil Oil Frence have provided teaching in reading, writing and artihmetic to workers with little or no formal education in their developing-country affiliates.[44]

Transnational corporations could also have an impact on the relevance of a national education system. In an economy in which the rate and type of change of technology depend primarily onchanges in the domestic economcy itself, the degree of interface between the educational system and the economy is usaully acheved with minimal effort. The knowledge and skills required for indigenous industries and organizations are generally institutionalized in national educational programmes. The presence of TNCs in a develop-

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44. Data compiled from Toyo Keizai Shimposha, Kaisha-betsu Daigai Shinshutsu Kigyo, 1991/1992 (Tokyo, 1991). On sogo shosha in developing countries generally, see Kiyoshi Kojima and Terutomo Ozawa, Japan's General Trading Companies (Paris, OECD, 1984).

ing country, somethimes contributes to sudden technological changes. Such changes require new and rapidly-changeing skills and knowledge that are often not synchronized with the knowledge and skills being provided by the local educational system. It is provided by TNCs.

(c) Impact on Vocational Training :-

Private vocational training capacity in developing countries is often weak; thus, formal training in vocational skills is largely provided by government agencies and ministeries. The efficiency of public vocational education and training, however, has often been questioned. Most new technology enters into a developing country though private foreign enterprise (thus ownership of the equipment, technical reside within TNCs). An important channel for government agencies to increase, improve and update their vocational training efforts is, therefore, through collaboration with TNCs. The Economic Development Board of Singapore, for example, has collaborated with various TNCs to established and improve training centres and institutes (table 2.7).

(Table 2.7).

Contributions by transnational corporations to vocational training in Singapore

TNC	Training provided
Tata	Tool-and die-making; precision machining
Brown-Boveri	Tool and die production; toolroom machining; precision machanies
Phillips	Precision machining
Computervision Corporation	Mechanical design; drafting; numberical control; structual analysis; circuit board design
ASEA	Robbotics applications; robotics programming; operating, maintenance and servicing; project engineering

Source: Hafiz Mariza, Multinational, Corporations and the Growth of the Singapore Economy (London, Croom Helm, 1986), p.68.

The most important aspect of vocational training by TNCs consists, however, of training provided to production workers in host-country affiliates and subsidiaries of TNCs. Most of the training is conducted to satisfy staffing and subsidiaries of TNCs. Most of the training is conducted to satisfy staffing requirements essential cording to available studies of manufacturing TNCs, the volume and quality of such training is important and extends to all categories of personnel, although training efforts are uneven and vary according to production sector, length of involvement in the

country, the qualifications of the available indigenous manpower and local training policies.[45] The training of manual (unskilled and semi-skilled) production workers represents the bulk of TNC training efforts in terms of numbers. But it is usually less developed than training provided to skilled workers and management staff; rather, it is geared towards complementing existing skill as required for the immediate performance of a specific production-line function in an enterprise. Such training is usually brief, on the job and conducted by the host-country affiliate. It is typically more specific than in local enterprises and sometimes of limited use in the wider national labour market.

The training of skilled workers is provided only to a small proportion of the labour force in a TNC, but is generally of a high quality. Training of the workers apparently absorbs the largest share of expenditure by TNCs on training, Apprenticeship training is also reported to be important in a major of TNCs, meeting significant standards and often going beyond the immediate needs of the TNCs.

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45. UNCTC, Transnational Corporations and World Development: trends and Prospects (United Nations publication, Sales No. #.88.II.A.7).

Thus the US claims (though without much facts and evidence) that TNCs and FDI are beneficial for the development of developing countries. So they should not be regulated and employment of TRIMs will be trade distortive. TRIMs will lead to distortions of both international trade and domestic development. These claims of US are examined in next chapter, to see the another face of the coin i.e views of the South, which considers, application of TRIMs as must for planned development.

CHAPTER III

Chapter III

IMPLICATIONS FOR THE SOUTH AND ITS STRATEGIES

NEGOTIATIONS IN THE URUGUAY ROUND :

The proposals and ideas of all ICs (industrialised countries) seek to deal with trade-restrictive or distortive effects arising out of governmental actions of the host states and measures in the area of investment. But there are no references to any actions or policies of TNCs that have an effect on trade or business of the developing counrties. In the discussions, Third World countries have raised this issue, but have elicted no real response. The Third World view had only been sought to be countered with the argument that the issue of RBPs had been raised at Punta del Este but there was no agreement to include it on the agenda, and hence the intentions is not to tackle them, and that GATT is only intended to deal with government measures and bringing in the measures of private parties would ater the nature of GATT.

Thus while all governmental measures are sought to be curbed under the proposals of the ICs, TNCs will be left free to carry on with their own central planning and management decisions over the practices and affairs of various

affiliates operating in multiple national spaces and concentrate their corporate strategic activities-in terms of top management technology development control and maintaining of their world wide affiliates etc-in the home country. Decisions on key trade, investment and production measures are to be internalised within the boundaries of the TNC in the home country-without any policy accountability, in any of the host countries. Also, while 'market' signals will operate in relations with the outside, within the TNC all issues (investment performance, purchases and sales of inputs and outputs) will involve no obligations for arms length or competitive market decisions, but rather would be guided by centrally planned corporate decisions to maximise profits and global capital accumulation in the interests of the home countries of the TNCs.

It is difficult to envisage a more brazen effort to enrich the TNCs and their home countries, at the expense of the public abroad, particularly in the Third World.[1]

The implications of the ICs proposals need to be considered in the context of the objectives and purposes for which investment measures are applied, particularly by the

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1. C.Raghvan : Recolonisation p. 156.

developing countries. Two broad categories of measures which have come up for considerations are :(i) investment incentives and (ii) conditions for investment.

The purpose of the first category of measures is apparent in as much as developing countries need foreign investment and consider it necessary to provide incentives to attract such investment. The main objectives and purpose of the second category (conditions for investment) are following:

* Countries prefer to channel investment in accordance with their development needs and priorities;
* They also invariably wish to ensure that the net outflow of current and capital payments associated with the investments (eg profits and other factor payments) does not cause an excessive strain on the balance of payments.
* Foreign investors, particularly the transnational corporations, may resort to restrictive business practices such as transfer pricing. The host countries consider it necessary to take measures to reduce the incidence and impact of such measures.

In contrast with the negotiating positions of ICs as discussed in the previous chapter, the developing countries have argued that trade-related investment measures are

legitimate instruments, when applied within the broader context of economic growth and development policy, for balance-of-payment reasons and for attainment of social and economic policy objectives consistent with the General Agreement. They have argued that the creation of comprehensive discipline for investment measures may frustrate the above-mentioned objectives and go far beyond the original mandate of the Uruguay Round by creating an international investment regime under GATT.

The intent of the Punta del Este mandate, according to the developing countries, was to focus on the trade-restrictive and distorting effects of investment measures, and not to circumscribe the capacity of Governments to employ investment measures per se. Furthermore, the Ministerial Mid-term Review Decision on TRIMs not only reaffirmed the original mandate, but also stipulated that development aspects be integrated into the negotiating process. In two joint submissions, developing countries presented a list of the main development objectives of the attainment of which Governments employ investment measures.[2] They include:

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2. For details, see joint submission by 11 developing countries (Argentina, brazil, Camenon, China, Colombia, Cuba, Egypt. India, United Repuublic of Tanzania and Yugoslavia), <u>MTN/GNG/NG12/W/25</u>; and Draft Declaration on TRIMs submitted by Bangladesh, Brazil, Colombia,

ensuring the most efficient and fullest contribution of investment to the national economy; enhancing and maximizing employment opportunities; facilitating restructuring under socially acceptable conditions;eliminating industrial, economic and social disadvantages of specific regions; alleviating pressures on available foreign exchange and making the most efficient use of it for the development of the external sectors; enhancing the contribution of investments to building and upgrading domestic technological capability ensuring the most effective use of natural resources and value-added contributions to the economy; and expanding export markets.

Developing countries have also stressed that, in addition to the development objectives mentioned above, there are a number of other significant considerations that need to be taken into account in the negotiations. They have argued that such considerations created the need for Governments to use TRIMs in order to offset the trade restrictive and distorting effects of transnational corporation. For example, local content requirements may be used as a response to vertically integrated corporate enterprises holding a dominant position of market power which might prefer

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...Continued...

u, Cuba, Egypt, India, Kenya, Nigeria, Pakistan,

e, United Republic of Tanzania and Zimb

MTG/GNG/NG12/W/26.

to source components and parts from parent companies or foreign sources even if comparable inputs are locally available. Manufacturing requirements may be used by host country Governments to avoid abusive pricing practices by transnational corporations or to protect local firms from predatory practices. Domestic sales requirements are often necessary to counteract the corporate entities' refusal to deal or unfair cartel pricing. Export-performance requirements are often a means for host country Governments to curb export prohibitions at the enterprise level and also to ensure quality products for competition in world markets.

The developing country submissions have also contested the applicability of GATT articles in relation of questions of investments. They argue that the General Agreement is designed to deal with international trade in goods, as they cross international frontiers and, as TRIMs are not border measures, the Agreement does not apply to them. In so far as investment measures imposed at the point of production deal with acts of exportation or importation, establishing the link between border measures and TRIMs will involve complex difficulties. To the extent that investment measures have an adverse effect on trade, such effect would need to be demonstrated on a case-by-case basis.

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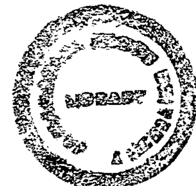

Many developing countries have also questioned the applicability of individual articles of the General Agreement to TRIMs.[3] Singapore and India have argued that Article I deals with discriminatory trade measures, and not with discriminatory effects.[4] Furthermore, Article I deals with border measures and not with production measures. Article II is concerned with whether a Government imposes additional charges on imports. The Singapore govt. has argued that if a TRIM increases the cost of importing, it is not a violation of this Article. Article III deals with discrimination between imported and domestic goods, and as such does not apply to a manufacturing requirement which is a production measure, which falls outside the scope of the General Agreement. The Indian submission stated that Article VI does not apply to TRIMs, as there is no evidence to establish a causal relationship between export performance measures and dumping. If, in certain circumstances, they lead to dumping of exports, the existing provisions in the Agreement against dumping would seem to suffice. Article XI deals with the importation of products and not those affect-

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3. For details see pp. 11-27 of this chapter.

4. For details, see the statement by Singapore, MTN/GNG/NG12/W/17, and the submission by India, MIN.GNG/NG12/W/18.

ing imported products, dealt with in Article III. Hence, India argues, it does not apply to performance requirements. Furthermore, in applying this article in relation to investment measures, full consideration would need to be given to the provisions in the General Agreement that allows developing countries to maintain import restrictions for balance-of-payments reasons. Article XVI concerns subsidies and its applicability to TRIMs has also been questioned by developing countries, arguing that if contracting parties are of the view that the products are being subsidized the existing remedies would suffice. The developing countries also stressed the provisions in Article XVIII which recognizes that it may be necessary for developing countries, in order to implement programmes and policies for economic development, to take protective or other measures affecting imports and that such measures are justified in so far as they facilitate the attainment of the objectives of the General Agreement.

In some of the proposals, the application of some GATT-type principles and provisions to the field of investment,e.g. application of article I (MFN) and article III (national treatment), has been suggested for consideration. If the MFN principle were to be made applicable to investment, investment opportunities would have to be auc-

tioned and host countries would lose their flexibility in the choice of the sources of investment. This is scarcely practicable. Often the sources are selected or preferred on grounds and criteria which are not always based on economic or commercial considerations. The principle of national treatment, if extended to investments, might mean not only that there should be no discrimination between domestic investment and foreign investment but also, in some instances, that there would be discrimination in favour of foreign investment (e.g. through incentives).

Such a situation could have serious implications. For example, the foreign investment creates obligations for repayment in foreign exchange and therefore it might be necessary to impose conditions which would reduce the balance-of-payments burden, whereas this would not be necessary for domestic investment. Sometimes it is argued that developing countries have the protection of article XVIII. In the FIRA dispute mentioned above, the panel held that some trade-related performance requirements contravened GATT but it also made the observation that this considerations might not equally apply to developing countries as they had special dispensation under article XVIII. However, this safeguard may prove to be illusory, particularly because propos-

als have been separately submitted for review of article XVII.[5]

One of the main objectives of seeking elimination of investment measures is ensuring wider and freer investment opportunities for terms. But very often the objectives of the investing firms, which are largely guided by the profit motive, may not be fully in consonance with the development needs and priorities of the host country. Investment measures are often fully intertwined with this development process. Various developed countries have,at different times, resorted to similar investment measures. For example, Japan undertook such measures through the Law concerning Foreign Investment, in 1950, and during the period 1956-1963 foreign firms could establish companies in Japan, provided earnings and liquidation proceeds were not remited abroad.

Measures which are in the nature of incentives to investment are at present outside the purview of GATT. Even though such measures have also been brought into the discussion, they are progressively attracting less attention,

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5. See the paper by Frances Stewart, "Proposals for a review of GATT article XVIII: An assessment", in "<u>URUGUAY ROUND: Papers on Selected Issues</u>", (UNCTAD/ITP/10) p.200.

presumably because they are also prevalent in many developed countries. For example, France awards generous tax breaks on the basis of job creation, industrial impact and export; Ireland offers cash grants for large-scale production supplying export markets; and in the United States 24 states have attractive packages of investment incentives.

In short, developing countries have argued that the prohibition of certain TRIMs would be a transgression of the limits of the Punta del Este mandate, that it will frustrate the development objectives of developing countries and the efficient use of investment there in and create an international regime with rights for investors and without any accompanying obligations for them.[6]

REJOINDER TO US ARGUMENT THAT GATT ARTICLES ARE APPLICABLE TO TRIMs :

As mentioned in Chapter No.2,pp.67-73, United States has argued that several GATT articles are applicable to TRIMs e.g. Art. I, II, III, VI, VIII, X, XI, XVI, XVII, XVIII, XXIII. The developing countries however, have vehemently opposed this claim of U.S. Their rejoinder to the U.S claim in this regard is as follows :

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6. C.Raghvan : Recononisation, p. 157.

1. Article I :

This article according to U.S contains the general most-favored-nation (MFN) principle, it deals with the avoidance of discriminatory trade measure which discriminates between goods on the basis of country of orign.

Investment measures imposed by government do not fall within the ambit of article I for a number of reasons. Firstly, investment measures are not imposed at the border. Secondly, even if an investment measure could be said to be trade distorting, article I is not relevant because this article deals with discriminatory trade measures, as implying discrimination between one country and another. It does not deal with discriminatory effects, if any. Thirdly, investment measures relate to issues of foreign capital treatment, industrialization policy, or balance-of-payments policy. The first two do not fall within the competence of GATT and, in respect of the third, there are clear balance-of-payment exceptions for developing countries. Decisions by government to accept foreign direct investment from a particular source are often taken on grounds and criteria which may involve considerations other than of an economic or commercial nature. Finally, investment measures, imposed as they are by sovereign governments for a variety of reasons

not necessarily linked to trade, cannot in their entirety be regarded as trade measures. Since article I deals only with discriminatory trade measures as applying to goods, it cannot ipso facto be said to apply to investors per se.

The applicability of article I to investment measures still remains to be demonstrated. Even if such investment measures have some trade distorting effects, these are neither direct nor significant and, in any case, involve situations other than for which article I was drafted. If article I was made applicable to decisions relating to investment opportunities this would result in host countries losing their flexibility in the choice and source of investments.[7]

2. Article II :

Article II contains both general and specific provisions aimed at protecting the value of tariff concessions. Its general language reaches broadly to require each contacting party to accord to the commerce of the other contracting parties treatment no less favourable than that provided for in tariff schedules. It has been argued that different kinds of TRIMs could increase the cost of importa-

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7. Hardeep Puri and Delfino Bondad, "TRIMs, Development Aspects and the General Agreement," Uruguay Round, Papers on Selected Issues (UNCTAD, ITP/42), pp.66-67.

tion. For instance, it has been alleged that trade-balancing requirements which require a particular level of exports before import licenses are granted can impose an additional cost on imports, thus undermining the value of a tariff concession. Considering that investment measures are imposed by governments with specific objectives, this argument would have the effect of broadening the coverage of the expression "all other duties or charges" in para. I(c) of article II beyond the intention of the article, which clearly relates to "on or in connection with importation".[8]

3. Article III :

Article III contains the national treatment principle. Article III:4 stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of regulations affecting their internal sale, offering for sale, purchase, transportation, distribution or use. Article III:5 prohibits the use of internal quantitative regulations which directly, or indirectly require the supply of products from domestic sources.

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8. ibid. p.67

As already, stated, the FIRA Panel found written undertakings by the investors to purchase goods of Canadian origin or from Canadian sources to be inconsistent with article III:4. In addition to the reservations placed on record by some contracting parties. Argentina had, in a submission before the Panel, argued inter alia that the dispute involved two developed contracting parties. The provisions and arguments invoked against Canada were not necessarily those which could be invoked against developing countries, considering the exception which these countries are entitled to under the General Agreement in order to promote the establishment of a particular industry. Argentina asked the Panel to take this into account in its deliberations. In its findings, the Panel gave due recognition to the submission by Argentina and stated that in any dispute involving less developed contracting parties, full account should be taken of the special provisions in the General Agreement relating to these countries (such as article XVIII :C). The Panel did not examine the issues before it in the light of these provisions since the dispute only involved developed contracting parties.

When the Panel report came up for consideration in the GATT Council, many developing countries reiterated this

point and reserved their acceptance of the Panel report on the clear understanding that in the event of a dispute involving less developed contracting parties being brought before GATT, the special provision relating to them would need to be considered.

It could be argued that the developing countries have no special dispensation in their favour in, relation to their obligations under article III. It may be argued that the need for protection of infant industries requires the invocation of the procedures of article XVIII C which provides for prior approval and compensation to other countries. However, it has been pointed out by some participants in the negotiating group that since article III deals with discrimination between imported and domestic goods, it does not deal with TRIMs which are production measures. It can also be argued that investment measures are imposed by developing countries in the broad context of development policies, and that if at all there is an effect on trade, such effect would have to be direct and significant to motivate contracting parties to seek recourse to existing remedies.[9]

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9. ibid pp.68-69

4. Article VI :

Article VI deals with and prescribes conditions under which counter-measures (anti-dumping and countervailing duties) can be applied if dumping or subsidization causes or threatens material injury to an established industry or materially retards the establishment of a domestic industry.

Article VI has been cited as being relevant to several TRIMs. Some illustrative examples are:

* Investment incentives that reward the attainment of export targets; and
* Requirements that increase exports.

The provisions of article VI of the General Agreement have been amplified in the Tokyo Round Anti-Dumping Code - which replaced in earlier 1967 instrument - and the Tokyo Round Subsidies and Countervailing Measures Code. However, neither the General Agreement, nor these Codes prohibit dumping and subsidization per se. It is only if dumping results in or threatens material injury to an established industry of another contracting party that counter/measures, under certain prescribed conditions, can be imposed. (The situation in respect of countervailing duties is somewhat different and will be examined separately.) As such, reme-

dies against injuries caused by dumping already exist. In any case, certain TRIMs which are alleged to have adverse effects (increasing exports through measures akin to dumping) would require the measure and the alleged adverse effect to be examined on a case-by-case basis. Existing remedies under article VI or the Anti-Dumping Code can be utilized where it is demonstrated that the TRIM in question has resulted in a situation of dumping causing or threatening material injury.

In the case of subsidies, the situation is somewhat different. Article XVI: 4 of the General Agreement and article 9 of the Subsidies Code prohibit contracting parties from granting any export subsidy on manufactured products. Developing countries are exempt from this prohibition, provided that they have entered into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with their competitive and development needs (articles 14,2 and 14.5 of the Code). In the case of subsidies on certain "primary products", [10] there is no blanket prohibition. In this case, the commitment is not

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10. These are difined as nay product of farm, forest or fishery, in its natural form or which has undergone such processing as is customarily required to perpare it for marketing in substantial volume in international trade. The reference to "or any mineral" originally found in articule XVI was subsequently removed.

to grant any export subsidy on such products in a manner which results in the contracting parties granting such subsidy on such products in a manner which result in the signatory granting such subsidy having more than an equitable share of export trade in such products. article XVI:3 of the General Agreement and article 10 of the Code provide guidance on how the concept of "more than an equitable share" is to be determined.

Neither of the situations listed above would appear to apply to TRIMs maintained by developing countries. In addition, the provisions of article II of the Tokyo Round Subsidiaries and Countervailing Measures Code (which deal with subsidies other than export subsidies) and article 14 (which deals with developing countries) sustain the position of developing countries. Article II of the Code recognizes that subsidies, other than export subsidies, are widely used as important instruments for the promotion of social and economic policy objectives. Some illustrative objective are cited in article 11 of the Code. There is, however, a recognition that such subsidies may cause or threaten to cause injury to a domestic industry of another signatory, or may nullify or impair benefits accruing to "another signatory under the General Agreement." Accordingly, signatories

should seek to avoid causing such effects. The Code stipulates that such subsidies do not create the basis for action, under the General Agreement, as interpreted by the Code. This is of course without prejudice to the rights of signatories under the Code. In overall terms, the language of article 11 would suggest that whilst some of these subsidies could be counter valuable in case injury can be demonstrated, the mere existence of such subsidy practices cannot lead to a presumption of nullification and/or impairment. Article 14 moreover contains an explicit recognition that "subsidies are an integral part of economic development programmes of developing countries".[11]

Given the nature and intent of TRIMs imposed by developing countries, it is clear that effects, if any, are not similar to those for which article VI was designed. In any case, if it can be demonstrated that the adverse trade effects are direct and significant, a conclusion which would need to be arrived at on the basis of a case-by case examination, then the remedies available under the General Agreement would appear to be sufficient.

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11. ibid pp.69-71

5. Article VIII :

Article VIII limits fees and formalities to the costs of services rendered in respect of imports. Like article II, it reflects the desire of the drafters of the General Agreement to obligate countries to employ duties should they wish to protect domestic industries or products. The article bans "fees and charges of what ever character" (other than those imposed consistently with articles II and III) to the extent they exceed the approximate cost of services rendered. Such fees and charges are not to represent indirect protection to domestic products.

TRIMs, whether they are designed to attract foreign direct investment or performance requirements imposing conditions thereon, do not take the form of fees or charges, as commonly understood in GATT. As such , article VIII would appear to have no relevance in the context of TRIMs.[12]

6. Article X :

Article X, the central "transparency" clause of the General Agreement, contains provisions requiring prompt publication of law, regulations, judicial decisions and administrative rulings of general application. This is to

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12. ibid.pp.71-72

enable governments and traders to become acquainted wit administration of trade regulations and specifically those pertaining to requirements, restrictions or prohibitions, that are generally applicable, and that affect the sale, distribution, transportation, insurance, warehousing, inspection, exhibition, processing, mixing or other use of imports or exports or on the transfer of payments therefore.

The requirements of article X should be distinguished from the general need for transparency which is a basic principle of GATT. Whilst the need for transparency in the matter of trade regulations is most desirable in the interests of governments and economic operations, the precise applicability of article X to investment measures which relate to issues of foreign capital treatment, industrialization policy, development policy, or balance-of-payments policy, none of which fall within the competence of the GATT, is not clear. Moreover, since TRIMs are imposed by governments on foreign private investors, there are grounds for serious doubt whether the underlying conditions of article X which deal essentially with government measures, as described above in relation to merchandise trade, would be applicable. Most developing countries provide transparency to their investment regimes but since the focus of discussions cannot be on the investment regimes of coun-

tries, it is not clear as to how article X would be applicable.[13]

7. Article XI :

Article XI contains provisions on the application of quantitative import and export restrictions and requires the general elimination of quantitative restrictions. This article deals with restrictions on importation or exportation of products. It deals with the act of importation and not with measures affecting "imported products" that are dealt with under article III. This view, that the General Agreement distinguishes between measures affecting the "importation" of products which are regulated in article XI:I, and those affecting "imported products" which are dealt with in article III was also upheld by the FIRA Panel report. Hence TRIMs which have the effect of restricting or constraining imports cannot be regarded as violating article XI. Such measures do not prevent importation by the concerned company. In any case, developing countries with balance-of-payments problems have a specific dispensation or exception in their favour for maintaining quantitative restrictions, under certain terms and conditions, under

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13. ibid. p.72

article XVIII.[14]

8. Article XVI :

Article XVI contains provisions on the use of subsidies. Some provisions of article XVI have been considered in the section dealing with article VI. Furthermore, article XVI is already under consideration in the negotiating groups on subsidies and countervailing measures. The US proposes to classify TRIMs as outrightly prohibited. Permitted yet actionable, etc., along the lines of the Mid-Term Review Decision on subsidies, presumes that all TRIMs have effects equivalent to subsidies. This assumption appears to be untenable. In this context, it is necessary to emphasize the existing distinction between subsidies on manufactured products for which developed countries have undertaken a commitment not to grant export subsidies (which does not apply to developing countries) and the provisions relating to export subsidies on certain primary products on which there is no ban even for developed countries. As in the case of subsidies, any action against TRIMs, in the context of article XVI, must be based on an examination of facts, on the legal provisions of the General Agreement and the Code, on the alleged adverse effects being direct and significant,

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14. ibid. pp.72-73

and on these so-called adverse effects resulting in or threatening material injury. In the event of clearly demonstrable adverse effects existing remedies could be applied. There appears to be no basis for additional provisions since article VI:I provides for consultation in the event of serious prejudice.[15]

9. Article XVIII :

It has been suggested that article XVII, which deals with State-trading enterprises, contains a number of principles which create rights in the General Agreement that are directly relevant to the trade-restricting and distorting effects of investment measures. Articles XVII:1(b) requires State enterprises to make purchase or sales involving either imports or exports solely in accordance with commercial considerations. Article XVII had been examined by the FIRA Panel. This panel having reached a decision on purchase undertakings in relation to article III: 4, did not consider it necessary to make a specific finding on the interpretation of article XVII:1(c) in the context of this case. It did not reach a separate conclusion, therefore, regarding the consistency of purchase requirements with this provision. Interestingly, as regards the undertakings by

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15. ibid. p.73

investors to export specified qualities or proportions of their production, the Panel concluded that article XVII:1(c) was not applicable. It found that there was no provision in the General Agreement which forbids requirements to sell goods in foreign markets in preference to the domestic market and in particular that the General Agreement does not impose on contracting parties the obligation to prevent enterprise from dumping. As a result, the Panel's view was that Canada was not acting inconsistently with any of the principles of non-discriminatory treatment prescribed by the General Agreement in accepting investment proposals on the condition that the investor export a certain quantity or proportion of production. therefore, it was not necessary to proceed a step further and examine the export undertakings in the light of the commercial considerations criterion of article XVII:1(b).[16]

10 Article XVIII :

This article deals with governmental assistance to economic development. It has been listed for review in the negotiating group on GATT articles where the attempt, in particular, is to recast the provisions of section B of this article and tighten the procedures for its invocation. The

16. ibid. p.74

attempt appears to be to encourage countries to move from invocation of article XVII B to article XVIII C dealing specifically with protection of infant industries which would involve prior approval of contracting parties and provision for compensation.

If the provisions of article XVIII B are diluted, the problems of many developing countries in GATT, which have balance-of-payments problems of a structural and persistent nature, would be aggravated. The proposals for review of this article have been examined in detail by Frances Stewart in an UNCTAD publication of the Uruguay Round.[17] This paper concludes that developing countries still need the right to impose quantitative restrictions for BOP purposes. Developments since this article was introduced in 1957, both in the external environment and in knowledge about economic behaviors, reinforce rather than reduce this need. the provisions of article XVIII form part of exceptions form certain GATT obligations in favour of developing countries, and as such should be fully respected, particularly with reference to the balance-of-payments effects of foreign direct investment and to the desirability of aligning the operations of for-

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17. Frence Stewart, " Proposals for a Review of GATT Article XVIII: An Assessment", Uruguay Round Papers on Selected Issues, (UNCTAD ITP.10), p. 143.

eign investors with each country's development and industrialization programmes.[18]

11. Article XXIII :

This article provides remedies when a party considers that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the agreement is being impeded as a result of the .... application by another contracting party of any measure whether or not it conflicts with the provision of this Agreement ....

As has been argued above, the General Agreement deals with trade in goods, not with investment. Hence it cannot be said that <u>all trade-related investment measures would ipso facto fall under the provisions of article XXIII</u>. Therefore it would be necessary to establish that the merchandise trade effects of investment measures are:

* restricting and distorting;
* direct and significant;
* directly related to the operation of specific articles in the General Agreement;

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18. ibid. pp.74-75

* that their effect is such as to lead to nullification and/or impairment of benefits, accruing to another contracting party.

Since investment measures are maintained by governments in the context of foreign capital treatment, industrialization policy, development policy, or balance-of-payments policy, the relevance of article XXIII would need to be examined in the light of the above.[19]

Concern of the developing countries regarding RBPs of TNCs and GATT proceeding on TRIMs (particularly ICs proposals on TRIMs) are beautifully enumerated in "South Commission Report".[20] Main cruxe of the report is following:

In pressing for the inclusion of TRIMs on the agenda for the negotiations, the capital-exporting developed countries seek to establish a new set of multilateral rules for private foreign investment which would end by severely curtailing the ability of government of the capital-importing countries to regulate these flows in accordance with their national development priorities. Their objective is to

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19. No.1, pp.75-76

20. Dated - 5 August 1988, venu - Mexico City (South Commission Publication Mexico)

design a multilateral system which would further strengthen the role, the expanding presence and the economic power of the transnational corporations.

Although the subject of investment rules goes beyond GATT's traditional concern for impediments to trade imposed at national borders, an attempt is made to justify the use of GATT for laying down these new rules on the grounds that, in an increasingly interdependent world, the distinction between investment and trade flows has been blurred and the GATT ought to be concerned with at least those aspects of investment policies which have a bearing on trade flows. In this context it is sought to focus particular attention to trade-related investment measures which are considered to have significant trade-distorting effects.

A multilateral investment regime designed to promote the interest of capital exporters in general and the transnational corporations in particular would clearly have serious adverse effects on the development prospects of host countries. There are very good economic reasons why developing countries need to regulate the inflows of private foreign investments and to impose on such investments conditions and performance requirements arising out of their development needs and priorities. In a situation character-

ized by vast imperfections in the product and factor markets, as is the case in most developing countries, the volume and pattern of foreign investment flows determined solely by the corporate objectives of foreign investor would not represent an efficient or optimum outcome form the standpoint of capital-importing countries.

In economic theory, trade-distortive practices are viewed against the background of the ideal of perfect competition. Yet the world markets for capital and technology hardly bear comparison to the competitive ideal in their dealings with the transnational corporations, the developing countries have to contend with market structures characterized by significant elements of market power and monopoly and a complete lack of transparency in the behavior of transnational actors. In such a setting, it is a travesty of the facts to describe as trade distortions measures adopted by the host countries to minimize the harmful and maximize the favourable impact of foreign investment on the national economy. In a world of monopolies, transfer pricing and internationalization of economic processes represented by the transnational corporations, investment regulatory measures are not trade distorting.

Clearly, all countries need screening procedures to block unacceptable and counterproductive activities or projects and to modify the terms of their operations to make them consistent with their development objectives. Furthermore, if proper balance is to be observed, preserving the integrity of the development objective must also be give prime consideration. As part of this exercise, equal attention must be paid to those aspects of behavior of the transnational corporations - restrictive business practices, restrictions on freer flow of technology, market-sharing arrangements, etc - which impede the realization of the development and trade policy objectives of the developing countries. Any equitable multilateral arrangements must then also include acceptance by the transnational corporations and the governments of developed countries of their own responsibilities to curb restrictive practices of TNCs and to facilitate the freer transfer to technology to the Third World countries. A great deal of work along these lines has been carried out in various international fora, but no concrete results have been achieved because of the opposition of the capital-exporting countries.

A good case can be made in favour of greater transparency, predictability, and non-discriminatory application of

investment regulations imposed by the developing countries. These would facilitate an objective assessment of the costs and benefits of various investment proposals. But insistence on transparency, predictability and non-discrimination as part of a multilateral arrangement which leaves transnational corporations wholly free to operate in any manner they like would only compound the inequities of the present system. There is no justification for GATT to have as its objective the strengthening of the transnational corporations and to limit, through multilateral rules, the negotiating scope of host governments while leaving untouched the policies of the TNCs in vital areas where they impinge on the development prospects of the host countries.

It is generally agreed that data on TRIMs are sparse and imprecise and the extent to which investment measures have a direct or indirect effect on trade is debatable. There are significant unresolved problems of definition and measurement. It is also well known that the issue of TRIMs is highly complicated involving as it does domestic policy-making in such a highly sensitive area as investment undoubtedly is. For all these reasons, great caution is necessary in rushing into a multilateral set of rules without careful and balanced consideration of all relevant issues and interests. Certainly, the developing countries can have

no enthusiasm for any multilateral system designed solely to promote the interests of the TNCs.

NATIONAL SOCIO-ECONOMIC CONSEQUENCES OF TNCs/FDI

TNCs and FDI have allegedly created dire economic consequences and social tensions in developing countries. Main allegations of developing countries against TNCs and FDI are following:

(1) Balance of Payment Effects : The balance-of-payment issue is far more important for less developed areas than for advanced countries. In the advanced countries, the need for foreign exchange varies considerably according to countries and to periods. For the less developed areas, however, foreign exchange is widely regarded as a scarce resource that chronically inhibits growth.

The prevailing view in developing countries is that foreign owned subsidiaries decapitalise that country that plays host to them; their operations are said on balance to reduce the supply of funds available for investment in the country and to burden the national balance of payments.[21] The demonstration is simple enough; from 1960 to 1968, when

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21. Raymond Vernon : "Sovereignty At Bay, The Multinational spread of US Enterprises". (Penguine Books, U.K, 1971). p.170.

approximately $1 billion of fresh capital was being transferred annually to US-controlled subsidiaries is less-developed areas, approximately $2.5 billion were being drawn annually in the form of income alone.[22] It withdraws in the form of royalties and of over pricing of intermediate good were added, the figure would be still larger.

However, it takes only a moments reflection to realise that figures of this sort are quite misleading, at least to the extent that they purport to measure balance-of-payments impact. Implicitly, the figures assume that the only balance-of-payment effects of foreign owned subsidiaries' operations is capital inflows and remission outflows. In reality, the presence of foreign-ownes subsidaries has an impact on every item in the balance-of-payments accounts.

(2) The Stock of Productive Resources : Apart from balance-of-payments effects, another key question regarding the impact of multivational enterprises in the less-developed countries has to do with their effect on the countries resources. That question breaks down into two parts: the effect on national resources, and the effect on human resources.

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22. Source - "Survey of Current Business, 49, No.10 (October 1969), p.30.

Perhaps the most specacular allegations that the US enterprises have ben wasteful of natural resources relate to the role of U.S oil companies in Mexico during the period from early 1920s until the time when their assest were nationalised in 1938.[23] During this period, so the allegation goes, the decline in Mexican oil production was owing in part to the wasteful cost-cutting practices of the foreign-woned enterprises.

Moreover, MNCs often introduces new product or process, after this however, the usual decline in relative benefits probably sets in the longer the enterprise operates on its original technological and organizational base, the less there is to be learned locally. what is more, the longer the enterprise operates, the move likely it is that alternative means will exist for acquiring necessary technology and organizational skills. In due course, in local personnel associated with the subsidiaries of foreign-owned enterprise, including employees and suppliers, may be gaining very little in capability and productivity.

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23. Summarized in J.R. Powell. <u>The Mexican Petroleum Industry</u> (Berkeley: University of California Press, 1956) pp. 15-32. cited in, n. 21, p.177.

The existences of the foreign-owned enterprise tends to stifle the development of human skills. The prevailing assumption in some of less developed countries is the formidable position of the foreign owned enterprise tends to kill arising unilateral disposition of local entrepreneurs to launch a competing business, even though they would be perfectly capable of operating the business efficiently.

(3) Dependence And Distortion Syndrome :

Practically all countries that harbour the subsidiaries of multinational enterprises suffer from a sense of dependence, a sense that is nurtured by the assumption that these enterprises may have extensive geographical options and that the exercise of these options could easily affect the local economy. This sense is especially acute in the less developed countries because of their relative reliance on foreign-controlled raw material exporters.

The economic concerns of less developed countries, however involve not only the familiar issues of dependence but also a group of issues that commonly go under the heading of 'distortions'. For instance, because those enterprises have their origins in advance countries, the assumption is that they are almost at home with a kind of technology, a technology based on large scale, on cheap capital,

and on relatively expensive labour.[24] This kind of orientation is thought to produce various harmful effects on the economies of less developed countries.[25] One of these is the misuse of local resources-misuse in the sense that too much capital and too little labour are used, given the relative price and supply of those local factors.

4. Foreign Control of Management :

An essential aspect ofthe critique raised against direct investments has been that of control. We have already noted that the essence of direct investment is management control; this factor distinguishes it from other forms of capital movements. If direct investments take place in a country, it means that part of its industry will be controlled by foreigners. Many host countries find this difficult to accept; it has led to counter-measures in host countries.

The problem has probably been most acute in Canada. here 59 per cent of the total capital in manufacturing is controlled by foreigners (40 per cent by Americans). Efforts

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24. Meir Merhav, Technological Dependence, Monopoly, and Growth (New York: Pergamon Press, 1969) pp.6, 55-60. cited in, n.21, p.179.

25. The issue is raised sometimes in Europe as well, although with much less emphasis.

have been made from time to time to increase Canada's control over foreign direct investments. In 1963 for instance, a new tax law was introduced requiring firms of less than 25 per cent Canadian ownership and with less than 25 per cent Canadian representation on the board of directors to be taxed at a somewhat higher rate than Canadian corporations. Some developing countries, such as Mexico require 50 per cent of ownership and directorship in the domestic hands. Although wholly foreign-ownership and directorship in the export process sector, all foreign owned investment is screened, as is also the case in India, by a Foreign investment commission, which lays down criteria (often statutory) for the investment. These requirements usually relate to such matters as the sector and location of the investment, the extent of local participation, the transfer of technology, and disclosure of company information. A number of less developed countries have also attempted to increase their control of foreign investments by means of equity participation and joint ventures. The latter can be viewed not only as a means of control over foreign investment but as training ground for local entrepreneurs, managers and technicians.

(5) Challenge to Local Elites :

Apart from economic, social consequences are following. The presence of foreign investment in any local economy generally helps to bolster the strength of certain local elite groups and is usually seen as a threat to the strength of others. To some extent identity and the relative strength of the various elites have changed predictably with country's growth. this has led to cause social tension in many areas.

Apart from this three groups are identified with whom TNCs have hostilities, they are: the government bureaucrat, as he sought to maintain power and control over local economy; the local businessman, as he aspired to shift from the role of supplier of foreign enterprise to the state of competitor; and the intellectual outside the local establishment, as he sought to develop and promote a competing, ideology.

(6) Challenges to Ideologies :

Coming from personal element at local elite to ideologies. After the second world war, the prevailing ideological views in the less-developed countries went into a new phase. Some countries elected socialism as an ideological commit-

ment. Even those nations that did not adopt socialism in from or substance, however, generally framed their national ideologies in terms that placed marked limits on the role of foreign investment. Insofar as an explicit ideology supported this position, the ideology tended at first to have a strong economic bias, based on the writings of such economists as Raul Prebisch and of institution such as the Economic Commission for Latin America (ECLA). The early ECLA views were build mainly on the observation that traditional foreign-owned investment in the less-developed countries was oriented to raw materials and on the assumption that this pattern would continue. According to ECLA, the terms of trade for raw materials were unfavorable in relation to industrial products; the less-developed countries, therefore, would have to shift out of the business of specializing in the production and export of raw materials into the business of producing manufactured products for their own needs. Presumable this kind of shift was not one for which much help could be expected from the foreign enterprise. though the early articulation of this set of assumptions came mainly from Latin America, it quickly grew clear that India, Pakistan, Indonesia, Nigeria and other countries were thoroughly in agreement.

In time, however, some of the factual assumptions of the early E C L A position began to seem questionable. The terms of trade for raw-material exporters were obviously unfavorable in some periods, but quite favourable in others. Moreover, the price indexes used for terms of trade calculations proved to have serious weaknesses which were biasing them in the directions of the E C L A finding. The underlying assumption in E C L A regarding the negotiating position of the less-developed countries also proved questionable. The less-developed economies. found that they could negotiate themselves into a dominant position in foreign-owned raw-material industries, at least as measured in profit-sharing terms. Foreign-owned manufacturing enterprises profit-sharing terms. Foreign owned manufacturing enterprises proved unexpectedly responsive to pressures that obliged them to set up producing facilities inside the less developed countries and required them to increase the depth of their operations in the local economy. Even the assumption that such enterprises would resist exporting their manufactured products from the less-developed countries eventually proved at striking variance with the facts.

Further, the impact of TNCs may be analysed in respect of research and development activities:

(7) Effect on Research and Development :

Foreign ownership of important parts of a country's industry can stifle scientific research and development work in the host country. The main determinant of direct investments in superior technology or managerial skills. Direct investments, especially U.S. direct investments in Europe, tend to be made in technologically advanced industries whose importance for economic development is great. The research for further development of these key industries tends, however, to be located in the investing country, i.e. primarily in the United States, Thereby the host countries are deprived of the important stimulus given by research in these industries. It is this concern which motivated the demands for a Code of Conduct for the transfer of technology at the fourth conference of UNCTAD.

Thus research tends to be concentrated in the home country. The home country started with a comparative advantage in the production of goods which are intensive in research and innovating capacity. By the cumulative effects related to direct investments, this comparative advantage tends to become even more pronounced, and the host countries tend to sink into a position of second rate economic powers.

(8) External Effect of Research and Development :

Another important point in this connection concerns external effects. it is widely believed that expenditures on research and development have important external effects. In the process of developing a certain product or improving production techniques, scientists and technicians are stimulated; new applications valuable outside the immediate project will be discovered; encouragement for, and incentives to, research in universities and other organizations outside the industry will be provided; and so on. A rational attitude geared toward experimenting will be fostered. Competent scientists will be trained, etc, and all this will have positive effects on the whole intellectual climate of the country.

If foreign firms via direct investments take over control important parts of a country's industry, they will tend to shift research to their home country. This could be entirely rational from the point of view of the international firm, which is simply taking advantage of the economies of scale connected with the research activity. It can even be argued that this behavior is rational from the world's standpoint, because it maximizes world income. It still can have very detrimental effects on the host country, which is deprived of research activities detrimental effects on the

host country, which is deprived of research activities that are perhaps comparatively inefficient but which, to the country itself, can be of great important. How this question is viewed is largely a matter of values. It depends, in technical language, largely on the kind of preference function used, whether international, for the home country, or for the host country. Before pursuing this, I will touch on a closely related question, that of the `brain drain'.

(9) Brain Drain Syndrome :

The tendency, inherent in direct investments, to lead to a reallocation of research activities could also induce scientists and technicians to leave their home countries-to what has popularly been called the `brain drain'. According to this argument, the United States will induce a `brain drain' from Canada and Europe; Britain and France, too will tend to siphon off scientific and technical talent from their formerly dependent areas.

It should be pointed out that such movements of educated and skilled people from the periphery to the center can be explained in rational economic terms. Education is a time-consuming activity, and teaching is a labor-intensive activity. It could therefore be expected that human capital (to use the existing jargon) should be produced in low-cost

locations, as presumable the less developed or semi-developed countries are, being rich in labor. This probably to some extent what happens. Several less developed and semi-developed countries have probable, in relative terms, quite a large supply of certain types of educated people who might have difficulty finding adequate work in their home countries . As wages are higher in the developed, industrial countries, the educated people will naturally move away from their home countries to more developed countries, i. e. a `brain drain´ will take place. This type to migration is also encouraged by laws and institutional factors, as most countries tend to favor immigration of educated persons rather that those with less training. To this should also be added the important fact that these skilled immigrants will be provided with more material capital to work with as the ratio of material to human capital is often much higher in the rich countries. Hence an English scientist will often be more efficient in the United States, and an Indian doctor will be more highly productive in England. The migrating scientist can often truthful argue that what attracts him to move, to take part in the `brain drain´, is not the increased salary but the opportunity to work with better equipment and more assistance in more congenial surroundings.

(10) Direct Investment and exploitation : Marxist View.

Direct investments have in the Marxian tradition played a double role, and an both roles they have had important political implications.

In the first variant, direct investments are necessary to postpone the collapse of the capitalist system, and in the second and milder variant they are merely one of many forms of capitalist oppression.

The first line of thought was started by J.A. Hobson and taken up and developed by Lenin. The essence of the argument is that capitalism needs new markets to survive. The inner forces of capitalism, primarily the relentless pursuit and application of new innovations, make it expand to new territories to find new markets and new consumers to postpone the collapse that history, according to **Marx,has in store for it**. The drive to technical progress also makes capitalists look for cheaper sources of raw materials in distant countries. Imperialism, according to Hobson and Lenin, is simply the logical consequence of the economic forces inherent in the capitalist system of production.

Marxists of later vintages have some difficulties in explaining this theory in its strict Leninist formulation.

The Marxian theories of impending collapse of the capitalist system, impoverishment of the workers, etc., are not easy to uphold in the light of the development of the capitalist system. The strong version of the Marxian theory of direct investments, which argues the necessity of these investments for the survival of the capitalist countries derive profits from their direct investments abroad is one thing; it is quite another thing to argue that the industrial, capitalist nations are so dependent on the territories they in some sense dominate via direct investments that their economies would break down without them. It is hardly correct to argue that the United States, Britain, France, etc., are so dependent on their direct investments (or their trade with third countries in general for that matter) that their economic systems could not be sustained without them. A certain lowering of U.S. economic welfare would follow if, to take a drastic example, all U.S. foreign investments were nationalized overnight by the countries is question and no compensation paid. But there is no doubt that the effect of such an action would imply marginal changes in the American economy rather than a collapse of its capitalist system.

The strong version of the first line of thought which argues that direct investment are necessary for the survival of the capitalist system is not easy to uphold. Capitalism's

powers of survival should not be underestimated. However, this does not imply that part of international politics cannot be explained in economic terms, even in fairly crude terms like `search for profits'. The second tent of Marxist theory which relates to the need for raw materials has to a certain extent been vindicated in recent years.

This is not primarily due to the strength of Marxist methodology. However, the assumptions underlying the Marxist analysis, with it emphasis on conflict between various factors of production, on the importance of power relationships and of the natural interest on the part of the producers to try to limit completions and control markets, would seem to be more realistic than the often simpleminded, harmony-geared assumptions of neo-classical economics.

It is not difficult to find examples of varying degrees of economic exploitation. If one country has a strong economic influence over another, and couples that with an allegiance with certain ruling forces of the host country and maintains a close military cooperation with those ruling forces, the host country could be in a difficult position. Then it can certainly be maintained that both political and economic exploitation can occur.

An attempt to deal with a situation such as that just sketched would, however, quickly take us beyond the scope of the present work. Suffice it to say that, in general, we expect direct investments to benefit both the investing and the host country, for reasons set out earlier in this chapter. Nevertheless, the multinational corporation remains a topic of considerable controversy. There is no doubt that the large multinational firm, through its dominance of local markets and research and development and its ability to shift taxable income, can have substantial negative effects on the host country.

FAILURE TO PURSUE GLOBAL COALITIONAL STRATEGY :

Although, I have mentioned, negotiating position of South in Uruguay Round, regarding TRIMs, would like to give overall strategy of South in above mentioned Round.

A key feature of the Uruguay Round was the lack of unity among the developing countries. Want of unity ensured that their interests were deemed unworthy of cognizance. In fact one reason why the developed countries had chosen GATT to conduct negotiations on new issue areas was that "the Third World countries are at the weakest inside GATT, in terms of collective organization and bargaining. They do not negotiate or bargain collectively inside GATT. There was

coordination only at the informal level. There were three possible reasons for this. The first was the general perception that trade negotiations were not amenable to a global coalitional strategy. That is to say, it was felt that states tended to pursue their individual interests with greater vigour in such negotiations, or at best the interests of the subgroups of which they formed a part. Second, "the bargaining format of GATT" made it less suitable to the approach that the Group 77 had pursued in forums like the United Nations Conference on Trade and Development (UNCTAD). Third the developing countries had not actively participated in the earlier round of GATT negotiations. This meant that they had little opportunity to activate a group approach within GATT. UNCTAD, as is known, was established precisely because the developing countries were not getting a hearing in GATT. For this reason negotiations in GATT never received the attention they deserved. However, once the developed countries proposed to include the new issue areas of TRIPS, TRIMS, and services in the Uruguay Round, the reasons for the absence of a global coalitional strategy all but disappeared. It was no longer simple trade negotiations, and it clearly transcended the bargaining framework of GATT. Furthermore, these were issue areas on which the developing countries had been pursing a global coalitional strategy in

forums like UNCTAD (draft codes of conduct on transfer of technology and transnational corporations) and WIPO (revision of the Paris Convention). The reasons for the failure of the developing countries to pursue a global coalitional strategy in the Uruguay Round must therefore, be traced to certain other factors. Unless they are identified and appropriate lessons drawn, the developing countries may not be able to safeguard their interests in future negotiations, whether inside or outside GATT.[26]

From the very outset the developed countries implemented a strategy of divide and coerce. First, in every possible way it was suggested to the developing counteis that they had little in common and that in view of their heterogenous nterests the pursuit of a global coalitional strategy would only prove counterproductive.[27] Sincce this did not appear to represent a radical departure form past practice in GATT,

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26. B.S.Chimni, "Political Economy of Uruguay Round of Negotiations: A Perspective", International Studies, Vol. 29, No.2, 1992 pp.141-142.

27. For example, a Ford Foundation study coordinated by John Whalley, states : Because of the heterogeneity of interests among the developing countries, we feel that an overly rigid bloc-wide approach by all developing countries in all groups in unrealistic, and to some degree [it] may even be undesirable. Countries both will, and should, pursue their individual interest in the various groups as vigorously as possible. Whalley n. 8, p. 63. Cited in Chimni, n.26;p.142.

the developing countries did not appreciate the serious implications of this proposition. To put it differently, by treating the Uruguay Round like any othe trade negotiation, the developing countries deprived themselves of the most significant reason for pursuing a global caalitional strategy. Second, the developed countreies proposed that if at all there was need for a coalition, it should cut across the North-South divide. The formation of the Cairns Group, the socalled nonsubsidizing agricultural exporters form the North and the South, reflected this approach. Named after the Australian town where they first met, its members were Argentiana, Austrialia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay. Third, the developed countries used a "variety of pressures" to persuade a group of countries under the leadership of Colombia and uruguay to abandon their opposition to the new round of trade negotiations. These included the member countries of the Association of South-East Asian Nations (ASEAN), Bangladesh, Chile, Colombia, Pakistan, South Korea, Sri Lanka, uruguay, and some Francophone menbers like Senegal and Zaire. But for the Group of Ten led by Brazil and India the developed countries would have freely defined the mandate of the Uruguay Round and included services in a single-track negotiation. Even

then it was able, as noted earlier, to force a nominal two-track negotitatin framework for goods and services.[28]

Even after four years of the Round "disarrary and disunity" exists, among the countries of the developing world. To prevent all possibilities of a global coalition strategy from taking shape the United States listed the countries like Brazil and India, which were capable of offering leadership, to the south. India had, for example, been carrying out negotiations form April 1989 onwards under the threat of super and/or Special 301 issued under the US omnibus Trade and Competitiveness Act. 1988. Brazil was for a while also placed under this threat. These bilateral threats were held out in complete violation of the spirtis of multilateral negotiations. As P.V. Narasimha Rao, then India's External Affairs Minister, observed in a special address at a meeting held to commemmorate the twentyfifth anniversary of the Group of 77, "there cannot be multilateral trade negotations under bilateraal threat".[29] Yet the thereats continued, the explicit purpose being to discourage India's efforts to unite south in the negotiations. In fact the new Super and Special 301 sections were specially de-

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28. Chimni, n.26,p.142.

29. Times of India (New Delhi), 24 June 1989. Cited in, Chimni, n.26,p.143.

signed to force action in the Uruguay Round. The outcome was that in the post-mid-term review phase of the negotiations Brazil and India failed to mobilize the developing countries to take a united stand on new issue areas like TRIPs, TRIMs and Services. These bilateral pressures would have been successfully resisted if the feeling of isolation had not already crept in. In fact, after Montreal, the unity of the Third World collapsed.[30] It was helped on its way by an unprecedentedly hostile international economic environment, the failure of South-South cooperation to take off, the collapse of the Socialist world, and the demoralization which set in after the Gulf War. These events provided the developed countries the opportunity they were looking for to spread disinformation. On the other hand the ruling classes in the developing world willingly imbibed the imperial world-view.

The hope and desire that what they fail to get unitedly they could gain separately or in coalition with the developed countries was, however, effectively extinguished by

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30. In April 1989 India agreed to discuss what was in substance a global regime on IPRs. It thus modoified its earlier stand that only "trade-related" IPRs should be discussed and that negotiations should essentially be confined to the issue of counterfeit goods. Chakravarty Raghavan. "India Yields in lUruguay Round". Mainstream (New Delhi), 6 May 1989. pp. 15-26. Cited in, Chimni n.26,p.143.

the experience of the developing countries in the talks. Gains of developing countries taken individually were meager compared with the critical concessions they gave in the new issue areas due to the failure of a global coaltitional strategy. Take, for example, the African countries. Earlier they had taken up the strategy of a global coalition. In the present negotiations, however, they did not give their "unqualified adherence" to such a strategy.[31] First, it was felt that in view of the increased hostility of the developed countries to the wholesale retention of the principle of special and differential treatment, it was worth courting the concept of 'graduation" of the more advanced developing countries in order to ensure that it still applied to the least developed countries.[32] Second, the African countries had significant interest in protecting the benefits which were accruing to them through the preferences made available to them by the Lome conventions. [33] This placed Africa, according to Oyejide, "in opposition to many other developing countries and has tended to move African

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31. Oyejide. "The Participation of Developing Countries in the Uruguay Round An African Perspective". World Economy (Oxford), vol. 13 no.4 p. 429. Cited in, Chimni n.26.

32. Ibid.

33. Ibid.

countries out of the global coantion.[34] However, the moment the African countries gave up the global colitional strategy, they found that they were no longer able to protect their interests in areas like TRIPS. TRIMS, and services although these interests were the same as those of most other developing countries. Moreover, while the DDT did offer special and differential treatment to the least developing countries, in was never the position of the developed countries to scrap it altogether. In fact they were committed to it in the mandate itself. Thus, as Kahler and Odell observe, the belief that only through Southern unity could negotiating concessions be obtained from the Northern countries remained "to be disproven by the critics".[35] As Julius K. Neyevere of Tanzania pointed out years ago, the strength of the sub-groups within the developing world would never be sufficient "to allow its members to become full actors, rather than reactors, in the world economic system.[36]

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34. Ibid.

35. Kahler and John Odell. "Developing Country Coalition-Building and International Trade Negotiations, in John Whalley, ed., Developing Countries and the Global Trading System (London 1989), p. 162.

36. Address by Julius K. Nyerer to the Fourth Ministerail Meeting of the Group of 77.

Western critics of a global coalitional strategy argue that the developing countries can maintain a high degree of unity only at the expense of bargaining inflexibility. Going by past experience, they aver that unity is achieved simply through accepting the demands of all subgroups. Robert Rothstein observes: "Procedural unity without substantive unity diminishes the possibility of achieving viable settlements.[37] However it does not mean to abandonment of the idea of a strategy of global coalition, but to a new thinking on how best it can be taken without confusing means and ends. The subgroups of the developing countries need to be more careing to each other's demands. By accommodating contradictory but noncrucial demands internally, they can protect their interest on major issues. The alternative, as the Uruguay round of Negotiations discloses, is that "accommodations"in any case take place but at the cost of unity and through sacrifice of crucial interests. Another lesson is that the unity of the Developing World tends to split up under too hostile conditions. The international economic and political environment obtaining at present can only be expressed as hostile. It makes states to split away and to

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37. Robert L. Rothstein, Global Bargaining CNCTAO and the Quest for a New International Economic Order (Princetion. No.1. 1979), pp. 121-22 and 150. Cited in, Chimni n.26,p.145.

have special relationships with the developed countries, in the desire that they would be able to muster more concessions and help than they would if they were a part of a global coalition. This hope, is counterproductive. The right way is to pursue the path of South-South cooperation and with a sense of urgency. South-South cooperation alone can ensure that conditions never reach a point when "re-entry" into the international division of labour has to be sought at any cost. A third lesson is ideological. It is that an unequal system not only generates institutions and norms which construct and preserve it but also sustains ideas which legitimize it. Such a dominant ideology justifies the existing order of power relations by indication the benefits accruing (or accruable) to all principal parties including in particular the subordinate and less favoured.[38]

Thus an uncritical adherence to the ideas of free market and interdependence will only lead to ever tasting dependence, notwithstanding all suggestions to the contrary. Even countries which propagate such ideas discard them as soon as they find it unnecessary to protect their interests.

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38. Robert W. Cox, "Ideologies and the New International Economic Order: Reflections on Some Recent Literature". International Organization (Madison Wis). Vol. 33. no. 2. spring 1979, p. 259.

CHAPTER IV

Chapter IV

INDIA'S POLICY TOWARDS FOREIGN DIRECT INVESTMENT

I. INTRODUCTION

The Government of India's policy towards foreign direct investment (FDI),or "foreign collaboration" as it is most commonly referred to in official statements, has evolved from cautious promotion in the late 1940s, to a brief period of near "open door" in the 1950s, to a policy of rigorous selectivity in the late 1960s and 1970s, and to a policy of increasing liberalization in the 1980s which iscontinuing in 1990s also. These policy swings have reflected the broader economic development priorities and objectives of the Government embedded in a political culture that has favoured incremental rather than radical advances. The resultant policy towards FDI has been highly selective, strictly regulating the entry and operations of foreign enterprises in accordance with the priorities of industrialization programmes and the primary objective of selfreliance. In the Indian context, it is thus vital to remember that the single most influential factor determining the magnitude and pattern of FDI has been the policies of the Government which have clearly assigned to it only a marginal and highly circumscribed role.

The legal and institutional framework governing FDI in India consists of a complex labyrinth of legislative enactments and policy directives designed primarily for the regulation of domestic investment. No separate laws exist that deal exclusively with FDI. The Government exercises virtually complete discretion in interpreting and applying these legal and policy provisions to shape and control FDI in the economy in pursuance of its policy goals.[1] Thus, an understanding of the policy governing FDI requires a comprehensive analysis of the various laws and policies and their intricate relationship in light of the highly regulated nature of the Indian economy.

II. GENERAL BACKGROUND: ECONOMIC DEVELOPMENTAND THE ROLE OF THE STATE -

The transformation and development of the Indian economy has taken place within a planned, rigidly regulated and relatively closed economic framework. This approach was most strongly influenced by a blend of the self-sufficient egalitarian economy envisioned for India by Mahatma Gandhi, the spiritual leader of the nationalist movement, and the democratic-socialist philosophy preached by Jawaharlal

1. M.J.Williams, "Foreign Investment in India", Columbia Journal of Transnational law, Vol. 26,3 (1990) pp. 609-613.

Nehru, the first Prime Minister of independent India. In the quest for self-reliance and rapid industrial development, greater reliance was put on indigenous manpower, capital, technology, skills and other resources. Foreign trade and, more specifically, FDI were assigned a limited role.

The ideologies and choices of the leaders were reinforced by historical memories of the penetration of India's markets by the British East India Company and the subsequent British colonial rule, as well as by the economic and political exigencies of the situation.[2]

A. The Planned Approach to Development:

The current plan is the Eighth Five Year Plan which visualizes a massive step-up in the total plan outlay from Rs.3,400 billion during the Seventh Plan period to Rs.6,500 billion. The Plan seeks an industrial production growth rate

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2. Indian business, smarting under the discriminatory policies of the British Government on the eve of independence, assumed an attitude of hostility towards foreign capital and underplayed the need for foreign resources. Advocating reduced reliance on foreign finance and technology, domestic capital conceded a large role to the state in the economy within the framework of a mixed economy in which a strong public sector would be complementary to a growing private sector. This view was explicitly endorsed in the Bombay Plan of 1944 authored by prominent Indian industrialists like G.D. Birla and J.R.D. Tata. For details see, Sir P.Thakurdas, <u>A Plan of Economic Development of India</u> (Bombay, Commercial Printing Press, 1944),p.81-82.

of 12 per cent. In light of the massive investment and technology requirements, the Plan also targets higher foreign investment inflows during the five year (1990-95) of around Rs.70-80 billion. This implies an average inflow of Rs.16 billion per year compared to the 1987 level of a little over Rs.4 billion. Undoubtedly, this will require a more liberal policy towards FDI.[3]

B. Industrial policy and FDI : Integral Relationship

The Industrial Policy Resolutions of 1948 and 1956 outlined the basic objectives of the country's industrial development strategy. The wide range of priorities included optimum production and higher productivity, diversification and modernization of the industrial sector, faster promotion of small scale and export-oriented industries, prevention of concentration of economic power, removal of regional imbalances, higher employment generation and self-reliant growth.[4]In pursuance of these objectives, the policy resolu-

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3. Planning Commission, Government of India, Perspective and Issues and Implications of Alternative Growth Rates for Eighth Five Year Plan (New Delhi, 1988); D.N.Saxena, "Foreign direct investment: India's requirements of foreign capital and foreign technology and the role of FDI in that context", Foreign Trade Review, vol.24, 1(1989), pp. 76-97.

4. Indian Investment Centre, Investment Policy for the Eighties (New Delhi, Indian Investment Centre, 1985), P.8.

tion of 1948 also stated that effective control and majority ownership of foreign enterprises should remain in domestic hands in order to regulate the entry and channel their growth in the "national interest".[5]

The Industrial Policy Resolution 1948 broadly classified industries into three categories, Schedule A of the resolution reserved the establishment of new production in certain industries to the public sector. Schedule B designated industries in which both the public and private sector might undertake new projects, although the initiative generally would come from the state. The Schedule A and B are given below.

SCHEDULE A

Industries reserved for the public sector. Arms, ammunition and other defence production; atomic energy; iron and steel, heavy castings and forging of iron and steel; heavy plant and machinery for production of iron and steel, mining, machine-tool production and such other basic industries as may be specified by the central Government; heavy electrical plant, including large hydraulic and steam turbines; coal and lignite;mineral oils; mining of iron ore,

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5. Government of India, "Guidelines of industries: Part I, policies", Ministry of Industry, January 1988.

manganese ore, chrome ore, gypsum, sulphur, gold and diamonds; mining and processing lead, zinc,tin,molybdenum and wolframite; minerals specified in the schedule of the Atomic Energy (Control of Production and Use) Order, 1953; aircraft; air transport; railway transport; shipbuilding; telephones and telephone cables, telegraph and wireless apparatus (excluding radio-receiving sets); and generation and distribution of electricity.

SCHEDULE B

Industries open to both the public and private sectors. All other minerals except "minor minerals" as defined in Sec. 3 of the Minerals Concession Rules, 1949; aluminum and other nonferrous materials not included in Schedule A above; machine tools; ferroalloys and tool steels; basic and intermediate products for chemical industries, such as drugs, dyes and plastics; antibiotics and other essential drugs; fertilizers; synthetic rubber; carbonization of coal; chemical pulp; road transport; and sea transport.

The remaining industries were open to the private sector,but foreign enterprises could be excluded if industrial know-how and capital were available locally. Within the confines of this basic industrial structure, private foreign participation has been permitted in all three broad

categories at the discretion of the Government. Nevertheless, such a strategy has necessarily limited the scope of private domestic and foreign capital in Indian economy. This policy resolution continues to guide India's industrial policy though it has been modified and refined in 1956, 1970, 1973, 1977, 1980, 1985 and 1990 to make it responsive and receptive to the changing technology needs for the modernization and growth of industry.

The Industries (Development and Regulation) Act of 1957 provided the basic regulatory framework for policy implementation. A complex network of licensing procedures was designed to control the allocation of scarce industrial inputs, and the growth, composition and concentration of industrial capacity. Except for small firms and a few others, all companies are required to obtain a license to start production of a new item (with the exception of a few items delicenced recently), expand existing capacity for production, or change the location of an existing industrial undertaking.[6] FDI has been made an integral and essential part of this system of industrial licensing and the overall development and industrialization strategy.

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6. Ibid.

The Monopolies and Restrictive Trade practices (MRTP) Act, passed in 1969, also has implications for the foreign investor. The MRTP Act was designed to ensure that the "operation of the economic system does not result in the concentration of economic power to the common detriment" and to prohibit monopolistic and restrictive trade practices. The regulatory provisions of the Act apply to both domestic and foreign enterprises: (i) undertakings whose assets alone or together with those of their affiliates total Rs. 1 billion or more; (ii) dominant undertakings, defined as those that alone or with affiliated firms control, produce or distribute, at least one fourth of the Indian market for any product. Undertakings registered under the MRTP Act must obtain prior approval from the Government or the establishment of a new undertakings, substantial expansion, or the merger or takeover of another undertaking. However, there is a high priority list of industries for which prior approval of the Government under the MRTP Act is not necessary. In recent years, the Government's concessions have considerably diluted the actual impact of the Act.

The industrial policy and the accompanying legislative framework have been amended over the years without a drastic break with the past orientation. The modifications have been

primarily aimed at rationalizing and restructuring policy, simplifying procedures, delicensing a number of industries, removing bottlenecks to capacity expansion and technology development. These policy changes have had significant implications for both domestic and foreign investors.

III. EVOLUTION OF FOREIGN INVESTMENT POLICY :

Foreign direct investment in India and non-equity arrangements in the form of technical collaborations with translational corporations (TNCs) are permitted only on such terms as are determined by the Government to be in national interest. To reduce some of the uncertainty that necessarily accompanies such an approach, the Government periodically issues press notes, high-level policy resolutions, notifications and illustrative lists to update the information available to the foreign investor of its current policy stance. These policy guidelines interact with the legislative framework to define and determine the pattern and level of foreign collaboration in India.

As a general rule, in the matter of foreign collaboration approvals, the Government has given first preference to the acquisition of technology against a one-time lumpsum payment; second preference, to arrangement involving a payment of royalties; and third preference, to equity par-

ticipation. Foreign investments unaccompanied by technology are discouraged. More recently, however, the Government has decided to permit FDI in new ventures in preference to the outright purchase of technology. It has also permitted FDI in existing Indian companies in high technology areas. Further, in the 1980s, two exceptions were made to permit portfolio investments by investors from oil exporting developing countries (OEDC) and non-residents of Indian origin.

A. Foreign direct investment :

1. Basic principles :

India's FDI policy was first enunciated by Prime Minister Jawaharlal Nehru in his address to the Constituent Assembly on 6 April 1947. The guiding principles of the policy were and continue to be the following:

* All undertakings-Indian or foreign-have to conform to the general requirements of the Government's industrial policy;

* Foreign enterprises will be treated at par with Indian enterprises;

* Foreign enterprises have freedom to remit profit and repatriate capital, subject to foreign exchange considerations;

* If foreign enterprises are compulsorily acquired, compensation will be given on a fair and equitable basis; and

* As a rule, the major interest, ownership and effective control of an undertaking, should be in Indian hands.[7]

In India, the regulatory framework was used especially for controlling international flows of capital and technology to local markets. A policy of "selectivity" was adopted to minimize the country's dependence on foreign investment through better utilization and promotion of domestic human and material resources. As a corollary, the access of foreign investors was limited, the ceiling for foreign equity participation, as a rule, was kept at 40per cent, and FDI was largely channeled to priority industries-industries requiring a high level of technology, undertakings with high export earnings capacity, or industries where indigenous technology was not available and a critical production gap existed.

Thus, the policy towards FDI has been looked upon as a vehicle for the transfer of the sophisticated technology required for the realization of country's development objective and the conservation of foreign exchange through import substitution and/or export promotion. The discretionary nature of the investment policy and its case-by-case ap-

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7. Indian Investment Centre, Partners in Progress 1960-1985, Silver Jubilee Brochure (New Delhi, Indian Investment Centre,1985).

proach has allowed the Government to make exceptions to investment ceilings or application of restrictions in the case of proposed projects conforming closely to the country's development priorities and objective. For example, a United States engineering company which proposed a joint venture in India's offshore oil industry was granted liberal terms of investment. The technology to be used was sophisticated, the company had few competitors and the firm agreed to a 50 per cent export commitment. The firm was allowed a 76 per cent start-up equity stake in the joint venture, an exceptional concession.[8]

A brief examination of the Government's FDI policy from a historical perspective will illustrate how the application of the policies has most often been guided by economic and political exigencies confronting the Government.

2. Historical development of India's FDI policy, 1948-1990

The post-independence period may be divided into three distinct phases in terms of shifts in the Government's policies towards FDI.

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8. "ILT: India", Business International (August 1989),p.9.

(a) 1948-67, the period of cautious promotion

Post-colonial India was initially highly protectionist towards the import of foreign funds and ambiguous towards the import of foreign capital.[9] Not surprisingly, during the early years of independence, few TNCs were attracted to invest in the Indian market.[10]

However, by the mid-1950s, the suspicion of foreign capital yielded to the urgent need for accelerated industrialization and growth. As early as 1948, a shift in the Government's previous rigid opposition to FDI could be detected. In 1949, Nehru's statement to the Parliament made it clear that foreign investment was considered "necessary", not only to supplement domestic capital, but also to secure (in the absence of alternate channels) scientific, technical and industrial knowledge and capital equipment.[11] Restrictions on FDI were considerably relaxed. Though majority ownership and control in local hands was still preferred,

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9. Nationalistic sentiment and longstanding popular support for socialist policies encouraged a selective approach to FDL. "ILT: India", <u>Business International</u> (November 1990), P.2.

10. D.J. Encamation, <u>Dislodging Multinationals: India's Strategy in Comparative Perspective</u> (Ithaca, New York, Cornell University Press, 1989), p.180.

11. M.Kidron, Foreign Investment in India (London, Oxford University Press, 1965), pp.98-105.

exceptions were made in the case of industries using highly sophisticated technology and for export-oriented units. The Government also promised to treat foreign enterprises at par with domestic firms (non-discriminatory national treatment) for all practical purpose and allowed them freedom to remit profits, dividends and interest. These measures were designed to promote FDI on mutually advantageous terms.

In 1957, the Government, faced with two unprecedented crises-a foreign exchange drain and a crisis in financial resource mobilization for the Second Five Year Plan (1956-61)- further liberalized its stance towards FDI. In its drive to boost production and investment and attract FDI to the country, the Government sent abroad as well as received, several trade and industrial delegations. In 1961, the government issued a list of industries which had earlier been reserved for the public sector but were now to be opened to foreign investment in order to realize the plan targets.[12]

The Government also made significant concessions to foreign investors in the form of tax holidays, subsidies and

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12. Nagesh Kumar, Multinational Enterprises in India (London, Rutledge, 1990) p.9.

long-term credit.[13] The Indian Investment Centre, with a network of offices in major cities of the word, was established in 1960 to facilitate the transfer of technology and FDI into the country.

From 1956 to 1965, FDI became essential to the development strategy of the Indian Government. In fact, during the 1956-1966 period the Government's approval rate of applications for production licences from TNCs matched that for state-owned enterprises and exceeded that rate achieved by all but a few Indian business houses.[14] In the 10-year period, 1957-1967, TNCs came to control one fifth of India's corporate assets, up from one tenth in 1957.[15] Combining finance with technology, TNCs were able to negotiate highly favourable investment terms during this period, including majority ownership and control. This permitted foreign enterprises to remit a substantial portion of their earnings through dividends, profits, royalties and other remuneration.

(b) 1968-79, the tightening of restrictions

In the late 1960s, the policy towards FDI became re-

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13. M.Kidron, n.11, p. 91.

14. Encamation, n.10, p.181.

15. Ibid.

strictive. This shift in policy occurred in part due to a revival of concern about certain adverse effects of FDI, including the drain of foreign exchange and foreign economic domination. The foreign exchange crisis in the late 1960s also contributed to this change in attitude and prompted the Government to regulate FDI more strictly.

The policy towards FDI up to the late 1960s largely governed the entry of fresh foreign investment into India. It was silent on regulation on existing FDI in Indian industry.[16] TNCs could expand and diversify their activities, until they were required to induct fresh foreign capital, which required government clearance.

Subsequently, in 1968, the Government set up the Foreign Investment Board (FIB) to deal with cases of foreign investment or collaboration which did not involve more than 40 per cent of the paid-up equity capital of the company and Rs. 20 million share capital. The Cases exceeding this limit were to be considered special and referred to the Cabinet

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16. Indian Investment Centre, n.7

Committee.[17] Further, a list was issued which classified industries into 3 categories: (i) where foreign collaboration was not considered necessary; (ii) where only technical collaboration was to be allowed; and (iii) where FDI might be allowed.[18]

In 1973, the Government announced a select group of core industries to which it sought to further restrict the activities of TNCs and large domestic industrial houses.

However, it was the passage of the Foreign Exchange Regulation Act (FERA) in 1973 that significantly tightened the scope of the FDI regime. FERA was implemented to regulate business activities which directly or indirectly affected India's foreign exchange reserves, "for the conservation of the foreign exchange resources of the country and the proper utilization there of in the interests of the economic development of the country".[19] In the coming years,

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17. The FIB seeks the opinions on a proposed foreign collaboration venture from various concerned governmental ministries. Based on these opinions, the FIB then considers the terms and conditions of the proposal to determine if its is in accordance with the Government's overall policies.

18. Government of India, press note, 20 July 1968.

19. Foreign Exchange Regulation Act, Preamble. Further, in the text accompanying the Act, it is explicitly stated the purpose of FERA is to facilitate the Government's efforts to achieve self-sufficiency and Indian control, instead of foreign domination, over the economy:

FERA became the central piece of legislation guiding and controlling FDI in India.

Under FERA, the requirement of minority foreign equity participation was statutorily enacted. It effectively required foreign enterprises to Indianize or divest their foreign shareholdings to 40 per cent and convert to Indian companies under the Companies Act of 1956. However, enterprises engaged in the core sector or engaged in the manufacture of items involving sophisticated technology or in a predominantly export-oriented industry could retain up to 51 or 74 per cent foreign equity. Thus,FERA divides companies with foreign investment into two categories for regulatory

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...Continued...

(a) By regulating the inflow of foreign capital so that foreign shareholdings are progressively reduced over the shortest practical period of time in both manufacturing and trading activities, particularly in low technology areas;
(b) By controlling the outflow of foreign exchange to ensure that inflows through exports and import substitution do not exceed outflows in the form of imports and remittances;
(c) By directing foreign companies into areas of high technology where indigenous expertise is not available and encouraging diversification of effort by both trading and manufacturing companies into the so-called "core" sector of the economy and also into export-oriented activities;
(d) By exercising greater control over the use of foreign brand names and trade marks to reduce the outflow of foreign exchange on this account.
R.A.Nair, "The role of India's foreign investment laws in controlling activities of multinational corporations", Syracuse Journal of International Law and Commerce, vol.14,3 (1989),pp. 519-553.

purpose: Indian companies with 40 per cent or less foreign equity investment and companies in which foreign equity investment exceed 40 per cent and thus falls under the stringent set of government regulations under the Act. All other companies, incorporated in India and with foreign equity up to 40 per cent, after having received approval were assured equal treatment with other Indian enterprises and freedom to expand, diversify and operate in any field. As a result, large number of TNCs diluted their equity share to avoid the stipulations of FERA and enjoy the benefits arising from Indianization.[20] A few, like IBM and Coca-Coal, preferred to divest rather than dilute their equity holdings. There is little doubt the FERA sparked a drastic change in the organizational structure of the foreign controlled sector in India and in the existing distribution of dividends and the private benefits resulting form FDI.

(c) The 1980s, the trend towards liberalization

Within the overall policy framework, the approach

20. Barely a handful of TNCs chose to leave India given the light Indian restrictions on imports. Further, in most cases, the FERA regulations allowed dilutions to be effected though the issue of fresh shares rather than the sale of foreign held shares to Indian nationals. This process ensured a wide dispersement of the new shareholdings, allowing TNCs to retain unchallenged managerial control even with foreign holdings less than 40 per cent and to expand and diversify with few restrictions.

towards FDI during the 1980s and particularly since 1984-1985 became more liberal. This shift in official policy occurred in the wake of the second oil crisis and India's failure to boost significantly her manufactured exports.[21] It drew the Government's attention to the fact that the highly protected domestic market, the formal and informal restrictions on expansion and diversification of firms (thus preventing them form exploiting economies of scale in production and product development) and the curbs on foreign collaboration and impost to technology had seriously undermined the international competitiveness of Indian industry.[22] Consequently, a multi-pronged strategy was evolved for the promotion of exports, including the removal of bottlenecks for capacity expansion, facilitating access to imported inputs, modernizing and improving the productivity of plants and machinery, and encouraging TNCs to undertake export-oriented manufacturing.

Many of the liberalization efforts to attract and promote FDI have taken place within the realm of industrial

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21. N.Kumar, n.12, p. 13.

22. For instance, see India, Ministry of Commerce, "Report of the Committee on Export Stalegy" (Tandon Committee), (New Delhi, Government of India, 1980); India, Ministry of Commerce, "Report of the Committee on Trade Policies" (Hussain Committee), (New Delhi, Government of India, 1984).

licensing in an attempt to dismantle bureaucratic entanglements, streamline industrial procedures and promote private enterprise and competition. The recent amendments to large and foreign control under MRTP and FERA signal this more liberal investment environment. For instance, the joint venture Tata Timken Ltd, a major collaboration between the Tata Group and the United States based Timken Co., was approved despite protests from local manufacturers that the venture would flood the Indian market with its output and give the Tata group a dominant share. The objections were countered on the grounds that the venture would create a competitive force and would bring new and superior technology. Just a few years ago, the clearance for such a joint venture would have been difficult to obtain.[23]

In recent years, a policy of progressive delicensing has been combined with greater incentives for better capacity utilization and increased production. Some 25 broad categories of industries have been exempted form the licensing requirements of 1985, subject to the conditions that the undertaking is not a FERA or MRTP company, is not reserved for the small sector and is not located within an area of

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23. P.C. Abraham, "US-Indian JV shows India's anti-trust law is losing its teeth", Business International, vol. 36, 136 (September, 1989), p.278.

industrial concentration. In order to facilitate diversification of production, provide flexibility to adjust product-mix within the overall licenses capacity and to realize the optimum utilization of manufacturing facility, a scheme of broad-banding firms in 34 industrial groups was introduced. To date, this facility has been extended to 45 industries. Further, the government created provision for liberal re-endorsement of production capacity based on a 33 per cent increase over the highest annual production in previous years. The procedure for re-endorsement of capacity was simplified where modernization, replacement or renovation resulted in increases of up to 49 per cent of licensed capacity. In addition, the imports of raw materials and capital goods were significantly liberalized, the number of core-sector industries were expanded to 23, corporate income tax was substantially lowered, excise duties were rationalized through a modified value-added tax and a decision was reached to add four more export processing zones to the two existing ones to attract TNCs to set up export-oriented units.[24]

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24. S.Tripathi, "foreign investment in India: new initiatives by the new regime", Multinational Business, No.3 (1985),pp. 10-17; A.R.Negandhi, "Indian foreign investment policies", in W.Teng and N.T. Wang eds., Translational Corporations and China's Open Door Policy (Lexington, Mass.,Lexington Books, 1988), pp. 121-143.

The liberalization in industrial, trade and fiscal policies was paralleled with an increasingly receptive attitude towards FDI. In a bid to cut red tape and remove certain procedural and administrative obstacles which hampered even the smooth inflow of desirable FDI, the Government sought to streamline the foreign collaboration approval procedure by the implementation of a one-committee approval system, the requirement that collaboration approvals be decided upon within 60 days, and the enhancement of the delegated powers of the Administrative Ministry to approve certain technical collaborative agreements more expeditiously.[25] In 1988, the Government also announced the setting up of a "fast channel" for the expeditions clearance and flow of Japanese FDI and technology. In order to attract Japanese TNCs particularly in export-oriented areas, measures were announced to streamline the remittance process and exempt expert profits form income tax. The fast channel was subsequently extended to German TNCs.[26]

With a view to modernization, technological upgrading, and improving the productivity and international competi-

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25. Indian Investment Centre, Monthly Newsletter (25 February 1987), p.1.

26. N.Kumar, n.11, p.15.

tiveness of Indian industry, a more flexible attitude concerning foreign equity participation was adopted. Wholly foreign-owned subsidiaries for 100 per cent export-oriented units have been permitted. These are defined as firms which export at least 75 per cent of their output.[27] Furthermore, to facilitate the flow of high technology to existing industry, a decision was taken in 1986 to permit foreign equity participation to these high-tech industries. In 1989, the tourism sector, India's largest foreign exchange earner, was opened up to a maximum of 51 per cent foreign ownership.[28] This more liberal and flexible approach to FDI could be clearly seen in the impressive decline in the rejection rate of foreign collaboration approvals from 30 per cent to between 5 and 8 per cent in 1988.[29]

In May 1990, a new industrial policy was announced by the Government,indicating a continuation in the liberalization trend to open up the Indian economy and increase its efficiency and competitiveness. If the new policy is imple-

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27. Investment in EOUs increased from about $239 million in 1985 to as much as $3.38 billion in 1989. S.Ganguly, "Understanding India's attitude toward foreign investment", The International Executive (July-August 1990),pp. 15-18.

28. C.Goldstein, "New singer, old song", Far Eastern Economic Review (4 January 1990), pp. 50-52.

29. India Today (31 December 1988), p. 121.

mented in its present form, it will exempt certain production lines from licensing requirements for investment or expansion up to Rs. 250 million, (and up to Rs. 750 million in Government-designated "backward areas") and in 100 per cent export-oriented units.[30] The implementation of these proposals is in question due to the premature collapse of the Government.

3. New Industrial Policy, 1991 :

A series of sweeping changes were announced by the Government in the form of the New Industrial Policy, 1991, on July 24, 1991. The basic philosophy of the new policy has been summarised as "continuity with change".

Objectives : The new industrial policy seeks to achieve the following objectives: (i) to consolidate the strength build up during the last four decades of economic planning and to build on the gains already made; (ii) to correct the distortions or weaknesses that may have crept in the industrial structure as it has developed over the last four decades; (iii) to maintain a sustained growth in the productivity and

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30. This exemption would apply to FERA and MRTP companies as well. The Government has also proposed automatic approval for foreign equity of up to 40 per cent. See, Government of India, "Policy measures for the promotion of small scale and agro-based industries changes and in procedures for industrial approvals", Ministry of Industry, New Delhi, 1990.

gainful employment; and (iv) to attain international competitiveness. The pursuit of these objective will be tempered by (a) the need to preserve the environment, and (b) the need to ensure the efficient use of available resources.

Policy Measures :

In pursuit of the above objectives, the Government has decided to take a series of initiatives in respect of the policies relating to the following areas; (A) Industrial licensing policy (B) Foreign investment, (C) Foreign technology agreements (D) Public sector policy, and (E) MRTP Act.

A. Industrial Licensing Policy :

(i) Industrial licensing will be abolished for all projects except for a short list of industries[31] related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons,

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31. 18 such industries have been identified. these are: (i) coal and lignite, (ii) petroleum and its distillation products, (iii) distillation and brewing of alcoholic drinks, (iv)sugar, (v)animal fats and oils, (vi) cigars and cigarettes of tobacco and manufactured tobacoo substitutes, (vii) asbestos and asbestos-based products, (vii) plywood, decorative venees and other wood-based products, (ix) raw hides and skins, leader, (x) tanned or dressed furskin, (xi) motor cars, (xii) paper and newsprint (xiii) elecronic aerospace and defence equipment,(xiv) industrial explosives, (xv) hazardous chemicals, (xvi) drugs and pharmaceuticals, (xvii) entertainment electronics, and (xviii) white goods. The list has been further reduced.

and items of elitist consumption.

(ii) Only eight industries groups where security and strategic concerns predominate will be reserved exclusively for the public sector.[32]

(iii) In projects where imported capital goods are required, automatic clearance will be given in the following cases :

(a) where foreign exchange availability is ensured through foreign equity;

(b) If the CIF value of imported capital goods required is less than 25% of the total value of plant and equipment,upto a maximum value of Re. 2 crore.

(iv) In locations other than cities of more than I million population, there will be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing.

Industries other than those of non-polluting nature such as electronics, computer software and printing will be

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32. These eight industry groups are: (i) Arms and ammunition and allied items of defence equipment, defence aircraft and warships, (ii) atomic enerty, (iii) coal and lignite, (iv) mineral oils, (v) mining of iron ore, manganses ore, chrome ore, gypsum, sulphur, gold and diamond, (vi) mining of copper, lead, zinc, tin, molydbenum and wolfram, (vii) minerals specified in the schedule to the Atomic Energy (control of production and use) order, 1953, and (vii) railway transport.

located outside 25 kms. of the periphery, except in prior designated industrial areas.

(iv) The mandatory convertibility clause will no longer be applicable for term loans from the financial institutions for new projects.

B. Foreign Investment :

(i) Approval will be given for direct foreign investment upto 51 per cent equity in high priority industries (34 such industries groups have been identified.) Such clearance will be available if foreign equity covers the foreign exchange requirement for imported capital goods.

(ii) To provide access to international markets, majority foreign equity holding upto 51 per cent equity will be allowed for trading companies primarily engaged in export activities.

(iii) A Special Empowered Board would be constituted to negotiate with a number of large international firms and approve direct foreign investment in select areas.

C. Foreign Technology Agreements :

(i) Automatic permission will be given for foreign technology agreements in identified high priority industries

upto a lumpsum payment of Rs. 1 crore, 5 per cent royalty for domestic sales and 8 per cent for exports, subject to total payments of 8 per cent of sales over a 10 years period from date of agreement or 7 years from commencement of production.

(ii) In respect of industries other than those included in (i) above, automatic permission will be given subject to the same guidelines as if no foreign exchange is required for any payments.

D. Public Sector :

(i) Portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure. Whereas some reservation for the public sector is being retained there would be no bar for areas of exclusivity to be opened up to the private sector selectively. similarly, the public sector will also be allowed entry in areas not reserved for it.

(ii) Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes be referred to the board for Industrial and Financial Reconstruction.

(iii) In order to arise resources and encourage wider public participations, a part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers.

E. MRTP Act :

(i) The MRTP Act will be amended to remove the threshold limits of assets in respect of MRTP companies and dominant undertakings.

(ii) Emphasis will be placed on controlling and regulating monopolistic, restrictive and unfair trade practices.

The move towards liberalisation has generally been accepted by industry and trade in the economy-the rate of industrial growth which has been sagging right since mid-sixties began to pick up with the onset of the eighties. However, the process of liberalisation has been slow and the government has been moving in an unduly cautious manner in time direction. What is worse, the administrative machinery which is charged with the responsibility of administering this policy is habituated to the earlier system of complex controls and cannot be easily wooed to the emerging scenario. The momentum gathered by the Indian economy on accounts of the liberation measures is not to be lost in the maze of licensing procedures, the implementation of the policies

will have to be synchronised with corresponding improvements in procedures.

4. Growth Centres :

With a view to promote balanced regional development, a scheme of growth centres was announced on June 3, 1988. These growth centres would be set up in 433 districts. These centres would act as a magnet for attracting industries to backward areas. The centres would be endowed with infrastructural facilities on a par with the best available in the country, particularly in respect of power, water telecommunications and banking. To being with, at least 100 such growth centres would be developed throughout the country over the next five years. Each centre would be provided with funds of the order of Rs. 25 crores to Rs. 30 crores for creating infrastructural facilities. An investment of Rs. 2500 crores to Rs. 3000 crores would be required over the five year period. As and when these growth centres become fully operational the various schemes now in operation for industrial development of backward areas, like the ones providing for central investment subsidy, transport subsidy and assistance for infrastructure development would be withdrawn.

Industrial policy reforms were carried further in 1992-93. The capital market was freed from Government control and the office of the Controller of Capital Issues was abolished. Foreign Exchange Regulation Act was amended and investment restrictions on FERA companies were substantially removed. Foreign investment was further liberalised by removing the conditionality of dividend balancing for the non-consumer goods. Private investment in exploration and refining was allowed in the hydrocarbon sector. The Textile Control Order was repealed. Investment activity has picked up as evidenced by the substantial increase in investment proposals from both domestic and foreign investors. There was a quantum jump in new capital issues after the decontrol of the capital marked.

5. Measures to Attract Foreign Investment(1992-93) :

6.6 A number of measures have been put in place to attract foreign investment.[33]

(i) Under the new Industrial Policy, approvals for foreign direct investment up to 51 per cent of equity in specified high-priority industries were to be given automatically subject to the condition that the divided

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33. Economic Survey 1992-93, Government of India Publication p.124

payments should be balanced by export earnings over a specified period of time. This condition of divided balancing was withdrawn in respect of all foreign investment approvals except for some notified consumer good industries. The list of high-priority industries where foreign investments up to 51 per cent were allowed automatically was revised, rationalising the earlier grouping and adding new items. the software industry is now included in the list.

(ii) Automatic approval of RBI for raising foreign equity up to 51 per cent will be available to:1) companies wishing to raise foreign equity as part of an expansion programme in the high-priority industries and ii) companies predominantly engaged in high-priority industries can issue equity abroad at prices determined by the shareholders by a special resolution.

(iii)Approvals for foreign investment and foreign technology agreements had a condition earlier prohibiting the use of foreign brand name or trade mark in good sold in the domestic market. This restriction has since been withdrawn.

(iv) Foreign Exchange Regulation Act 1973 (FERA) was substantially liberalised through an Ordinance promulgated by the President on 8 January, 1993. All restriction on

FERA companies in the matter of borrowing funds or raising deposits in India as well as taking over or creating any interest in business in India companies have been removed. Indian nationals are now allowed to start joint ventures abroad and accept directorships in overseas companies. FERA companies are also exempted from restrictions on the establishment of branches, liaison offices and acquisition of the whole or a part of any undertaking or company in India carrying on business in trade, commerce or industry excepting agriculture and plantations.

(v) Non/Resident Indians (NRI) and Overseas Corporate Bodies (OCB) predominantly owned by them are allowed to invest up to 100 per cent foreign equity in high priority and other industries with full benefits of repatriation of capital invested and income accruing thereon. Investment by NRIs up to 100 per cent on full repatriation basis is also allowed in export houses, trading houses, hotels and tourism-related industries.

B. Technology Transfer :

Throughout the 1960s and 1970s, the Government of India showed a clear preference for importing technologies via licensing arrangements rather than FDI. However, even the

licensing arrangements were subject to stringent controls. Each agreement was closely scrutinized to ensure that indigenous technologies were not being excluded and "excessive" prices were not being changed.

1. Technology Policy

Government policy towards imports of technology has been highly selective throughout the post-independence period. In general, the Government has been more favourably disposed towards agreements in high technology areas, in export-oriented or import substitution manufacturing or arrangements which enable indigenous industry to upgrade its existing technology. An extension of this policy has been the emphasis placed by the Government on the efficient absorption and adaptation of imported technology through adequate investment in research, engineering and development. The objectives of the Indian Government's technology policy, as embodied in the Statement issued in January 1983, have been to:

* Attain technological competence and self-reliance particularly in strategic and critical areas, by making maximum use of indigenous resources;
* Provide the maximum gainful and satisfying employment to all strata of society;
* Ensure maximum development with minimum capital outlay;

* Identify obsolescence in technology currently in use and arrange for the modernization of both equipment and technology;
* Develop technologies that are internationally competitive, particularly those with export potential;
* Improve production speedily through greater efficiency and fuller utilization of existing capabilities and enhance the quality and reliability of performance and output;
* Reduce demands in energy, particularly energy from non-renewable sources;
* Ensure harmony with the environment and preserve and promote ecological balance[34]

2. Guidelines governing technology transfer :

In order to ensure that foreign technical (and/or financial) collaboration proposals conform to government priorities, domestic enterprises have been advised to adhere to the following guidelines:

(a) The Indian company should fully explore alternative sources of technology and furnish reasons for prefer-

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34. "Technology policy statement", Commerce (15 Januray 1983).PP.80-3

ring the particular technology and the sources of import.

(b) The agreement should not prohibit sub-licensing of the know-how to other Indian parties.

(c) No restrictions should be placed on the licensee regarding the procurement of capital goods, components, spares, raw materials pricing policy, selling agreements, etc.

(d) The agreement should place no export restrictions except where the collaborator has a sub-licensing arrangement.

(e) The use of foreign brand names on products of the domestic market is prohibited, although there is no objection to their use on products to the exported. a foreign firm may, however, provide its trademark free to charge or use it with a suffix or prefix (e.g. Lehar-Pepsi, Hero Honda).

(f) Any consultancy required to execute the project would be obtained from an Indian firm. If foreign consultation is required, an Indian firm should still be the prime consultant.

(g) Provisions for training Indians in production and management should be included where applicable.

Collaboration agreements are normally approved for a period of five years plus in some cases, and additional three year start of period. An extension of five years may be granted if the Government is satisfied that the technology transferred needs more time to be properly assimilated, or the licensor is going to make available new technology, or the agreement relates to an export-oriented industry. Moreover, Indian regulations allow former licensees to continue production after the licensing contract expires without making new payments to the licensor, even through the product continues to be protected by Indian patents.

The royalty depends on the nature of technology and is generally allowed at 3-5 per cent over a period of 5 year, Higher rates of royalty are permissible on exports and products involving the import of sophisticated technology. The Government views unfavorably royalty agreements that provide only the right to exploit a patent and do permit continuing access to technical know-how and new research and development. In recent year, the Government has softened the licensing terms in cases where the licensor has pledged to form a joint venture with the would-be licensee.

With a view to streamlining the approval procedure, powers have been delegated to various Administrative Minis-

tries to handle the approval of licensing and technical assistance arrangement Provided no foreign equity is involved exchange outflows for royalties and fees do not exceed Rs.10 million. To further simplify and expedite the approval procedure in respect to transfer of technology. the policy announcement of 1990 permits the entrepreneur to conclude an agreement without obtaining any clearance from the Government provided the royalty payment does not exceed 5 per cent on domestic sales and 8 per cent on exports. If however, lumpsum payments are involved. the proposal will require government clearance, but a decision will be communicated within 30 days.

C. Portfolio Investment :

In India, FDI is viewed as a vehicle for the transfer of technology. In other words, FDI should invariable be accompanied by the transfer of technology. however, two exception have been made to this rule.

In the case of investors from oil exporting developing countries, the technology transfer condition was delinked from foreign investment because these countries may not have the type of modern technology that India needs. Such investments are limited to new companies that are export oriented or which undertake manufacturing activities in high priority

industries.[35] exceed 40 per cent of total equity participation.

The second exception applies to non-residents of Indian origin who are allowed to invest in India industrial units certain schemes and subject to certain conditions even if there is no transfer of technology accompanying the investment.

IV <u>IMPLICATIONS OF POLICY FOR FDI</u> :

The India Government has followed restrictive policy towards FDI and technology inflows over the last 40 years. A maze of rules, regulations and procedures have been evolved to build a self-reliant economy by circumscribing foreign capital and technology to sectors in which indigenous capability does not exist and by increasing local control of industry by majority local ownership. Government policy has sought to limit the role of FDI, both in terms of the sectors it is allowed to enter and the percentage of equity shareholding foreign firms are permitted. In recent years, the Government has clearly decided that FDI has positive role to play in the economy's growth and development. But it has continued to attract the investment on its

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35. Government of India, press note, 28 Octobner 1980

own terms. Thus, the level of inflows continues to be relatively small.

The following analysis of the magnitude, sectoral distribution and ownership patterns of Indian FDI will help to show how far the Government has succeeded in directing FDI to realize its primarily technology-related objectives. For in India FDI is not looked upon so much as a source of capital, but as vehicle for the transfer of technology. [36]However, an analysis of this nature is limited by the lack of data. Particularly, more recent data on FDI and technical collaborations are highly aggregated and are mostly available in the form of number of collaborations approved rather than the number of approvals actually implemented. Nevertheless, the approval data may be taken as broadly indicative of the trends in FDI flows.

A. Magnitude and form of Foreign Collaborations :

The "stop-go"pattern of India's economic liberalization and policy swings towards foreign investment and technology transfer can clearly be observed from the approval pattern

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36. Undoubtedly, the pattern of FDI in India reflects the influence of market economic forces also. Yet, it would not be incorrect to suggest that the influence of the policy-induced, highly interventionist FDI regime is quite significant.

of foreign collaborations (see table 4.1). In the wake of the economic crisis of 1957, a gradual opening of the economy to foreign investors resulted in almost a five-fold increases in the number of foreign collaboration approvals. The average number of approvals per year jumped from 50 during 1948-1958 to 297 during 1959-1966. Since investible resources were a major constraint during this period, the percentage of financial collaborations was relatively high-at 36 per cent. During the restrictive phase (1967-79), the number of collaboration approved per year slumped to 242 and the share of those with financial participation declined to nearly 16 per cent of the total, a victim of FERA. In the 1980s, liberalizations once again resulted in a considerable increase in the approval rate. The average number of approvals per year increased during 1981-1989 to 752 and the share of collaborations with equity participation in total approvals increased to 25 per cent.

Although the number of approvals declined from 926 in 1988 to 605 in 1989 the value of investments increased from Rs.2.4 billion Rs.3.16 billion. Indeed, between 1981 and 1989, the value of total investments approved increased nearly 29 times form Rs. 108 million of Rs.3.16 billion in 1989. Still the numbers are small for an economy of the size of India and also extremely low when compared to other developing countries in Asia and Latin America.[37]

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37. "ILT.India", <u>Business International</u> (November 1980).

Table 4.1. Foreign collaboration approvals, 1948-88*

Year	Total number of cased approved	Cases involving foreign capital participation	Foreign investment involved (Rs. million)
1948-55	284	-	-
1956	82	-	-
1957	81	-	-
1958	103	-	-
1959	150	-	-
1960	380	-	-
1961	403	165	-
1962	298	124	-
1963	298	115	-
1964	403	123	-
1965	241	71	-
1966	202	49	-
1967	182	62	-
1968	131	30	-
1969	134	29	-
1970	183	32	24.52
1971	245	46	58.38
1972	257	37	62.27
1973	265	34	28.17
1974	359	55	67.13
1975	271	40	32.05
1976	277	39	72.69
1977	267	27	40.03
1978	307	44	94.06
1979	267	32	56.87
1980	526	73	89.24
1981	389	57	108.71
1982	592	113	628.10
1983	673	129	678.70
1984	752	151	1,130.00
1985	1,024	239	1,258.70
1986	957	240	1,069.52
1987	853	242	1,077.05
1988	926	282	2,387.50
1989	605	193	3,166.66
Total 1981-89	6,769	1,646	11,456.97
1990	666	-	-

* Source: Indian Investment Centre, New Delhi.

Note : - indicates not available.

B. Sectoral Distribution of FDI :

The Indian Government has deliberately sought to channel foreign investment and technology into specific sectors by means of an elaborate licensing and approval system. The sectoral composition of FDI has changed considerably over the years as a result of this policy (see table 4.2). The share of the manufacturing sector has increased sharply over the years in comparison with the primary and service sectors. It accounted for about 25 per cent of FDI stock in 1948, 40 per cent in 1964, 87 per cent in 1980, and 89 per cent 1986.[38]

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38. N.Kumar, n.11, p.17.

Table 4.2 Industrial distribution of foreign direct investment stock*
(in millions of Indian rupees)

Sector and industry	Inward investment 1980	1986
Primary sector	831.0	857.3
Agriculture	385.0	411.3
Mining and quarrying	78.0	78.0
Petroleum	368.0	368.0
Secondary sector	8,116.0	12,608.0
Food, beverages and tobacco	391.0	496.1
Textile, leather and clothing	320.0	365.8
Paper and allied products	...	14.9
Chemicals and allied products	3,018.0	4,032.5
Coal and petroleum products	...	6.4
Rubber products	463.0	499.4
Non-metallic mineral products	...	681.9
Metals	1,187.0	1,492.3
Mechanical equipment	710.0	1,245.8
Electrical equipment	975.0	1,637.5
Motor vehicles	480.0	1,302.1
Other transport equipment	35.0	122.4
Other manufacturing	537.0	710.9
Tertiary sector	385.0	682.5
Construction	64.0	64.0
Distributive trade	209.0	209.0
Transport and storage	...	8.7
Finance and insurance	47.0	47.0
Other services	65.0	353.8
TOTAL	9,332.0	14,147.7

* Source: Reserve Bank of India; UNCTC, World Investment Directory.

Note: Foreign direct investment inward stock for 1980 reflects India's actual foreign direct investment in banking, insurance and government companies. Inward stock for 1986 is estimated by adding cumulative inflows for the period 1981-1986 (calendar years) in joint ventures between and Indian enterprises to the inward stock of 1980. Agriculture consists of plantations. Other manufacturing includes building materials. Construction includes utilities and transport.

Within the manufacturing sector, new investments have largely gone to technology-intensive sectors such as chemical and allied products, electrical equipment, metals, motor vehicles and mechanical equipment. In 1989, the share of these five broad categories was over 65 per cent of total FDI in the manufacturing sector.

C. Ownership Pattern :

The FDI policy has had a significant impact on the ownership pattern of foreign collaborations, encouraging a trend towards foreign minority participation. Based on a sample of 179 companies (with more than 40 per cent foreign equity) which came under the purview of FERA when the legislation was enacted in 1973, a Reserve Bank of India survey showed that 52 per cent diluted their foreign shareholdings to 40 per cent or less between 1973 and 1981 (see table 4.3). However, nearly 48 per cent were allowed to retain more than 40 per cent foreign equity. These enterprises operated in industries, employing sophisticated technology or exporting most of their product and thus qualifying for exemptions outlined in FERA. Greater flexibility towards higher foreign equity participation is likely as the Government actively seeks to promote foreign collaborations in these priority areas.

The ownership pattern has also changed in terms of home country distribution. In 1981, the United States (Rs. 22.48 million) surpassed the United Kingdom (Rs. 7.12 million) as the largest source country in India. In 1989, the Federal Republic of Germany overtook the United States as the leading source of FDI in India. Out of total approved investment of Rs 3.16 billion, Germany accounted for Rs. 1.2 billion, followed by the United States (Rs. 621.5 million), the United Kingdom (Rs. 329.5 million), Denmark (Rs. 98 million), the USSR (Rs. 95.8 million) and Japan (Rs. 87.8 million). Investments from Denmark and the USSR grew dramatically in 1989.

Table 4.3. Foreign ownership patterns and after FERA, 1973-1981*

Foreign shareholdings as a proportion of total equity (Percentage)	Foreign affiliates 1973		1981	
	Number	Percentage	Number	Percentage
1-40	-	-	93	52
41-50	81	45	34	19
50-74	54	30	36	20
74-99	9	5	16	9
100	35	20	-	-
TOTAL	179	100	179	100

* Source: Reserve Bank of India, Foreign collaboration in Indian Industry: Fourth Survey Report, 1985, pp.60-61.

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Taking a broader perspective. India's FDI policy has served as a double-edged sword. It has fostered indigenous development and a diversified industrial structure on the one hand. On the other hand, it has created stagnation in technological development.

Undoubtedly, India has come a long way in its quest for an independent and self-reliant base in production and technology. The large and diversified base, especially in the capital goods sector, is evidenced by the magnitude of Indian technology exports and joint ventures aboard. There are individual firms which have become highly efficient and competitive by international standards and which have judiciously combined technology imports with their own R and D to keep pace with latest technological developments.

However, the same set of policies have discouraged desirable foreign investment inflows and technology imports. In addition to the cumbersome, time-consuming approval procedure, the restrictions on majority equity participation and long-term technology licensing agreements have particularly discouraged TNCs with highly sophisticated technologies from investing in India. Further, the policy of closing a number of industries to FDI and competition has fostered

widespread areas of inefficiency and technological backwardness.

The new liberal policy towards FDI in the 1980s, particularly from 1984-85 onwards, addresses itself to the maladies of inefficiency, incompetitiveness, low productivity and technology lags afflicting the Indian economy. It has made foreign investment and technology transfer an important element in India's strategy for technological modernization, efficiency and international competitiveness. However, these measures represent only initial steps on what remains a long and difficult journey toward a more flexible, efficient and open economy.

V. OUTLOOK FOR THE FUTURE :

The Indian economy is facing one of its worst crises. The foreign debt in January 1991 had risen to $ 70 billion and the debt service ratio threatened to touch 30 per cent. The Gulf war could increase the import bill by $ 13 billion a year as exports to Iraq and Kuwait and remittances from Indian workers there are lost. The foreign exchange reserves of $ 1.4 billion are barely enough to cover 20 days of imports.[39] In the coming years, the domestic budget deficit

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39. "The Hindu rate of growth returns to India", The Economist (12 January 1991), p. 27.

and the adverse balance-of-payments situation are likely to accelerate India's efforts to attract foreign capital.

The Government's policy towards FDI in the past has resulted in a vicious cycle in which FDI has been discouraged because of fears that the repatriation on profits will further deplete foreign exchange reserves, while hard currency-earning exports remained low because domestic industry, in the absence of genuine domestic competition, could not compete internationally.[40]

It was this cycle that the Government in the 1980s attempted to break. The New Industrial Policy of 1991 sought to consolidate and expand the liberalization trend by announcing automatic approval for foreign investment of 40 per cent and single list identifying industries where more than 40 per cent foreign equity would be freely permitted. However, these reforms face an uncertain future under the new Government.

The considerable political turbulence and economic squeeze confronting the country can be expected to have significant implications for the FDI regime. But Narsimha

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40. "New singer, old song", Far Eastern Economic Review (4 January 1990), p. 52.

Rao Govrnment has shown its firmness to attract FDI by several measures.[41] For example, several initiatives have been taken to promote foreign investment such as automatic permission for foreign eqity holdings upto 51% in several industries, expeditious clearing of other foreign investment proposals by the Foreign Investment Promotion Board (FIPB) facilities for portfolio investment by foreign investment institutions and permission to reputed Indian companies to float equity abroad. It is too early to judge the actual inflow of investment on this account but early results are encouraging. The total volume of foreign investment at Rs 42.9 billion granted under the automatic and nonautomatic route during August 1991 to December 1992 is more than three time the Rs 12.7 billion foreign investment approved in the last decade. By June 1993, it was clear that there is a considerable increase in the interest on the part of foreign investors to invest, in some of our important priority areas such as power and petroleum refining.

In the long run, whatever the political and ideological configuration of the Government in New Delhi, it is reasonable to sumrise that the trend towards liberalization is unlikely to come to a halt. While the underlying policy

41. For details see pp.205-207, of this dissertation.

structure will not change drastically and restrictive regulations and a selective approach will continue to remain its cornerstones, the Government will increasingly court those investors, especially from Japan and Germany, who offer sophisticated technology with equity participations.

Resistance from local business, as well as the fear of outgoing remittances will continue to keep FDI in consumer products and low-tech areas insignificant. On the other hand, TNCs that offer sophisticated and high technology not available localy, manufacture export-oriented products and can offer foreign currency financing, will receive considerable concessions, incentives and exemptions from the restrictive regulations in terms of foreign equity levels, licensing fees, tax holidays, export credits, etc. On the more positive side, tight budgetary constraints, increasing confidence of local business and IMF induced structural adjustment programme may be expected to further open the economy to foreign investors.

CHAPTER V

Chapter V

CONCLUSION

The developing countries who got independence after World War II are characterised with mass poverty and under-development. For the overall development of society, in these countries, foreign capital investment is one of the most important factor. Thus developing countries have been looking for direct foreign investment from Industrialised Countries (ICs).

But the developing countries, since last two or three decades have brought to bear to their development an element of planning. Through various types of measures, developing countries, have sought to regulate foreign direct investments and projects in line with their developmental objectives and national priorities.

Generally they have two sets of investment measures those providing incentives to investors and those laying down conditions for investment. Since these countries need foreign investment, they feel impelled to provide incentives to attract the investor, particularly at a time of scarce capital in the world. But even while doing so, many coun-

tries also stipulate conditions for a number of reasons. The chief among these relate to their developmental need and, they desire to ensure :

(a) That the investments are in accordance with their development needs and priorities.

(b) The restrictive business practices of the TNCs are kept under control and their adverse effects on host country's economy are reduced if not eliminated.

The performance requirement measures put up by the developing countries on TNCs, have raised eyebrows in the North, which is home of TNCs. These performance requirements of TNCs, which are imperative for the planned development of the developing countries, have been regarded as trade distortive and trade restrictive by the North, led by US.

In the present environment, particularly after the attenuation of cold war, things have become conducive for more economic cooperation and interaction between North and South. Consequently liberalisation of investment policies has taken place. Most of the developing countries have either liberalised or in the process of doing so, thus have created a congenial environment for foreign investment. Still clash of interest exists. Developed countries are fighting for more liberalisation of investment policies of

developing countries, and protection of foreign investors night there in. Again developing countries find it must to put performance requirements on TNCs for their planned development. Thus on one hand economic interests of TNCs are at stake, on the otherhand socio-economic development of poor countries, who need foreign investment according to their need, is endangered.

As revealed in the various meetings of GATT, the developing countries are opposed to US moves to create an multilateral regime on TRIMs, which curtails their right to regulate TNCs investment.

The developing countries have jointly advocated for regulations on investment rights such as export requirement which obliges an investor to export a fixed percentage of production. Through this they seek to stem the net outflows of foreign exchange. They also counter restrictive business practices (RBPs) of TNCs. Developing countries have also demanded for local content requirement rights on TNCs, to oblige them to purchase of produce from local sources a percentage of the investors production. Transfer of technology requirement, which works as a catalyst in development process is most sought after demand of developing countries.

Domestic requirements, investment incentives are the major demands of developing countries.

The US objectives and efforts in the negotiations have to be seen against the background of the evolution of the international regime on property rights of foreigners in the 18th and 19th century. The norms of 18th and 19th century included the concept that the property of foreigners cannot be expropriated except for recognised public purpose and on payment of compensation according to international standards and subject to international arbitration.

In 20th century despite the absence of accepted international norms on TRIMs, US sought to get them accepted through bilateral commerce and friendship treatise. The US also sought to use bilateral aid (and its control of multilateral aid through the World Bank and other international and regional financial institutions) to get developing countries to accept these norms. But by and large these proved counter-productive. Third World countries have developed a strongly nationalistic attitude to foreign capital, to some extent due to their realisation that the state has to play an important role in the economic transformation of their countries and also as a reaction to deep seated

historical memories of the way foreign capital came and established itself in their countries.

In tabling its proposals in GATT, the US has tried to relate them to individual GATT articles and provisions.

Under local content requirements, it has tried to attack several production and sales arrangements, trade-balancing, equity shares, technology commercialisation practices, various licensing arrangements. Argument has been that such requirements, directly or indirectly, can limit imported products being sold or used in a country and hence it is trade-restrictive and distortive.

US has also sought to attack production and sales requirements which restrict the ability of other countries to export to a host country of specific foreign investment. Thus they are trade distortive.

While some of the US demands could be claimed to relate to existing GATT articles, others (such as those relating to equity holdings, remittance practices or licensing provisions) are very difficult to relate to the GATT provisions or said to be directly trade-related.

In fact US, Japan and EEC want to use the multilateral negotiations as a starting point for putting into place an international investment regime with rules and principles that will restrict and limit host country policies and laws in relations with foreign investors and technology suppliers.

The proposals and ideas of all ICs seek to deal with trade-restrictive or distortive effects arising out of governmental actions and measures in the area of investments. But there is no reference to any actions or policies of TNCs that have an effect on trade or business.

A multilateral investment regime designed to promote the interest of capital exporters in general and TNCs in particular would clearly have serious adverse effects on development prospects of host countries. In a situation characterised by vast imperfections in product and factor markets, as is the case in most developing countries, the volume and pattern of foreign investment flows determined solely by corporate interests of foreign investors would not represent an efficient or optimum outcome from the stand point of capital-importing countries. In their dealings with TNCs developing countries have to contend with market structures characterised by significant element of market power

and monopoly and complete lack of transparency in the behaviour of TNCs. In a world of monopolies, transfer of pricing and internationalisation of economic processes represented by the TNCs, investment regulating measures are not trade distorting. Clearly all countries need screening procedures to block unacceptable and counterproductive activities or projects to modify the terms of their operations to make them consistent with their development objectives. If proper balance is to be observed, preserving the integrity of development objective must be given prime consideration. Equal attention must be paid to those aspects of the behaviour of TNCs restrictive business practices, restrictions of free flow of technology, to enhance the development in host third world country.

This conflicting situation, had led to negotiations on TRIMs, since interwar period. Firstly bilaterally and then multilaterally. The issue of TRIMs firstly brought to UNCTC (UN Centre for Transnational Corporation), but attempts to reach an agreement was blocked by US and other major home-countries of TNCs. Again in 1980s US brought the issue to GATT's Uruguay Round in 1986. It was the declining trade competitiveness of the U.S. and economic crisis which impelled it to bring the issue to GATT. US is keen for the

establishment of an international investment regime with rules and principles that will restrict and limits host country policies and laws in relations with foreign investors. However, this is conceded in the South, as a covert hegemonic designs of the North, to create rights for TNCs and make, restrictions imposed on the flow of investment through TNCs as violative of the international legal obligations.

The conclusion of the Uruguay Round of GATT negotiations has been stalled because of differences and conflict of interests among the developed countries on some matters and issues, most prominent among these being in respect of trade in farm commodities and its subsidisation. But the far more fundamental and acute differences between the developed and developing countries, are being treated by a handful of developed countries led by USA, with disdain. These differences, and the sharp conflict of interests they involve, are sought to be resolved by the G-7 by political diktat and economic pressure on the developing countries to secure favourabe terms of trade for the developed countries. They are also trying to impose on the domestic economies of the developing countries "structural" adjustments which will expose them to the unhindered exploitation of the their natural resources and labour. The sharp contradictions among

the G-7, the group of the developed countries and the Third World are indeed most crucial. The Uruguay Round has been so arranged and conducted to resolved these contradiction in favour of the developed countries.

Significantly, the Dunkel Draft Text has sought to achieve the aim of G-7 in the GATT, it allows sufficient scope for the developed countries to make adjustment in their position. It has deleted from this package, in deference to the interests and wishes of the G-7, all the reservations and demands raised by the developing countries during the five years of the GATT Round.

In spite of the attempts in the Commerce Ministry in India and the vociferous urgings of Indian comprador elements working through various industry and trade organisation, to submit to the arrangements embodied in the Dunkel Draft, for an international treaty under GATT auspices, the government has been forced to go slow in the face of the strength of popular opinion against the Dunkel proposals. But the idea is being vigorously canvassed by vested interests that there is no option in the GATT negotiations but to accept the Dunkel Package. The GATT Round is nothing but part of a wider plot to complete the process of establishing the New World Order of colonial dependency for the develop-

ing countries. They have already been dragooned by foreign creditors into the tricky course of structural adjustment which will fit their economies into the frame of the world order which G-7 headed by USA is feverishly promoting.

The provisions in the Dunkel Draft are sinister which, if accepted without changes at the conclusion of the GATT Round, will assume the status of a self-executing and binding international treaty. Instead of offering strategies for strengthening scientific and technological abilities of the South, this dispensation will mean emasculation of the talents and the resources that have already been built up at great sacrifices in the Third World in the last half a century. Instead of developing national self-reliance, it will open the way for unlimited control of the national economies of the developing countries by the TNCs. Instead of offering full scope for the use of highly skilled personnel from the South, it will clear the way for the very organised financial, communications and transport giant service corporation of the West to strangle the development of the service sector in the Third World. If Dunkel proposals on TRIMs, TRIPs, and Services are accepted as international agreement, they will subvert domestic laws of developing countries which protect their interests and promote

self-reliant development. The Draft certainly curtail the sovereign rights of the developing countries.

So, the Third World countries need also to gear up for what lies beyond the Uruguay Round on this issue. And preparation for a concerted strategy must begin now. The issue facing the South is not simply whether or not to meet the US demands on TRIMs. There are at least four other question that each developing country might wish to consider. If there is to be a GATT agreement (Dunkel Draft) on this, issue, what manner of changes might be written into it, so as to address the concerns of developing countries? If such an agreement is to be approved, what manner of quid pro quo might be sought in other MTN groups, as compensations to developing countries? If some manner of accommodation is not reached with the US on TRIMs, will the country face the prospect of coercive bilateral negotiations? And, can US retaliatory initiatives of this sort be more effectively restrained, through negotiation, of a more comprehensive GATT agreement on dispute settlement procedures? These are extremely wide-ranging questions and the South must look for their answers in entirety in a way that their interests are not adversely affected.

Even as the negotiations in Uruguay Round (on Dunkel Draft) are on, not all sections and policy makers within Third World governments seem to be aware of the full implications of the Uruguay Round, whose sweep goes for beyond the normal international trade policy issues of a country. Some of the major Third World countries do not even seem to have a single nodal point or ministry providing continuity, institutional memory and an overall perspective on the Round, its issues and implications. This lack of attention is partly due to the fact that peoples and governments in the Third World are daily fighting a battle for survival, and international issues seem so remote. But part of the reason is the dependence of the Third World media on transnational information flows and systems. While western international news agencies are not necessarily and deliberately setting out to distort information, the `demands' of their principal markets in the North and their cultural milieu inevitably result in a one-side information flow. Also, most developing countries do not have the expertise or resources to play a prominent role in negotiations on such a technical subject.

Anyone making an objective assessment of the South and its situation at the present juncture cannot but be dissat-

isfied with the disunity and improper coordination. It is an irony that the South which has to seek equity and justice in the united and organised way, in the current iniquitous and unjust international economic system, is not united and organised, whereas the North, which already enjoys a vastly disproportionate part of world wealth and income and is now striving to get more, has become increasingly united and coordinated. At this juncture, there can be no higher priority for the South and its movements, Governmental or non-governmental, than to understand this and take remedial measures through unity and with determination.

In the arena of government actions, the first priority must be to rediscover the unity and solidarity of the South and strengthen the emerging united front. This too is a priority for non-governmental forces in the South. They should persuade and lobby their governments to take the necessary steps. The existence of diversified sets of negotiation interests in a few areas should not be allowed to come in the way of a common stand on the more important issues like TRIMs. The effort should not be an attempt to form a bloc and cut the South off from the North, but rather an attempt to deal with the North in a way where the South and its interests will be heeded. As we know, the DCs concert among themselves, while discouraging any such moves on

the part of the Third World countries. Only periodic and political level consultations within the South could help in maximising their commonality of interests and present a credible countervailing force. Any effort by any of the countries, big or small, to deal singly or in small sub-regional groups would fail to safeguard legitimate interests of these countries and their future generations.

The GATT processes of consultations and decision-making, typified in the so-called `green room consultation', have intended to isolate and intimidate Third World negotiators, with the `invitees' to this process `selected' in a non-transparent way. Democratisation in the GATT is a must. Agreement with the North is not even needed to end the asymmetric processes of `consultation' and decision-making in GATT. Only a political decision in a few capitals is needed. If enough countries, not involved in the `green room' process, refuse to accept "chairman's texts" sprung on them as a result of the `green room' process and insist on full discussion and negotiations, this practice will come to an end. This is particularly necessary on new themes and systemic issues like TRIMs that have far-reaching effects on the future. It is also essential that the countries of the South speak up loudly and clearly in the GATT meetings. It

is not enough if they speak in their own informal meeting. Often they are diffident and hesitant because of the hush-hush atmosphere there and the aura of GATT being a contract. The Third World countries must shed their hesitation and clearly spell out what they will accept and what they will not accept.

Considering the differing perceptions and specific interests of the countries of the South, it is not possible that all of them will speak uniformly on all the subjects. However, a system of mutual support needs to be built up. On issues like TRIMs, where the interests of all coincide, they should together issue and present a common statement. On issues of interest only to some of them. those who are interested should issue their common statement and those among the others whose interests are not opposed should provide open support. on such issues where there are differing interests, the various interest groups among the countries of the South should hold consultations in order to understand each other with the objective of achieving agreements through appropriate mutual concessions, and then meeting the North with this modified position which should then have the open support of all in the South. Although these are suggestions advocating only elementary principles of solidarity, but the south is still in disarray and it is

necessary for them to commit themselves to such a code of solidarity.

In the area of TRIMs, the South must make sure that corporate policies and practices are explicitly covered and disciplines on governments are matched by disciplines on private operators in the market. Any disciplines covering government actions, without covering the actions of the private firm, would make the system even more asymmetrical. Third World countries must work for and ensure new rules and disciplines on the exercise of economic power and privileges by firms, including obligations on `home´ countries to enforce the rules and disciplines on their enterprises.

The packages of DCs on the TRIMs will result in creating further barriers to the Third World´s planned development and capacity to develop a modern infrastructure. Third World countries will find the price of development much higher: the ground rules, and the terms and conditions will make the external environment more restrictive and hostile, rather than supportive. The real immediate challenge before Third World countries is to ensure at least damage-minimisation´ and preserve their political and economic independence and right of autonomous development.

As mentioned earlier, trade is not an end in itself, even under theories of `free trade´. It must result in net gains for society, and enable Third World countries to develop and bring about equity within and among countries, without which there will never be peace. This involves issues of gains and their distribution. Distributional conflicts and contradictory perspectives aggravate relations among nations as well as within them. It is comfort indeed, but cold comfort, for developing nations to suspect that although trade strengthens their economy, it strengthens the economies of developed nations far more. to the strong go most, to the weak only what their residual veto, `we will not trade´ can extract. Distribution based on market owner is worse than arbitrary from the perspective of the developing countries. it is inimical. It condemns them to a vicious circle of relative poverty, from which they can emerge only by chance. The future of the people of the South depends on the FDI but performance requirements are must for planned development according to national priorities and to check unethical practices of TNCs.

The impasse in Uruguay Round on TRIPs can be a signal of storms ahead. There are two choices; either a greater glasnost in Dunkel Draft or proceeding blindly. The positive

approach will be the former. All the signs however point to the adoption of a negative approach by the DCs. That could lead to a more pushing, more twisting, more tripping of the weaker states - one by one. There may be some temporary gains in pursuing such a negative path by the DCs, but all this could lead, in the end, only to more brutal pressure, more trade war, more acrimony, more conflicts among nations, Unfortunately DCs have proved blind to lessons of the past.

In the present situation the South cannot afford to fight its battles on the ground chosen by the North or according to rules formulated by the North. The South need not fight trade actions only on the trade or economic front. The South should evolve its own `globality´, not only within the Uruguay Round but other issues too on the North's political, cultural and economic agenda. The lessons of the history have been hammered into the postwar political relationships, but its lessons have not been grasped in the area of international economic relations, particularly when the concepts and consensus about international economic cooperation have now given way to greed and aggrandisement. Appeasement is as useless an exercise in the economic and trade spheres as in the political and security spheres. It only whets appetites. The more countries yield now, the more they will be asked to yield in the future.

"Minor adjustment, fine-tuning" of Dunkel Draft, and an international investment regime based on Dunkel Draft will help developing countries, is a myth. Developing countries must refuse to but such a policy of capitulation. It is time to ask for complete glasnost of Dunkel Draft, only united effort of South can achieve this goal.

ANNEXURE

ANNEXURE 1

TEXT OF DUNKEL DRAFT

TRADE-RELATED ASPECTS OF INVESTMENT MEASURES
PREAMBLE

The CONTRACTING PARTIES

Considering that Ministers agreed in the Punta deal Este Declaration that following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade:

Desiring to promote the expansion and progressive liberalisation of world trade and to facilitate the movement of investment across international frontiers so as to increase the economic growth of all trading partners, and particularly developing countries, while ensuring free competition:

Taking into account the particular trade, development and financial needs of developing countries, particularly those of the least-developed countries:

Recognising that certain investment measures can cause trade restrictive and distorting effects;

decide as follows:

ARTICLE 1: Coverage

1. The Decision applied to investment measures related to trade in goods only (hereafter referred to as "TRIMs"),

ARTICLE 2: National Treatment And Quantitative Restrictions

1. Without prejudice to other rights and obligations under the General Agreement, no contracting, party shall apply any TRIM that is inconsistent with the provisions of Article III or Article IX of the General Agreement.

2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in Article III: 4 of the General Agreement and the obligation of the general elimination of quantitative restriction provided for in Article XI: of the General Agreement is contained in the Annex to this Decision.

ARTICLE 3: Exceptions

All exceptions under the General Agreement shall apply, as appropriate, to the provisions of this Decisions.

ARTICLE 4: Developing Countries

1. A developing contracting party shall be free to deviate temporarily from the provisions of Article 2 above to the extent and in such a manner as Article XVIII, of the General Agreement, as interpreted by the CONTRACTING PARTIES, permits the contracting party to deviate from the provisions of Articles III and XI of the General Agreement.

ARTICLE 5: Notification and Transitional Arrangements

1. Contracting parties, within ninety days of the entry into force of this Decision, shall notify the CONTRACTING PARTIES of all TRIMs they are applying that is not in conformity with the provisions of this Decision. Such TRIMs of general or specific application shall be notified along with their principal features.[1]

2. Each contracting party shall eliminate all TRIMs which are notified under paragraph 1 above within two years of the date of entry into force of this Decision in the case of a developed contracting party, within five

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1. In the case of TRIM applied under discretionary authority each specific application shall be notified. Information that would prejudice the legitimate commercial interests of particular enterprises need not be disclosed.

years in the case of a developing contracting party, and within seven years in the case of a least-developed contracting party.

3. On request, the CONTRACTING PARTIES may extent the transition period for the elimination of TRIMs' notified under paragraph 1 above for a developing contracting party which demonstrates particular difficulties in implementing the provisions of this Decisions. In considering such a request, the CONTRACTING PARTIES shall take into account the individual development, financial and trade needs of the country in question.

4. During the transition period, a contracting party shall not modify the terms of any TRIM which it notified under paragraph 1 above from those prevailing at the date of entry into force of this Decision so as to increase the degree of inconsistency with the provisions of Article 2. TRIMs introduced less than 180 days before the entry into force of this Decisions shall not benefit from the transitional arrangements provided in paragraph 2 above.

5. Notwithstanding the provisions of Article 2 above, a contracting party, in order not to disadvantage

established enterprises which are subject to a TRIM notified under paragraph 1 above, may apply during the transition period the same TRIM to a new investment (i) where the products of such investment (ii) where necessary to avoid distorting the conditions of competition between the new investment the new investment shall be notified to the CONTRACTING PARTIES. The terms of such a TRIM shall be equivalent in their competitive effect to those applicable to the established enterprises, and it shall be terminated at the same time.

ARTICLE 6: Transparency

1. Contracting parties reaffirm, with respect to TRIMs, their commitment to existing obligations in Article X of the General Agreement and to their undertaking on "notification" contained in the 1979 Understanding Regarding Notification, consultation, Dispute Settlement and Surveillance, at interpreted by the CONTRACTING PARTIES.

2. Each contracting party shall notify the GATT secretariat of the publications in which TRIMs may be found, including those applied by regional and local governments and authorities within their territories.

3. Each contracting party shall accord sympathetic consideration to requests for information, and afford adequate opportunity for consultation, on any matter arising from this Decision raised by another contracting party. In conformity with Article XI of the General Agreement no contracting party is required to disclose information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests for particular enterprises, public or private.

ARTICLE 7: Committee on TRIMs

1. A Committee on Trade-Related Investment Measures shall be established, open to all contracting parties to the General Agreement. The Committee shall elect its own Chairman and Vice-Chairman, and shall meet not less than once a year and otherwise at the request of any contracting party.

2. The Committee shall carry out responsibilities assigned to it by the CONTRACTING PARTIES and shall contracting parties the opportunity to consult on any matters relating to the operation and implementation of this Decision.

3. The Committee shall monitor the operation and implementation of this Decision and shall report thereon annually to the CONTRACTING PARTIES.

ARTICLE 8: Consultation and Dispute Settlement

The provisions of Articles XXIII of the General Agreement, and the Understanding on Rules and Procedures Governing the Settlement of Disputes under Articles XXII and XXIII of the General Agreement on Tariffs and Trade as adopted by the CONTRACTING PARTIES shall apply to consultations and the settlement of disputes under this Decision.

ARTICLE 9: Review by the CONTRACTING PARTIES

Not later than five years after the date of entry into force of this Decision, the CONTRACTING PARTIES shall review its operation and, if necessary revise its text. In the course of this review, the CONTRACTING PARTIES shall consider whether it should be complemented with provisions on investment and competition policy.

Annexure

Illustrative List

1. TRIMs that are inconsistent with the obligation of

national treatment provided for in Article III:4 of the General Agreement include those which are mandatory or enforceable under domestic law or under administrative, rulings or compliance with which is necessary to obtain an advantage, and which require:

a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, 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:

b) 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.

2. TRIMs that are inconsistent with the obligation of the general elimination of quantitative restrictions provided for in Article XI:O of the General Agreement include those which are mandatory or enforceable under

domestic law or under administrative rulings or compliance with which is necessary to obtain an advantage, and which restrict.

a) the importation by an enterprise of products used in or related to its local production that it exports.

b) the importation by an enterprise of product 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;

c) 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.

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2376