

WORLD TRADE ORGANIZATION

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**Working Group on the Relationship
between Trade and Investment**

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COMMUNICATION FROM AUSTRALIA

The following communication, dated 15 December 1997, has been received from the Permanent Mission of Australia with the request that it be circulated to Members.

On 21 October 1997, the Chair circulated a note on specific areas where some delegations felt that further study was necessary. This communication deals in a preliminary way with some of the issues raised in that note.

Treatment of performance requirements under the TRIMs Agreement and the GATS, and those performance requirements not covered by these Agreements

Performance requirements remain an issue in decisions to invest and in the operation of investments, but they don't give the complete picture. Many delegations have noted that the TRIMs Agreement and the GATS deal with some of them, but there are others worth looking at. More broadly, Chapter VI of the 1996 *World Investment Report* lists a large number of measures relating to admission and establishment, ownership and control, and operations. The Working Group could usefully go through the list of these measures with a view to identifying those that have a genuine impact on trade. The obverse of restrictions is incentives. The *Agreement on Subsidies and Countervailing Measures* already contains a framework for the handling of subsidies within the WTO. Nevertheless, there is a strong case for enquiring as to what types of investment incentives may have an impact on trade performance.

"Negative list" and "positive list" approaches

The relative merits of negative lists and positive lists were discussed extensively during the Uruguay Round negotiations on services. Little can be added to what was said in these discussions, but each approach has its advantages in certain circumstances. The principal advantages of negative lists are that they put all exceptions or non-conforming measures on the table. In this way, they promote transparency of regulation, and they also permit the identification of measures that may be amenable to gradual liberalization. Negative lists are usually accompanied by a commitment not to add further items after a certain date. Positive lists have their use when confidence-building measures are required. Participants are only required to list a limited range of measures, and they may add others as they become more familiar with the relevant issues. Positive lists therefore require continuous updating if they are to assist transparency and support the aim of trade liberalization. It is possible that positive listings do little to prevent the emergence of new non-conforming measures, but a generalized judgement is not possible.

Differences between investment agreements and WTO instruments as regards the coverage of portfolio investments

While an examination of the differences between investment agreements and WTO instruments as regards the coverage of portfolio investments may be useful in producing some insights relevant to the mandate of the Working Group, we do not think these insights would in the end be a major factor in the way the Group handles its future work. Portfolio investment is generally assumed to be a holding of ten per cent or less of a firm's equity. Holders of portfolio investment are therefore often precluded from exercising direct control of the firm unless the other equity holdings are quite fragmented. This suggests that portfolio investors apply some investment criteria that differ from those used by investors seeking a controlling interest. Portfolio investment also is more mobile than direct investment. On the whole, it is likely that portfolio investment is rather more related to international capital movements than to the promotion of trade, and we see no need to examine this issue in any great detail.

The effects of various types of trade measures on foreign direct investment (e.g. high tariffs and tariff escalation, BOPs safeguards measures, preferential rules of origin, anti-dumping measures, subsidies, regional trade arrangements and the protection of intellectual property)

Firms invest in other countries for many reasons. We consider that this Working Group should examine some of these reasons, especially where they are related to trade. High tariffs and tariff escalation may induce a firm to invest in local production facilities because it might otherwise do little business there. It is therefore worth examining the extent to which decisions caused by these factors are in fact second-best. The 1996 *WTO Annual Report*, for example, notes that the gains from using high tariffs tend to be limited, and that foreign direct investment attracted to protected markets tends to take the form of stand-alone production units, geared to the domestic market and not competitive for export production. This is of course something we would expect. A well-established principle among trade negotiators is that countries tend to have few export interests in products where they apply high import tariffs.

The formation of regional trade agreements presents another interesting aspect of the interaction between trade and investment. If the tariff barriers between the partners and third countries are high, the resulting situation will resemble to some extent the situation occurring under conditions of high tariffs or tariff escalation in a single country. One important difference may, however, be that the creation of a free-trade area or a customs union will engender its own dynamic effects as trade diversion occurs. These dynamic effects may in turn lead to new investment from third countries. But the activities of these firms may still only be directed at supplying the internal market. Obviously, a free-trade area that leads to genuine trade creation could result in a considerably enhanced inflow of new investment.

Preferential rules of origin are a subset of the relationship between trade and investment in regional trade agreements. They further constrain a firm's ability to make the best investment decision. They may also result in higher overall costs for the economies concerned as firms again have to find the second-best solution for conducting their business. Added to this is the cost of administering preferential rules of origin. This would have to be taken into account by a firm making an investment decision, but the subject might be better dealt with elsewhere within the WTO structure.
