

UNCERTAINTIES BEYOND THE HORIZON: THE METAMORPHOSIS OF THE WTO INVESTMENT FRAMEWORK IN THE PHILIPPINE SETTING

Prof. Ma. Lourdes A. Sereno*



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* Prof. Ma. Lourdes A. Sereno is the President of Accesslaw, Inc. Currently, she serves as a lecturer in International Law at the Philippine Judicial Academy. An advocate in international arbitration proceeding, Prof. Sereno is an acknowledged Filipino legal expert on WTO issues.

I. INTRODUCTION

In the *Punta del Este Declaration* which launched the Uruguay Round of General Agreement on Tariffs and Trade (GATT) Negotiations that led to the creation, eight years later, of the World Trade Organization (WTO), the Ministers stated:

“Following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade.”¹

The mandate to the Members was to discuss the effect of investment measures and its relation to international trade, with special attention to how such measures can produce trade-distorting effects. Investment rules have always been in the special domain of rules in which sensitiveness are particularly high, tied up as they are with notions of national sovereignty over economic activities within a particular territory, with the exploitation of natural resources, and with colonial and neo-colonial exploitation of the developing world.

Contrary to the level of details, therefore, that attended other areas of trade discipline, the disciplines sought to be imposed by the WTO on national investment measures contrast by paucity. This is not difficult to explain, considering that what is at stake in the investment debate carry what might be highly-charged discourses on national sovereignty.

This reticence, to link investment regulation with the legal disciplines in the WTO, compared to the eagerness with which other issues are linked to trade rules, was evident even in the precursor to the *Marakkesh Agreement*.²

¹ TRIMS:Background, <http://www.wto.org/english/note/htm> (last accessed February 12, 2008.)

² *Marakkesh Agreement* established the World Trade Organization and replaced GATT as an international organization. It was signed by ministers from most of the 123 participating governments at a meeting in Marrakesh, Morocco on April 15, 1994. http://en.wikipedia.org/wiki/Marrakesh_Agreement (last accessed February 12, 2008).

The World Trade Organization (WTO) was established on January 1, 1995. It is a multilateral institution charged with administering rules for trade among member countries. The WTO functions as the principal international body concerned with multilateral negotiations on the reduction of trade barriers and other measures that distort competition. The WTO also serves as a platform for countries to raise their concerns regarding the trade policies of their trading partners. The basic aim of the WTO is to liberalize world trade and place it on a secure basis,

II. PRE-WTO VIEW OF TRADE AND INVESTMENT

In the 1947 Havana Charter, otherwise known as the General Agreement on Tariffs and Trade, other than the article requiring the elimination of quantitative restrictions on the export and import of goods, investment was an area that remained unregulated by the GATT disciplines. At most, it can be said that there was a reference under Part IV on “Trade and Development” by way of an expression of the desire to provide investment assistance to developing countries. Investment regulation as an international area of concern was left to other international organizations, primarily the United Nations Conference on Trade and Development (UNCTAD), the Organization of Economic Cooperation and Development and eventually the World Bank, through the International Center for the Settlement of Investment Disputes.

Part IV of the GATT, the “Trade and Development” part, prescribed greater latitude and assistance to less-developed Contracting Parties through trade concessions, trade facilitation and assistance, promotion of items of export interest, and close cooperation with the development goals and programs of international development organizations such as the UNCTAD. It did not prescribe any rule nor standard on how Contracting Parties to the GATT were to regulate foreign direct investment within their territories.

That this state of things remained for a long time was largely the case. The WTO Secretariat notes by way of historical background, that:

“In 1955, the GATT CONTRACTING PARTIES adopted a resolution on International Investment for Economic Development in which they, *inter alia*, urged countries to conclude bilateral agreements to provide protection and security for foreign investment.”

and that, except for a GATT Dispute Settlement Panel ruling on a contested Canadian investment measure, nothing much of legal significance has happened in the GATT in the area of investment regulation:

“Perhaps the most significant development with respect to investment in the period before the Uruguay round was a ruling by a panel in a dispute settlement proceeding between the United States and Canada. In Canada – Administration of the Foreign Investment Review Act (“FIRA”) (BISD 30S/140, 1984) a GATT dispute settlement panel considered a complaint by the United States regarding certain types of undertakings which were required from

thereby contributing to economic growth and development. <http://www.fas.usda.gov/info/factsheets/wto.html> (last accessed February 13, 2008).

foreign investors by the Canadian authorities as conditions for the approval of investment projects. These undertakings pertained to the purchase of certain products from domestic sources (local content requirements) and to the export of a certain amount or percentage of output (export performance requirements). The Panel concluded that the local content requirements were inconsistent with the national treatment obligation of Article III:4 of the GATT but that the export performance requirements were not inconsistent with GATT obligations. The Panel emphasizes that at issue in the dispute before it was the consistency with the GATT of specific trade-related measures taken by Canada under its foreign investment legislation and not Canada's right to regulate foreign investment *per se*.

"The panel decision in the FIRA case was significant in that it confirmed that existing obligations under the GATT were applicable to performance requirements imposed by governments in an investment context in so far as such requirements involve trade-distorting measures. At the same time, the panel's conclusion that export performance requirements were not covered by the GATT also underscored the limited scope of existing GATT disciplines with respect to such trade-related performance requirements."³

III. THE AGREEMENT ON TRADE-RELATED INVESTMENT MEASURES (TRADE-DISTORTING INVESTMENT MEASURE)

The *Marakkesh Agreement* made a step towards imposing disciplines on investment measures, but largely maintaining the hesitation to do so, by confining its approach to investment issues within the general idea that there are some investment measures that distort trade, thus it makes sense to have some trade rules discipline WTO Members' investment measures. The legal obligation to prevent this distortion is drawn from the existing obligation to provide national treatment to goods of other WTO Members as well as the prohibition against the maintenance or imposition of quantitative restrictions. Thus, contrary to the popular perception that all trade-boosting investment incentives are prohibited, what the Agreement on Trade-Related Investment Measures (for brevity, "ATrims") – which is the principal annexed agreement governing investment

³ *Id.*

measures – provides for by way of legal obligation is that no Member may apply an investment measure related to trade that is inconsistent with the “National Treatment Obligation” under Article III of GATT 1994 or with the “Obligation to Eliminate Quantitative Restrictions” under Article XI of the same Annexed Agreement.

In essence, Article 2 of “ATrimis” prohibits the application any investment measure that violates the National Treatment Obligation of the Prohibition against the Elimination of Quantitative Restrictions. Said Article 2 provides:

“National Treatment and Quantitative Restrictions”

1. Without 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.
2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.

ANNEX

Illustrative List

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 by any domestic sources, 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.
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.

Article 4 of ATTrims

Developing Country Members

A developing country Member shall be free to deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994, the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Articles III and XI of GATT 1994.”

To understand the above rule, one must be acquainted with Articles III and XI of GATT 1994.

IV. INVESTMENT, NATIONAL TREATMENT (ART. III) AND QUANTITATIVE RESTRICTIONS (ART. XI) OF GATT 1994

Article III of GATT 1994 is more popularly known as the national treatment article of GATT. In essence, the national treatment rule requires treatment of goods coming from WTO Members no less favorable than the treatment granted of goods of national origin, the moment that the goods have already been imported. Differing enters the importing Member’s internal market, then it must be accorded no less favorable treatment in all regulatory matters concerning their sale, offer sale, purchase, transportation, distribution or use. Paragraph 4 of the Article best embodies the said rule and it provides:

“4. The products of the territory of any contracting

party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.”

By way of illustration, the above rule has already been the basis for several WTO Dispute Settlement Body rulings requiring tax regimes to be applied similarly to goods that are imported from WTO Complaining Members as those more favourably applied to similar goods of national origin.

V. INVESTMENT AND THE RIGHT TO IMPORT OR EXPORT

The *Marakkesh Agreement*, specifically the GATT 1994 (GATT 1947 obligations), prohibits restrictions on import and export of goods, save only when these fall within the exceptions of Article XX and XXI, or for balance-of-payments exceptions. In practical terms, together with the Illustrative List of Trade-Related Investment Measures that is Trade-distortive under the ATrims, government authorities cannot unduly restrict entry and exit of goods, save when they fall within narrow exceptions. Restrictions are to be applied primarily by way of tariff measures, not trade prohibitions.

Article XI, the relevant part of the GATT 1994 provides:

Article XI

General Elimination of Quantitative Restrictions

1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting or on the exportation or sale for export of any product destined for the territory of any other contracting party.
2. The provisions of paragraph 1 of this Article shall not extend on the following:
 - (a) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or

other products essential to the exporting contracting party;

(b) Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade;

(c) Import restrictions on any agricultural or fisheries product, imported in any form, necessary to the enforcement of governmental measures which operate:

(i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted; or

(ii) to remove a temporary surplus of the like domestic product, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted, by making the surplus available to certain groups of domestic consumers free of charge or at prices below the current market level; or (iii) to restrict the quantities permitted to be produced of any animal product the production of which is directly dependent, wholly or mainly, on the imported commodity, if the domestic production of that commodity is relatively negligible.

Any contracting party applying restrictions on the importation of any product pursuant to subparagraph (c) of this paragraph shall give public notice of the total quantity or value of the product permitted to be imported during a specified future period and of any change in such quantity or value. Moreover, any restrictions applied under (i) above shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions. In determining this proportion, the contracting party shall pay due regard to the proportion prevailing during a previous representative period to any special factors which may have affected or may be affecting the trade in the product concerned.

VI. INVESTMENT AND MOST FAVORED NATION TREATMENT (MFN)

Investment regulations must also be applied in a non-discriminatory as between goods coming from different countries or Member states. It means that in terms of trade and investment treatment extended beneficially to an investor or exporter from one country, such treatment must be applied across the board to goods coming from all WTO Members. Article I of GATT 1994 provides:

Article I

General Most-Favoured-Nation Treatment

1. With respect to customs duties and charges of any kind imposed or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III* any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

VII. INVESTMENT AND SUBSIDIES

Very much linked to the concept of trade-distortive investment measures are also investment subsidies. Subsidies are of three kinds: prohibited, actionable and permissive. For purpose of this paper, we will draw attention only to the first.

The Agreement on Subsidies of the Marakkesh Agreement provides:

Article 3

Prohibition

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact⁴, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;⁵
- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall either grant nor maintain subsidies referred to in paragraph 1.

In other words, support to investments through different incentives schemes is not necessarily GATT-violative unless they fall squarely within the above definition of prohibited subsidies. Other subsidies may be actionable only when damage can be directly proven to the trade interests of another. Because of the complication of discussing actionable subsidies, we defer consideration of this aspect of the WTO law for now.

VII. SERVICES AND INVESTMENT

The GATS requires that committed areas of services be subject to trade discipline such as the MFN rule and the National Treatment rule. The General Agreement on Trade in Services provides in relevant part:

Article XVI

Market Access

1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations

⁴This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason all alone be considered to be an export subsidy within the meaning of this provision.

⁵ Measures referred to in Annex I as not constituting exports subsidies shall not be prohibited under this or any other provision of this agreement.

and conditions agreed and specified in its Schedule.⁶

2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its schedule, are defined as:

- (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
- (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;⁷
- (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
- (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
- (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

It means practical terms that the commitment by one country to open a

⁶ If a member undertakes a market access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Article I and if the cross border movement of capital is an essential part of the service itself not member is thereby committed to allow such movement of capital. If a market undertakes a market access commitment in relation to the supply of the service through the mode of supply referred to in subparagraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory.

⁷ Subparagraph 2(c) does not cover measures of a member which limit inputs for the supply of services.

service area to foreign participation, unless there are express reservations to the contrary, must be subject to similar rules as those governing trade in goods.

IX. PHILIPPINE EXPERIENCE IN DISPUTES BROUGHT ABOUT BY THE APPLICATION OF THE AGREEMENT ON TRADE-RELATED INVESTMENT MEASURES

In 1995, the Philippines notified the WTO regarding two measures that are incompatible with the illustrative list of Article 2 of the ATTrims. These two measures involve the investments provided to assembly or manufacture of automobiles in the country using parts or components manufactured by local parts suppliers, and the requirement that only local coconut fatty alcohol be used as surfactants for local detergent manufacture.

The Philippine Notification (April 25, 1995) provides:

1. "Local Content and Foreign Exchange Requirements under the Car Development Programme (CDP), Commercial Vehicle Development Programme (CVDP), and the Motorcycle Development Programme (MDP)I.⁸

* * * * *

The local content requirement under the motor vehicle development programme aims to develop viable automotive parts and components manufacturing sector. Participants in the CDP, CVDP, and MDP are required to comply with the local content requirement in order for them to remain in the programme. From a list of locally produced automotive parts and components, the automotive assemblers can select which automotive parts they wish to manufacture or source locally in order to meet local content requirement...

Aside from local content, automotive assemblers are required to earn foreign exchange through exports of automotive parts and components to finance a proportion of their imports of completely knocked down (CKD) and semi-knocked down automotive parts and components for the assembly of motor vehicles."

⁸ EO 248 (24 July 1987), CDP - MO 136 (1 December 1987), MO 286 (9 March 1990), MO 68 (21 December 1992), MO 134 (31 May 1993), MO 238 (28 July 1994), MO 242 (2 December 1994), CVDP - MO 157 (9 February 1988), MDP - MO 160 (29 February 1988).

2. “2. Local Content Requirement for Coconut-Based Chemicals.

Soap and detergent manufacturers are required to use at least 60 percent locally produced cocochemical surfactant. The requirement applies to all soap and detergent manufacturers, whether new or existing manufacturers...

The requirement above is contained in Executive Order 259 which was enacted in July 1987 for the purpose of rationalizing the soap and detergent industry and promoting the utilization of chemicals derived from coconut oil. Compliance is mandatory.”

The Philippine government, under the phase-out requirement of the ATrims, which required that these notified Trims be removed five (5) years after the effectivity of the *Marakkesh Agreement*, i.e., no later than December 31, 1999, provided for the gradual elimination of those two measures. However, the government found strong opposition to the move to remove such investment measures, from both the automobile parts manufacturers and the local coconut industry, including from a sizeable labor force that would have been affected by the elimination of the above measures. Both were eventually eliminated, but after a lot of serious internal dissent.

Of these two measures, the only one that became the subject of WTO dispute settlement was the auto parts measure.⁹ The other measure, the cocofatty content requirement for detergents, despite strong internal pressure from importers of Indonesian chemical surfactants, did not ripen into a complaint, formal or informal, by any other WTO member.

The first measure, the car parts manufacturing measure, became the subject of a formal dispute procedure. The Philippines requested for an extension or the TRIMs under the Transitional Provisions of the ATrims until the end of 2004. This was vigorously opposed by the United States who eventually filed a request for consultation and establishment of a Panel, setting off the initial stages of a formal WTO dispute.

The only other domestic measure that became the subject of a TRIMS dispute in the WTO was the import measure related to pork and poultry relative to the tariffication requirement under the Agreement on Agriculture.¹⁰ The

⁹ WT/DS195/4, G/L/405, G/TRIMS/D.17, G/SCM/D35/2, 7 November 2000 (00-4772,) Philippines – Measures Affecting Trade and Investment In the Motor Vehicle Sector.

¹⁰ WT/DS102/1, G/L/191, G/LIC/D/12, G/TRIMS/D/9, 9 October 1997 (97-4300) Philippines – Measures Affecting Pork and Poultry.

Agreement on Agriculture, required that existing import quotas or prohibitions be converted into tariff protection. To allow the local market to be introduced in a favorable manner to these newly-imported products, which had been banned before, a small volume, equivalent to a small percentage of domestic consumption of the same local products, were to be imported at preferential rates. The manner of granting these preferences was embodied in an administrative order on the grant of these preferences. This became the subject of a bitter complaint by the United States who alleged that these rules were stacked in a lopsided manner in favor of local producers.

As earlier mentioned, in both cases, the United States was the principal complainant, although in the pork and poultry case, the European Community was also active as a complain party. Despite intense bilateral consultations on the matter, the United States saw fit to adopt two approaches to the dispute, (a) informal negotiations and consultations, and (b) the more formal dispute settlement procedure under the WTO. This could be considered as adopting a "soft approach" to achieving compliance by the Philippines to the request of the United States together with a "big stick" approach whereby difficulties in bilateral negotiations could immediately be transformed into a hard-nosed dispute settlement process. At several points in both instances, the Philippines objected to the request for consultation and establishment of a panel, the initial points for WTO formal dispute settlement process. At several points in both instances, the initial points for WTO formal dispute settlement, precisely because good faith negotiations were being conducted by the Philippines with the United States.

After more than three years of negotiations and protracted proceedings within the WTO dispute settlement process, eventually, these two measures were resolved not through a ruling by any WTO Panel on the matter, but largely through backroom negotiations and a mutually acceptable agreement between the Philippines and the United States. This was done in the context of intense lobbying by both Philippine producers and even United States politicians and industry/agriculture lobby groups, which groups launched intense public relations campaigns for or against those two Philippine policies.

X. CONCLUSIONS

The Philippines is in the throes of entering into bilateral agreements with other countries that will impact the degree of obligations that it has theretofore exposed itself to. It is self-evident that a more thorough study of such obligations that had even been done before is both imperative and urgent. Foremost of this

is the Japan-Philippines Economic Partnership Agreement,¹¹ the Investments Chapter of which merits a separate and deeper treatment altogether.

¹¹ Japan-Philippines Economic Partnership Agreement was signed on September 9, 2006 at the sidelines of the Asia-Europe Summit in Helsinki, Finland. It is the Philippines first free trade agreement and Japan's fourth. It envisages as a partnership to include possible free trade agreement and other components covering services, investment, human resources development and other forms of cooperation. At present, the agreement is not yet ratified by the Senate of the Philippines because of some infirmities which they deem as violative of the Constitution. <http://www.bilaterals.org/> (last accessed February 13, 2008).