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**Negotiating Group on the Multilateral Agreement on Investment (MAI)**

**Expert Group No.3 on “Special Topics”**

**PERFORMANCE REQUIREMENTS**

**(Note by the Chairman)**

## PERFORMANCE REQUIREMENTS

### I. Introduction

1. The present Note discusses the possible configuration of MAI obligations on Performance Requirements (PRs) in light of the guidance provided by the Negotiating Group at its 25-26 January 1996 session on this subject. It is recalled that the orientation debate was carried on the basis of a note by the Chairman [DAFFE/MAI(96)4] and a contribution by one delegation [DAFFE/MAI/RD(96)4]. The results are summarised under item 5(b) of DAFPE/MAI/M(96)1.

2. This Note is the second document for consideration by the Expert Group at its first meeting on 28-30 May 1996 [see DAFPE/MAI/EG3/A(96)1]. Delegates will be invited to examine it with a view to developing proposals for the Negotiating Group, including proposals for text where appropriate. These proposals would need be finalised at the third meeting of the Expert Group in September 1996.

3. The obligations being explored take due account of the work that has been done so far on other aspects of the MAI [notably on Definition and Treatment of Investors and Investments, DAFPE/MAI/DG2(96)2]. They do not prejudge possible solutions on outstanding issues, the treatment of issues not yet discussed or the nature and scope of the reservations that the Contracting Parties may eventually formulate to the MAI obligations on PRs.

### II. Possible coverage and nature of MAI obligations on PRs

4. The majority view in the Negotiating Group was that the MAI provides a unique opportunity to create comprehensive obligations on PRs. PRs were understood to mean requirements used by governments to influence the behaviour of foreign investors and secure certain benefits for their economies.

5. The debate also differentiated between two broad categories of PRs. The first category were PRs which are enforceable under domestic law, administrative rulings such as authorisation, licensing and other regulatory requirements. They were referred to as mandatory or compulsory PRs. The second category were PRs for which compliance with might be necessary to obtain an advantage (financial aid, tax incentives, government contracts...). These PRs involve contractual obligations.

6. The Negotiating Group felt that these two categories of investment measures could be covered by the MAI, whether they are discriminatory or not, although the nature of the disciplines might not necessarily be the same in every case. The focus should be on investment distorting PRs and not on trade distorting PRs. The MAI should try to go beyond existing agreements (such as the WTO, the ECT and NAFTA).

a) *"Mandatory" PRs*

7. For the MAI obligations on PRS to be as comprehensive as the WTO disciplines, it would be necessary that they prohibit PRs subject to the *TRIMS Agreement* (the same TRIMS are prohibited under Article 5 of the ECT for the energy sector ) as well as those subject to the *Agreement on Subsidies and Countervailing Measures*.

8. By interpreting GATT articles on National Treatment and the Elimination of Quantitative Restrictions, the *TRIMS Agreement* prohibits trade-related investment measures, including those investment measures that require the purchase or use by an enterprise of products of domestic origin or the purchase or use of imported products in proportion to local production. It also prohibits investment measures that restrict the importation of products by an enterprise or relate them to local production exported or foreign exchange earnings.

9. This prohibition applies to both the TRIMS that are mandatory or enforceable under domestic law or under any administrative ruling and to those with which compliance is necessary in order to obtain an advantage. It also applies irrespective of whether the enterprise is foreign- or domestically controlled.

10. The *Agreement on Subsidies and Countervailing Measures* prohibits export subsidies altogether and, as a result, any TRIMS associated with them. Neither this Agreement or the TRIMS Agreement, apply to services. The TRIMS Agreement does not, however, cover export requirements.

11. A large part of *NAFTA* obligations under Article 1106 cover the same investment measures as those subject to the WTO provisions, but they are cast in broader terms because the focus is on their investment distorting effects. Export PRs are also prohibited, as are requirements to transfer technology, production processes and other proprietary knowledge and exclusive supplier arrangements.

12. In most cases, the *NAFTA* provisions cover goods and services. The prohibitions apply to any enforceable commitments in connection with an investment activity being "establishment, acquisition, expansion, management, conduct or operation of an investment". Moreover, all investments in the territory of the Contracting Parties benefit from this provision whether they are undertaken by an investor of a Contracting Party or a non-Contracting Party.

13. Ideally, the MAI could prohibit any measure which may have a significant distorting effect on investment decisions. Establishing a complete inventory of these measures would require, however, a thorough assessment of their economic impact, which would appear to be an impossible task in view of constraints in time and resources that MAI negotiators have. A few additional PRs have nevertheless been identified as potential candidates for MAI disciplines. They include local hiring and management requirements and requirements relating to intellectual property rights (such as compulsory licensing). Some of these measures would or could be addressed by the National Treatment and Most Favoured Nation Treatment provisions<sup>1</sup>, but it may also be possible to submit them to an explicit "prohibition" discipline.

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<sup>1</sup> For example, it might be more important to prohibit discrimination (i.e. requiring National Treatment or Most Favoured Nation Treatment) with respect to transfer of technology or use of intellectual property than to prohibit local content requirements. Certain intellectual property agreements permit certain PRs under certain conditions (as in the case of compulsory licensing). Local equity requirements would also be contrary to National Treatment.

14. If it were the desire of experts to built upon the most comprehensive features of existing agreements, the following text may provide a useful basis for discussion:

***Paragraph 1***

*"No Contracting Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition<sup>2</sup> of an investment of an investor of a Contracting Party or of a Non-Contracting Party [in its territory<sup>3</sup> [including<sup>4</sup>]:*

*(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<sup>5</sup> 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; or*

*(g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market<sup>6</sup>; or*

*(h) (Others to be defined)<sup>7</sup>.*

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<sup>2</sup> This list of investment activities reproduces the list proposed in the context the National Treatment and Most Favoured Nation obligations [see DAFPE/MAI/DG2(96)2, page 4].

<sup>3</sup> The place of this term is still to be determined in the National Treatment and Most Favoured Nation Treatment provisions [See DAFPE/MAI/DG2(96)2, page 4].

<sup>4</sup> The brackets raise the question whether the list should be an open or closed one. The answer is probably partly dependent on the extent to which non-discriminatory measures are covered by the prohibition.

<sup>5</sup> A person of a Contracting Party could be defined as a natural person or an enterprise.

<sup>6</sup> This obligation does not apply under NAFTA 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.

<sup>7</sup> No other item appear in any existing agreement.

**Questions:**

- Does the above text provide a constructive basis for outlining the MAI obligations on mandatory PRs? How might it be completed and/or improved?
- Should the prohibition obligation apply to investments of investors of a Contracting Party as well as to investments of investors of non-Contracting Parties ?
- Can it be confirmed that national treatment and most favoured nation treatment shall automatically apply to "mandatory PRs" which escape the prohibition obligation? If not, which mandatory PRs should not be subject to these obligations?

15. During the orientation debate last January, several delegations felt that the MAI disciplines on PRs should not prevent the Contracting Parties from adopting or maintaining measures necessary to secure compliance with national laws and regulations generally recognised as having beneficial effects on the economy and society. Environment measures were specifically mentioned by name.

16. NAFTA excludes from the prohibition of technology-related PRs measures to use a given technology to meet generally applicable health, safety or environmental standards. The PRs in question must meet, however, the national treatment or most favoured nation treatment obligations.

17. If the MAI were to include a similar provision, it could be formulated as follows:

***Paragraph 2:***

*"Notwithstanding Paragraph 1, no measure requiring an investment of an investor of a Contracting Party or of a non-Contracting Party to use a technology to meet generally applicable [health, safety or environmental] requirements shall be considered to be inconsistent with this paragraph provided that the national treatment or most favoured nation treatment obligations are respected."*

**Questions:**

- Would it be necessary for the MAI to identify, for greater clarity, the "mandatory" PRs which would be permissible if they were to be applied on a national treatment and MFN basis?

18. Finally, there is the question of whether any prohibition under the MAI of mandatory PRs should be applicable immediately (or after a transition period, as in the TRIMS Agreement) or whether non-conforming measures could be subject to country specific reservations, in which case standstill and rollback would normally apply. The latter approach might be easier to accept and could result in a longer list of prohibited PRs. It would still be necessary, however, to avoid any inconsistency with the WTO. No OECD countries, except one, has notified the existence of TRIMS to this Organisation<sup>8</sup>.

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<sup>8</sup> Developed country Members are obliged under the TRIMS Agreement to eliminate all relevant measures within two years of the entry into force of the WTO Agreement (i.e. by 1 January 1997). Only Mexico (for the automotive sector) (and Poland with respect to certain tax rebates) have notified the existence of such measures.

**b) Performance requirements as a condition for the receipt of an advantage**

19. The discussion in the Negotiating Group suggested that while it would be desirable to develop disciplines on PRs linked to the receipt of a government advantage, the existence of these measures may respond to a different logic than that for mandatory PRs. Governments may want to make sure that the tax payer's money is used in a way that ultimately benefits the host economy. There might be legitimate political reasons for seeking economic returns from government programmes. This type of PRs may therefore not be ruled out completely.

20. NAFTA specifically allows a Party from conditioning the receipt or continued receipt of an advantage in connection with an investment in its territory, 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. The NAFTA list of prohibited "voluntary" PRs is therefore shorter than the list of prohibited "mandatory" PRs. NAFTA also excludes services from the prohibition on local purchase requirements or purchases favouring local production.

21. Even if certain PRs linked with an advantage were to be excluded, however, it would still be desirable, as in the case of "mandatory" PRs reviewed in the previous section, that the MAI does not undermine existing agreements. It would therefore be necessary that the MAI prohibits those PRs under the TRIMS Agreement (and ECT) with which compliance is necessary in order to obtain an advantage (see paragraphs 7-8 above) or any PR linked to export subsidies (see paragraph 9 above). Due account would also need to be taken of the relationship between "voluntary" PRs and the MAI obligations on investment incentives. This subject is being addressed in document DAFFE/MAI/DG3(96)3.

22. The WTO, the ECT and the NAFTA do not define what is meant by an "advantage".

23. If the MAI were to have separate disciplines on "voluntary" PRs inspired by existing agreements and consistent with the formulation of the "mandatory" PRs provisions in paragraph 14 above, the basic obligation for this category of investment measures might read as follows:

**Paragraph 3**

*No Contracting Party may condition the receipt or continued receipt of an advantage, in connection with an investment [in its territory]<sup>9</sup> of an investor of a Contracting Party or of non- Contracting Party, on compliance with any of the following requirements:*

*(a) to receive a given level or percentage of domestic content;*

*(b) to purchase, use or accord a preference to goods [and services]<sup>10</sup> produced 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 an 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".*

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<sup>9</sup> See note (3)

<sup>10</sup> In NAFTA, services are not included in this provision.

**Questions:**

- Does the above provisions constitute a constructive basis for delineating the MAI obligations of PRs associated with the granting of an government advantage?
- In particular, would it be desirable that the prohibition on local purchases in subparagraph b) be extended to services?
- Should an attempt be made to define the term "advantage"?

24. Excluded PRs such as those mentioned in paragraph 19 above, could then be defined as follows:

**Paragraph 4**

*"Nothing in paragraph 3 shall be construed to prevent a Contracting Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Contracting Party or of a non-Contracting 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".*

**Questions:**

- Would it be possible to reduce the list of permissible PRs?
- Can it be assumed that the PRs listed above would be subject the MAI provisions on National Treatment and Most Favoured Nation Treatment?

25. The ECT and NAFTA also exclude certain government programmes from the obligations on PRs. This exclusion involves PRs which are made a condition of eligibility for export promotion, foreign aid, government procurement, or preferential tariff or quotas programmes. If the experts felt it desirable to also exclude these programmes from the obligation of paragraph 3, this could be done in the following way:

**Paragraph 5**

*"Nothing in paragraph 3 shall be construed to prevent a Contracting Party from applying performance requirements listed in that paragraph as a condition for [eligibility of export promotion, foreign aid, government procurement or preferential tariff or quota programmes]".*

**Question:**

- Even if the exclusions in paragraph 5 are found in NAFTA and the ECT, should the MAI be more ambitious in limiting their scope? If so, how?