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**Author:** Genest, A.
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Part VII sets out the findings of this thesis and formulates proposals that can help interpret and apply existing PRPs and draft future PRPs in a more deliberate and informed way.

II. Characteristics and General Objectives of Performance Requirements and PRPs

The concept of “performance requirement’ is not an unambiguous term,” its meaning likely to shift depending notably on the industry sector at issue and on whether goods or services are concerned.26 This part will first appraise scholarly and non-treaty-based attempts at defining the expression “performance requirement.” Since characterising a measure as a performance requirement hinges on “not only the nature, but the end-purpose of a government measure,”27 this part will identify, in a second section, the legion of purposes pursued through performance requirements. The third section of this part will analyse the congenitally dual purposes of PRPs: ensuring the operational freedom of investors and lasting trade benefits for home States that export goods, services and capital. The fourth section highlights the near inseparability of advantages and performance requirements as part of a quid pro quo.

A. Conceptual Characteristics of Performance Requirements and the Absence of a Universally Accepted Definition

Performance requirements influence the quantity, quality and location of investment28 by increasing or reducing its profitability, by altering its risks, by modifying the location and scale of production or by affecting an investor’s import or export decisions.29 They amount to investment measures because of their application in connection with authorising an investor to establish, acquire, expand or operate an investment in a host country or as pre-conditions to the granting of an advantage to an investor.30 Performance requirements act as investment disincentives

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30 European Communities (“EC”), Submission to the GATT Group of Negotiations on Goods – Negotiating Group on Trade-Related Investment Measures, MTN.GNG/NG12/W/8 (23 June 1987) 1-2; OECD Secretariat, Note on Trade-Related Investment Measures for the Working Party of The Trade Committee,
when they compel an investor to conduct its activities contrary to its own best interests. Performance requirements can be understood as “a special category of [investment] disincentives that direct an investor to buy from or sell to certain markets.”

Performance requirements impose specific operational undertakings upon investors and/or their investments with a view to serving specific national objectives of the host State. Performance requirements act as policy instruments for achieving broadly-defined economic and developmental objectives, especially industrial and technological development objectives. Although performance requirements were initially construed as imposed upon foreign investors, the concept now encompasses any condition imposed on domestic or foreign investors in a discriminatory or non-discriminatory fashion. Performance requirements may prescribe the use of inputs or outputs, that purchases be made from specific sources or that

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31 David Greenaway, “Trade Related Investment Measures and Development Strategy” 45(2) Kyklos 139-159 (1992), 139-140. See also: OECD, First Note on TRIMs (n 30) 4-5; Theodore H. Moran and Charles S. Pearson, Trade Related Investment Performance Requirements (study for the Overseas Private Investment Corporation (“OPIC”), March 1987) 9.

32 Guisinger (n 28) 81; Moran and Pearson, “Careful With TRIPs” (n 29), 120; OECD, First Note on TRIMs (n 30) 9.


38 Kenneth J. Vandevelde, Bilateral Investment Treaties: History, Policy, and Interpretation (Oxford University Press 2010) 419.
sales be made to specific markets.\textsuperscript{39}

To some extent, all investment policies inherently distort FDI flows among countries and therefore distort trade and production patterns.\textsuperscript{40} Performance requirements have been described as “the unique barrier that links trade and investment.”\textsuperscript{41} One way of narrowing the field and refining the analysis has consisted of distinguishing between investment measures which merely affect trade remotely or indirectly and investment measures which effectively distort and/or restrict trade by focusing directly on trade considerations such as exports or imports.\textsuperscript{42} The broader concept of performance requirements therefore encompasses TRIMs, a more limited group of measures which basically aim at increasing the exports generated by an investment or the proportion of local inputs used by an investment.

Beyond these general characteristics common to most definitions of performance requirements, one must underline the inescapable conclusion that “there is no commonly accepted definition of either TRIMs or performance requirements.”\textsuperscript{43} The multiplication of concepts often add to the prevalent confusion since they do not carry universally recognised meanings.\textsuperscript{44}

Attempts at defining performance requirements do not reflect strictly economic or empirical considerations, but rather expediency, practicality and political feasibility, with a view to developing a “workable definition.”\textsuperscript{45} Definitions lack comprehensiveness and definitiveness and are not meant to provide a “rigid definitional framework.” they often serve merely as a starting

\textsuperscript{39} Guisinger (n 28) 81.


\textsuperscript{41} Coughlin (n 36) 140.

\textsuperscript{42} WTO and UNCTAD (n 5) para 15; Switzerland, Submission to the GATT Group of Negotiations on Goods – Negotiating Group on Trade-Related Investment Measures, MTN.GNG/NG12/W/16 (7 July 1989) 2; Safarian (n 29) 613; Bergsten, Performance Requirements (n 34) 1-2; Edward M. Graham, “Fred Bergsten as an Early Architect of an International Regime for Foreign Direct Investment,” ch. 6 in Michael Musa (ed), C. Fred Bergsten and the World Economy (Peterson Institute for International Economics 2006) 119.


\textsuperscript{44} For example, this thesis will avoid using the unnecessarily confusing expressions “host-country operational measures,” “trade-related performance requirements” and “trade-related investment performance (TRIP) requirements”: UNCTAD, “Host Country Operational Measures” in UNCTAD Series on Issues in International Investment Agreements, UN Doc UNCTAD/ITE/IIT/26 (2001) 1, 5-8; Guisinger (n 28) 80-81; Moran and Pearson, “Careful With TRIPs” (n 29) 119; Moran and Pearson, TRPRs OPIC (n 31) 5.

\textsuperscript{45} Moran and Pearson, TRPRs OPIC (n 31) 7.
point to ground analyses and to calibrate survey and data collection efforts. Definitions often skip the conceptual implications and put forward illustrative lists based on a list of priority considerations and accompanied by concrete examples of the measures entertained.

In this respect, this thesis follows the lead of GATT Members during the negotiation of the TRIMs Agreement by defining performance requirements mainly by resorting to illustrative lists of measures described as performance requirements and by providing concrete examples of such performance requirements.

B. General Objectives of Performance Requirements

The myriad measures that can be grouped under the designation of “performance requirements” have been invoked as policy instruments in order to achieve numerous objectives pertaining directly or indirectly to trade. Generally speaking, States adopt performance requirements with a view to maximising the beneficial impacts of FDI on the economy, to bolstering, diversifying and expanding a State’s industrial base notably through new products or processes, and to increasing the generation of value added from FDI.

46 OECD, First Note on TRIMs (n 30) 26.
47 WTO and UNCTAD (n 5) para 15; OECD, Framework – Investment Disincentives (n 27) paras 8, 15;
Performance requirements are undeniably mercantilist in nature. Many performance requirements aim at reducing imports and increasing local production as substitution, regardless of the cost of such a policy to the host State or to other States.\textsuperscript{49} Simply put, many performance requirements aim at improving a State’s balance of payments and foreign exchange reserves through the reduction of imports and the increase of exports.\textsuperscript{50} Performance requirements can also be understood as instruments through which a host State attempts to appropriate “excess’ rents” of foreign investments.\textsuperscript{51}

Performance requirements may also aim to achieve objectives beyond trade. Side effects on imports or exports do not always fully explain the motivations behind such measures.\textsuperscript{52} In the 1970s, developing countries challenged the neo-classical/traditional economic understanding that international investment flows reflect properly functioning free-market competition for fear that in the absence of corrective measures, the wealth generated by FDI would find its way back to the States of origin, designated as “home States,” of multinational corporations (“MNCs”) and other foreign investors.\textsuperscript{53} Such challenge rested on the view that industry sectors in which international investment is concentrated are often characterised by oligopolistic market structures and by barriers to the entry of competitors.\textsuperscript{54} Faced with such imperfect market conditions, numerous host States thus embarked on pro-active agendas using performance

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Policy” 1(10) World Development (October 1973) 1, 2; UNCTAD, FDI & Performance Requirements (n 5) 7; Feng Wang, International Law and the Evolving Legal Regime of Foreign Direct Investment - A Developing Country’s Perspective, thesis submitted to the Faculty of Law in conformity with the requirements for the degree of Master of Laws (Queen’s University, 2000) 118-122; Allan W. Wolff, “Prepared Statement on behalf of the LICIT” in U.S. Senate Investment Policy Hearings (defined in this same footnote above) 36.

\textsuperscript{49} Graham (n 42) 121.


\textsuperscript{54} McCulloch and Owen (n 48) 336; WTO and UNCTAD (n 43) 39, 60-61.
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requirements to enrol FDI in their pursuit of social and economic objectives.\(^55\)

Most notably, States may use performance requirements in response to two types of market imperfections. First, market externality imperfections reflecting a host State’s failure to fully capitalise on externalities\(^56\) generated by economic activities of foreign investors. A host State may impose performance requirements as instruments to improve its capacity to absorb spillovers from foreign investors (such as their technological and production know-how), for example by improving the number and skillset of local jobs, local employment and local training requirements, as well as local R&D requirements. Performance requirements can also help foster additional linkages between foreign investors and the local economy by creating backward linkages, i.e., commercial relations between subsidiaries of foreign investors in a host State and local suppliers of inputs (components, accessories or services) that such subsidiaries need in order to produce their goods or deliver their services.\(^57\)

Second, performance requirements can also serve to counter market power imperfections manifested by the control that parent MNCs may exert by over the operations of their subsidiaries through restrictive business practices ("RBPs").\(^58\) MNCs orchestrate global production strategies by allocating tasks to specific subsidiaries which do not always correspond to market conditions or economic competitiveness that prevail in their respective host States.\(^59\)

For example, export performance requirements ("EPRs") may be aimed at counteracting a subsidiary’s orders from MNC headquarters not to export its production meant to supply the host State’s domestic market. As another example, local content requirements ("LCRs") and local sourcing requirements ("LSRs") may be aimed at encouraging the substitutive use of domestic product components or accessories by a subsidiary which is otherwise ordered to import goods produced within its MNC’s network abroad. As a third example, technology transfer requirements may aim at combating restrictions placed upon a subsidiary by its MNC which prevent the use of the MNC’s most advanced technologies in the subsidiary’s host

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55 Bergsten (n 53) 14.
57 Du, Harrison and Jefferson (n 56) 235.
58 McCulloch and Owen (n 48) 336; OECD, Second Note on TRIMS (n 48) para 8; UNCTAD (n 37) 119.
59 India Submission 18 (n 35) paras 13-17.
Finally, infant industry considerations have served to justify reliance on performance requirements to the benefit of domestic producers. The infant-industry argument rests on protecting first entrants by delaying the entry of outside competitors onto the domestic market created by first entrants while they recover their start-up costs associated with learning production processes and while they create a local sales base. For example, enacting LCRs and LSRs could guarantee nascent local suppliers a market share and shield them from the competitive pressures of mature worldwide suppliers.

C. The Ubiquitous Presence of Advantages Alongside Performance Requirements

While States impose performance requirements as standalone mandatory requirements, they also directly condition the conferral of investment incentives upon compliance with performance requirements. This section explains the intricate relationship between investment incentives (referred to as “advantages” in the TRIMs Agreement and in IIAs) and performance requirements. Investment incentives and performance requirements are highly correlated. Investment incentives are used as part of wider efforts to redress the balance of payments, to encourage the development of specific regions, to create or maintain jobs, and/or to accelerate industrialisation. Host States strive to improve their industrial expertise by counting on the contribution of foreign-owned subsidiaries within their borders while they do not dispose of their own domestic firms with comparable expertise. Foreign subsidiaries that operate in host States are owned by or related to parent corporations located in home States where the major and most advanced production processes in a given industry sector take place. As a result, host States face an uphill battle when they try to convince foreign investors to undertake some of

60 McCulloch and Owen (n 48) 336; “Answer of C. Fred Bergsten during the Statement of Allan W. Wolff” in U.S. Senate Investment Policy Hearings (n 48) 45-46. See also LICIT (n 48), 65; Bergsten, Performance Requirements (n 34) 7; GATT Secretariat, Note on the Meeting of 29-30 January 1990, GATT Group of Negotiations on Goods – Negotiating Group on Trade-Related Investment Measures, MTN.GNG/NG12/15 (19 February 1990) para 68.

61 Bergsten (n 60) 45-46; LICIT (n 48), 65; Theodore H. Moran, “Strategic Trade Theory and the Use of Performance Requirements to Negotiate With Multinational Corporations in the Third World: Exploring a ‘New’ Political Economy of North-South Relations in Trade and Foreign Investment” 7(1) Int’l Trade Journal 74-76; Wang (n 48) 118-119; Moran, “Product Cycle” (n 51) 305; OECD, Second Note on TRIMs (n 48) para 8; UNCTC and UNCTAD (n 43) 33-34, 64.


their more sophisticated operations in the host State’s territory. Investment incentives influence the location of FDI by increasing the attractiveness of host States offering them. Host States must offer foreign investors “more-than-compensating incentives to invest” for them to relocate their more value-added operations within their borders. Host States impose performance requirements that may sometimes induce costs for investors in part in order to recoup part of the cost of investment incentives. Host States thus trigger a bargaining process between a host State and a foreign investor. While incentive and performance requirement packages can be negotiated on a case-by-case basis, States can also set out such packages in regulations that condition the conferral of incentives on compliance with specified performance requirements.

D. Prohibiting Performance Requirements Aims at Ensuring the Operational Freedom of Investors and Lasting Trade Benefits for Home States

Trade and FDI have become inseparable as a result of the operations of MNCs: MNCs scatter

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64 UNCTC and UNCTAD (n 43) 40.
66 Moran and Pearson, “Careful With TRIPs” (n 29) 120; Moran and Pearson, TRPRs OPIC (n 31) 9-10, 22.
67 GATT, Note on TRIMs (n 60) para 10; Charles Oman, Policy Competition for Foreign Direct Investment: A Study of Competition Among Governments to Attract FDI (OECD Development Centre, 2000) 21.
69 Bergsten, Performance Requirements (n 34) 2; McCulloch and Owen (n 48) 335-336; Moran and Pearson, “Careful With TRIPs” (n 29) 120; Moran, “Strategic Trade and Performance Requirements” (n 61) 79, fn 59.
70 OECD Secretariat, Notes on Trade-Related Investment Measures for the Working Party of The Trade Committee, TC/WP(88)30 (1st revision) (8 July 1988) (“OECD, Third Note on TRIMs”) para 8; UNCTAD, WIR 1996 (n 5) 131-132; Greenaway (n 31) 145, 151; Ariff (n 40) 352.
various operations within their production chains in different countries according to cost-benefit considerations and in order to avail themselves of the best options in terms of production and sale. In some instances, MNCs engage in transactions that fall within trade policies of States (the cross-border sales of goods or services), while in others MNCs opt for cross-border investment (notably by purchasing production or sales facilities within different States), with the resulting FDI flows falling within investment policies of States. MNCs thus contributed to the creation of integrated cross-border trade and investment networks.

The convergence of trade and investment within operations of MNCs prompted a similar convergence within State policies. Performance requirements and their prohibition in a number of IIAs provide examples of such convergence. Performance requirements initially became a concern on the basis of trade considerations from the vantage point of home States (as opposed to that of their investors abroad). Home States realised that they had much to gain from increased outward FDI. If guaranteed operational freedom, subsidiaries of MNCs abroad would likely choose, as suppliers of product components or accessories or as service providers, corporations related through their common MNC links and located in the home States of MNC subsidiaries abroad. Such purchases would increase exports originating in the home State and stimulate outward-oriented domestic production of home States.

The following remarks stem from documentation pertaining to the American foreign investment policy, but they reflect a reality shared by all capital-exporting countries. The United States considered that additional American outward FDI would spur American exports to and economic activity in developing countries, that the interests of all countries mandated free-flowing FDI, and that such openness toward FDI would foster the growth of international trade. The American approach to IIAs clearly insisted on the interconnectedness of investment and trade: American

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73 ibid.
IIAs also serve American commercial interests and are also meant to generate trade benefits.\textsuperscript{75} The American policy towards performance requirements underlines “investment and trade as two sides of the same coin” and that “the ability to invest in manufacturing, sales and service operations is a primary vehicle of trade.”\textsuperscript{76} Outward FDI generates significant demand for home-State exports of goods and services,\textsuperscript{77} since foreign subsidiaries are the “best customers” of home-State exporters.\textsuperscript{78} Establishing foreign subsidiaries and having “on-site presences” proved essential for providing the necessary services in the insurance, banking and computer sectors abroad and for maximising sales and distribution networks.\textsuperscript{79}

Prohibiting performance requirements gained traction in the United States at the same time as an increase in American outward FDI during the 1970s.\textsuperscript{80} From the vantage point of the neoclassical economic theory embraced among others by the United States,\textsuperscript{81} performance requirements clearly distort trade and investment flows, negatively impact global and host State welfare (through misallocation of resources and nullification of international comparative advantage)\textsuperscript{82} and potentially disrupt investment decisions compared to business-as-usual scenarios.\textsuperscript{83} The United States considered that some performance requirements (and notably

\textsuperscript{75} “Statement of Asst. Sec. of State McAllister” in 1992 \textit{U.S. Senate Hearings on BITs} (n 74) 3.

\textsuperscript{76} Prepared Statement of Rowland H. Thomas, Jr., on Behalf of the American Electronics Association (“AEA”) in \textit{U.S. Senate Investment Policy Hearings} (n 48) 22, 23.


\textsuperscript{79} Tarullo (1992) (n 74) 7; “Questions by Sen. Thompson and Replies by Robert D. Hormats” in 1995 \textit{U.S. Senate Hearings on BITs} (n 74) 37.

\textsuperscript{80} Coughlin (n 36) 129; Robin (n 48) 946; Bale (n 77) 5.

\textsuperscript{81} Bergsten (n 53) 2, 13-14; Bale (n 77) 5; UNCTC and UNCTAD (n 43) 32-34; Robin (n 48) 932, 946, 949; Helen Shapiro and Lance Taylor, “The State and Industrial Strategy” 18(6) \textit{World Development} 861 (1990) 863, 866-867; Klaus Stegemann, “Policy Rivalry among Industrial States: What Can We Learn from Models of Strategic Trade Policy?” 43(1) \textit{International Organization} (January 1989) 73; Vandevelde (n 53) 391.

\textsuperscript{82} Juts like performance requirements, PRPs also reflect mercantilism: home States oppose performance requirements by host States because they reduce their exports: see Graham (n 42) 121.

\textsuperscript{83} “Statement of Harvey E. Bale, Jr., Assistant U.S. Trade Representative for Investment Policy, Office of the U.S. Trade Representative” in \textit{U.S. Senate Investment Policy Hearings} (n 48) 180, 181; “Prepared
LCRs) can cancel out the positive effects of outward FDI for a home State by reducing both home-State exports and host-State imports. American labour and industry representatives expressed concerns over trade-distorting performance requirements due to their negative effects on home States which include “direct transfers of investment, jobs and production to the country which imposes them – and away from other countries.” Performance requirements were criticised as “a new form of beggar-thy-neighbour policy” whose alleged and at best minimal increase the economic welfare of the host State imposing them would come at the expense of other countries. Performance requirements were also viewed as threats to America’s manufacturing base. The United States considered that performance requirements (notably LCRs, EPRs and technology transfer requirements) can deprive American producers of foreign market access, increased exports, and of the repatriation of specialised knowledge acquired thanks to increased commercial activity in host States.

The United States aimed at eliminating performance requirements for both trade and investment considerations. Performance requirements reduce balance of trade benefits generated by FDI that would otherwise accrue to home States by reducing American exports that can reach American subsidiaries abroad and domestic markets of host States. Performance requirements further distort FDI flows. Performance requirements therefore became a home-State/foreign subsidiary issue as well as a trade/investment issue. While export ambitions of home States originally drove PRPs, performance requirements fall on a fault line common to trade and to investment policies by causing potential distortions to both trade and investment.

PRPs in American IIAs, in the same way as was noted for Article 1106 of the NAFTA (1992) and more generally in the same way as most if not all PRPs in IIAs, are meant to achieve two


85 LICIT (n 48) 54.
86 ibid 54, 56; Jacobsen (n 34) 1183.
87 LICIT (n 48) 77.
88 “Statement of Ambassador Charlene Barshefsky” in 1993 U.S. Senate Hearings on BITs (n 78) 20.
89 “Statement of Asst. Sec. of State McAllister” in 1988 U.S. Senate Hearings on BITs and Tax Treaties (n 74) 4; Gwise (n 28) 80.
90 “U.S. State Dept. Responses to Sen. Pell” (n 78) 40.
91 Vandevelde (n 84) 387.