

**UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT**

**HOST COUNTRY  
OPERATIONAL MEASURES**

UNCTAD Series  
on issues in international investment agreements



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## NOTE

UNCTAD serves as the focal point within the United Nations Secretariat for all matters related to foreign direct investment and transnational corporations. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). In 1993, the Programme was transferred to the United Nations Conference on Trade and Development. UNCTAD seeks to further the understanding of the nature of transnational corporations and their contribution to development and to create an enabling environment for international investment and enterprise development. UNCTAD's work is carried out through intergovernmental deliberations, research and analysis, technical assistance activities, seminars, workshops and conferences.

The term "country" as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable;

A slash (/) between dates representing years, e.g. 1994-95, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g. 1994-1995, signifies the full period involved, including the beginning and end years.

Reference to "dollars" (\$) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

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## *IIA Issues Paper Series*

The main purpose of the UNCTAD Series on issues in international investment agreements – and other relevant instruments – is to address concepts and issues relevant to international investment agreements and to present them in a manner that is easily accessible to end-users. The series covers the following topics:

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## Preface

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on international investment agreements. It seeks to help developing countries to participate as effectively as possible in international investment rule-making at the bilateral, regional, plurilateral and multilateral levels. The programme embraces capacity-building seminars, regional symposia, training courses, dialogues between negotiators and groups of civil society and the preparation of a Series of issues papers.

This paper is part of this Series. It is addressed to Government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers. The Series seeks to provide balanced analyses of issues that may arise in discussions about international investment agreements. Each study may be read by itself, independently of the others. Since, however, the issues treated closely interact with one another, the studies pay particular attention to such interactions.

The Series is produced by a team led by Karl P. Sauvant and Pedro Roffe. The principal officer responsible for its production is Anna Joubin-Bret who oversees the development of the papers at various stages. The members of the team include S. M. Bushehri, Patricia Mira Pontón, Aimé Murigande and Jörg Weber. The series' principal advisors are Arghyrios A. Fatouros, Sanjaya Lall, Peter T. Muchlinski and Patrick Robinson. The present paper was prepared by John Gara. It benefitted from a background paper prepared by Elisabetta Righini. The final version reflects comments received from Bijit Bora, Michael Gestrin, Edward M. Graham, Joachim Karl, Mark Koulen, Mina Mashayeki, Theodore Moran, Antonio Parra, Mansur Raza and Marinus Sikkel. The paper was desktop-published by Teresita Sabico.



Rubens Ricupero  
Secretary-General of UNCTAD

Geneva, June 2001

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UNCTAD has carried out a number of activities related to the work programme in cooperation with other intergovernmental organizations, including the Secretariat of the Andean Community, l'Agence pour la Francophonie, the Inter-Arab Investment Guarantee Corporation, the League of Arab States, the Organization of American States, La Secretaria de Integración Económica Centroamericana and the World Trade Organization. UNCTAD has also cooperated with non-governmental organizations, including the German Foundation for International Development, the Centro de Estudios Interdisciplinarios de Derecho Industrial y Económico - la Universidad de Buenos Aires, the Consumer Unity and Trust Society - India, the Economic Research Forum - Cairo, the European Roundtable of Industrialists, the Friedrich Ebert Foundation, the International Confederation of Free Trade Unions, Oxfam, SOMO - Centre for Research on Multinational Corporations, the Third World Network, la Universidad del Pacifico, the University of the West Indies, and World Wildlife Fund International.

Funds for the work programme have so far been received from Australia, Brazil, Canada, France, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom and the European Commission. Countries such as China, Egypt, Guatemala, India, Jamaica, Malaysia, Morocco, Peru, Sri Lanka and Venezuela have also contributed to the work programme by hosting regional symposia. All of these contributions are gratefully acknowledged.

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## Executive summary

The concept “host country operational measures” (HCOMs) captures the vast array of measures implemented by host countries concerning the operation of foreign affiliates once inside their jurisdictions. HCOMs can cover all aspects of investment (such as ownership and control, hiring of personnel, procurement of inputs, sales conditions) and usually take the form of either restrictions or performance requirements. They are usually adopted to influence the location and character of foreign direct investment (FDI) and, in particular, to increase its benefits in the light of national objectives. Some are those investment measures affecting trade flows, better known as trade-related investment measures (TRIMs). Often, HCOMs are also methods of intervention whose aim is to correct actual or perceived market distortions.

In international investment agreements (IIAs), HCOMs have rarely been considered as a separate issue. More often than not, the international regulation of such measures has to be deduced from more general norms on post-entry treatment of investment. One IIA, however (the WTO Agreement on TRIMs<sup>1</sup>), specifically deals with a number of HCOMs. The more recent IIAs that regulate HCOMs tend towards the restriction of some of these measures. However, the majority of IIAs, especially most bilateral investment treaties (BITs), adopt an approach to investment that does not explicitly address the use of operational restraints as a specific issue on its own; each host country government is free to regulate FDI within its jurisdiction, in line of course with its international obligations.

This paper groups HCOMs into three categories (table 1) and proceeds with discussing them in the context of some of their restrictions at different international levels:

- HCOMs that are explicitly prohibited at the multilateral level, i.e. by the TRIMs Agreement. A number of interregional, regional and bilateral agreements also explicitly prohibit the same HCOMs (or, where these agreements are in a draft form, envisage their prohibition). To use a traffic light analogy, these are “red light” HCOMs, i.e. measures that the international community as a whole (or, more precisely, as represented in the WTO) has agreed should not be employed (although not all countries feel comfortable with the implementation of this agreement).
- Additional HCOMs that are explicitly prohibited, conditioned or discouraged by interregional, regional or bilateral (but not by multilateral) agreements (or drafts thereof). These are “yellow light” HCOMs in the sense that negotiators of IIAs ought to be aware that some countries (or groups of countries) have indeed prohibited them in some IIAs and perhaps would like to do so also at the multilateral level. Categorising these measures as yellow light HCOMs should not suggest that they are not as legally binding as the red light HCOMs. Indeed both derive from instruments governed by international law, and which, among the parties, create binding legal obligations. The point of emphasis is that the red light HCOMs have, in terms of parties, a wider application.
- All other HCOMs. These are “green light” HCOMs. Such measures are generally not subject to control through IIAs although their use may be subject to other international obligations, e.g. to apply national treatment.

**Table 1. Three categories of HCOMs**

<b>Category</b>	<b>HCOM</b>
<b>“Red light” HCOMs</b>	<p>Local content requirements</p> <p>Trade-balancing requirements</p> <p>Foreign exchange restrictions related to foreign exchange inflows attributable to an enterprise</p> <p>Export controls</p>
<b>“Yellow light” HCOMs</b>	<p>Requirements to establish a joint venture with domestic participation</p> <p>Requirements for minimum level of domestic equity participation</p> <p>Requirements to locate headquarters for a specific region or the world market</p> <p>Employment performance requirements</p> <p>Export performance requirements</p> <p>Restrictions on sales of goods or services in the territory where they are produced or provided</p> <p>Requirements to supply goods produced or services provided to a specific region or the world market exclusively from a given territory</p> <p>Requirements to act as the exclusive supplier of goods produced or services provided</p> <p>Requirements to transfer technology, production processes or other proprietary knowledge</p> <p>Research-and-development requirements</p> <p>Measures contrary to the principle of fair and equitable treatment</p>
<b>“Green light” HCOMs</b>	All other HCOMs

*Source* UNCTAD.

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Today, countries negotiating international investment rules need to take as given the first group of HCOMs (unless there should be a renegotiation or modification of the TRIMs Agreement). Negotiations — should they at all include HCOMs — are likely to focus on “yellow light” HCOMs. But options go beyond either covering or not covering certain HCOMs. For example, the extent to which certain HCOMs are tied to certain conditions (e.g. incentives) or the legal nature of any coverage (e.g. best-efforts clauses) can introduce some flexibility. In fact, even when it comes to the TRIMs Agreement, various options as to its further implementation exist.

### Note

- <sup>1</sup> Unless otherwise noted, all instruments cited herein may be found in UNCTAD 1996a or 2000a.

## INTRODUCTION

Governments of host countries adopt various measures that affect the day-to-day life of foreign affiliates and domestic firms in a number of ways and for a number of reasons. In fact, virtually all countries have an elaborate regulatory framework that prescribes the rights and responsibilities of firms. A number of these measures are specifically designed to affect the operations of foreign investors. It is the latter set of measures that is labelled “host country operational measures”. Among them are local content and export requirements, that is to say, measures requiring that a certain percentage (determined either by value or by quantity) of the output resulting from a foreign investment has to be locally sourced or has to be exported. Also used are local equity participation requirements (which may shift management decisions to domestic interests), as well as measures affecting the employment and training of personnel, particularly at the managerial and professional levels; technology transfer and research-and-development requirements; trade-balancing requirements (which link imports/exports of one product to exports/imports of another product); foreign exchange restrictions (such as limiting the availability of foreign exchange to an amount related to foreign exchange inflows attributable to a firm); and earnings remittance limits (which specifically restrict the amount of profit which can be repatriated).

Usually, HCOMs are implemented with the aim of influencing the location and character of investment and, in particular, its costs and benefits. Governments frequently attempt to influence the pattern of resource use through investment policies. For example, local content requirements have been imposed on affiliates of transnational corporations (TNCs) to encourage industrialization or to expand local employment; technology transfer obligations have been used to develop and diffuse industrial skills; and minimum export requirements have been imposed to earn foreign exchange. Local equity requirements have also been used to ensure a certain degree of control for local management, and licensing requirements to strengthen the position of domestic firms in contract negotiations with foreign enterprises. In this sense, HCOMs are intended to

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perform a developmental role. On the other hand, it has been argued that efforts by Governments to influence where or how production should take place, except to correct for negative externalities or byproducts of firms' actions that damage society (like pollution), often lead to a misallocation of resources. Policies that affect the free interplay of market forces can also cause distortions in the pattern of international trade and investment.

More generally, HCOMs are usually part of a broader policy regime aimed at enhancing national welfare. Moreover, such measures are often used by host country Governments in conjunction with other specific policy instruments such as investment incentives. Incentives may be granted in various forms such as cash grants, tax breaks, inputs and factor subsidies or export incentives. FDI may also be favourably induced by the prospect of supplying a protected market. In the bargaining process with potential investors, Governments can thus use HCOMs, together with incentives, to impose some kind of development-conditionality on an investment (UN/DESD/TCMD, 1992).

## Section I

### EXPLANATION OF THE ISSUE

A number of HCOMs gained prominence as an investment policy tool during the 1970s. During that period, host countries increasingly evaluated the contribution of FDI towards their own major development objectives (e.g. the improvement of their balance of payments, the strengthening of technological capacity and improved labour skills) and their non-economic interests (e.g. social and cultural values, environmentally friendly development). As they determined that the contribution of FDI was not always fully consistent with their objectives, a number of host country Governments started implementing measures aimed at modifying the behaviour of foreign affiliates. This was the birth of a more widespread use of HCOMs.

The increasing role of FDI during the 1980s and 1990s as an important and more stable source of private capital inflows to developing countries contributed to a change in attitude of Governments to the use of HCOMs. There was a recognition that the potential to attract foreign investors is not a static phenomenon, and that policy measures by host country Governments play a role in designing an environment conducive to FDI. There was also an increasing recognition that not all HCOMs had positive effects under all circumstances and that, in a number of areas, other policy tools may be more effective. Nevertheless, HCOMs remain a policy tool used by Governments to further their development objectives (as discussed further in the concluding chapter of this paper).

A commonly accepted definition of what constitutes a HCOM does not exist. Literally, the term “host country operational measure” refers to any policy measure adopted by a host country Government to influence the operations

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of foreign investors. In this broad sense, HCOMs could include not only operative restrictions or performance requirements (see below), but also investment incentives and any administrative requirement likely to impinge on the activity of a foreign investor. Moreover, HCOMs are often deliberately opaque or sometimes even regarded as a matter of confidentiality between a host Government and an investing firm.

All these complex factors make it difficult to categorize HCOMs in a comprehensive and accurate way. To overcome this complexity, HCOMs have usually been elucidated by a documentary approach, that is to say, by illustrative lists of measures so far observed (box 1).

### Box 1. Illustrative list of HCOMs

- Restrictions on employment of key foreign professional or technical personnel, including restrictions associated with the granting of visas and permits.
- Requirements to establish a joint venture with domestic participation.
- Requirements for a minimum level of domestic equity participation.
- Requirements on location of headquarters for a specific region or the world market.
- Public procurement restrictions (e.g. foreign affiliates are excluded as Government suppliers or subject to providing special guarantees).
- Restrictions on imports of capital goods, spare parts, manufacturing inputs.
- Restrictions/conditions on access to local raw materials, spare parts and inputs.
- Restrictions on long-term leases of land and real property.
- Restrictions to relocate operations within a country.
- Restrictions to diversify operations.
- Restrictions on access to telecommunications networks.
- Restrictions on the free flow of data.
- Restrictions relating to monopolies or participation in public companies (e.g. an obligation to provide a public service at a certain price).

/...



**Box 1 (concluded)**

- Restrictions on access to local credit facilities.
- Restrictions on access to foreign exchange (e.g. to pay for foreign finance, imports of goods and services or remitting profits).
- Restrictions on repatriation of capital and profits (e.g. case-by-case approval, additional taxation or remittances, phase out of transfers over a number of years).
- “Cultural” restrictions, mainly in relation to educational or media services.
- Disclosure of information requirements (e.g. on the foreign operations of TNCs).
- Special requirements on foreign firms in certain sectors/activities (e.g. on branches of foreign banks).
- Operational permits and licences (e.g. to transfer funds).
- Special requirements on professional qualifications, technical standards.
- Advertising restrictions for foreign firms.
- Ceilings on royalties and technical assistance fees or special taxes.
- Limits on the use of certain technologies (e.g. territorial restrictions), brand names, etc., or case-by-case approval and conditions.
- Rules of origin, tracing requirements.
- Linking local production to access or establishment of distribution facilities.
- Restrictions related to national security, public order, public morals, etc.
- Sourcing/local content performance requirements.
- Manufacturing performance requirements.
- Technology transfer requirements.
- Regional and/or global product mandates.
- Research-and-development requirements.
- Employment performance requirements.
- Training requirements.
- Export requirements.
- Trade-balancing requirements.
- Import restrictions, local sales requirements.
- Linking export quotas to domestic sales.
- Export/foreign exchange earning requirements.

*Source:* Based on UNCTAD, 1996a; UNCTAD, 1996b p.179; and UNCTAD 2000a.

Although such an inventory can be quite detailed, it provides little insight into the different characteristics of the various measures listed, as well as into the characteristics and political economy of this category as a whole.<sup>1</sup> Further considerations can help the elaboration of some special characteristics of HCOMs:

- ***They are meant to respond to special host country Governments' policies...***

HCOMs are typically adopted in the framework of special host country Governments' policies, either through instruments of general application (laws, regulations, administrative guidelines) or on a specific basis during the investor-host State bargaining process that may precede an investment decision.

- ***... cover a very wide range of measures ...***

HCOMs may affect almost all aspects of foreign affiliates' operations. They range from restrictions or requirements on ownership and control, to sourcing of inputs, production technologies, and sales.

- ***... are specifically designed to affect FDI ...***

Among the vast array of national measures that may concern the operations of foreign investors, only those specifically designed to affect foreign affiliates are usually categorised as HCOMs by IIAs. If such a distinctive criterion is not applied, almost any law or regulation of a host country could be viewed as an operative requirement, thus indeed rendering the category of HCOMs so vast as to be almost meaningless.<sup>2</sup>

- ***... generally focus on the post-entry phase of investment ...***

HCOMs focus on the post-entry phase of investment, i.e. the actual operating life of foreign affiliates. Although

various Government measures are sometimes imposed on foreign investors at the time of entry and often affect the same aspects of FDI as admission measures, HCOMs are here distinguished from restrictions and conditions imposed by Governments that apply only in the pre-entry phase of investment.<sup>3</sup>

- **... and are often used in conjunction with incentives.**

HCOMs and investment incentives are often used in conjunction with one another and are also often based on the same economic rationale. Indeed, some IIAs emphasize this relationship.<sup>4</sup> However, it is important to note that incentives and HCOMs operate in a different manner. Investment incentives provide advantages, such as tax relief, subsidies and cash grants, that are designed to induce foreign affiliates to bring about certain results.<sup>5</sup> HCOMs, on the other hand, are designed to prescribe a certain behaviour for foreign affiliates to bring about (perhaps the same) results.

A distinction can also be made between two main forms that HCOMs usually assume. The first are limitations, expressed either as behavioural constraints or as quotas, that a host country imposes on the operations of foreign affiliates; in other words, they are obligations *non facere*. The second form comprises governmentally imposed stipulations (“performance requirements”) that firms meet certain specified goals with respect to their operations within the Government’s jurisdiction (Graham and Krugman, 1995). They are thus obligations *facere*, requiring a positive action from (or imposing a positive condition on) foreign investors. Often, the results achieved by the imposition of either type of obligation are the same. For instance, the promotion of local employment can be achieved either by imposing a quota or other form of restriction (visas, work permits, etc.) on the employment of foreign personnel, or by establishing a local hiring target that foreign affiliates have to meet. But even such a classification fails to address the fundamental

issue that faces negotiators of IIAs, namely whether to prohibit, restrict or simply not deal with certain HCOMs.

For the purpose of this paper, no effort is made to categorize HCOMs along substantive lines. Rather, they are grouped in three categories, with the discussion focusing on the first two:

- **HCOMs explicitly prohibited at the multilateral level, i.e. the WTO Agreement on TRIMs.** To use a traffic light analogy, these are “red light” HCOMs, so to speak, i.e. measures that the international community as represented in WTO has agreed should not be employed (although not all countries feel comfortable with the implementation of this Agreement). This affects both HCOMs that are mandated as well as those whose performance is necessary for the receipt of an advantage. More specifically, the TRIMs Agreement prohibits trade-related investment measures that are inconsistent with Articles III and XI of the General Agreement on Tariffs and Trade (GATT) (GATT, 1994).<sup>6</sup> The Agreement mentions specifically certain types of measures:
  - local content requirements;
  - trade-balancing requirements;
  - foreign exchange restrictions related to foreign exchange in flows attributable to an enterprise; and
  - export controls.

A number of interregional, regional and bilateral agreements also explicitly prohibit the same HCOMs (or, where these agreements are in draft form, envisage their prohibition).

- **Additional HCOMs that are explicitly prohibited, conditioned or discouraged by interregional, regional or bilateral (but not multilateral) agreements (or drafts thereof).** For the purpose of this paper, these are “yellow light” HCOMs, so to speak, in the sense that negotiators of IIAs ought to be aware that some countries (or groups of countries) have indeed prohibited or restricted their

use in some IIAs and perhaps would like to do so also at the multilateral level. These additional HCOMs include:

- requirements to establish a joint venture with domestic participation;
- requirements for minimum level of domestic equity participation;
- requirements to locate headquarters for a specific region or the world market;
- employment performance requirements;
- export performance requirements;
- restrictions on sales of goods or services in the territory where they are produced or provided;
- requirements to supply goods produced or services provided to a specific region or the world market exclusively from a given territory;
- requirements to act as the exclusive supplier of goods produced or services provided;
- requirements to transfer technology, production processes or other proprietary knowledge;
- research-and-development requirements; and
- measures contrary to the principle of fair and equitable treatment.

In contrast to the approach taken by the TRIMs Agreement, such IIAs in some cases allow these additional HCOMs (or some of them) in so far as they are linked to incentives. In other words, their use is restricted to specified circumstances.

- **HCOMs that are not contested.** For the purpose of this paper, these are “green light” HCOMs, so to speak, although their use may be subject to other international obligations, e.g. to apply national treatment. In other words, HCOMs not included in the two preceding categories are, presumably, not contested. This reflects the general view that each host country is free to regulate FDI within its jurisdiction, in line of course with its international obligations. There is, however, also a broader, and more fundamental, issue to be considered. Any analysis of

HCOMs must begin from the economic nature of most of these measures. But a conclusion as to their utility cannot be based solely on economic considerations. Any legal framework is rooted within specific national or regional traditions and cultures. At the core of legal rules, some of which might affect the operations of enterprises, lie fundamental societal values. In effect, some legal rules give expression to core societal values, and most governments find their legitimacy in so far as they take heed of such values. Thus, some HCOMs — especially those dealing with areas such as standards for the preservation of public health, employment rights and the environment, and, in the particular case of developing countries, those specifically meant to advance development — have at their roots core values. A Government that limits its sovereignty in such a way as to not be able to mandate measures that reflect such core values, when necessary, could jeopardize its legitimacy. It is important to realize therefore that, as investment rules delve deeper into areas that had not previously been subject to international disciplines, there are areas that may need to remain within the sovereignty of national Governments, on whose legitimacy the international system still depends. In any event, any negotiations touching upon HCOMs would need to be cognizant not only of the economic justifications, but also of the societal values that they reflect. In fact, even in the context of a proliferation of IIAs, many regulatory measures are not only uncontested but, in some instances, even encouraged by IIAs.

In various discussions concerning IIAs, emphasis has been put on a Government's prerogative to regulate at the national level with regard to such matters. In the ministerial statement on the Multilateral Agreement on Investment (MAI) of 28 April 1998, the ministers confirmed "that the MAI must be consistent with the sovereign responsibility of governments to conduct domestic policies" (OECD, 1998, p. 1). In an Expert Group Meeting of the UNCTAD Commission on Investment, Technology and Related Financial Issues, dealing with international investment

agreements, the Agreed Conclusions noted similarly “that flexibility, including with regard to a Government’s normal ability to regulate, can be reflected, *inter alia*, in the objectives, content, implementation and structure of IIAs” (UNCTAD, 1999b, p. 2). They also noted “that a key issue involves finding the proper balance between flexibility on the one hand and predictability and security on the other” (*ibid.*).

### Notes

- 1 More elaborate classifications, which try to gain an insight into the political economy of the measures at hand, exist mainly in relation to a particular category of HCOMs, namely “TRIMs”. See, for instance, UNCTAD and UNCTAD, 1991, and Greenaway, 1991.
- 2 However, one important IIA that deals with HCOMs does not use this criterion: the TRIMs Agreement is not limited to measures specifically directed at FDI. Thus, for example, a local content requirement may violate the TRIMs Agreement regardless of whether the nationality of the ownership of (or control in) a firm to which the measure applies is local or foreign.
- 3 The topic of conditions for admission and establishment of FDI is examined in a separate paper in this series (UNCTAD, 1999a).
- 4 Thus, some commentators have included investment incentives in their analysis of TRIMs (e.g. Balasubramanyam, 1991, p. 1215; Maskus and Eby, 1990, p. 527), whilst others suggest that the treatment of TRIMs in the WTO context only relates to performance requirements (Morrissey and Rai, 1995, p. 711).
- 5 The topic of “incentives” is examined in more detail in a separate paper of this Series (UNCTAD, forthcoming a). See also UNCTAD, 1996c.
- 6 The TRIMs Agreement provides an illustrative list of measures that are prohibited. It is important to keep in mind how some subsequent WTO dispute settlement rulings have interpreted the Agreement with respect to the nature of the list. In particular, in the *Canada — Certain Measures Affecting the Automotive Industry* case (WTO, 2000c), Canada argued that the Illustrative List in the TRIMs Agreement supported its view that “a measure linking an advantage to the use of domestic products is inconsistent with Article III:4 only if the measure ‘requires’ the use of domestic products” (*ibid.*, p. 372). With respect to this argument, the dispute settlement panel noted “that by definition the illustrative nature of the List means that it does not constitute an exhaustive statement of measures incompatible with Article III:4” (*ibid.*). (This case was appealed to the WTO Appellate Body on other grounds.) On the

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other hand, the measures listed continue to be specifically referred to in a number of WTO members' official communications as the ones delimiting the extent of coverage of the TRIMs Agreement (see, for instance, boxes 5 and 7).



## **Section II**

### **STOCKTAKING AND ANALYSIS**

No investment policy is effective until it is enforced through some form of national law, whether a statute, a regulation, administrative action or other provision. Similarly, no HCOM is effective until it is embodied in either a legal obligation imposed by the host country on a foreign investor or a contractual undertaking by the investor. This variegated and composite array of national obligations has then to be in conformity with the international law instruments that the same countries have established to regulate their exercise of national jurisdiction over foreign investors. The purpose of this section is to analyze, where and how the issue of host countries' adoption of operational measures has been addressed in IIAs.

#### **A. HCOMs explicitly prohibited at the multilateral level**

##### ***1. The TRIMs Agreement***

On the multilateral level, the most important norms prohibiting the use of certain HCOMs can be found in the GATT. The GATT did not contain specific norms on investment.<sup>1</sup> However, certain measures that affect trade flows were covered by the GATT principle of national treatment contained in article III (in particular paragraph 4, dealing with measures indirectly applied to trade), and by the general elimination of quantitative restrictions of article XI.<sup>2</sup>

In the light of this, the WTO Agreement on TRIMs, which was negotiated during the Uruguay Round and entered into force on 1 January 1995,<sup>3</sup> specifically regulated certain TRIMs. Article 2 of the Agreement provides that, “[w]ithout prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with

the provisions of Article III or Article XI of GATT 1994”. An illustrative list in the Annex to the Agreement describes measures that are inconsistent with Article III(4) and Article XI(1):

“1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 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; or
- (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 general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 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, generally or to an amount related to the volume or value of local production that it exports;
- (b) the importation by an enterprise of products 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; or

- (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”.

The Agreement bans not only TRIMs that are obligatory in nature, but also those whose compliance is necessary in order to obtain an advantage. Furthermore, no distinction is made among TRIMs with regard to the time of the investment at which they are imposed; the prohibition of Article 2 of the TRIMs Agreement thus applies to measures applied both at the time of the entry of the investment as well as afterwards.

On the other hand, two features of the TRIMs Agreement should be noted:

- The Agreement prohibits only a specific sub-set of operational measures as discussed in Section I. In fact, a number of other HCOMs prohibited by some other IIAs - such as export performance requirements, mandatory technology transfer requirements, and limits on equity participation and remittances — are not covered by the TRIMs Agreement.
- The Agreement applies only to investment measures related to trade in goods. It does not cover trade in services. Measures concerning service industries are addressed on the WTO General Agreement on Trade in Services (GATS) (box 2).

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

### **Box 2. The GATS**

The GATS does not contain explicit rules dealing with HCOMs or TRIMs. However, the establishment-related nature of much trade in services and the structure of the GATS require some further observations. The GATS is a framework agreement, whose main provisions can be divided into general obligations that apply to all services and other specific obligations, against both of which WTO members enter into commitments in their national schedules. Examples of the first type of obligations are most-favoured-nation treatment, transparency and reasonable, objective and impartial administration of domestic regulations. Specific commitments can, on the other hand, be assumed in relation to market access (see article XVI) and national treatment (see article XVII). Thus, for example, to the extent that a WTO member has made national treatment commitments with regard to services in a particular industry, it cannot apply domestic content requirements solely to foreign investors.

With regard to the latter obligations, the GATS does not require the immediate abolition of all non-conforming measures. Market access and national treatment are granted to foreign enterprises only in those service industries specifically indicated in a member country's schedule, and only to the extent described there. Thus, market access may be absent in all or some service industries, or may be conditional on national participation in management, or else may be limited to a certain percentage of ownership. Similarly, the presence of natural persons, be they individual foreign providers of services or employees of a foreign affiliate, may be subject to visa or other administrative requirements (the formula often used is "subject to the law and regulations" of the host country), or may be quantitatively limited to a certain yearly number, or, in the alternative, qualitatively limited to certain professional profiles. In a number of schedules, a member country's commitments for particular services are not even required to be undertaken before a given date. This flexibility allows each WTO member to open its market to foreign suppliers of services in the industries and under the terms and conditions deemed more appropriate for its level of development and for the attainment of its economic objectives (Mashayekhi, 2000b). At the same time, though, once these commitments are inscribed in the schedules, they cannot be withdrawn or lessened.

*Source* UNCTAD.

make notifications under Article 5.1 within 90 days after the date of their acceptance of the WTO Agreement (table 2) (WTO, 1995). Article 7 established a Committee on Trade-Related Investment Measures that monitors the operation and implementation of the Agreement and reports thereon annually to the Council for Trade in Goods.

**Table 2. Notifications submitted under Article 5.1 of the TRIMs Agreement, February 2001**

Member	Date of communication <sup>a</sup>	Sector	Category of the illustrative list
Argentina	30 March 1995; 21 March 1997	Automotive industries	Paragraph 1 (a) and 2 (a)
Barbados	31 March 1995	Pork processing enterprises	Paragraph 1 (a)
Bolivia <sup>b</sup>	24 June 1998	Hydrocarbons sector	Paragraph 2 (c)
Chile <sup>c</sup>	14 December 1995	Automotive industries	Paragraph 1 (a) and 1 (b)
Colombia	31 March 1995; 4 June 1995; 31 July 1995; 30 September 1996	Agro-industry	Paragraph 1 (a) Paragraph 2 (a)
Costa Rica <sup>d</sup>	30 March 1995	General	Paragraph 1 (a)
Cuba <sup>e</sup>	18 July 1995	Fuel, raw and other materials, tools, equipment, spare parts accessories, consumer goods; transport and marine insurance	Paragraph 1 (a)
Cyprus <sup>f</sup>	30 October 1995	Cheese and ground-nuts products	Paragraph 1 (a)
Dominican Republic	26 April 1995	General	Paragraph 1 (a), 1 (b) and 2 (a)
Ecuador	20 March 1996	Automotive industries	Paragraph 1 (a)

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**Table 2. Notifications submitted under Article 5.1 of the TRIMs Agreement, February 2001 (continued)**

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Member	Date of communication <sup>a</sup>	Sector	Category of the illustrative list
Egypt	29 September 1995	General	Not specified
India	31 March 1995; 22 December 1995; 18 March 1996; 11 April 1996	Consumer goods	Paragraph 2 (c)
Indonesia	23 May 1995; 28 October 1996	Automotive industries, utility boilers, soyabean and fresh milk products	Paragraph 1 (a)
Malaysia	31 March 1995; 14 March 1996	Automotive industries and industrial sector	Paragraph 1 (a)
Mexico	31 March 1995	Automotive industries	Not specified
Nigeria <sup>g</sup>	17 July 1996	General	Not specified
Pakistan	30 March 1995	Engineering, electrical goods and automotive industries	Paragraph 1 (a)
Peru	3 March 1995	Milk powders, anhydrous fat and other milk products	Paragraph 1 (a)
Philippines	31 March 1995	Automotive industries and coconut-based chemicals	Paragraph 1 (a) and 2 (b)
Poland <sup>h</sup>	28 September 1995	Cash registers	Paragraph 1 (a)
Romania	31 March 1995	General	Paragraph 1 (a)
South Africa	19 April 1995	Automotive industries, telecommunication equipment, tea and coffee	Paragraph 1 (a)
Thailand	30 March 1995	Automotive industries, manufacture of milk and dairy products, aluminium	Paragraph 1 (a)

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**Table 2. Notifications submitted under Article 5.1 of the TRIMs Agreement, February 2001 (concluded)**

Member	Date of communication <sup>a</sup>	Sector	Category of the illustrative list
		sheets, TV picture tubes, transformers, air-conditioners and paper products	
Uganda	17 June 1997	General	Not specified
Uruguay	31 March 1995; 30 August 1995	Automotive industries	Paragraph 1 (a)
Venezuela	31 March 1995	Automotive industries	Paragraph 1 (a)

*Source:* WTO, 2000b.

- a Most of the TRIMs notified are probably no longer in place as only ten members (Argentina, Chile, Colombia, Egypt, Malaysia, Mexico, the Philippines, Pakistan, Romania and Thailand) have sought extension of the transition period.
- b Bolivia subsequently submitted a notification indicating that it does not apply any TRIMs that are not in conformity with the Agreement.
- c Initially, Chile notified its measure under the Automotive Statute as a prohibited subsidy under the WTO Agreement on Subsidies and Countervailing Measures. However, after further analysis, this measure was also notified as a TRIM.
- d Costa Rica subsequently submitted a notification indicating that it intends to eliminate measures notified under Article 5.1 in advance of the expiry of the transition period.
- e Cuba subsequently informed the Committee that the measures notified by Cuba under Article 5.1 are no longer in force.
- f This notification superseded Cyprus' previous one of 29 June 1995; Cyprus subsequently submitted a notification indicating that it has eliminated measures notified under Article 5.1.
- g Nigeria subsequently submitted a notification indicating that the Nigerian Enterprises Promotion Act of 1989 has been repealed and replaced with the Nigerian Investment Promotion Commission Decree 1995.
- h Poland had subsequently submitted a notification indicating that it has eliminated measures notified under Article 5.1.

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The TRIMs Agreement allows some flexibility for developing countries, by both recalling the GATT norms on balance-of-payments difficulties, as well as by allowing developing countries and least-developed countries longer transition periods for the implementation of its rules. Article 4 allows developing countries to deviate temporarily from the obligations of the Agreement, as provided for in Article XVIII of GATT 1994 and related WTO provisions on safeguard measures for balance-of-payment difficulties. With regard to transition periods, developed, developing and least-developed countries were given, respectively, two, five and seven years from the date of entry into force of the WTO agreement to eliminate notified TRIMs. Furthermore, upon request, the transition period could be extended for developing and least developed countries that demonstrate particular difficulties in implementing the provisions of the Agreement.<sup>4</sup>

In May 2000, WTO members agreed to direct the Council for Trade in Goods to give positive consideration to individual requests for extensions of the transition periods presented in accordance with Article 5.3 (box 3). In this connection, it should be noted that some WTO members had already sought information on steps taken by other members that made notifications under Article 5.1 on how they are complying with their obligation to eliminate notified measures by the end of the transition period specified in Article 5.2 (WTO, 1999a).

### **Box 3. TRIMs transition period issues agreed by the General Council**

“In consultations held over the past weeks regarding the transition period issues in the TRIMs Agreement, and taking into account the Chairman’s statement on 17 December in the General Council urging countries to exercise restraint on deadline issues:

Members have noted the efforts made by many developing-country Members to implement their commitments under the TRIMs Agreement within the time period provided to them under /...



**Box 3 (concluded)**

Article 5.2, and that some Members have decided to exercise their rights under Article 5.3 to request an extension of the transition period for their measures notified under Article 5.1.

Members have also indicated that there is a need to preserve the multilateral character of this process and that the requested extensions shall be examined in accordance with the rights and obligations of Members under Article 5.3 of the TRIMs Agreement, taking into account the particular difficulties of any kind, including internal and external, encountered by developing countries in implementing the provisions of the Agreement, and the development, financial and trade needs of the country in question.

Taking into account such elements, Members agree to direct the Council for Trade in Goods to give positive consideration to individual requests presented in accordance with Article 5.3 by developing countries for extension of transition periods for implementation of the TRIMs Agreement.

Members have noted the concerns of those Members who have not notified TRIMs or have not yet requested an extension. Consultations on the means to address these cases should also be pursued as a matter of priority, under the aegis of the General Council, by the Chairman of the Council for Trade in Goods.

Members affirm that the above decisions are without prejudice to the mandated review provided for in Article 9 of the TRIMs Agreement.

The Chairman of the Council for Trade in Goods should be invited to pursue informal consultations in order to facilitate the process and to reinforce the multilateral character of the exercise and its rapid conclusion. The Chairman of the Goods Council should also be invited to keep the General Council informed of progress including information provided by the parties concerned.”

*Source:* WTO, 2000a, p. 1.

An important aspect of the TRIMs Agreement is that it is subject to further review. Article 9 of the Agreement provides that, not later than five years after the date of its entry into force, the Council for Trade in Goods shall review the operation of the TRIMs Agreement.<sup>5</sup> In this review, consideration is to be given as to whether the Agreement should be supplemented with provisions on investment policy and competition policy. The first WTO Ministerial Conference, held in Singapore in 1996, established “Working Groups” on trade and investment and on trade and competition to examine the relevant issues, “having regard to the existing WTO provisions on matters related to investment and competition policy and the built-in agenda in these areas, including under the TRIMs Agreement”. The importance of the review of the TRIMs Agreement lies in the fact that there is the possibility that WTO members may be faced with a number of options for consideration in this respect. Such options include the elimination of certain provisions and the incorporation of others which may prove more beneficial to developing countries. The various options are discussed in the Conclusion of this paper.

## **2. Similar HCOMs prohibited by interregional, regional or bilateral agreements**

The TRIMs Agreement is the only multilateral instrument that prohibits certain HCOMs. It is however noteworthy that all or some of the same types of measures prohibited by this Agreement are also banned — or, in the case of draft agreements, were sought to be banned — by a number of instruments at the interregional, regional and bilateral levels. Some did so before the TRIMs Agreement was adopted, others did so thereafter.

As early as 1988, the Free Trade Agreement between Canada and the United States foreshadowed the prohibition of local content HCOMs covered by the TRIMs Agreement. Article 1603 of the Free Trade Agreement provides:

“1. Neither Party shall impose on an investor of the other Party, as a term or condition of permitting an investment in its territory, or in connection with the regulation of the conduct or operation of a business enterprise located in its territory, a requirement to:

...

- b) substitute goods or services from the territory of such Party for imported goods or services;
- c) purchase goods or services used by the investor in the territory of such Party or from suppliers located in such territory or accord a preference to goods or services produced in such territory; or
- d) achieve a given level or percentage of domestic content”.

The 1992 North American Free Trade Agreement (NAFTA) is another example in this regard. Article 1106 prohibits, on the part of States parties to the agreement, the imposition or enforcement of a number of performance requirements “in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party ...” (box 4). The prohibited performance requirements include some of the measures mentioned in the Illustrative List of the TRIMs Agreement:

- to achieve a given level or percentage of domestic content;
- to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment.

In line with the approach taken by the TRIMs Agreement, article 1106(3) of the NAFTA makes it clear that no Party may “condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party” on compliance with any of the above prohibited HCOMs.

### **Box 4. NAFTA provisions on HCOMs**

#### **Article 1106: Performance Requirements**

- “1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
  - (a) to export a given level or percentage of goods or services;
  - (b) to achieve a given level or percentage of domestic content;
  - (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
  - (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
  - (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
  - (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
  - (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.
2. A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 and 1103 apply to the measure.

/...

**Box 4 (concluded)**

3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:
  - (a) to achieve a given level or percentage of domestic content;
  - (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
  - (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
  - (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.
4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.
5. Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.
6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1 (b) or (c) or 3 (a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:
  - (a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
  - (b) necessary to protect human, animal or plant life or health; or
  - (c) necessary for the conservation of living or non-living exhaustible natural resources”.

*Source* UNCTAD 1996a.

Some IIAs involving only developing countries have also followed this trend. An example is the 1994 Treaty on Free Trade between the Republic of Colombia, the Republic of Venezuela and the United Mexican States which covers the same measures covered by the TRIMs Agreement (Article 17-04):

- “1. No Party shall impose performance requirements by adopting investment-related measures that are mandatory or required for the establishment or operation of an investment, or for which compliance is necessary in order to obtain or maintain an advantage or incentive, or which prohibit:
  - (a) the purchase or use by an enterprise of goods of national origin of that Party, or from its national sources, whether specified in terms of specific goods, in terms of volume or value of the goods, or as a proportion of the volume or value of its local production;
  - (b) the purchase or use of imported goods by an enterprise from being limited to an amount related to the volume or value of the local goods exported by the enterprise;
  - (c) restrictions on imports of goods used by an enterprise in its local production or related thereto, limiting access by the enterprise to foreign exchange to an amount related to the entry of foreign exchange imputable to said enterprise;
  - (d) restrictions on the exportation or the sale for exportation of goods by an enterprise, whether specified in terms of the volume or value of the goods, or as a proportion of the volume or value of its local production”.

Some BITs also specifically prohibit a number of the same HCOMs covered by the TRIMs Agreement. For example, Article V of the 1995 BIT between Canada and the Philippines prohibits local content and trade balancing requirements. It provides:

“Neither Contracting Party may impose any of the following requirements in connection with permitting the establishment or acquisition of an investment or enforce any of the following requirements in connection with the subsequent regulation of that investment:

...

- (b) to achieve a given level of percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in that territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment” (UNCTAD, 1998, p. 82).

The 1998 BIT between Costa Rica and Canada specifically cross-references its HCOMs prohibitions to the provisions of the TRIMs Agreement. Article VI of that BIT provides as follows:

“Neither Contracting Party may impose, in connection with permitting the establishment or acquisition of an investment, or enforce in connection with the subsequent regulation of that investment, any of the requirements set forth in the World Trade Organization Agreement on Trade-Related Investment Measures contained in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakesh on 15 April 1994” (OAS, 1998).

The 2000 Agreement between the United States of America and Viet Nam on Trade Relations takes a similar approach. Article 11(1) provides as follows:

“Subject to the provisions of paragraph 2, neither Party shall apply any trade-related investment measures (TRIMs) which are inconsistent with the Agreement on Trade-Related Investment Measures of the WTO. The illustrative list of TRIMs set forth in the WTO Agreement on TRIMs (“the List”) is contained in Annex I of this Agreement. TRIMs contained on the List will be considered inconsistent with this Article regardless of whether they are imposed in laws, regulations, or as conditions for individual investment contracts or licenses”(UNCTAD, forthcoming b).

Furthermore, this Agreement reinforces the provisions of the TRIMs Agreement on the transition periods within which notified TRIMs have to be eliminated. Indeed, the provisions of the United States-Viet Nam Agreement seem to limit the flexibility that would otherwise be allowed for Viet Nam as a developing country to request for an extension of the transition period. Article 11(2) provides that:

“The Parties agree to eliminate all TRIMs (including those contained in laws, regulations, contracts or licenses) which fall under sub-paragraphs 2(A) (trade balancing requirements) and 2(B) (foreign exchange controls on imports) of the List by the time this Agreement enters into force. Vietnam shall eliminate all other TRIMs no later than five years after the date of entry into force of the Agreement, or the date required under the terms and conditions of Vietnam’s accession to the WTO, whichever occurs first” (ibid.).

In the MAI negotiations, performance requirements were dealt with under the heading “Treatment of Investors and Investments”, as one of the necessary corollaries to other basic obligations, namely, national treatment, most-



favoured-nation treatment and transparency. The Negotiating Text provisions on performance requirements prohibited the imposition, enforcement and maintenance of certain HCOMs with regard to “the establishment, acquisition, expansion, management, operation, maintenance, use, enjoyment, sale or other disposition of an investment”, no matter whether the investment originated in the jurisdiction of a contracting party or not. Among the number of prohibited HCOMs listed in the Negotiating Text were those covered by the TRIMs Agreement. Specifically, paragraph 1 (b) through (d) prohibited any of the following requirements:

- “(b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;”

The fact that some or all of the measures covered by the TRIMs Agreement are similarly covered by some other IIAs may suggest that the prohibitions in that Agreement are generally acceptable. At the same time, it is interesting to note that many of the prototype model BITs formulated since 1995 do not seem to address this issue in any detail (for examples of such BITs see part three, UNCTAD, 2000a). This may reflect increasing consensus that the measures prohibited by the TRIMs Agreement are adequately covered therein, and the subject requires no further treaty elaboration. On the other hand, it could simply mean that most countries consider it inappropriate to include such provisions in their BITs.

**B. Additional HCOMs explicitly prohibited, conditioned or discouraged by interregional regional or bilateral (but not multilateral) agreements**

**1. Prohibited measures**

While a number of the measures prohibited by the TRIMs Agreement have also found their way into interregional or regional agreements (or drafts thereof) and the BITs of some countries, there also are some instances in which explicit prohibitions of a number of HCOMs in non-multilateral IIAs go beyond those mentioned in the Illustrative List of the TRIMs Agreement. This is particularly the case in some regional agreements involving predominantly developed countries, as well as recent BITs involving a number of developed countries (table 3).

**Table 3. Examples of IIAs with “yellow light” HCOMs**

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HCOM	IIA
Requirements to establish a joint venture with domestic participation	MAI
Requirements for minimum level of domestic equity participation	MAI
Requirements to locate headquarters for a specific region or the world market	MAI
Employment performance requirements	MAI
Export performance requirements	NAFTA Canada - Barbados BIT Canada - Philippines BIT Canada - Trinidad and Tobago BIT Canada - Venezuela BIT United States - Trinidad and Tobago BIT United States - Bolivia BIT MAI

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/...

**Table 3. Examples of IIAs with “yellow light” HCOMs (concluded)**

HCOM	IIA
Restrictions on sales of goods or services in the territory where they are produced or provided	NAFTA United States - Bolivia BIT MAI
Requirements to supply goods produced or services provided to a specific region or the world market exclusively from a given territory	United States - Trinidad and Tobago BIT MAI
Requirements to act as the exclusive supplier of goods produced or services provided	NAFTA
Requirements to transfer technology, production processes or other proprietary knowledge	NAFTA Canada - Barbados BIT Canada - Philippines BIT Canada - Trinidad and Tobago BIT Canada - Venezuela BIT United States - Trinidad and Tobago BIT United States - Bolivia BIT MAI
Research-and-development requirements	United States - Trinidad and Tobago BIT United States - Bolivia BIT MAI
Measures contrary to the principle of fair and equitable treatment	French model BIT German model BIT

*Source:* UNCTAD.

At the regional level, the NAFTA provides an example of an IIA whose list of prohibited HCOMs goes beyond that of the TRIMs Agreement. To begin with, it covers both goods and services. Furthermore, in addition to the prohibitions similar to the ones covered by the TRIMs Agreement, Article 1106(1) (e) also prohibits requirements “to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.”

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There are also examples of additional HCOMs prohibited at the bilateral level. A number of BITs signed by Canada go further than the TRIMs Agreement and have also prohibited requirements related to export performance and transfer of technology, examples being the BITs concluded by Canada with Barbados, Philippines, Trinidad and Tobago and Venezuela (UNCTAD, 1998, p. 81). Paragraph (e) of Article V of the 1995 BIT between Canada and the Philippines provides:

“Neither Contracting Party may impose any of the following requirements in connection with permitting the establishment or acquisition of an investment or enforce any of the following requirements in connection with the subsequent regulation of that investment:

- (a) to export a given level or percentage of goods;
- ...
- (e) to transfer technology, a production process or other proprietary knowledge to a person in its territory unaffiliated with the transferor, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority, either to remedy an alleged violation of competition laws, or acting in manner not inconsistent with the provisions of this Agreement” (ibid., p. 82).

The 1994 United States model BIT and some BITs the United States has concluded with other countries also go further than the TRIMs Agreement to cover requirements related to export performance, product mandates, transfer of technology and research and development. For example, the 1994 BIT between the United States and Trinidad and Tobago provides in Article VI (e) and (f) as follows:

“Neither Party shall mandate or enforce, as a condition for the establishment, acquisition, expansion, management, conduct or operation of a covered investment, any requirement (including any commitment or undertaking

in connection with the receipt of a governmental permission or authorization):

...

- c) to export a particular type, level or percentage of products or services, either generally or to a specific market region;

...

- e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party's territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition laws; or

- f) to carry out a particular type, level or percentage of research and development in the Party's territory" (United States, Department of State, 1994).

In the Negotiating Text of the MAI, the list of prohibited measures also went beyond those covered by the TRIMs Agreement. Paragraphs 1 (a) and (e) prohibited the following requirements:

- “(a) to export a given level or percentage of goods or services;

...

- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales to the volume or value of its exports or foreign exchange earnings;...”

Besides these examples of IIAs that utilise an expanded documentary or illustrative list approach, some IIAs may cover additional HCOMs through an interpretative approach. BITs, in particular, although not explicitly mentioning HCOMs, could conceivably be interpreted to deal with them in

connection with fair and equitable treatment. For example, article 4 of France's 1999 model BIT considers as contrary to the principle of fair and equitable treatment, and therefore unlawful, the use of restrictions on access to inputs, manufacturing requirements, sales and transport limitations, and all other measures having an equivalent effect:

“Chacune des Parties contractantes s’engage à assurer, sur son territoire et dans sa zone maritime, un traitement juste et équitable, conformément aux principes du Droit international, aux investissements des nationaux et sociétés de l’autre Partie et à faire en sorte que l’exercice du droit ainsi reconnu ne soit entravé ni en droit, ni en fait. En particulier, bien que non exclusivement, sont considérées comme des entraves de droit ou de fait au traitement juste et équitable, toute restriction à l’achat et au transport de matières premières et de matières auxiliaires, d’énergie et de combustibles, ainsi que de moyens de production et d’exploitation de tout genre, tout entrave à la vente et au transport des produits à l’intérieur du pays et à l’étranger, ainsi que toutes autres mesures ayant un effet analogue.”

This provision continues by urging a positive approach, in the national laws of the Contracting Parties, towards the entry, stay, work permits and free movement of personnel from one Contracting Party engaged in an investment project on the territory of the other Contracting Party:

“Les Parties contractantes examineront avec bienveillance, dans le cadre de leur législation interne, les demandes d’entrée et d’autorisation de séjour, de travail, et de circulation introduites par des nationaux d’une Partie contractante, au titre d’un investissement réalisé sur le territoire ou dans la zone maritime de l’autre Partie contractante.”

Another approach is found in those BITs that, even if they do not address the issue of HCOMs *per se*, nevertheless impose an obligation on contracting parties not to impair

the maintenance, use, enjoyment or disposal of investment. This may be interpreted to amount to a prohibition of HCOMs. For instance, as early as 1991, article 2 of the German model BIT provided that:

“Each Contracting Party shall in its territory promote as far as possible investments by nationals or companies of other Contracting Party and admit such investments in accordance with its legislation. It shall in any case accord such investments fair and equitable treatment.

Neither Contracting Party shall in any way impair by arbitrary or discriminatory measures the management, maintenance, use or enjoyment of investments in its territory of nationals or companies of the other Contracting Party.”

However, this obligation is in some IIAs limited to the avoidance of “arbitrary”, “unreasonable” or “discriminatory measures”.<sup>6</sup> No specification is given in many such instruments on what constitutes an “unreasonable” or “discriminatory” measure.<sup>7</sup>

## **2. Restricted discretion to impose operational measures**

The HCOMs discussed so far are measures that, beyond the TRIMs Agreement, are prohibited in specific non-multilateral agreements. In a number of cases, however, these measures are allowed, provided they meet certain conditions. Usually this is for a particular purpose or for a specified period of time.

### **a. As conditions for the receipt or continued receipt of an advantage<sup>8</sup>**

A number of HCOMs are a *quid pro quo* for investment incentives. In this case, parties to an IIA may not treat them as mere restrictions on TNCs operations, but as a legitimate part of a framework designed to attract investment, while, at the same time, directing it towards the promotion of national

objectives. As such, these HCOMs can be considered as part of a package of “conditioned incentives”.

In the NAFTA, article 1106(4) explicitly allows the parties to condition the receipt of an advantage on compliance with a requirement to “locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development...”. In addition, implicit under article 1106(1) is that a number of other HCOMs may be linked to investment incentives. As noted before, while this article does not address the issue of conditioned incentives, article 1106(3), in referring to the list of HCOMs covered by article 1106(1), singles out HCOMs that cannot be linked to incentives, thus implying that the remaining HCOMs on the list may be coupled to advantages. These are requirements of an investor:

- to export a given level or percentage of goods or services;
- to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of the Agreement; or
- to act as the exclusive supplier of the goods it produces or services it provides.

Under the 1990 Charter on a Regime of Multinational Industrial Enterprises in the Preferential Trade Area for Eastern and Southern African States, the benefits accorded to an enterprise established according to the rules of the Charter are balanced by a series of obligations. The benefits regard the transfer of funds, the granting of visas and residence permits for employees, exemptions from import duties, tax exemptions, granting of licences and permits, infrastructure support, preferential tariff and non-tariff treatment. They



are thus very similar to the incentives usually offered at a national level. The obligations, on the other hand, replicate the most common HCOMs and require the increase of local value added of products (where “local” is equivalent here for “regional”), export support, training, minimum volume of supply for the national market and disclosure of information.

A good example of conditional restrictions of HCOMs is provided by the provisions of some United States BITs. Article VI (2) of the 1994 BIT between the United States and Trinidad and Tobago provides that the prohibition of HCOMs in its paragraph (1) does not “preclude a Party from providing benefits and incentives conditioned upon such requirements”; the exception thus covers even those HCOMs listed in paragraph 1 that are prohibited by the TRIMs Agreement (United States, Department of State, 1994). Even the more recent BITs, concluded by the United States after the TRIMs Agreement, provide such exceptions, covering, *inter alia*, requirements prohibited by the TRIMs Agreement. Thus, for instance, Article VI of the 1998 BIT with Bolivia provides as follows:

“Neither Party shall mandate or enforce, as a condition for the establishment, acquisition, expansion, management, conduct or operation of a covered investment, any requirement (including any commitment or undertaking in connection with the receipt of a governmental permission or authorization):

- (a) to achieve a particular level or percentage of local content, or to purchase, use or otherwise give a preference to products or services of domestic origin or from any domestic source;
- (b) to restrict imports by the investment of products or services in relation to a particular volume or value of production, exports or foreign exchange earnings;
- (c) to export a particular type, level or percentage of products or services, either generally or to a specific market region;

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- (d) to restrict sales by the investment of products or services in the Party's territory in relation to a particular volume or value of production, exports or foreign exchange earnings;
- (e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party's territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition of laws; or
- (f) to carry out a particular type, level or percentage of research and development in the Party's territory.

Such requirements do not include conditions for the receipt or continued receipt of an advantage" (United States, Department of State, 1998a).

Similar provisions are contained in other more recent BITs concluded between the United States and other countries. Examples include article VI of the 1998 BIT with Mozambique and article 6 of the 1999 BIT with Bahrain (United States, Department of State, 1998b and 1999).<sup>9</sup>

In the negotiation of the draft MAI, one of the issues discussed was whether the prohibition of certain HCOMs should cover both mandatory measures and requirements linked to the granting of an advantage to the investor, i.e. investment incentives, or whether a separate provision should be drafted for the latter. In other words, there were two options: whether certain HCOMs should be completely prohibited; or whether, when linked to an incentive, they should be considered as a legitimate *quid pro quo* (Engering, 1996). The last MAI draft text indicates that certain HCOMs would have been permitted if linked to an advantage. While there was no final agreement concerning the specific HCOMs that would have been allowed if linked to an advantage, the draft explicitly permitted, under this condition, certain

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non-trade related HCOMs, namely the following requirements:<sup>10</sup>

- “(f) to transfer technology, a production process or other proprietary knowledge to a natural or legal person in its territory, except when the requirement
  - is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws, or
  - concerns the transfer of intellectual property and is undertaken in a manner not inconsistent with the TRIPS Agreement.
- (g) to locate its headquarters for a specific region or the world market in the territory of that Contracting Party;
- (h) to supply one or more of the goods that it produces or the services that it provides to a specific region or the world market exclusively from the territory of that Contracting Party;
- (i) to achieve a given level or value of research and development in its territory;
- (j) to hire a given level of nationals;
- (k) to establish a joint venture with domestic participation; or
- (l) to achieve a minimum level of domestic equity participation other than nominal qualifying shares for directors or incorporators of corporations.”<sup>11</sup>

Specifically with respect to these measures, paragraph 2 of the article on performance requirements provides:

“A Contracting Party is not precluded by paragraph 1 from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of a Contracting Party or of a non-Contracting Party, on compliance with any of the requirements,

commitments or undertakings set forth in paragraphs 1(f) through 1(l).”

### ***b. As a part of Government economic development programmes***

Some IIAs recognise the necessity of certain HCOMs in the context of economic development programmes. Article 5 of the Energy Charter Treaty prohibits the application by member States of investment measures that are inconsistent with article III or XI of GATT. However, it qualifies the prohibition by allowing the application of certain requirements applied as a condition of eligibility for export promotion, foreign aid, government procurement or preferential tariff or quota programmes.<sup>12</sup> It provides as follows:

- “(1) A Contracting Party shall not apply any trade-related investment measure that is inconsistent with the provisions of article III and XI of the GATT; this shall be without prejudice to the Contracting Party’s rights and obligations under the GATT and Related Instruments and Article 29.
- (2) Such measures include any investment measure which is mandatory or enforceable under domestic law or under any administrative ruling, or compliance with which is necessary to obtain an advantage, and which requires:
  - (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; or
  - (b) that an enterprise’s purchase or use of imported products be limited to an amount related to the volume or value of local products that it exports;

or which restricts:

- (c) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;
  - (d) the importation by an enterprise of products 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; or
  - (e) 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.
- (3) Nothing in paragraph (1) shall be construed to prevent a Contracting Party from applying the trade-related investment measures described in subparagraphs (2)(a) and (c) as a condition of eligibility for export promotion, foreign aid, government procurement or preferential tariff or quota programmes.”

The 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment implicitly recognise the need for operational measures in support of Government economic development programmes. Thus with regard to employment of local labour and transfers of capital, the Guidelines accept the existence and the need to protect other interests, in that they exhort host countries to authorize the employment of foreign personnel, but, at the same time, also recognise the host State’s right to require a foreign investor “to reasonably establish his inability to recruit the required personnel locally ... before he resorts to the recruitment of foreign personnel ...” (UNCTAD, 1996a, vol. I, p. 250).

Some draft IIAs proposed by non-governmental organisations have adopted the approach of overriding exceptions relating to economic development programmes.

The 1998 draft International Agreement on Investment prepared by the Consumer Unity and Trust Society (CUTS) lays out what, according to CUTS, an equitable alternative international agreement on investment should look like.<sup>13</sup> In the draft, under the section on “Performance Requirements”, certain obligations are sought to be imposed on contracting States. Paragraph 1 contains 12 clauses prohibiting the contracting States from imposing requirements relating to export production, local content, volume of imports, sales, transfer of technology, location of headquarters, supply of goods, achieving a given level of production, hiring local personnel, establishing joint ventures or achieving a minimum level of local equity participation. Paragraphs 2,3,4,5 and 6 permit certain relaxations of the prohibition for specific measures and to varying degrees. In addition, and importantly in this context, paragraph 7 then provides a blanket exemption in the following terms:

“Notwithstanding anything contained in paragraph 1, a Contracting Party shall be free to adopt a measure otherwise prohibited by that paragraph for compelling social or economic reasons”.

### 3. The “best efforts” approach

Some IIAs merely discourage the use of HCOMs through “best efforts” clauses. The 1984 BIT between the United States and Zaire (now the Democratic Republic of Congo) only requires the host country to use its best efforts to avoid imposing operational measures. Article II (7) provides:

“Within the context of its national economic policies and goals, each Party shall endeavor to avoid imposing on the investments of nationals or companies of the other Party conditions which require the export of goods produced or the purchase of goods or services locally. This provision shall not preclude the right of either Contracting Party to impose restrictions on the importation of goods and services into their respective territories” (UNCTAD, 1998, p. 82).

A number of other (also not so recent) United States BITs use similar language.<sup>14</sup> For example, Article II (7) of the 1985 United States-Turkey BIT provides:

“Each party shall seek to avoid performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other similar requirements” (United States, Department of State, 1985, p.5).

Some BITs between developing countries also address HCOMs through this approach. For example, the 1991 BIT between Malaysia and the United Arab Emirates provides (Article 2) as follows:

“Contracting States shall seek as far as practicable to avoid performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced or which specify that goods or services must be purchased locally or which impose any other similar requirements” (UNCTAD, 1998, p. 82).

Similarly, in 1994, the Asia-Pacific Economic Cooperation (APEC) countries adopted Non-Binding Investment Principles that expressly call on members to “minimize the use of performance requirements that distort or limit expansion of trade and investment”.

As compared to such older clauses, a more specific indication of the desire to phase out some operational measures can perhaps be found in the 1998 Association of South-East Asian Nations (ASEAN) regional Framework Agreement on the ASEAN Investment Area. Article 3 calls for the progressive reduction or elimination of “investment regulations and conditions which may impede investment flows and the operation of investment projects in ASEAN”. Schedule

III of the Agreement invites member States to “liberalise, among others, (i) rules, regulations and policies relating to investment”.

### **C. HCOMs that are not contested**

The right to impose a number of HCOMs remains uncontested in IIAs. While the prohibition of certain of these measures is now embedded in a multilateral agreement — the TRIMs Agreement — and even some additional measures are being brought into the ambit of other IIAs in which some countries seek to restrict their usage, the underlying context remains one in which it is recognised that States have the right to exercise regulatory powers with respect to investors operating within their jurisdictions, including through the imposition of operational measures.

For example, NAFTA article 1106(2) specifically excludes the mandating of the use of certain technologies as being considered a performance requirement under Chapter 11. It provides:

“A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 and 1103 apply to the measure.”

In some cases, the liberty to impose HCOMs has, in fact, been expressly encouraged by regional agreements. Thus, the 1984 Caribbean Common Market (CARICOM) Guidelines for use in the Negotiation of Bilateral Treaties reads as follows under the heading “Performance Obligations”:

- “(i) CARICOM countries should not accept any restrictions on their freedom to impose performance obligations;
- (ii) performance obligations, which should include but not limited to, export performance, employment, conformity with national laws and with trade union



practices, and transfer of technology, should be linked to the benefits to be derived and in this context provision should be made for such obligations to be reviewed periodically”.

Some IIA draft proposals by non-governmental organizations have treated the topic of HCOMs in similar fashion. One such example is the text titled “Toward a Citizens’ MAI: An Alternative Approach to Developing a Global Investment Treaty Based on Citizens’ Rights and Democratic Control” and prepared by a non-governmental organization as an input to the discussions during the MAI negotiations.<sup>15</sup> As opposed to suggesting any restrictions on HCOMs, its section on “Performance Standards” provides that, to “ensure that corporations fulfill their social obligations, States may impose performance requirements”. Particular areas recommended for such HCOMs relate to job creation, labour standards, environmental safeguards, sustainable communities, and social security.

Recognition of the right of States to impose some operational measures has a number of precedents. At the multilateral level, the 1948 Havana Charter for an International Trade Organization is instructive. On the one hand, it was recognized in article 12 that “international investment, both public and private, can be of great value in promoting economic development and reconstruction, and consequent social progress”, and provided that “the international flow of capital will be stimulated to the extent that Members afford nationals of other countries opportunities for investment and security for existing and future investments”. On the other hand, each member retained the right (article 12 (1)):

- “ ...
- (ii) to determine whether and to what extent and upon what terms it will allow future foreign investment;
  - (iii) to prescribe and give effect on just terms to requirements as to the ownership of existing and future investments;

- (iv) to prescribe and give effect to other requirements with respect to existing and future investments”.

In other words, FDI had to be promoted, but control of inward investment and imposition of HCOMs were recognized as legitimate rights of host States. The latter rights, however, were strongly contested by some key countries (UNCTAD, 1999c, p. 16).

In the context of the call for a New International Economic Order, the “[r]egulation and supervision of the activities of transnational corporations” through measures taken “in the interest of the national economies of the countries where such transnational corporations operate” were considered as founding principles.<sup>16</sup> On this basis, requirements related to transfer of technology and managerial skills, limits on repatriation of profits<sup>17</sup> and, more generally, measures to ensure that the activities of TNCs conformed with a country’s economic and social policies, were confirmed among the basic economic rights of States.<sup>18</sup>

The 1985 draft International Code of Conduct on the Transfer of Technology also explicitly recognized the subject of host countries’ use of HCOMs. In regulating the flow and effects of transfer of the technology, States were accorded (in article 3.4) the possibility to “deal with”, among other things, the use of local and imported components; terms, conditions and duration of transactions; and loss of ownership and/or control of domestic technology acquiring firms.

Yet another example of this approach is the 1983 draft United Nations Code of Conduct on Transnational Corporations. It reaffirmed the right of host countries to treat TNCs in accordance with their laws, regulations and administrative practices; and it affirmed the duty of TNCs to collaborate with host States. Among the latter, some reflect closely the usual objectives of some HCOMs: local equity participation, employment of host country nationals, export promotion, repatriation of capital, transfer of technology, and environmental protection.

A different approach has been taken by the Declaration on International Investment and Multinational Enterprises, first adopted by the Organisation for Economic Co-operation and Development (OECD) member countries in 1976, and revised in 2000 (OECD, 2000). An integral part of the Declaration are the Guidelines for Multinational Enterprises. They constitute recommendations jointly addressed by member countries to TNCs operating in their territories and beyond. Rather than *discourage* host countries from utilising HCOMs, they *encourage* TNCs to undertake some activities among which some touch on areas traditionally covered by certain HCOMs. Thus, the text and Commentary of the Guidelines asks TNCs, among other things, to encourage local capacity building through close co-operation with the local community, including business interests; to create employment opportunities and facilitate training opportunities for employees; and to transfer technology (*ibid.*).

The majority of BITs, including those between developing and developed countries, adopt, although to different degrees, an approach that leaves open the issue of HCOMs. However, by providing that host countries retain the right to regulate the mode and manner in which investments are made in their territories, they implicitly recognise the right of States to utilise them. A common inference of this is the principle that foreign investments are to be made “in accordance with the host State’s laws and regulations”.<sup>19</sup>

\* \* \*

Virtually any measure taken by a Government may affect, positively or negatively, the interests of the enterprises operating in its territory. Most routine regulatory actions, such as the issuance of a construction permit, are not contested. The same applies to those that fall in categories such as the protection of public health or the protection of the environment. Others are becoming increasingly subject to international scrutiny — a reflection of the internationalization

of production (UNCTAD, 2000c) and, with it, of the domestic policy agenda. The stocktaking undertaken in this section suggests that the realm of measures coming under international scrutiny is expanding. Care needs to be taken, however, that this does not occur at the expense of the ability of Governments to promote development.

### Notes

- <sup>1</sup> At the beginning of the 1980s, a United States paper on “Investment performance requirements and incentives” expressed concern that “the increasing world-wide use of such measures might also affect third countries’ trading interests, even to the point of impairing benefits negotiated under the GATT” (GATT, 1982, p. 75). On this basis, the United States, Japan and the European Community asked for a survey of trade-related investment performance requirements and incentives to be undertaken within the GATT to ascertain if any of these practices violated specific GATT provisions. The developing countries objected to this proposal, arguing that “the competence of GATT to deal with many of the practices referred to was doubtful... If GATT’s activities were to be extended in this direction, it would also be necessary to cover the activities of transnational corporations, access to capital markets, structural adjustment, restrictive business practices and so on” (ibid, p. 76). No further action followed this debate until the launch of the Uruguay Round in 1986.
- <sup>2</sup> On this basis, discriminatory requirements or Government regulations that imposed import or export quotas were prohibited by GATT rules. This was ascertained at the beginning of the 1980s when the United States contested, in the context of the GATT dispute settlement mechanism, Canada’s Foreign Investment Review Act. The legislation authorized the Government of Canada to enter into written undertakings with foreign investors on the basis of which the investors were to give preference to the purchase of Canadian goods over imported goods and to meet certain export performance requirements. The United States submitted that these undertakings constituted requirements giving less favourable treatment to imported products than to like products of national origin, imposing quantitative regulations relating to investors’ processing and use of products and preventing the investors from acting solely in accordance with commercial considerations. They thus violated, in the United States view, Article III and Article XI of the GATT. The Panel judging the case agreed with the United States submission that these measures were inconsistent with Article III, but, in the case at issue, did not find any violation of Article XI (GATT,

1984). The importance of this Panel decision goes beyond the solution of the factual issue at stake. For the first time, the GATT dispute settlement mechanism had been used to evaluate the effects of investment policies that could cause restrictions of imports and exports of contracting parties. Although all parties involved strongly stated the general lack of competence of GATT on investment, this case nonetheless acknowledged that TRIMs were, to some extent, covered by existing GATT rules.

3 For a close analysis of the negotiating positions of developed and developing countries, see Stewart, 1993; and Mashayekhi, 2000a. For an analysis of the TRIMs Agreement itself, see UNCTAD, 1994, chapter VII.

4 Members that (as of February 2001) had sought extensions of the transition period were Argentina, Chile, Colombia, Egypt, Malaysia, Mexico, the Philippines, Pakistan, Romania and Thailand.

5 The Council for Trade in Goods formally initiated the review provided for under Article 9 in October 1999 but, as of September 2000, no specific proposals had been made by members in this context.

6 See, for instance, article 4 of the 1995 Swiss model BIT and article 3 of the 1994 Chilean model BIT.

7 For further elaboration on investor treatment issues, see UNCTAD, 1999d; UNCTAD, 1999e, and UNCTAD, 1999f.

8 It should be noted that the TRIMs Agreement specifically provides that the measures it prohibits include those that may have to be complied with to obtain an advantage or incentive.

9 To the extent that such provisions may not be compatible with the TRIMs Agreement, reliance is placed on Article XI of the 1994 United States model BIT (found in all the BITs mentioned here) which specifies that “[t]his Treaty shall not derogate from any of the following that entitle covered investments to treatment more favorable than that accorded by this Treaty: ... (b) international legal obligations.” The effect of that provision is understood as fulfilling the requirements of customary international law, as reflected in Article 30 (2) of the Vienna Convention of the Law of Treaties (United Nations, 1969), according to which when a Treaty “specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty...” that earlier or later treaty prevails in case of conflict.

10 See, para. 2 of the article on performance requirements (UNCTAD, 2000a).

11 The prohibitions against HCOMs addressed in the MAI, other than those also covered by the TRIMs Agreement, were subject to a number of exceptions and/or qualifications. These are provided for in the original text as well as in relevant footnotes, but are omitted here.

12 It should be noted that one of the parties to the Treaty is not a member of GATT/WTO and the provisions of the Treaty are applicable only between the

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- Energy Charter Treaty parties. But, otherwise, Article 4 of the Energy Charter Treaty provides that nothing in the Treaty “shall derogate, as between particular Contracting Parties which are parties to the GATT, from the provisions of the GATT and Related Instruments as they are applied between those Contracting Parties.”
- 13 The draft was prepared for discussions at the UNCTAD Round Table between Ambassadors and NGOs on a Possible Multilateral Framework on Investment, jointly organized with the United Nations Non-governmental Liaison Service in Geneva on 10 June 1998.
- 14 Bangladesh 1986 BIT, art. II:7; Egypt 1986 BIT, art. II:6; Haiti 1983 BIT, art. II:7; Morocco 1985 BIT, art. II:5; Tunisia 1990 BIT, art. II:5; Turkey 1985 BIT, art. II:7.
- 15 The instrument was prepared by the Polaris Institute for the Council of Canadians in 1998 as a working instrument designed to assist civil society in developing “an alternative MAI”. Inputs were made by various individuals and institutions from a number of countries around the world. The document contains a set of propositions with the aim that citizen activists in each country could study them, modify them if necessary, and develop a negotiating agenda. Thus the proposed texts were seen as part of an ongoing process of developing consensus amongst civil society groups regarding an alternative approach to global investment rules (CoC, 1998).
- 16 United Nations General Assembly Resolution 3201 (S-VI): Declaration on the Establishment of a New International Economic Order (UNCTAD, 1996a).
- 17 See United Nations General Assembly Resolution 3202 (S-VI): Programme of Action on the Establishment of a New International Economic Order of 1974 (UNCTAD, 1996a).
- 18 See Article 2 of United Nations General Assembly Resolution 3281 (XXIX): Charter of Economic Rights and Duties of States of 1974 (UNCTAD, 1996a).
- 19 See for example, article 1(1) of the model 1994 BIT of the People’s Republic of China.

## Section III

### INTERACTION WITH OTHER ISSUES AND CONCEPTS

Given the broad range of HCOMs, the connections they have with other issues addressed in this series are numerous and, in fact, indicate at least some moderate interaction with all of them (table 4). However, some of these have extensive interaction, as elaborated in this section.

**Table 4. Interaction across issues and concepts**

Concepts in other papers	HCOMs
Scope and definition	+
Admission and establishment	++
Incentives	++
Investment-related trade measures	+
Most-favoured-nation treatment	++
National treatment	++
Fair and equitable treatment	++
Taxation	+
Transfer pricing	+
Employment	++
Social responsibility	+
Environment	++
Home country measures	+
Illicit payments	+
Taking of property	+
State contracts	+
Funds transfer	++
Transparency	++
Competition	++
Transfer of technology	++
Dispute settlement (Investor-State)	+
Dispute settlement (State-State)	+

Source: UNCTAD.

Key: 0 = negligible or no interaction.  
+ = moderate interaction.  
++ = extensive interaction.

- **Admission and establishment.** HCOMs are designed to affect the operational life of foreign affiliates, i.e. the post-entry phase of investment. Nonetheless, they present many points of contact with measures meant to regulate the entry and establishment of FDI. First of all, the limits and requirements imposed by the two sets of measures may concern the same aspects of investment. Restraints on foreign ownership, for instance, may well apply both as a condition to entry and as a requirement necessary for the continued operation of an investment. Similarly, restrictions on the import of capital goods or exchange control requirements can equally affect the ability of investors to enter a market and their ability to remain in that market. Second, HCOMs may well be imposed at the time an investment is established and can constitute preconditions for the investment being allowed in the first instance. Examples of such HCOMs include those regulating technology transfer or local-content requirements.
- **Incentives.** Incentives may be defined as any measurable economic advantage granted to specific enterprises or categories of enterprises by host countries in order to encourage them to behave in a certain manner (UNCTAD, 1996c). Very often, an explicit link exists between the granting of investment incentives and the use of certain HCOMs. Governments usually offer incentives in their competition to attract FDI or to improve its performance, and then use HCOMs to impose some kind of conditionality on foreign affiliates with a view towards encouraging this FDI to contribute as much as possible to national development objectives. From this point of view, the role of HCOMs with respect to incentives is a redistributive one. According to some commentators, such measures would simply not exist were it not for pre-existing distortions caused, among other things, by investment incentives for TNCs (Greenaway, 1992).<sup>1</sup>
- **Most-favoured-nation treatment, national treatment, fair and equitable treatment.** As measures related to the



“operation and maintenance” of an investment, HCOMs might be expected to be covered by the standards imposed on host countries for the treatment of investment in its post-entry phase. However, this is not frequently the case. The majority of IIAs dealing with the treatment of foreign investment require that it shall receive fair and equitable treatment in the host country, or, in other words, that all “unreasonable” and “discriminatory” measures shall be prohibited with regard to the activities of the investment. In this sense, HCOMs are no exceptions. Thus, in the many arrangements that are silent on the use of such measures, the standard of fair and equitable treatment can serve to limit their legitimacy. More complex is the relationship of HCOMs with the most-favoured-nation and national treatment standards. The reason is that HCOMs are designed, by their very nature, to impose some form of conditionality on FDI *qua* FDI. Even if some HCOMs may be concealed in language which, in principle, applies to both foreign and domestic firms, in practice they would apply only to the foreign firms.

- **Employment, environment, funds transfer, transfer of technology.** The interaction of HCOMs with these issues is of a substantive nature. The promotion of employment, protection of the environment, regulation of funds transfers, and the transfer of technology are among the economic objectives for which HCOMs are usually applied. Consequently, rules on such measures are not only found in general investment clauses regulating the treatment of foreign affiliates’ operations, but also in agreements or provisions specifically covering these specialized areas.
- **Transparency.** HCOMs often involve confidential arrangements between a host Government and an investing firm, especially where the granting of certain advantages is involved. Yet, at the same time, for other foreign investors, knowing the regulatory environment of a host State in as transparent a manner as possible may be essential to their investment decisions and to the management of their

operations. The TRIMs Agreement recognizes this by establishing an obligation of transparency, to be fulfilled through the publication of all laws, regulations and administrative decisions pertaining to TRIMs and through notification to the WTO Secretariat of all publications in which they may be found; as well as an obligation of notification of all TRIMs in force at the entry into force of the Agreement. Provisions establishing transparency obligations are also found in other multilateral and regional instruments, such as for instance article III of the GATS and article 20 of the Energy Charter Treaty. These also contemplate, in order to facilitate requests of information and thus transparency, the creation by member States of enquiry points. On the contrary, no provisions on transparency are usually found in BITs.

- **Competition.** Another reason given for the existence of some HCOMs concerns restrictive business practices (e.g. limitations on exports by foreign affiliates). In these instances, HCOMs are justified as a means to counteract restrictive business practices of TNCs. The implication is that the elimination of restrictive business practices would reduce the need for host countries to use HCOMs (Morrissey and Rai, 1995).

### Note

- <sup>1</sup> Other commentators approach the relation between investment incentives and HCOMs from a different point of view and consider that the former are offered to offset the negative effects derived from the imposition of the latter. (Maskus and Ebi, 1990).

## **CONCLUSION: ECONOMIC AND DEVELOPMENT IMPLICATIONS AND POLICY OPTIONS**

A general economic analysis of HCOMs and of their developmental implications is difficult for several reasons. First, the concept itself comprises a wide range of measures whose characteristics and effects differ substantially. Second, while these measures are applied in different industries, where their influence varies greatly, there is little systematic evidence on the frequency of HCOMs and their effect; the (partial) data available are fairly dated (see UNCTAD and UNCTC, 1991, pp. 24-25), and do not suggest that they are prevalent. Third, they are usually part of a larger framework of investment incentives and disincentives in which their effects may be difficult to distinguish from those of other measures. Finally, a general appraisal of HCOMs presupposes the availability of a theoretical framework of analysis which, given the different levels of development and market structures of the States which use them, is hard to establish.

### **A. Development strategies and HCOMs**

Notwithstanding these difficulties, a review of the empirical evidence on the use of some HCOMs — especially TRIMs — allows at least some considerations that can help structure the policy options open to host Governments.<sup>1</sup> It suggests that the outcome from such measures cannot be assumed to be automatically undesirable or distortionary. In other words, public sector intervention can either have a positive impact on national development or, if carried out improperly, worsen the situation rather than improve it (UNCTC and UNCTAD, 1991; Moran, 1998).<sup>2</sup> Of course, this leaves public policy analysts with a demanding task. Every kind of intervention requires a micro-level, cost-benefit examination of the economic (or non-economic) objectives that are meant to be achieved and of its possible impact over national welfare.

But what is important to note is that investment policies in general, and some HCOMs in particular, can help capture — and, indeed, increase — a part of the benefits associated with FDI. For example, it has been demonstrated that such HCOMs as export performance requirements have sometimes played a crucial role in stimulating TNCs to reorient their patterns of international sourcing to include a given host country site within the parent firms' regional or global networks (Greenaway, 1992). The resulting operations have often offered particularly valuable benefits to the host country economy, first from the operations of the foreign affiliates; second from the enhanced performance of the indigenous suppliers linked to these affiliates; and third from the spillovers and externalities associated with such operations. A *prima facie* case can, in such situations, be made that export performance requirements, as a tool of host country development policy, make economic sense under certain circumstances (Balasubramanyam, 1991; Greenaway, 1992).

On the other hand, from the long-term perspective of what policies best serve host country development, a number of HCOMs often do not, in fact, seem to serve to create viable and competitive operations within host countries (Moran, 1998). Instead, they can position host country firms behind the frontier of best practices and most advanced technology used in a given industry. Therefore, they can generate high cost and relatively inefficient firm behaviour. Furthermore, they may not generate the dynamic learning and positive incentive structure to move firms or their suppliers along the path from infancy to competitive maturity. There has been, for example, some evidence that foreign affiliates subject to local-content requirements, adopted with an infant-industry logic to promote industrial development or job creation, have high costs, can lead to less efficient production, and have little hope to mature to competitive levels (Moran, 1998). Similarly, while in a number of cases joint-venture requirements adopted for the attainment of development objectives (such as technology transfer) have achieved those objectives, it has been argued that they sometimes cause friction between

partners, instability and, in fact, result in a slow pace of technology transfer to the local economy (ibid.).

However, in the context of negotiating HCOMs in IIAs, Governments often cannot just focus on the long-term perspective. In the short term, the elimination of some HCOMs may throw firms and employees in industries into an unsustainable position, possibly leading to economic disarray. Thus, for example, in the area of domestic content requirements a long-term perspective on what best serves the development needs of a country might suggest the elimination of such requirements as being in the best self-interest of the country concerned, whereas the short-term perspective may require an orderly process of phasing in certain obligations for adjustment reasons. An over hasty termination of domestic content requirements, for example, may well lead to widespread dislocation in industries in which such requirements are prevalent. Firms (and, for that matter, TNCs) will, irrespective of the consequences, redeploy their assets to uses that are viable without artificial support. In the absence of adjustment and retraining mechanisms, this could lead to serious economic disruption. To minimize the impact of such disruptions, a host country might want to establish a phase-out period and schedule for such domestic content requirements. This would provide appropriate incentives for firms and workers alike, and could serve to avoid the preservation of uncompetitive and antiquated operations.

In addition, there is the further consideration that HCOMs, in particular those subject to the TRIMs Agreement, are not the sole aspects of investment policies meant to influence investment flows and their impact on national economies. The influence of HCOMs is part of a wider framework of regulations for investment, some of which may be provided by home countries. Of particular importance here are high domestic content rules of origin, certain forms of anti-dumping actions, and locational incentives.<sup>3</sup> To the extent that they produce the same effect as some HCOMs, their increasing

use, by home countries, can have developmental implications as well.

These various considerations raise a number of questions. What role should host countries assign to certain operational measures in the framework of their development strategies? Should they resist any expansion of prohibited HCOMs? Should they seek to balance the prohibition of certain HCOMs with restrictions on investment-holding or investment-diverting measures, such as rules of origin and anti-dumping regulations? Should they apply for extensions of their phase-out periods under the TRIMs Agreement? Should countries, as part of their review of the TRIMs Agreement, expand the agenda by addressing the various complementarities among trade, investment, and competition policies? Or should these issues be dealt with in IIAs other than the WTO TRIMs Agreement? All these questions imply a number of options for IIA negotiators on the issue of HCOMs. Some of them require particular attention in light of the review of the TRIMs Agreement that has begun in 2000. But they are also relevant because the negotiation of other IIAs increasingly touch upon HCOMs. Various policy options available in this respect are outlined next.

### **B. Policy options: the TRIMs Agreement**

In considering the TRIMs Agreement, two provisions are of particular relevance to a discussion of policy options:

- Article 5.3 offers developing and least developed countries that demonstrate particular difficulties in implementing the TRIMs Agreement the option to request an extension of the transition period for the elimination of TRIMs. In considering such requests, the Council for Trade in Goods is instructed to take into account the development needs of the country making a request; the financial and trade needs of the country making a request; and particular difficulties in implementing the TRIMs Agreement.

- Article 9 of the TRIMs Agreement calls for a review of the Agreement after five years and for proposals to the Ministerial Conference to change the text, as might be appropriate. Article 9 specifies consideration, in particular, of whether the Agreement should be complemented with provisions on investment policy and competition policy. There is a possibility that negotiations on the review may end with a recommendation that no changes be immediately made to the Agreement. The Agreement would therefore continue to be applied as is currently done. A possible argument in this regard may be that, since the advantages and disadvantages of applying some TRIMs remain debatable, the subject-matter requires still further study by the WTO.

### **Option 1: Close or decrease coverage**

In the light of the difficulties to meet obligations to date, one option might be to close the TRIMs list to its current coverage. A related alternative may in fact be to reconsider and reduce the list of TRIMs (box 5). However, since the TRIMs Agreement interprets Articles III and XI of the GATT, the substantive obligations under those provisions would also have to be reconsidered. Otherwise, according to this logic, even if the TRIMs Agreement ceased to exist, this would not affect the substantive obligation of WTO members under GATT articles III and XI. On the other hand, this logic would imply that the negotiation of the TRIMs Agreement was therefore a redundant exercise of no consequence. This is a questionable conclusion considering that the view by many developing countries prior to the TRIMs Agreement was that the GATT did not apply to investment related measures (Hoekman and Kostecki, 1995). It can be argued that the point of view of these developing countries is explicitly affirmed by virtue of the eventual negotiation and conclusion of the TRIMs Agreement by all the WTO members.

**Box 5. Proposals regarding the Agreement on TRIMs in terms of paragraph 9(a)(i) of the Geneva Ministerial Declaration: Communication from India**

“Measures taken by governments to impose conditions to encourage and direct investment according to certain national priorities are considered as “trade-related investment measures — TRIMs”. The Agreement on TRIMs prohibits five types of such measures as they are considered to be inconsistent with GATT rules on “national treatment” and the rules against use of “quantitative restrictions”. Important among these are “domestic content” and “export performance” requirements. The developing countries have a transitional period of five years, that is up to 1.1.2000, to eliminate TRIMs covered by the Agreement, provided they have notified them to WTO when the Agreement became operational.

However, the domestic content is an extremely useful and necessary tool from the point of view of developing countries. Such a requirement is often necessary for (i) encouraging domestic economic activities in raw material and intermediate input sectors; (ii) up-gradation of input production; (iii) prevention of wastage of foreign exchange in the import of raw material and intermediate inputs; (iv) ensuring linkages of FDI with domestic economic activities; (v) encouraging indigenization in case of FDI; and (vi) acting in several other ways as an important instrument in the development process. Similarly developing countries also find export performance requirements to be useful and necessary from the point of view of balanced economic growth and national development.

In the light of the above, there is therefore a need to review these provisions in the Agreement, as they come in the way of accelerating economic growth in developing countries and deny these countries the means to maintain balance-of-payments stability. In particular, the transition period mentioned in Article 5 paragraph 2 needs to be extended and developing countries be provided another opportunity to notify existing TRIMs measures.

The Agreement poses problems both with respect to the limited transition period available for removing TRIMs and the denial of freedom to countries to channelize investments in such a manner

/..



**Box 5 (concluded)**

that fulfils their developmental needs. There is therefore a need to review provisions in the Agreement relating to local-content requirements as the existing provisions come in the way of accelerating the industrialization process in developing countries and deny these countries the means to maintain balance-of-payments stability. With a view to ensuring that these instruments may be maintained by developing countries till such time that their developmental needs demand, the transition period mentioned in Article 5 paragraph 2 needs to be extended.

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

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

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

*Source:* WTO, 1999b.

**Option 2: Extend phase out period**

An argument can be made that extension of the phase out period is needed to give developing countries more time to address their specific needs regarding economic, financial or social policies. It may be argued that the five year period disregards inequalities among countries and there is need to allow developing countries some flexibility or policy space to implement development policies that may still include the use of some TRIMs (box 6). The point has also been made that the five year period appears arbitrary and unfair in light

of longer phase-out periods granted to developed countries for some obligations incurred by the latter; for example, the Multi-Fibre Arrangement has a ten year horizon for elimination. If this were a model, the current phase-out period for TRIMs could be extended by five years (box 7). It has also been suggested that developing countries be allowed to maintain TRIMs indefinitely (box 8).

### **Box 6. The Agreement on TRIMs: Communication from Brazil**

“The WTO Agreement on Trade-Related Investment Measures (TRIMs Agreement) established equal disciplines, rights and obligations for all Members. Except for a few transitional provisions, there are no actual clauses for special and differential treatment, which would allow developing countries to address specific needs regarding economic, financial or social policies.

The disciplines of the TRIMs Agreement disregard obvious structural inequalities among Members, which could not have been overcome within the five-year transition period. Solutions to those problems would require, for the most part, long-lasting policies and adequate financing for their execution.

However, the implementation of development policies is usually constrained by lack of official funds, either from domestic or foreign sources. Investments from the private sector could cover those shortcomings, but they have proved to be, for the most part, highly volatile and closely linked to the fortuitous circumstances of the international financial markets.

Apart from the fundamental need of developing countries to attract investments in order to maintain adequate economic growth and to improve social conditions, other important fiscal and monetary factors come into play. The high volatility of international capital flows, for example, aggravates balance-of-payment difficulties inherent to the early stages of productive investments, when expenditures with imports largely outstrip export revenues. Liberalizing undertakings, such as those expected to ensue from a multilateral round of negotiations, usually set off an investment cycle that requires special care in sensitive areas such as employment relocation, currency stability, and fiscal equilibrium.

/...

**Box 6 (concluded)**

All these elements make clear that developing countries must have some flexibility when making use of trade-related investment measures. Developing countries should be allowed some latitude in devising policies that may attenuate the negative effects of investment cycles, create a hospitable environment for foreign and domestic investors, and promote social and economic development, also addressing the situation of impoverished regions. Thus, it would be fair and imperative to review the concepts that led to the acceptance of horizontal and uniform TRIMs disciplines without due consideration to the needs and singularities of developing countries. Brazil therefore submits the following proposal to the General Council and reserves its right to complement it with other proposals or to further specify its particulars.

Specific provisions shall be included in the TRIMs Agreement to provide developing countries the necessary flexibility to implement development policies (intended to address, among others, social, regional, economic, and technological concerns) that may help reduce the disparities they face vis-à-vis developed countries.”

*Source:* WTO, 1999b.

**Box 7. The Agreement on TRIMs: Communication from Mexico**

“The Agreement on Trade-Related Investment Measures regulates the application of the TRIMs that are considered to be incompatible with Articles III (National Treatment) and XI (General Elimination of Quantitative Restrictions) of the GATT 1994. The TRIMs considered to be incompatible with those provisions are set out in an Illustrative List attached to the Agreement.

The Agreement on TRIMs established different transitional periods for maintaining certain TRIMs and deciding on their dismantling, provided that they have been notified to the Committee on TRIMs. The transitional periods originally established were of five years as from the entry into force of the WTO for developing countries and seven years for the least developed countries.

/...

### **Box 7 (concluded)**

When the Agreement on TRIMs was negotiated, many doubts were raised as to whether the established transitional periods were sufficient, both for practical reasons as well as for reasons of balance and equity with regard to other WTO Agreements in which developed countries insisted on and obtained transitional periods in their interests of up to ten years.

From a practical standpoint, when the Agreement on TRIMs was being negotiated, there was no guarantee that the original transitional periods would be enough for carrying out the structural adjustments that would enable developing countries, including the least developed, to eliminate the use of the TRIMs notified to the Committee, without thereby causing developmental dislocations and problems in sensitive areas of their economy.

Hence, unlike other agreements, the Agreement on TRIMs clearly and explicitly made provision for:

- (a) The right to request that the Council for Trade in Goods prolong the transitional period initially envisaged (see Article 5.3 of the Agreement), and
- (b) The review of the Agreement based on experience, leaving open the possibility of proposing amendments to any of its provisions (see Article 9).

In the preparatory work for the Third Ministerial Conference a large number of developing countries have spoken out in favour of a review of the substance of the Agreement on TRIMs, including its transitional periods, and a number of developing countries have expressed their interest in extending their TRIMs.

In the light of the foregoing, Mexico believes that rather than having to agree on the way of going about granting the extensions envisaged in Article 5.3 of the Agreement and determining how those extensions would relate to the review envisaged in Article 9 of that same Agreement, it would be best for the Ministerial Conference to decide to extend the original transitional periods by a further five years.”

*Source:* WTO, 1999b.

**Box 8. Proposal regarding the Agreement on TRIMs:  
Communication from Colombia**

“The Agreement on Trade-Related Investment Measures provides for the elimination of TRIMs by the end of 1999 at the end of the five-year transition period granted to developing countries. It also provides that account will be taken of the developing countries’ development, financial and trade needs.

TRIMs include measures to encourage the use of products of domestic origin, which plays an important role in the process of improving the industrial base of developing countries and the ensuing generation of income, employment and balance-of-payments equilibrium.

In the absence of large-scale investment, whether in the form of foreign direct investment or production subsidies, the five years provided for as a transition period are insufficient for restructuring the industrial base of developing countries in order to obtain the income and employment benefits stemming from the application of TRIMs.

Accordingly, bearing in mind the present circumstances of developing countries in terms of unemployment and competitiveness, it is necessary for them to be able to maintain TRIMs indefinitely.”

*Source:* WTO, 1999b.

The counter arguments include the suggestion that, with the inevitable prospect of a phase-out, host country authorities would find it in their own interest to see to it that foreign investor operations that are granted some new transition arrangement are governed in the interim by a specific schedule for drawing-down their TRIMs requirements to ensure that adjustment is accomplished in an orderly fashion. A simultaneous schedule for lowering trade protection and/or other protection from international competition would ensure the creation of appropriate signals to all concerned, with an aim towards providing new resources to render the hitherto protected operations more competitive or towards redeploying resources to more viable uses.

What this discussion suggests is that — if an extension is considered — the development of objective criteria on the basis of which a phase-out period can be considered, could be of help. Since individual countries are making the case that some TRIMs have been of economic benefit and have served developmental ends, the development of such criteria might call for individual country studies.

### Option 3: Increase coverage

Another option for consideration is the expansion of the TRIMs Agreement so as to enlarge the list of TRIMs covered (box 9). The fact that a number of HCOMs beyond those specifically covered in the TRIMs Agreement are being prohibited in certain bilateral or regional contexts suggests

#### **Box 9. General Council discussion on mandated negotiations and the built-in agenda, 23 November 1998: Communication from the United States**

“Article 9 of the Agreement requires a review of the Agreement not later than five years after the date of entry into force by the Council on Trade in Goods. Its purpose is to consider the operation of the Agreement, propose amendments as appropriate and consider whether the Agreement should be complemented with provisions on investment policy and competition policy. Neither the Committee nor the Council have established any plans or procedures for conducting this review, which is to be conducted before the end of next year.

Issues for the Review: The work of the TRIMs Committee is likely to be influenced by work underway in the Working Groups established at Singapore on Investment and on Competition Policy and the reports to be submitted to the General Council before the end of the year. Nonetheless, the Committee and Council on Trade in Goods should examine additional improvements in the review.

The Committee and the Council should consider the desirability of broadening the Agreement by expanding the disciplined list of TRIMs to include export performance requirements, technology transfer requirements, and product mandating requirements.”

*Source:* WTO, 1998.

that a number of countries may, indeed, like to move in this direction. However, the enlargement of the TRIMs list may be perceived as placing further limitations on some policy tools available to host countries, and this may not be acceptable to many of them, especially since some are already pressing for mitigating what they consider certain rigours of the existing TRIMs Agreement. One variation would be to adopt an approach in which countries only commit themselves to disciplines over additional HCOMs once they feel they can do so. This would provide a certain degree of flexibility. Another variation would be to increase coverage to additional HCOMs but allow their use provided they meet certain conditions such as the continued receipt of an advantage or incentive.

### **C. Policy options: other IIAs**

While the TRIMs Agreement is to date the most comprehensive multilateral agreement that most countries adhere to as far as certain HCOMs are concerned, the negotiation of other IIAs on this issue and their policy implications remain relevant. It is of course important when negotiating them to take into account the existing obligations under the TRIMs Agreement. At the same time, such IIAs can be used to deal with real or perceived loopholes in the TRIMs Agreement. But if this is done, and where the inclusion of additional HCOMs goes beyond the coverage of the TRIMs Agreement, it must be realized that this can create precedents that could be used to build support for the expansion of the current multilateral list. In negotiating such IIAs a number of options present themselves.

#### **Option 1: Prohibition of certain HCOMs not covered by the TRIMs Agreement**

One option that host countries have in negotiating IIAs is to prohibit some HCOMs (presumably those all parties involved consider as not important to promote their development objectives), in addition to those already covered

by the TRIMs Agreement. This can be done on a one-off basis or incrementally as countries commit themselves not to use certain HCOMs if and when they are ready to do so. The issue is how to link the creation of a favourable investment climate for FDI with the need of maintaining a certain policy space to pursue national development objectives through utilising, amongst other policy measures, certain HCOMs.<sup>4</sup>

### Option 2: Restrict HCOMs, but allow exceptions

Host countries may choose to negotiate the possibility of restricting the use of a particular HCOM, limiting it on the basis, for instance, of a non-discriminatory application, or of an application only in certain pre-determined industries or under special circumstances. In this case, the message sent to international investors is that host countries retain the right to impose a particular contested operational measure, but this right is limited by internationally agreed, and thus internationally enforceable, rules.

**Limitations based on most-favoured-nation and national treatment.** One way of limiting the effect of HCOMs is through a requirement that they be applied on a most-favoured-nation and national treatment basis only. In this case, foreign affiliates would be subject to operational restrictions that are no more unfavourable than those applied to domestically owned firms in like circumstances.

**Limitations based on specific measures.** Under this option, host countries could agree to apply certain HCOMs only in certain areas. This limited use could in particular take into account a number of issues that the market cannot cope with, such as the restructuring of economic activities and the modernization of infrastructure, or with socially optimal investments in such areas as training, education and the environment.

**Limitations based on the provision of incentives.** Countries may want to deal with HCOMs together with incentives. This option would involve a *quid pro quo*: TNCs accepting the receipt



of an advantage (such as investment incentives) would at the same time commit themselves to observe certain HCOMs. Under this option, host countries may also retain the right to impose certain HCOMs in respect of products by investors benefitting from regional preferential status. It is interesting to note that, at the same time that the TRIMs Agreement has obligated Governments to eliminate domestic content requirements on foreign investors, there has been a simultaneous increase in the use of rules of origin to protect investors in preferential trading arrangements or shift production to them. Participants in regional trade agreements have been using rules of origin to demand that high percentages of certain products that enjoy preferential status be created locally. The (high domestic content) rules of origin require the purchase or use by an enterprise of products of internal origin, often specified in terms of specific products, volume or value of products, or a proportion of volume or value of local production, frequently with explicit quantitative specifications.

### **Option 3: Cross-references**

Host countries could provide in one IIA that their obligations concerning operational measures will always be the same as, or not derogate from, those that may be enumerated in another specified IIA. Any changes in the obligations of the latter mentioned IIA would automatically apply to the former. States, for example, may wish simply to incorporate their existing (and future) obligations under the TRIMs Agreement in other bilateral or regional IIAs. An important point to note in this regard is that, while the substantive effect of this technique is the same as under the first two options, the interpretation and application of the provisions within the context of bilateral or regional investment relations could be different. This option allows for the interpretation and application of the provisions under the specific dispute settlement provisions of a given IIA, which might provide for investor-State dispute settlement processes, thus providing the investor with direct access to dispute settlement procedures

not presently available under the WTO dispute settlement processes.

Similarly, States might wish to confine any specific State-to-State dispute settlement provisions in the IIA to the relevant parties, thereby limiting the scope of any ruling to their specific bilateral or regional context, rather than providing precedent for rulings concerning them within the multilateral system of the WTO.

### **Option 4: Hortatory or “best efforts” provisions on measures not covered by TRIMs**

For host countries that wish to send the signal that they are not in favour of certain HCOMs, but are reluctant to foreclose the issue altogether, a hortatory approach may be an option. By definition, the hortatory approach does not create a binding obligation on host States not to impose those measures. States could go a little further and indicate that they commit themselves to make best efforts towards a progressive elimination of certain measures.

### **Option 5: No references to HCOMs**

Since the TRIMs Agreement already provides generally accepted prohibitions of certain HCOMs, the question arises whether there is any need for further elaboration on the issue by other IIAs. In the past, most BITs (as well as other IIAs) kept open the issue by not specifically addressing the question of whether to prohibit some measures. Today, States may simply opt not to address the issue in an IIA on the understanding that it is adequately addressed by the TRIMs Agreement.

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The analysis conducted in this paper shows that the scope for an unconditional use of HCOMs as regards foreign affiliates has narrowed over the past two decades. At the same

time, the debate remains open as to which, how and under what circumstances HCOMs do or do not contribute to the development process. Ideally, therefore, any such regulation should be preceded by careful study and determination of the contribution by a specific HCOM to the development efforts of developing countries.

### Notes

- 1 Most of the studies on this issue concern TRIMs, and were conducted in the wake of the Uruguay Round negotiations. Detailed reviews of some of these surveys can be found in Moran and Pearson, 1988; Greenaway, 1991; UNCTC and UNCTAD, 1991; and Moran, 1998.
- 2 For comprehensive economic explanations of some of the most common HCOMs, see Moran, 1998; on local content requirements: Davidson, Matusz and Kreinin, 1985; Balasubramanyam, 1991; Greenaway, 1991; Moran and Pearson, 1988; on export requirements: Rodrik, 1987; Greenaway, 1991, 1992; on ownership regulations: Balasubramanyam, 1991; Greenaway, 1992.
- 3 For a detailed study of the treatment of anti-dumping in the Uruguay Round, see Cumby and Moran (1996).
- 4 A concept that can help make the link is “flexibility”, which can be defined as the ability of IIAs to adapt to the particular conditions prevailing in developing countries and to the realities of the economic asymmetries between these countries and developed countries (UNCTAD, 2000b).

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