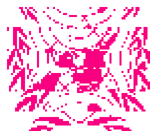
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

INVESTMENT-RELATED TRADE MEASURES

UNCTAD Series
on issues in international investment agreements



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NOTE

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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.

Details and percentages in tables do not necessarily add to totals because of rounding.

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IIA Issues Paper Series

The main purpose of the UNCTAD Series on issues in international investment agreements is to address key 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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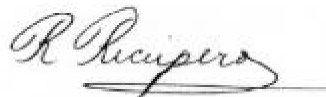
Preface

The United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on a possible multilateral framework on investment, with a view towards assisting 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, and including Victoria Aranda, Anna Joubin-Bret, John Gara, Assad Omer, Jörg Weber and Ruvan de Alwis, under the overall direction of Lynn K. Mytelka; its principal advisors are Arghyrios A. Fatouros, Thomas L. Brewer and Sanjaya Lall. The present paper is based on a manuscript prepared by John Kline. The final version reflects comments received from Mark Koulen, Mina Mashayekhi and Peter T. Muchlinski. The paper was desktop published by Teresita Sabico.

Funds for UNCTAD's work programme on a possible multilateral framework on investment have so far been received from Australia, Brazil, Canada, the Netherlands, Norway, Switzerland, the United Kingdom and the European Commission. Countries such as India, Morocco and Peru have also contributed to the work programme by hosting regional symposia. All of these contributions are gratefully acknowledged.



Rubens Ricupero
Secretary-General of UNCTAD

Geneva, December 1998

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Executive summary

Investment-related trade measures (IRTMs) are a diverse array of trade policy instruments that influence the volume, sectoral composition and geographic distribution of foreign direct investment (FDI). Some trade measures classified as IRTMs (such as tariffs, quotas, and export financing programmes) are not principally designed to influence FDI flows but nevertheless can have major consequences on the decisions of international investors. Other devices (such as export processing zones, and co-production or buy-back trade arrangements) are designed with FDI effects more clearly in mind. In either case, whether the FDI consequence is intended or not, the resultant impact on production location decisions and intra-company trade flows exerts an influence on world commerce. IRTMs help, therefore, to shape how international business activities affect both global welfare and the relative distribution of benefits among national economies through their impact on FDI flows. IRTMs are thus relevant to international investment agreements, including discussions about a possible multilateral framework on investment.

The interaction between trade and FDI policies becomes a matter of concern for national governments as FDI assumes an increasingly important role in the global economy. Numerous international negotiations and agreements have historically addressed international trade issues compared to the attention given to FDI. International trade negotiations recently incorporated the impact of FDI policies on trade flows (trade-related investment measures, or TRIMs), but there has been less recognition of the converse effects that trade policies can have on FDI decisions. An examination of IRTMs provides a way to understand some of these effects so that they can be assessed and, if appropriate, addressed in international discussions on trade and FDI policies.

For developing countries, it is important to assess accurately the interactive link between trade and FDI in order to understand the effects of changes in national policy regimes as well as the

potential consequences of international investment agreements. For example, the use of import substitution in development policies relies on trade restrictions to encourage local production and thus often attracts FDI. Regional trade agreements that stimulate or induce FDI within member countries, as well as administrative devices such as rules of origin, anti-dumping regulations, safety and health standards, and national security controls can have significant impacts on FDI patterns through their effects on prospective trade flows. These FDI undertakings may also produce impacts on later trade flows, particularly through the coordination of intra-firm trade among the affiliated units of transnational corporations (TNCs). Understanding the effects that trade policies can have on FDI decisions is therefore important to assessing and enhancing the development dimension of national and international economic policies.

INTRODUCTION

IRTMs, as a concept, suggests a shift away from traditionally trade-centered perspectives towards a greater recognition of the importance of investment decisions in shaping international economic relations, including related trade flows. As a category of policies, IRTMs encompass a range of trade policy instruments that, intentionally or not, have a significant influence on FDI flows.[1] When these policies are being used or their principles negotiated, both the immediate trade *and* second-stage FDI impacts should be considered and evaluated, along with longer-term, third-stage trade effects that may emerge from FDI locational decisions.

Investment-related trade measures are the reverse of the trade-dominated perspective represented by the concept of trade-related investment measures (TRIMs). TRIMs emerged from the Uruguay Round of trade negotiations. They address national investment policies that could distort international trade flows. TRIMs incorporate investment incentives or trade requirements attached to an FDI project, generally as part of the investment approval process. They include, for instance, domestic content and trade balancing requirements.

By contrast, compared to TRIMs, IRTMs are more general trade measures that are usually not tied to a specific trade or FDI transaction. These trade measures have first-stage effects on immediate trade flows; but as IRTMs, they also influence the decision-making calculus of prospective investors in ways that may have second-stage effects on subsequent FDI flows. IRTMs help shape, positively or negatively, the attractiveness of the investment climate by altering trade conditions associated with a given country or region. Hence, IRTMs can change the distributional pattern of FDI flows compared to what would have emerged otherwise if directed by market forces, absent government policy interventions. It is worth noting that such FDI pattern changes may also have important subsequent third-stage effects on future related trade

flows. These types of impacts can be identified, evaluated and addressed in relation to national trade and FDI policy regimes; they can also be assessed in the context of international investment agreements.

Note

1 For a first discussion of IRTMs, see UN-TCMD, 1992, ch. XI. The relevance of IRTMs has been recognized by the World Trade Organization (WTO) Working Group on the Relationship between Trade and Investment which included in its work programme "the economic relationship between trade and investment; the impact of trade policies and measures on investment flows, including effects of the growing number of bilateral and regional arrangements". (See the "Checklist of issues suggested for study. Non-paper by the Chair", 4 June 1997.)

Section I

EXPLANATION OF THE ISSUE

Various types of trade policy measures can be identified as IRTMs and examined to demonstrate the nature and scope of this issue. Most IRTMs primarily affect market access, serving to *attract* FDI inside markets where trade measures disadvantage imports. In some cases, these IRTMs may also act to *retain* FDI by discouraging outflows of capital to countries whose comparative advantages otherwise might attract export-oriented FDI designed to serve home country markets. The effectiveness of preferential trade policies designed to favour developing country exports can also be influenced by market access IRTMs. Other types of IRTMs affect FDI flows by promoting or supporting exports, or, conversely, by restricting exports for reasons associated with national security controls.

For the purpose of this analysis, the following broad categories of IRTMs have been identified: market access restrictions, market access development preferences, export promotion devices and export restrictions (table 1). These categories of IRTMs are examined throughout the paper in terms of their relative importance, frequency of use and impact on national and international trade and investment outcomes.

An illustrative example of IRTMs is found in the sectoral trade policy effect of the North American Free Trade Agreement (NAFTA)[1], which exhibits the three-stage effects of the IRTMs concept. Prior to NAFTA, no projection television tubes were being manufactured in North America. NAFTA affected trade at a first stage by offering an opportunity for firms to qualify for NAFTA trade benefits if they could meet rule-of-origin requirements that the major value-added component of colour televisions, the television tube, be produced in North America. Over the next few years,

stage two FDI effects were observable as five North American factories were planned or established by firms that included Hitachi, Mitsubishi, Sony and Samsung. This new FDI-based production led to third-stage effects when these foreign affiliates began United States export sales of television tubes, not only to Mexico (within the NAFTA) but also to Asia (Jensen-Moran, 1996a).

Table 1. IRTMs

Market access restrictions
Tariffs and quantitative restrictions on imports
Sectorally-managed trade arrangements (including voluntary export restraints)
Regional free trade agreements
Rules of origin
Anti-dumping regulations
National standards (e.g. safety; health; environment; privacy)
Non-monetary trade arrangements

Market access development preferences
Generalized System of Preferences (GSP); Caribbean Basin Initiative (CBI); Lomé; etc.

Export promotion devices
Export processing zones
Export financing
Taxation measures

Export restrictions
Export controls

Source: UNCTAD.

This example indicates how governmental trade policies can influence business strategy decisions, with corresponding impacts on FDI and subsequent related trade flows. Trade and FDI considerations become interwoven as elements of TNC decision-making. The TRIMs concept, introduced during the Uruguay Round of Multilateral Trade Negotiations, drew attention to one dimension of these interactive impacts. Increasing discussions about international

investment agreements present an opportunity to explore the concept of IRTMs as the converse dimension of this relationship. In fact, examining these interactive effects from an investment perspective is becoming essential to understand fully the growing impact of FDI on world trade.[2]

The influence of FDI derives not only from its relatively faster growth compared to international trade but also from its interactive effects, as FDI increasingly structures the direction and volume of related trade flows. This influence arises from the fact that trade occurs as individual, discrete transactions (i.e. there is no continuing "stock" measure for trade), whereas individual FDI decisions have produced a cumulative stock of in-place investments that influence where future production and related trade flows will occur. Approximately one-third of global trade is now intrafirm trade, meaning that it occurs within a TNC's affiliated network. Another one-third involves a TNC trading with unrelated foreign enterprises (UNCTAD, 1995). In other words, approximately two-thirds of global trade is influenced in terms of its direction and distribution by the location of TNC facilities established by past FDI decisions. This effect represents the third-stage impact that can arise from IRTMs which affect first trade, then FDI, and finally FDI-related trade flows.

Notes

1 Unless otherwise noted, all instruments cited herein may be found in UNCTAD (1996a).

2 See note 1 in the Introduction. For a broad discussion of the interrelationship between trade and investment, see UNCTAD (1996b).

Section II

STOCKTAKING AND ANALYSIS

A wide array of trade measures (table 1) can impact FDI decisions. This section examines these measures more closely, using specific examples to help define their nature and illustrate their relative importance with relation to interactive trade and FDI effects. These IRTMs extend over national, regional and multilateral policies and programmes. For some measures, the FDI impact is direct and intentional whereas for others it can appear as an unintended or even unrecognized side-effect. The effectiveness and relative importance of IRTMs also vary greatly.

Market access restrictions comprise the broadest and most numerous category of IRTMs. These measures generally restrict or otherwise disadvantage import competition, thereby increasing the attractiveness of gaining market access through FDI. Some measures may operate in conjunction with each other, for example when rules-of-origin policies are used to enforce product content requirements to qualify for regional trade agreement preferences. A separate IRTM category is reserved for *market access development preferences* which represent a distinctive application of trade measures, granting privileged access to otherwise restricted markets. In these cases, the FDI effect can favour investment in the countries benefiting from the trade preference, but the preference's relative importance can again be affected by measures such as rules-of-origin definitions on qualifying products. *Export promotion devices* are less frequently associated with FDI effects, although export processing zones constitute one of the most direct and intentional uses of a trade measure to affect FDI by attracting foreign enterprises to invest in the zone. *Export restrictions* are another type of IRTM, but they are relatively infrequent compared with other types of IRTMs.

A. Market access restrictions

1. Tariffs and quantitative restrictions on imports

Trade measures that impose restrictive tariffs or quotas on imported products are among the most common types of IRTMs. Tariffs and quotas protect domestic products from foreign competition. Many countries pursued such policies as part of an import-substitution development strategy that sought to increase the amount of domestic value-added production taking place within their borders. The protected producers could be national firms or, if FDI was permitted, approved foreign investors. The classification of "tariff-jumping FDI" captures the investment impact of these trade measures because the principal motivation for the FDI comes from a desire to gain access to trade-protected markets by producing within the tariff or quota walls. Successive rounds of the General Agreement on Tariffs and Trade (GATT) tariff cuts and restrictions on quantitative measures have reduced the historical importance of these IRTMs, but their incidence in particular industries can still be significant.

2. Sectorally-managed trade arrangements

Sectorally-managed trade arrangements have sometimes evolved to replace or evade the use of trade quotas that are specifically prohibited by multilateral trade rules. Steel, textiles, automobiles, semiconductors, aerospace and construction are some of the industries in which managed trade arrangements have been employed (UNTCMD, 1992). These IRTMs can have a three-fold impact on FDI: keeping investment (*retention*) in the countries whose trade position is enhanced; drawing FDI (*attraction*) from other countries to the advantaged country(ies); and effectively excluding non-capital-exporting countries lying outside the pact from potential participation in affected sectoral transactions.

The WTO Agreement on Textiles and Clothing (ATC) (WTO, 1995) shows how such a trade measure can influence FDI decisions when enterprises establish operations in countries primarily to take advantage of their unmet textile export quota allocations. Some investors move out of countries with better factor endowments because those countries' export quota ceilings have already been reached. Of course, enterprises may also seek to circumvent the

quota system through a trans-shipment of goods without establishing significant FDI operations in other countries. Authorities in the ultimate importing country attempt to guard against this manoeuvre, however, and the intermediary country also has an interest in encouraging maximum value-added production within its borders. Although the ATC is a transitional agreement that phases out textile quotas by 1 January 2005, it serves as an example of how such managed trade quota restrictions not only distort free market trade flows but influence FDI location decisions as well.[1]

Other forms of sectorally-managed trade, sometimes referred to as "voluntary export restraints", are often more bilateral in nature. The United States' use of voluntary export restraints against Japanese auto imports in the early 1980s is another example of an IRTM where a trade restriction, imposed primarily to offer the domestic industry temporary protection from auto imports, produced a second stage effect of increasing FDI flows into the domestic automotive industry. Use of this managed trade measure is now recognized as providing the primary stimulus to Japanese FDI in the United States automotive industry in order to reduce United States protests over the bilateral trade deficit and secure market access against further possible trade restrictions (Graham and Krugman, 1995; Reich, 1992).

Sectoral restrictions imposed by certain European countries on auto imports from Japan also affected FDI decisions. Initially, some countries discouraged FDI, preferring to protect their domestic industry from both trade and investment competition. However, Japanese enterprises established operations in the United Kingdom and other countries whose membership in the European Community (EC) would permit market access to other EC members. This development prompted a debate about what constitutes a Japanese automobile and how auto exports from a Japanese company located in the United Kingdom would be counted in terms of national restrictions on Japanese auto imports into a country such as France.[2] The controversy was resolved through the incorporation of national restrictions into an EC-wide system of temporary sectoral trade restraints, but the FDI impact remained, prompting increased Japanese automotive investment throughout Europe.[3]

The automotive industry in a number of developing countries, such as Mexico and Brazil, offers an evolving hybrid of the IRTM

effect. Initially, both countries used trade restrictions on auto imports to encourage foreign enterprises to invest and produce within their countries, seeking to build a domestic automotive industry by progressively adjusting trade restrictions to prohibit the importation of higher value-added components. In these cases, the IRTMs were specifically linked to a policy of attracting FDI to establish a local automotive industry, as opposed to the United States and EC examples, where protection of an existing industry was the objective. Of course, depending on how tightly the trade and FDI regulations are drawn, enterprises comprising a new infant auto industry may also expect protection from competing imports even after they become established.

More recently, in the case of Mexico and Brazil automotive industry policies have evolved due primarily to their incorporation in the North American Free Trade Agreement (NAFTA) and the Southern Common Market (MERCOSUR), respectively. Auto trade within the regions was a significant component of the economic rationale for the agreements, which contain integrally linked trade and investment policy measures to manage the industry's development. A regional free trade agreement itself serves as an IRTM by granting favourable market access to internally invested firms, creating an incentive for FDI within the region. Specific auto industry provisions determine the height of the trade restrictions by using rules of origin to define the regional content required for a product to benefit from the free trade agreement. In NAFTA's case, the trade agreement denies benefits not only to automobile imports but also to automobiles partially produced or assembled locally if they fail to meet a relatively high standard of 62.5 per cent NAFTA content (Lipsey et al., 1994).

3. Regional free trade agreements

Regional free trade agreements constitute perhaps the most significant type of IRTMs, with an influence that extends far beyond their impact on FDI in the automotive industry. These trade agreements essentially allow member States to construct and implement non-MFN trade measures advantageous to enterprises operating within the region (and hence discriminatory against imports from firms located outside the region). In order to be sanctioned by the WTO, these agreements should be structured to meet certain conditions regarding the eventual reduction of trade barriers with

non-member countries. However, their IRTM effect is often immediate, sometimes even occurring in anticipation of the actual approval and implementation of an agreement. The impact arises because regional free trade arrangements tend to attract FDI from enterprises based in non-member countries, affecting first those enterprises whose current exports will lose competitiveness to local producers that will benefit from the agreement. These foreign firms may undertake FDI in order to gain a "level playing field" within the regional trade area. Other firms may be drawn to invest by the factors associated with the increased attractiveness of market integration and greater economies of scale (UNCTAD, 1998).

This generalized influence of the formation and/or expansion of regional trade agreements on FDI is most evident in the case of Europe's movement from a sectoral Iron and Steel Community to a broader Common Market, then to the European Economic Community and now the European Union. The imposition of a common external tariff created FDI impacts similar to the tariff-jumping motivations induced by a single country's use of tariffs to protect an attractive domestic market, only larger due to the larger internal market. Announcement of the EC 1992 reform programme prompted firms from EC member countries such as France and Germany to expand intra-EC FDI flows, positioning themselves to take advantage of the new market integration opportunities (UN-TCMD, 1992; UNCTAD, 1993). Enterprises based outside the EC also increased their FDI within the region, responding partly to the same market integration opportunities but also seeking to protect against competitive exclusion from the enhanced market, i.e. reflecting concerns (whether or not justified) about a "Fortress Europe" (Wallace and Kline, 1992).

The trade walls established by NAFTA and MERCOSUR create analogous conditions for potential FDI effects. In these cases, however, the regional accords more explicitly recognize the investment dimension, incorporating FDI-related provisions as part of the NAFTA agreement and, in MERCOSUR's case, in a companion accord, the Colonia Protocol. Some FDI impacts are internal to the region although they may differ depending on the region: for example, United States enterprises increasing their investment in Mexico or Brazil, and Argentina's cross-investment in MERCOSUR. The number of Brazilian firms investing in Argentina jumped from 20 to over 400 after the customs union was formed (UNCTAD, 1997a

and 1997b).[4] Other FDI impacts arise when enterprises external to the region invest within the free trade area, either substituting for previous imports and/or to take better advantage of expected market growth.[5]

The proliferation of regional trade agreements around the world enlarges the potential FDI impact of these IRTMs. For example, the common external tariff of the Treaty Establishing the Caribbean Community (CARICOM) was not put into effect until 1991. Since that time, FDI flows in the CARICOM subregion have increased at an annual rate of 20 per cent, growing from $412 million in 1991 to $900 million in 1995 (UNCTAD, 1997b). Many regional agreements are now being negotiated or revised with a more explicit recognition and assessment of how the incorporated trade measures will affect FDI decisions relative to market access considerations and the attractiveness of the internal investment climate. For example, a protocol has been signed for FDI promotion and protection as part of the effort to create an Association of South East Asian Nations (ASEAN) Investment Area (UNCTAD, 1998, ch. III). Cooperative schemes among ASEAN members already have achieved some integration in automobile manufacturing, where auto parts production and assembly in different countries benefit from a preferential duty arrangement (UNCTAD, 1997b). The specific importance of FDI to a regional trade agreement depends, of course, on many factors, including a region's internal investment endowment and its stage of economic development.

4. Rules of origin

With respect to regional trade agreements, rules of origin set the standard for determining the level of regional content that must be embodied in a product to qualify for the trade benefits granted under an agreement. In other cases, rules of origin are used to determine the country of origin for an imported product. This determination is essential to implement restrictive trade devices as well as to grant preferential trade status to selected countries.

Depending on the definitional methods chosen to administer a rules-of-origin policy, this type of IRTM can be more or less protectionist, with a concomitant impact on FDI flows. The easiest method would rely on a change in a product's classification in

the tariff schedule to determine when (and thereby where) a substantial transformation on a good took place. However, the change of classification in the tariff schedule does not necessarily demonstrate the substantiality of transformation occurred in the good, since the tariff schedule is originally established for the purpose other than origin determination. In addition, countries discovered possible national advantages to designing rules of origin in ways that encouraged greater local value-added production. Hence, rule-of-origin methods may also use specified percentages of local content and/or certain stages of production to designate the point at which a product's country of origin changes in terms of the application of particular trade measures.

An illustration of how rules of origin, used in conjunction with regional trade agreements, influence FDI flows is the European Union's 1989 decision to require that the wafer fabrication stage of semiconductor production be performed in the European Union to avoid a 14 per cent tariff. The measure was a significant factor in the jump in FDI in European semiconductor fabrication facilities, which rose 20 per cent between 1987 and 1990, despite higher production costs relative to the United States or Asia. For example, Intel's decision to expand FDI in Europe was influenced by the need to meet this new standard (Jensen-Moran, 1996a).

NAFTA rules of origin in high technology products had similar FDI impacts, particularly affecting both existing and prospective investment decisions regarding production in Asia. ATT shifted production of telecommunications equipment from Asia to Mexico due to a requirement that at least nine of ten printed circuit boards (the key component of office switching equipment) be packaged within NAFTA to qualify for its trade benefits. Canon reportedly invested over $100 million in a new United States copier facility, rather than building the plant in (lower-cost) China or Malaysia, because a special NAFTA rule of origin for copying machines required the equivalent of 80 per cent local value added (Jensen-Moran, 1996b).

Even where FDI is placed outside the member countries of a regional trade agreement, investment patterns can still be influenced by the region's rules of origin. For example, General Motors invested in an engine plant in Hungary but needed to use German steel rather than lower cost alternatives from Hungary

or other non-European Union member countries in order to meet the 60 per cent sectoral domestic content requirement contained in the European Union's association agreements with Central and Eastern European countries (Moran, 1998). This outcome can affect investment patterns in those countries. German and other European Union steel makers would be less likely to relocate outside the European Union, while TNCs from other countries would also have reduced interest in using FDI to build new facilities or undertake joint ventures to improve steel plants in association countries. In this case, the rule-of-origin requirements function as an IRTM that limits the benefits of a European Union trade policy aimed at granting preferential treatment to imports from Central and Eastern European countries.

The actual impact of rules of origin depends, of course, on their specific definition and applications. For example, using rules of origin for imported products from developing countries that receive preferential tariff treatment is one way to try to ensure that the economic benefit of the trade preference actually accrues to developing countries. In such cases, the effect of a relatively high domestic content rule of origin may depend on the ability of a developing country to meet the required standard. If it has, or can attract, the necessary level of local production capacity, the rule could benefit its value-added production and perhaps even serve as leverage to attract more FDI seeking to qualify for the trade preference. On the other hand, an unrealistically high rule-of-origin standard might preclude a developing country from benefiting from a trade preference if local productive capacity proved inadequate without the use of significant imported components that would mean exceeding the foreign value-added limit.

In either case, rules of origin influence FDI flows. Even where a particular developing country benefits from more FDI due to the particular rules of origin employed in a trade preference scheme, that gain may come at the expense of other countries (developing or developed) excluded from that particular preference arrangement. The principal point is that rules of origin as trade measures will impact investment flows, distorting their direction and location compared to FDI decisions taken in the absence of such IRTMs.

5. Anti-dumping regulations

Anti-dumping regulations are a trade measure that can be used to prevent predatory pricing practices by importers seeking to gain future monopolistic advantages by driving competitor firms out of a market. Historically, anti-dumping actions relied on an international price discrimination test. If imports were sold at prices below those charged in the producing firm's home market, the pricing differential was taken as evidence that the firm benefited from trade protection at home that subsidized its pricing strategy in foreign markets. (If the home market were not protected, the products could simply be re-exported and sold at the higher price charged in the home market.) More recently, the definitional methods used to determine anti-dumping actions have been changing in ways that can disadvantage actual low-cost foreign production sites.

In recent years, the United States and the European Union have increasingly been using a "fair cost of production" standard rather than price discrimination to administer anti-dumping regulations. Their methodology relies on average total cost plus a markup for profit and overhead to determine a "fair price".[6] The use of average total cost as a measurement penalizes importers which, for competitive reasons, often price according to marginal cost or average variable cost rather than average total cost. Discrimination against imports occurs because domestic enterprises may price near marginal cost without being penalized by government regulations while foreign firms can fall victim to the imposition of anti-dumping duties for similar pricing methods. An Organisation for Economic Co-operation and Development (OECD) study of anti-dumping actions in the United States, the European Union, Canada and Australia concluded that 90 per cent of imports found to be unfairly priced under anti-dumping regulations would have been deemed fairly priced under comparable domestic competition standards (Moran, 1998).

If the import discrimination under anti-dumping regulations is significant enough, it could lead a foreign firm to invest in the protected market to avoid the dumping penalties. However, an equally if not more significant FDI impact in developed countries could be to discourage enterprises from engaging in FDI. By restricting

or causing increased concern about the access of imports to a market, anti-dumping regulations can exert an indirect influence on prospective FDI decisions and to keep investors at home rather than establishing operations abroad at lower-cost production sites. The domestic producer may not want to risk FDI, even though it could lead to competitive efficiencies in serving the home market, if anti-dumping measures raise substantial doubts about whether the foreign-produced goods would be subject to punitive anti-dumping duties upon importation.

These IRTM effects from the application of anti-dumping regulations may be increasing in significance. The WTO reported nearly 1,600 anti-dumping investigations between 1985 and 1994, with the United States and Australia each accounting for over one-fourth of the total and the remainder divided nearly equally between the European Union, Canada and other countries together. While the initiation of anti-dumping investigations in developed countries remains high (although below rates recorded in the early 1990s), developing countries registered a significant expansion in their own use of anti-dumping regulations, with investigation rates rising from 31 to 118 to 246 in three-year increments between 1988 and 1996 (Moran, 1998).

6. National standards

A range of national regulatory standards that may (or at least appear to) be based on legitimate domestic policy concerns can effectively raise non-tariff barriers to imports. When such measures impair market access, they function as possible IRTMs by encouraging FDI necessary to meet the national standards requirements and thereby compete for sales in that market. For example, if plant visits are required by national government inspectors to certify compliance with product health or safety standards, foreign producers are effectively disadvantaged, if not excluded from that national market, unless the inspectors travel to the other country (unlikely) or an intergovernmental agreement exists to accept the other country's inspection certification (infrequent). Faced with such national standards barriers, FDI may be the only alternative for a foreign producer to compete in the market, resulting in local production that would substitute for potential (and perhaps more competitively efficient) production in other countries.

The scope of national standards that may function as IRTMs is broad, and it is often difficult to establish clearly the extent to which a standard intentionally or unintentionally impedes imports. There is also wide variation in how well such standards are addressed by various intergovernmental agreements. For instance, environmental standards are subject to WTO and/or regional trade agreement discipline when they unfairly discriminate against imported products or services. However, this area is quite new and the rules, their interpretation and application, and the effectiveness of possible remedies are yet to be confirmed by substantial experience and practice. National cultural standards have proven especially controversial, precluding widespread agreement on whether or how to subject these measures to intergovernmental discipline. Even differing national standards regarding the protection of personal privacy raised issues of trade discrimination that had direct and indirect impacts on FDI decisions, resulting in negotiations in the Council of Europe and the OECD to achieve agreements to ameliorate the resulting market distortions (Kline, 1985).

7. Non-monetary trade arrangements

Often grouped under the general term "countertrade", certain non-monetary trade arrangements function as IRTMs by structuring trade contracts in ways that result in FDI flows that would not otherwise have occurred. These mechanisms increased in frequency during the debt crisis of the early 1980s when many countries lacked sufficient hard currency to finance normal import flows. Non-monetary trade also takes place most often in certain industries, such as aerospace and electronics, and is most likely to occur in highly competitive industries, especially in major transactions that may involve governmental funding.

Co-production requirements are probably the most common and significant IRTM in this category. Rather than importing a finished product through a monetary transaction, a co-production arrangement will require that a substantial part of the production take place locally, often to reduce the drain on scarce foreign exchange. The result is a shift in the location of value-added production from a foreign site to the purchasing country, often involving FDI by a foreign enterprise to provide necessary capital, technology or quality control processes. Once in place, such an

investment could also influence the geographical distribution of future production as the enterprise utilizes the new facilities to provide follow-on local sales, or possibly as a base for exports to additional countries.

Other forms of non-monetary trade could also influence FDI decisions. Buy-back arrangements may involve FDI when foreign exchange restrictions preclude the purchase of imported consumer products. A foreign enterprise may establish operations to serve the local market, arranging to repatriate profits in the form of exported production destined for its home market, or elsewhere, rather than as monetary transfers. Bilateral arrangements that designate a portion of a country's available hard currency reserves to promote trade with another specific country for foreign policy or other reasons can also cause TNCs to shift the production of an item to the country favoured by the bilateral arrangement because exporting from an established third-country site is not an option if foreign exchange is not available for such trade (Yoffie, 1984).

Non-monetary trade arrangements may be trade distorting or trade enhancing, depending on whether the transactions could have taken place without the arrangement. In cases in which severe foreign exchange problems legitimately preclude trade on a monetary basis, non-monetary exchanges may be the only option. However, questions about the severity of the shortage and the priority designations for available funds can raise issues similar to the debate over national standards. As IRTMs, non-monetary measures can be used as barriers against imports in order to increase local value-added production, in many cases drawing in FDI as an alternative to the precluded imports.

B. Market access development preferences

A special category of IRTMs emerges when the trade policy measures discussed above are modified to provide preferential market access for developing countries. These preferences, permissible under multilateral trade rules upon fulfillment of certain criteria, are granted by countries or regional groupings to other countries or regional groupings on terms and conditions that vary with specific cases. Although generally discussed and implemented as trade

policy preferences, these measures also result in distinctive FDI impacts that are becoming more explicitly recognized, acknowledged and intentionally exploited. These IRTMs usually serve to attract export-oriented FDI to the developing countries favoured by the preferences.

The Generalized System of Preferences (GSP) is an example of this kind of policy instrument. In the case of the United States, for example, the GSP now provides preferential duty-free entry for approximately 4,500 imported products from over 140 beneficiary countries and territories (Robinson, 1998). The designated products and countries change periodically, sometimes after mandated reviews of United States legislated criteria. Regulations also require direct shipment of the imported goods with a minimum 35 per cent local content in order to control transshipment problems while ensuring substantial value-added local production in the developing country. The FDI impact of this trade preference arises from the increased attractiveness of GSP-designated countries as production sites for eligible goods destined for the United States market, giving these locales an advantage over countries whose exports face United States tariffs. Duty-free treatment of imports may also influence decisions by United States firms contemplating FDI as a response to competitive cost-reduction pressures.

The United States Caribbean Basin Initiative (CBI) is a more region-specific development preference begun in 1984 that uses trade incentives and economic aid to promote both trade and FDI. The goal of increasing FDI is explicit in the programme as a way to encourage economic diversification and increased export earnings for the eligible developing countries. Rule-of-origin regulations vary somewhat from the GSP standard, specifying that United States-origin materials may constitute 15 per cent of the minimum 35 per cent local value-added content in a CBI country (CBI, 1998). Overall, the trade and aid benefits can provide a location for FDI-based, export-oriented production that is even more advantageous for gaining preferential access to the United States market than sites available in non-CBI GSP-eligible countries.

The European Union also provides market access trade preferences through various association agreements with countries in Central and Eastern Europe, as well as for certain developing

countries through its GSP scheme and the Lomé trade regime. Begun in 1975 as an arrangement between nine EC member States and 46 countries in the Africa-Caribbean-Pacific (ACP) group, the periodically revised Lomé Conventions now link the 15 European Union members with 71 ACP countries. This preferential arrangement received a waiver from GATT MFN rules in 1994.

The Lomé arrangements grant duty-free access to the European Union market for all industrial and fish products and nearly 80 per cent of agricultural products, with the latter governed by certain exceptions and quota controls. Under this preferential status, nearly one-half of ACP agricultural exports gain a significant advantage over exports from countries with simple (non-preferential) MFN status which face an average tariff of about 23 per cent. For industrial products, the preference is less significant, with only about 16 per cent of ACP exports receiving duty-free entry that is unavailable to non-preferential MFN trading partners, whose comparable products face an average duty of 8 per cent (European Commission, 1998). The Lomé Conventions also have an important financial assistance component. Although the goals are not so specifically targeted as the CBI at promoting economic development through private business opportunities (including FDI), the assistance may nonetheless enhance the developing countries' investment climate, especially through projects to improve physical infrastructure, education and fiscal management.

An example of FDI impact related to these development preferences arose during a controversy over the European Union's application of tariff and quota preferences to bananas exported from ACP countries. The preference scheme disadvantaged banana exports from some Latin American countries, which protested to the WTO.[7] United States TNCs, which had concentrated FDI in Latin America, faced a decision about whether to invest within ACP countries and the European Union in order to compete for the preferentially protected market in bananas. Two of the three principal United States firms did choose this FDI route and gained additional market share. The firm that chose to expand FDI in Latin America instead lost market share in the European Union (Southey, 1995).

C. Export promotion devices

1. Export processing zones

Export processing zones (EPZs) function directly as IRTMs because the free trade benefits granted within the zone are designed specifically to attract (domestic and) foreign investment. Developing countries often use an EPZ's trade incentives explicitly with the intention of attracting FDI resources that are unavailable domestically in order to create local employment, facilitate technology transfer and generate export sales. These zones (also known by names such as foreign trade zones, special economic zones and free economic zones) operate under very liberal trade rules designed to promote business activity free from normal customs restrictions and import duties.[8] In this way, a zone can promote export growth while maintaining a country's general regulations governing access to the domestic market. Although the main objective is to promote exports competitive on the world market, many zones also permit input warehousing or local value-added processing for products later offered for domestic sale.

Areas designated as EPZs allow the tariff-free import of raw materials, components, machinery, equipment and supplies used to produce manufactured goods for export. They induce investment by providing low-cost processing, rapid duty-free entry and tax-free exit. In addition, products entering the domestic market from an EPZ are not charged duty on the value-added in the zone. EPZs also offer other indirect benefits. Firms may save on transport costs by moving larger shipments without having to pay duty upon arrival. Storage of the product in the final country thus shortens response time between orders and distribution. Spare parts may be held in a zone without duty payment, and no customs duties are paid if merchandise is returned to a zone. In some cases, if part of the merchandise is processed in the zone, it may not be subject to any quota.

There has been much growth in EPZs. In early 1989, some 200 zones employed 1.5 million workers and accounted for exports of $15 billion (UN-TCMD, 1992). By 1996, at least 840 such zones existed (UNCTAD, 1998, p. 59). In the United States alone, the number of foreign trade zones increased by over 50 per cent between 1988 and 1994. More than 300,000 United States jobs

were created by FDI in these zones, with twice as many jobs attributable to related services outside the zones (Burns, 1995). But, overall, approximately 90 per cent of production in current EPZs is located in developing countries (Burns, 1995). For example, Viet Nam had 18 EPZs in 1997, attracting 264 FDI projects worth $2.54 billion; the government hopes that these EPZs could bring as many as 2,400 projects worth $20 billion to Viet Nam in the future.[9]

In order to facilitate the movement and production of goods, EPZs have sparked investment not only in processing, but also in EPZ infrastructure, communications and financial services. Foreign investors build and operate some EPZs primarily to coordinate their own international trade and processing needs. For example, Japan's Sumitomo Corporation has developed fourteen EPZs in countries throughout Asia in order to provide the necessary infrastructure to manufacture and distribute its products (WEPZA, 1998). The company can then link up related processes among the EPZs in order to maximize tariff-free production.

In regional trade areas such as NAFTA and the European Union, EPZs can heighten the investment attraction already provided by a regional trade agreement, combining duty-free production with preferential access to the regional market. For instance, the creation of NAFTA led to the establishment of 30 general purpose United States zones directly related to trade with Mexico. Under NAFTA, goods made in a United States free trade zone are considered manufactured in the United States; yet because the zone is not within the United States customs territory, foreign-sourced materials may be admitted free of duty. Moreover, goods may be shipped among free trade zones in NAFTA countries without paying duties until the article is completed; then, only duty on those components shipped from abroad is paid. The rule-of-origin requirements in NAFTA will reduce this incentive by 2001, however, when the duty-free factories (*maquiladoras*) that exist in Mexico's "free perimeter" EPZ along the Mexico-United States border will require at least 60 per cent North American content to enjoy duty-free status (Burns, 1995). Most pre-NAFTA *maquiladora* plants were also linked to an IRTM, with United States tariff provisions (schedule 806/807) imposing duty only on the value-added portion of goods reimported after assembly by lower-cost labour in facilities located in Mexico.

2. Export financing

Competitive export financing programmes can function as IRTMs by attracting new or expanded export-oriented FDI to the country providing the greatest subsidization and/or retaining FDI by offsetting economic advantages that might lead a TNC to source an export sale abroad. Historically, national governments have competed for export sales through the use of government-backed credits offering favourable interest rates and repayment terms and/or the use of "tied" aid packages where development assistance is linked to the purchase of goods from the grantor country. Differentials in the export financing support available in various countries can affect FDI through corporate decisions on where to source an export sale. For example, the type of large export orders typically supported by public export credit agencies may lead to the expansion of a TNC's plant and equipment in the sourcing country.

Market distortions arising from competition in export financing were significant enough to lead most OECD members in 1978 to approve an *Arrangement on Guidelines for Officially Supported Export Credits*. Although negotiated and administered within the framework of the OECD, this "gentlemen's agreement" is not a formal, legal OECD instrument. The terms have been adopted into European Union law for member States, but other countries are officially bound only by so-called "soft law" commitments. The arrangement covers interest rates, cash-down payments, repayment periods, concessional financing levels and, most recently, minimum premium rates for country and sovereign risk (OECD, 1998a and 1998b). The objective is to prevent an export credit race where subsidized trade financing terms, rather than product and service quality and pricing, determine the source country for the export sale (and its potentially related FDI impact).

The arrangement on export credits has a development dimension in that the agreed financing terms vary, depending on the development category of the importing country. The World Bank's graduation threshold is used to classify countries regarding some export credit terms while gross national product (GNP) per capita income criteria determine eligibility for tied aid. The United Nation's distinction between developing and least developed countries

is utilized to set minimum concessionality levels for countries eligible for tied aid credits and grants (OECD, 1998b). Although limitations on export credit subsidies for developing countries may enhance the role of product quality and price factors in trade transactions, the overall direct cost to the developing country may be increased by the arrangement's restrictions. The effect on the tied aid components is more problematic; it depends on whether the arrangement's limitations result in a greater loss in concessional aid compared to economic efficiency gains realized through a broader choice of sourcing locations for products and services purchased with the aid funds.

3. Taxation measures

Multilateral trade system rules governing tax rebates on exports affect FDI both directly and indirectly. Original GATT rules were established to prohibit rebates on direct (income) taxes as illegal export subsidies while rebates on indirect (sales or value-added) taxes were permissible. The effect of this trade policy decision is to favour exports from countries that rely more heavily on value-added taxes compared to countries with high direct income taxes. Consequently, companies choosing a new international location for an export-oriented investment may consider this tax-related trade measure among the factors that influence their selection of an FDI site.

An instance where such a trade policy measure directly affected FDI emerged from the GATT debate over the United States Domestic International Sales Corporation (DISC). Faced with a GATT panel decision ruling that the DISC constituted an illegal export subsidy through its deferral of direct taxes on export income, the United States replaced the DISC with Foreign Sales Corporations (FSC). Under this new programme, United States firms could gain tax advantages by establishing a foreign-based entity through which exports could be channeled. Because the FSC's export income from a sale is foreign-source income, its taxation is not covered by GATT trade rules (Hill, 1986). Hence, this United States trade measure provided an incentive for United States firms to engage in FDI, at least to the extent of establishing a foreign-based facility to manage export trade. These United States tax-related trade measures aimed at the retention of investment at home (assuming

that the GATT rules might induce firms to move export operations abroad) by equalizing taxation effects on exports, either through a deferral of direct taxes on export income or favourable treatment for related foreign-source income.

D. Export restrictions

An atypical and somewhat narrow category of IRTMs consists of export restrictions that can influence FDI decisions through a corporate desire to escape or minimize such controls. Export restrictions are often imposed for military security or other foreign policy purposes, either to prevent militarily sensitive products from reaching potential adversaries or to deny otherwise beneficial goods and services to political opponents. At times these trade policies may be coordinated internationally, but more often their imposition is either unilateral or else broad compliance differences exist among cooperating countries.

When internationally-agreed trade controls are not achievable or effective and extraterritorial enforcement is impractical or too politically costly, the evasion of national export controls through FDI becomes a viable business option. Enterprises facing export restrictions in one country may seek to invest or expand operations in non-controlled countries in order to conduct business more freely. In such cases, the initial trade controls encourage FDI, which in turn sets new trading patterns from the FDI base. Conversely, potential foreign investors may also hesitate to place or expand FDI in countries employing export controls, particularly in sensitive industries.

The end of the Cold War might appear to lessen the military context for export controls, but in reality the scope of such controls could widen as they are applied across a broader range of products for a variety of reasons. Militarily, more countries may focus on lower-level threats, with greater diversity in their evaluations of particular situations. Questions surrounding dual-use technologies complicate this issue, particularly as concerns increase over the spread of chemical or biological weapons capabilities. In addition there is an increasing temptation and opportunity to invoke export controls to serve economic objectives, particularly to restrict transfers of technology that might threaten current or future domestic

employment. Hence, differing national trade control policies and priorities could expand the potential for FDI diversion that responds to these differences.

Notes

1 Before the ATC took effect on 1 January 1995, bilateral negotiations had established textile quotas, governed by the Multifibre Arrangement. This system departs from basic GATT non-discrimination principles. The ATC will terminate by integrating the sector fully into normal WTO trade rules.

2 A similar debate arose over whether exports of Honda automobiles from Marysville, Ohio, in the United States should be considered United States or Japanese autos. This issue also relates to the discussion of regional trade arrangements and rules-of-origin policies.

3 In a recent development, Toyota announced plans for a new automobile plant in France, which that country now welcomes, in part as a way to encourage more employment-generating FDI.

4 The FDI amounts involved are, however, still modest; see UNCTAD, 1998.

5 This discussion of regional free trade agreements (FTAs), similar to the NAFTA illustration used in section I of this paper, focuses on how such trade measures can induce FDI flows. A related concern, particularly for developing countries considering membership in an FTA, is where the FDI would locate among member countries. For an examination of the various economic, policy and business facilitation determinants affecting FDI location, including among common FTA members, see UNCTAD, 1998, Chapter IV.

6 Countries in transition from former centrally planned economies can be particularly vulnerable to anti-dumping pricing methodologies. When market forces in these economies do not provide enough accurate information on average production costs, the importing government may choose "surrogate" countries and simulate "constructed costs" based on input prices in those economies. The choice of "surrogates" can be quite arbitrary, however, leading to significant anti-dumping penalties against imports from the transitional economies. See Moran, 1998, pp. 110-111.

7 See WTO dispute panel ruling on this matter (Reports: WT/DS 27/R/ECU WT/DS 27/R/GTM-WT/DS 27/R/HND, WT/DS 27/R/MEX and WT/DS 27/R/USA) as modified by an Appellate Body ruling (Report: WT/DS 27/AB/R) and adopted by the Dispute Settlement Body on 25 September 1997.

8 For a recent critical review of EPZs, see ILO (1998).

9 "Vietnam: US$ 2.5 billion flows into EPZ", *The Saigon Times Daily*, 14 May 1997.

Section III

INTERACTION WITH OTHER ISSUES AND CONCEPTS

The concept of IRTMs is, by its very nature, interactive across many traditionally segregated investment issues. Interactive effects are particularly important in the areas indicated in table 2.

Table 2. Interactions across issues and concepts

Issues in other papers	IRTMs
Scope and definition	+
Admission and establishment	+
Incentives	+
Most-favoured-nation treatment	+
National treatment	+
Fair and equitable treatment	+
Taxation	+ +
Transfer pricing	+ +
Competition	+
Transfer of technology	+
Employment	+
Social responsibility	+
Environment	+
Home country measures	+
Host country operational measures	+ +
Illicit payments	0
Taking of property	0
State contracts	0
Funds transfer	+
Transparency	+
Dispute settlement (investor-State)	+
Dispute settlement (State-State)	+
Modalities and implementation	+

Source: UNCTAD.

Key: 0 = negligible or no interaction.

\+ = moderate interaction.

++ = extensive interaction.

- **Taxation and transfer pricing.** Multilateral trading rules aim to prevent the use of tax regulations to subsidize exports and, thereby distort trade patterns. However, differential treatment of rebates on direct and indirect taxation can influence FDI decisions for export-related production, which in turn will also be assessed in terms of how overall taxation policies affect FDI profitability, including the treatment of foreign source income and the applicability and effectiveness of bilateral tax treaties. In the DISC/FSC example discussed earlier, United States regulations governing foreign source income were specifically modified to favour FDI operations related to United States exports.

  Transfer pricing policies may also interact with IRTM issues, particularly as they link international trade and FDI decisions through corporate calculations regarding intrafirm trade. International standards and national regulations governing the pricing of goods and services traded between affiliated enterprises in different countries influence intrafirm transactions, which comprise one-third or more of global trade. If transfer pricing practices embody an "arm's-length" standard that reflects transactions between unaffiliated enterprises, these policies do not distort international trade or FDI flows compared to their free market patterns. However, to the extent that a firm manipulates intrafirm transfer prices to escape national taxation or evade foreign exchange controls, there are trade-FDI interactive effects. The dispersion of a firm's FDI relative to differences in national taxation or exchange regulations would certainly help determine both whether and how transfer pricing might be used to shift trade flow measures and hence the taxable profits associated with them.

- **Host country operational measures**. Among these types of measures, sourcing and local content requirements are particularly relevant, even though some of them may derive from trade policy decisions or depend on measures such as rule-of-origin regulations for their implementation. Regional and/or global products mandates also interact with trade policy to the extent that national or FDI-specific standards affect trade flows. Restrictions on imported goods or

manufacturing inputs needed for FDI-based operations rely on administrative trade measures and may arise from trade policy decisions that neglected the policy's ramifications for FDI operations.

CONCLUSION:

ECONOMIC AND DEVELOPMENT IMPLICATIONS AND POLICY OPTIONS

Trade measures affecting market access (to imports) or trade competitiveness (for exports) can influence FDI decisions where trade is an option to FDI or where trade is a related follow-on effect of an investment. A country's degree of trade policy liberalization or export support can affect potential FDI decisions which, once made, can structure longer-term trade flows as well. Measuring the potential impact of trade policy instruments only on the basis of their most obvious short-term trade results may therefore yield an incomplete and potentially distorted assessment. Similarly, making trade policy decisions without carefully weighing their impact on FDI flows could yield unforeseen and potentially counter-productive results, including distorted longer-term trade flows.

Historically, most developing and developed countries have used trade measures as part of their economic development policies. For example, tariffs and/or quotas were used in import substitution policies to encourage local production, stimulate the spillover benefits of new industrial activity and promote infant industries and enterprises. These policies often induced "tariff-jumping" FDI that sometimes proved questionable for long-term development purposes because it was motivated primarily by protective IRTMs. However, in many instances it also proved effective in overcoming market failures involved in learning more complex technologies and capturing widespread externalities. In those cases in which protected operations did not raise their technical efficiency, however, continued protection was needed for their survival, imposing costs on the economies concerned.

The use of IRTMs, especially by developed countries, can also yield FDI impacts that affect the goals and potential outcomes of economic development policies in other countries. Regional trade agreements among developed countries, or between certain developed and developing countries, shape the relative attractiveness of member and non-member countries as future investment sites. Specific rules-of-origin policies can operate to increase the disadvantage of locating outside a trade agreement area, even where non-member countries may offer comparative economic advantages for production. For example, regional market access restrictions can shift traditional patterns of import or component supplier relationships for firms within a trade zone. In fact, traditional foreign suppliers may feel impelled to invest within the regional market in order to remain competitive, shifting the resulting distribution of trade and other economic benefits among countries. Unless the FDI impact of both the larger trade area and its specific trade policy implementation measures (such as rules of origin) are explicitly recognized and evaluated, projected outcomes from a regional trade agreement may well be inaccurately perceived and measured.

Programmes granting preferential market access for developing countries to developed countries and regional free trade areas constitute a special category of market access IRTMs that can shift FDI in ways similar to the impact of regional trade agreements themselves. Rather than attracting FDI into the consuming market, however, programmes such as the United States CBI or the European Union's Lomé arrangements have the effect of encouraging FDI in the developing countries benefiting from the grants of preferential access. Rules-of-origin measures are often applied by these programmes, with the rules' relative restrictiveness affecting how attractive a developing country site becomes to different value-added stages of the production process.

Modern EPZs integrate trade and FDI objectives even more closely by using liberal trade rules and other incentives to attract investment for local export-oriented production or assembly. A scarcity of domestic investment and technological capabilities often leads developing countries to design these zones expressly for FDI. For countries that are in the process of liberalizing their economies, EPZs can serve as an interim measure to provide a free trade environment while gradually restructuring their economies.

For countries with liberal trade regimes, such as the United States, EPZs are a means of reaping economies of scale and scope in providing inputs, infrastructure and administrative services. By adopting a viewpoint that specifically evaluates and incorporates the projected FDI impact of this export promotion measure, a country essentially recognizes and manages this trade mechanism from the perspective of an IRTM.

Variability exists both in the frequency and the relative importance of the market-access types of IRTMs. The growth of regional free trade agreements has expanded the influence of IRTMs on FDI at the same time as rules-of-origin measures have increased their impact, both as a part of regional market regulations and as programmatic devices associated with national initiatives such as development preferences and EPZs, which themselves have proliferated. By contrast, traditional national tariff and quota restrictions have been progressively reduced or prohibited through successive rounds of multilateral trade negotiations. During the past decade, a number of sectorally managed trade restraints have also been phased out or brought under stricter multilateral discipline.

These market access IRTMs and some export promotion programmes function largely in relation to the tariff levels that surround a country's market, either by defining the market's enclosed boundaries or by granting special reduced or duty-free preferences to imports from certain external producers. This tariff-based link means that the effects of these IRTMs will vary in proportion to the level of the tariff involved. A general lowering of tariff levels serves to moderate the importance of market access IRTMs where the benefits accruing to related FDI is based on the avoidance or reduction of the tariff. For example, the growth in regional trade agreements increases their overall impact on FDI, but the actual height of the tariff barrier to imports from non-member States has decreased as trade negotiations have lowered overall tariff levels. The barrier to market access that can motivate FDI within a region therefore declines in importance as the height of the tariff is reduced. Similarly, rules of origin linked to regional market access or development preferences based on duty-free entry of imports both become relatively less important as the size of the tariff barrier is lowered. In somewhat parallel fashion, the benefit derived from duty-free treatment in EPZs is proportional to the tariff being avoided, although other EPZ advantages, such as faster and less burdensome customs procedures, would still

prove to be influential in FDI decisions.

Other categories of IRTMs are not so directly linked to tariff-based market access barriers. Differing national standards can operate as barriers to a market, at times perhaps serving as intentional replacements for the reduced effectiveness of tariff-based barriers. These measures display much variety and a strong connection to domestic policy that poses complex issues for multilateral negotiations. Nevertheless, the increasing importance of national standards and their effect on trade flows has been recognized, prompting efforts in several multilateral organizations to address their possible distortionary trade impacts. However, the potential second-stage influence that trade-distorting national measures can have on FDI has been less well recognized or evaluated.

The increasing frequency of anti-dumping actions in both developed and developing countries also suggests the need for greater attention to the potential for this device to function as an IRTM in influencing FDI flows. Anti-dumping measures may be even more problematic than some other categories of IRTMs because they operate with more administrative discretion in individual cases compared to the type of generalized market access restrictions promulgated by most other IRTMs. The use of discriminatory anti-dumping measures in developed countries can affect development goals and the distribution of economic results by discouraging the outflow of FDI to developing country locations where comparative economic advantages might otherwise attract foreign investors in the absence of a home government's policy intervention. Aggressive anti-dumping policies may dissuade firms from moving to foreign locations, even where comparative advantages make production less costly, by increasing the risk and uncertainty regarding importation of the resulting output. This potential retention impact on FDI may become increasingly tempting for developed countries that have begun to worry more about domestic job dislocations and the loss of traditional areas of manufacturing strength.

These diverse economic consequences of IRTMs suggest the importance of taking them into account when considering ways to enhance the development dimension in international investment agreements. An analysis of IRTMs can help inform and guide trade policy choices in ways that enhance development objectives. A first step is to adopt a perspective that expressly considers how trade policies may impact FDI. Both the decision to invest in a

particular location and the qualitative nature and market orientation of a given FDI project are affected by national and international trade policies. With expanding FDI, foreign production and intrafirm trade increasingly shape global trade patterns. Initial trade policy decisions that influence second-stage FDI decisions can thereby subsequently affect third-stage trade flows as well. These impacts should be considered when evaluating IRTMs that relate to national and regional trade policies as well as discussions of international investment agreements.

Some categories of IRTMs relate principally to national or regional market policies where some fundamental differences continue to exist over the priority goals and relative effectiveness of development policies. In these areas, proposals and programme options should realistically assess the interrelated trade and FDI effects on development objectives. Although the historical use of high tariffs in import substitution programmes has declined, other trade policy tools can serve a similar function, whether deployed as sectorally managed trade restraints, coproduction requirements, anti-dumping actions or non-tariff barriers such as national standards. These import substitution policies tend to encourage barrier-jumping FDI in relation to the attractiveness of the national market. These policies simultaneously impede beneficial linkages between a new facility and its global affiliates while at the same time protecting the operation's inefficiencies from the discipline of international competition. However, there may be legitimate grounds for temporary protection and the promotion of local content where these support valid infant industry and externality benefits, and these have to be carefully balanced against the potentially harmful effects of excessive and prolonged protection. The new international rules of the game increasingly constrain the use of trade interventions in any case, and this has to be taken into account in assessing IRTMs. The evaluation of IRTMs relative to markets created by regional trade agreements encompasses similar concerns, with the added importance of how rules-of-origin policies are defined and implemented.

Rules of origin have an additional developmental impact because they may define the nature and composition of products that can benefit from preferential trade policies, such as the Lomé trade regime or the United States GSP programme. The effect of these IRTMs helps shape the characteristics and location of

investments (including FDI) undertaken in response to development programmes. From a developing country's standpoint, the programmes' rules of origin should be drafted to fit the characteristics of the developing country. If the rules require a higher local value-added content than can be supported by a particular developing country's endowments, even with some increase in FDI, then the country is unlikely to realize substantial benefits from the programme. Rules that specify particular stages of product manufacture or assembly that match a country's endowment potential might be the most likely to attract productive FDI designed to take advantage of the preferential export opportunity.

A developmental irony of tariff-based IRTMs is that, as international trade negotiations have progressively lowered tariff levels, the relative export benefit (and related FDI attraction) derived from many preferential trade policies has been simultaneously reduced. Tariff-free entry is advantageous to the degree that the relevant tariff being avoided is high. Similarly, the tariff-jumping impact of free trade agreements corresponds to the height of the common external tariff established for a regional market. Of course, non-tariff market access barriers such as national standards are not similarly affected. Even the relative incentives offered by EPZs relate to the level of duty being avoided or delayed, although expedited customs treatment provides an additional benefit for zone-based activities.

Trade policy decisions related to IRTMs in capital exporting countries may also have a developmental impact. Protective measures that restrict imports may discourage outward FDI flows by enterprises that might have established export-oriented production in lower-cost developing countries aimed at serving the investor's home country market. As more developed countries encounter unemployment or other labour adjustment problems related to an integrated global economy, domestic political pressures may lead to an increased use of IRTMs that intentionally act to retain investment at home as well as potentially attract FDI from abroad. Rules of origin and anti-dumping regulations are particularly susceptible to being employed in this fashion.

The increased use of anti-dumping actions in some developing countries could serve to validate the expanded use of this IRTM in some other countries. Such an effect would be unfortunate for developing countries whose internal markets are not attractive enough to benefit from the FDI as well as the trade effects of such policies. On the other hand, for developing countries with large and attractive home markets, increased use of discriminatory anti-dumping methodologies could actually promote inward FDI and discourage outward FDI, while disadvantaging other country locations (including other developing countries) that may offer more economically efficient, lower-cost production sites. Placing greater international constraints on the administration of discriminatory anti-dumping actions could have a differential impact that tended to favour the least developed countries with small internal markets but potentially low-cost export production sites.

Trade promotional IRTMs such as export financing programmes also impact trade flow patterns and FDI decisions of TNCs able to source global sales among a number of national locations. On its face, the developed countries' decision to constrain competitive export financing programmes through an OECD-based "gentlemen's agreement" may initially reduce the benefits that importing developing countries might enjoy from a competition on export financing rates and terms. Restrictions on "tied" aid components will likely benefit developing countries except to the extent that overall development assistance levels are concomitantly reduced. The FDI impact of export financing programmes falls primarily on the distribution of sourcing among developed country locations, however, without much related impact on FDI in developing countries or other development-related objectives.

The recognition and evaluation of IRTM effects is important to assessing the developmental impact of international economic agreements more generally. The existing international framework for trade relations only recently recognized the need to consider investment-related issues but, in focusing only on the unidirectional influence of TRIMs, generally overlooked the counterpart effects of how IRTMs influence FDI decisions and outcomes. The practical interrelationship of trade and FDI decisions at the operational level of enterprise decision-making suggests that these concepts should be assessed as interactive elements when policies are evaluated.

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