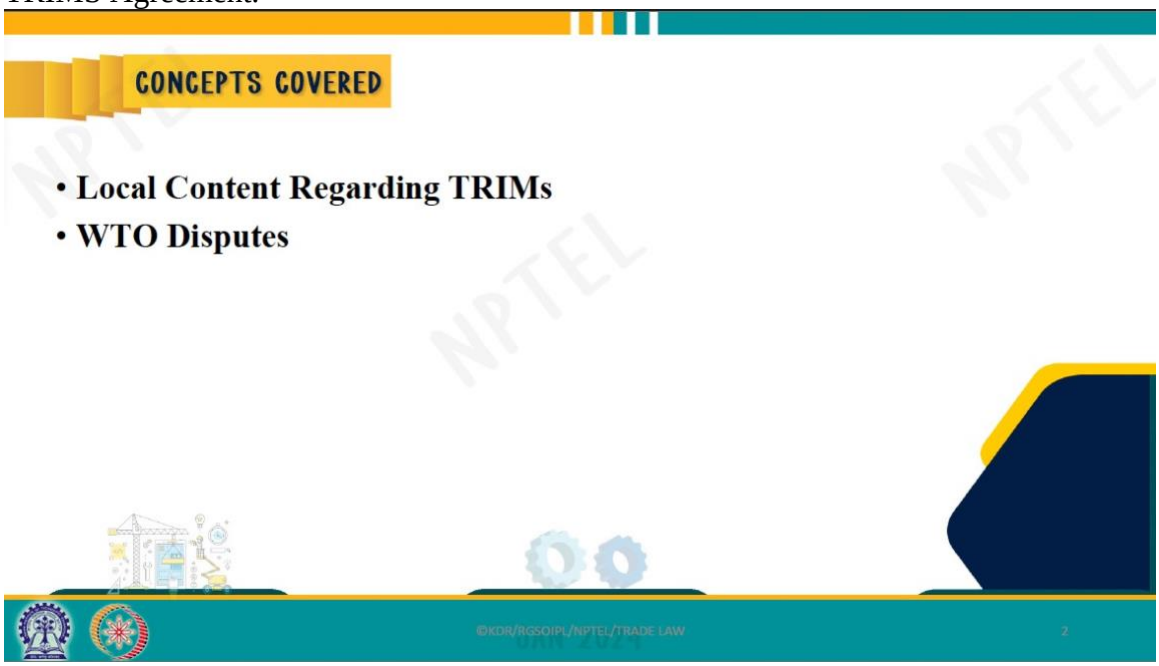
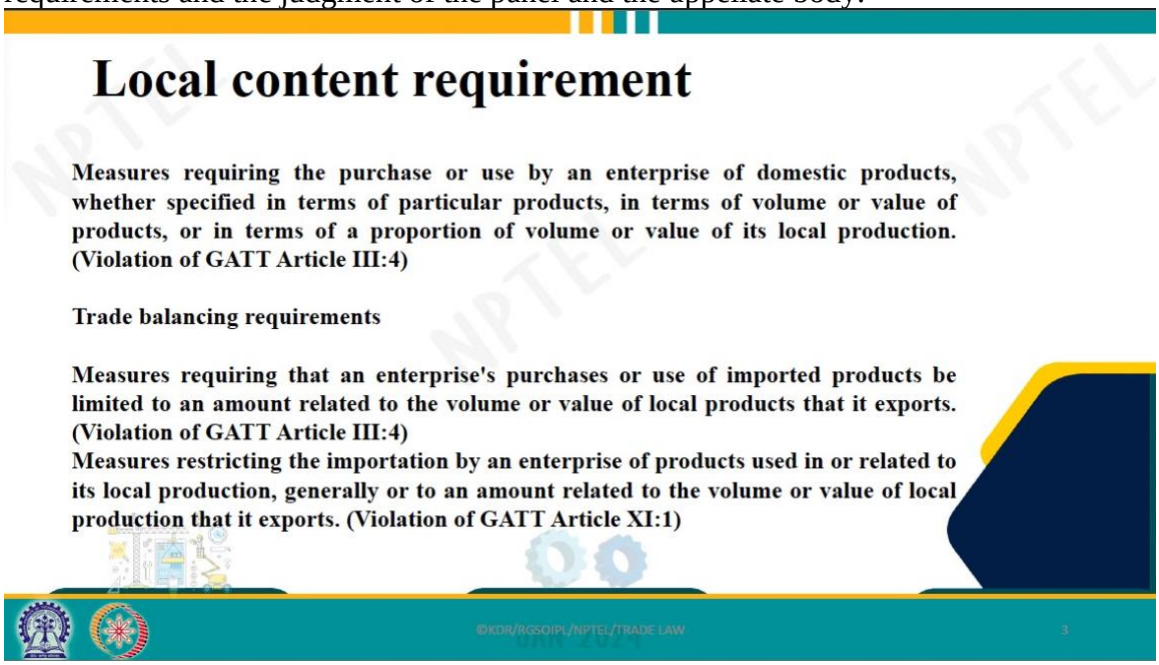
Lecture 21: Local Content and WTO disputes

Dear students, today we are going to discuss about the disputes mainly related to the TRIMS Agreement.

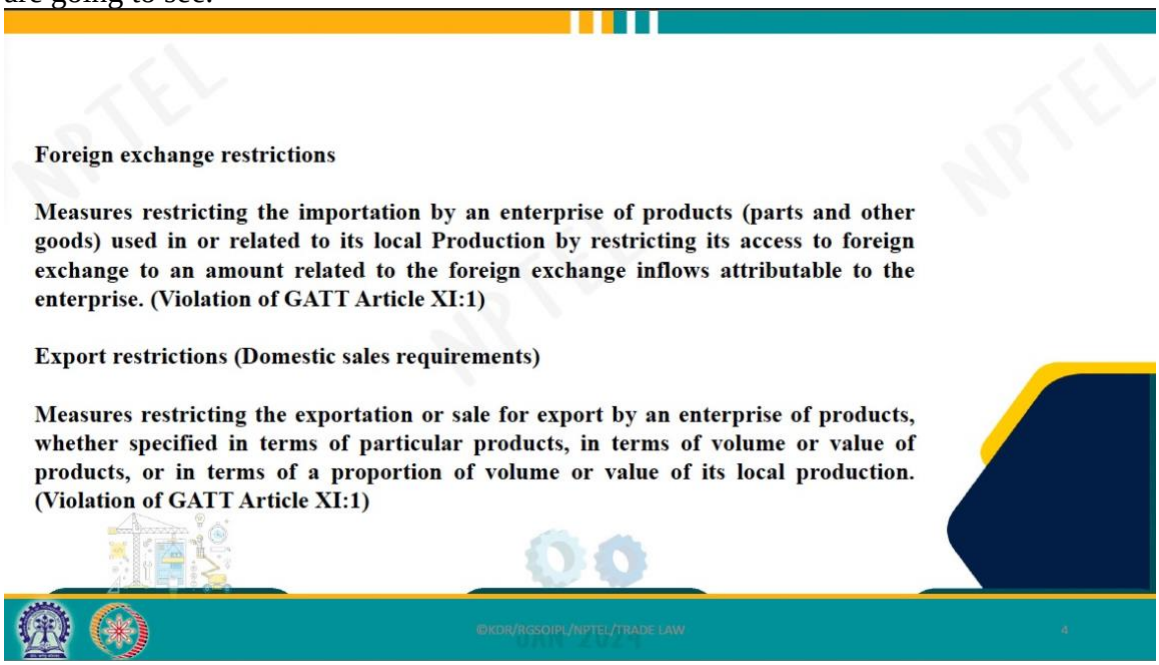


And TRIMS Agreement: we saw that the Agreement is mainly dealing with trade related investment measures. So, we saw the long list of trade-related investment measures as well. The most controversial and most discussed trade-related investment measure is local content, Local content requirements imposed by members from time to time. So, we will see in this class that WTO disputes mainly dealing with the local content requirements and the judgment of the panel and the appellate body.



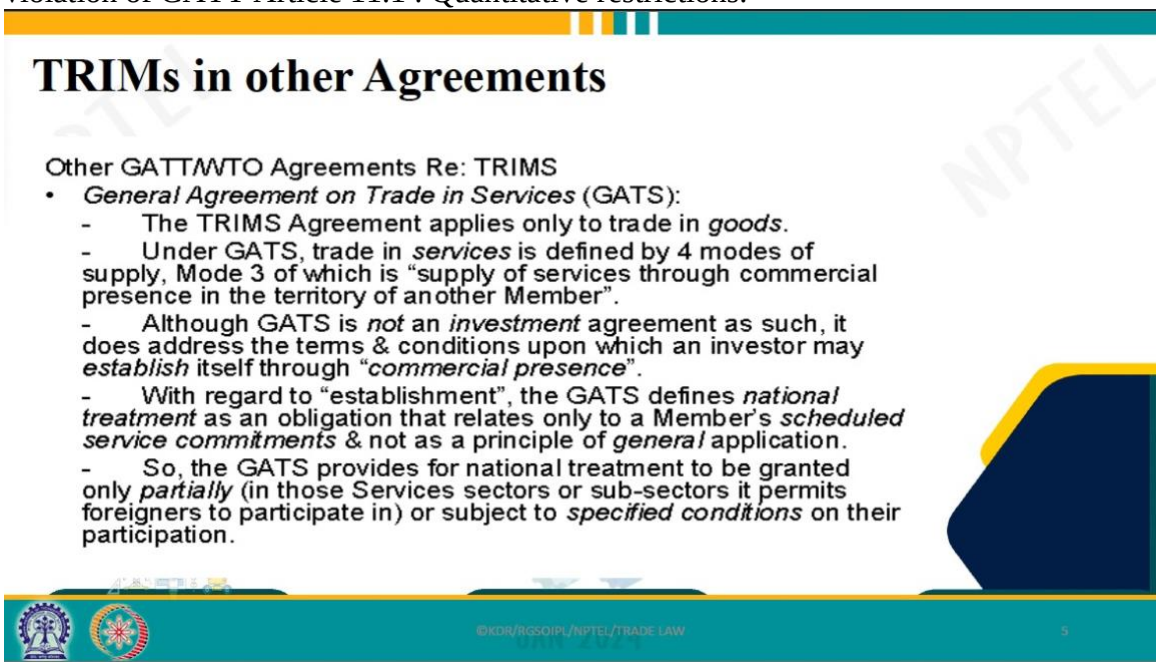
So, what is this local content requirement? The name itself says. So, some of the measures or some of the purchases by those companies who are working in India or

foreign companies who are working in India or the collaboration companies who are working in India. And the government insist on the purchase of certain products, certain spare parts, certain materials and certain equipment from the domestic market. It may be dealing with the volume, or it may be dealing with the value of the products, or you prescribe for a local production. This is in violation of GATT Article 3.4. So, local content requirement, you ask the manufacturer to produce or to manufacturer, or to purchase certain quantity of the product or value of the product from the domestic market - is against the GATT provisions or the new WTO Agreement on trade related investment measures. Another way you can see the trade related investment measures is the trade balancing requirements. So, here also the measures requiring that an enterprise or a company or a manufacturer may be using, every company may be using imported products, for manufacturing their product. It may be a car, it may be other products. And the measure stipulates that your import is limited to the amount of what you exports and that is known as the trade balancing requirement. So, that the host country does not lose foreign exchange. This is also in violation of Article 3.4 of the GATT. So, it means that it is related to local production. So, it amounts to the volume as well as the value of local production to the exports. That means that also is in violation of GATT Article 11.1. Quantitative restrictions: you put quantitative restrictions, trade balancing measures, export-import measures, you put local content measures, these are some of the trade related investment measures discussed in the WTO dispute settlement system which we are going to see.

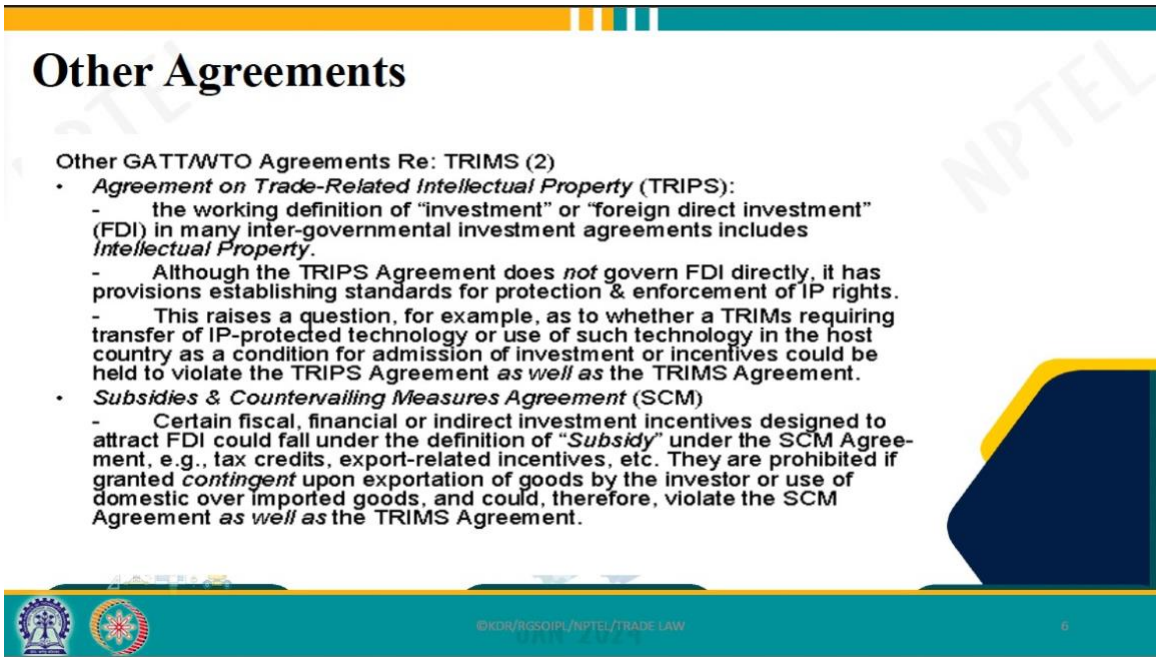


Another restriction which we can see is the foreign exchange restrictions. So, the measure also restricts the importation and exportation of, or foreign exchange flows-inflows. So, we know that, for example, in India, the foreign exchange inflows are controlled by FEMA, the Foreign Exchange Management Act. So, if you put restrictions on the inflow of foreign exchange, that also is considered to be in violation of GATT Article 11.1. Other restrictions are export restrictions or domestic sale requirements. We know that in most export processing zones, there can be 100 per cent export-oriented units. So, here you prescribe that the manufacturer or the exporter should sell an equal amount of

products in the domestic market as well. So, they may be exporting and the same equal quantity volume or value you sell as a requirement in the domestic market. This is also in violation of GATT Article 11.1 : Quantitative restrictions.



So, the TRIMS Agreement very clearly says that what the areas are? A set of trade-related investment measures. Also, we already discussed that the TRIMS is connected with the GATS Agreement as well. That is the General Agreement on Trade and Services, in which we discussed the 4 supply modes. And the third mode of supply is commercial presence. So, here also, you put this as a WTO-GATS agreed mode of service. So, this cannot be considered as a trade-related investment measure, but if you violate, for example, if you deny the commercial presence, then it is going to be in violation of the GATS Agreement. And also the commercial presence is subjected to mode 4 as well. So, you allow the commercial presence of a foreign firm or a foreign bank, but you do not allow the people to come and work here. So, if you put restrictions on the movement of natural persons under mode 4, then again, it is a violation of GATS. At the same time, this is a foreign direct investment, whether it is coming to the service or the financial institutions. So, then, that will be in violation of the TRIMS Agreement as well as the GATS Agreement, the service Agreement as well. So, there is a connection between trade-related investment measures and the Services Agreement.



And here you can see a connectivity between the TRIMS Agreement and TRIPS Agreement. TRIPS Agreement: we are going to see in the next week classes. Trade-Related Intellectual Property Agreement, you can see that, there is a connection with the Trade-Related Aspects of Intellectual Property Agreement. It says that we know that investment means foreign direct investment. There is a lot of foreign direct investment in the pharmaceutical sector as well. So, intellectual property protection is very important for all the FDI investors in the country. For example, China requires: a Chinese law requires: the transfer of technology to the Chinese counterpart within a period of 7 years. So, very recently, many countries, including the US, took China to the WTO dispute settlement system by saying that this particular provision is in violation of the TRIPS Agreement and GATT rules. So, you can see that you cannot prescribe, compel, or stipulate any foreign direct investment or foreign investor to transfer the technology to the host country within a period of time. This is in violation of the TRIMS Agreement. Then, the next agreement connection is with the Agreement on Substitutes and Counter-veiling Measures Agreement. So, in this Agreement, we can see that when you export a subsidized good to a foreign country, then the foreign country has a right to impose additional taxes on such subsidised goods in your home country. So, it means if India subsidises a product and is sending or exporting that particular product in another country and selling it for a lower price in the export market, then the importing country has a right to impose additional taxes to the tune of the subsidies. That is the subsidies and countervailing measures. So, you can take countervailing measures against subsidies. So, there is a connection between the subsidies agreement and the TRIMS agreement.

WTO Dispute Settlement

- The general WTO dispute settlement procedure, as laid down in the Dispute Settlement Understanding, also applies to disputes arising under the TRIMs Agreement (Article 8).
- Issues relating to the alleged inconsistency of particular measures with the TRIMs Agreement.

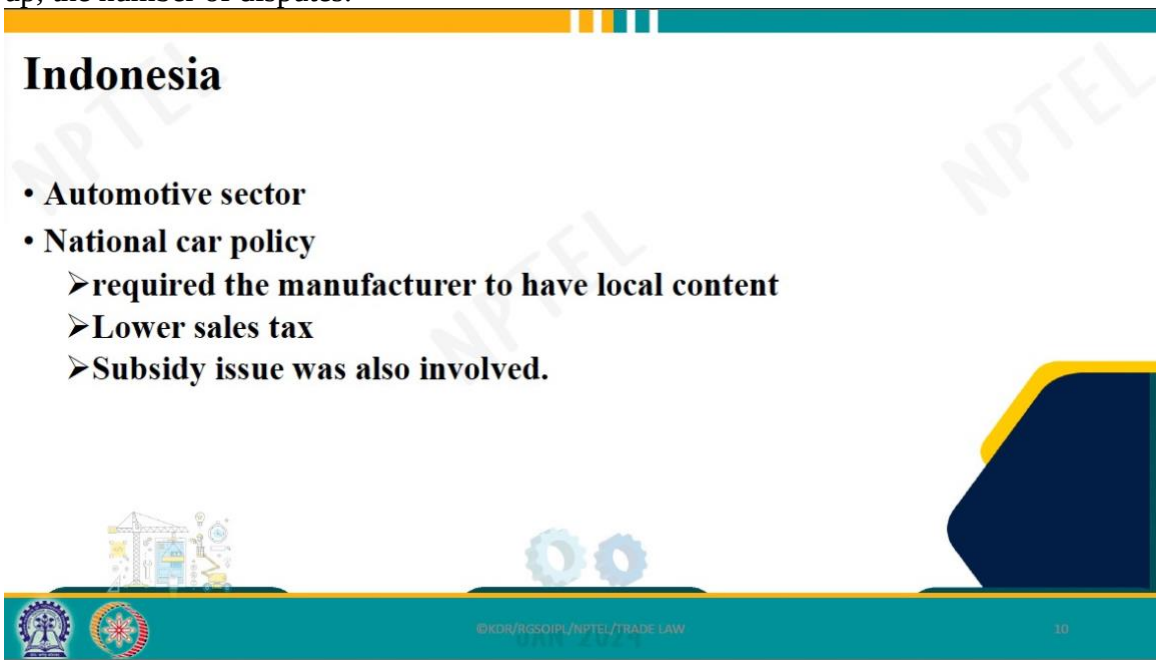
So, when we come to the dispute settlement, you can see that all the TRIMS-related Agreements are under the WTO-DSU, which is a dispute settlement understanding Agreement. So, all the disputes between several countries will be solved under this particular Agreement.

Issues

- Interests of countries where foreign investment originates and where it is invested, countries' right to regulate investment, development, public interest and individual countries' specific circumstances.

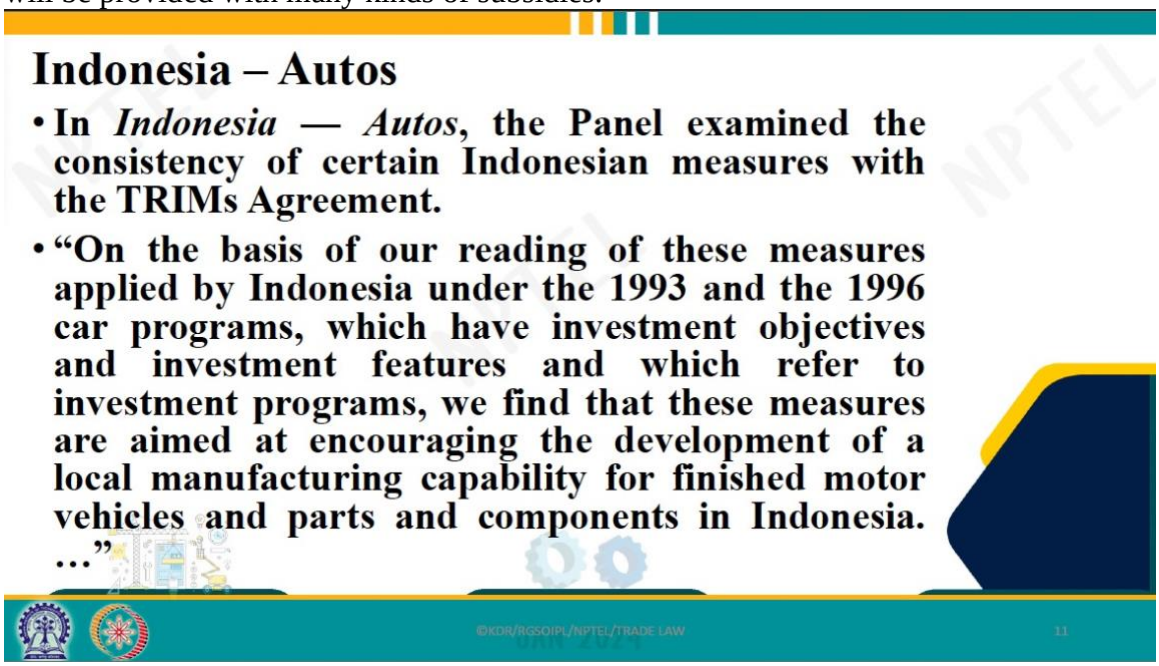
So, here you can see that in most foreign countries, we saw the origin of the TRIMS Agreement. Most of the foreign countries who want protection for their foreign direct investment in other countries, they enforce, they always try to enforce their rights if the other country, the host country, is violating any of the TRIMS provisions.

And so far, you can see around 45 disputes came to the WTO dispute settlement until 2022. So, there is a sizable number of disputes, and the TRIMS Agreement is now one of the fast-growing disputed areas that is a contentious area. This means that more and more countries are going for foreign direct investment, and so the number of disputes is also increasing. One point in time was 1995, when the WTO Agreement came into force, many countries were forced to eliminate trade-related investment measures. So, there was an increase in the number of cases during that time, and now, slowly, again, it is picking up, the number of disputes.



We will also examine some of these important cases from the TRIMS Agreement and one of the first such cases was the Indonesian automotive sector case. So, here, the Indonesian automotive car policy requires the manufacturer to have local conduct. So,

sourcing some of the parts from the local manufacturers and also lowering sales tax and subsidy issues were also involved. Definitely, the local market and local manufacturers will be provided with many kinds of subsidies.



But now, under the WTO, if you provide a subsidy to the domestic producer, you have to give it to the foreigner as well. That means the people who are coming to your country for investment have to be provided with that subsidy as well. There is no discrimination between foreigners and nationals: the national treatment principle one of the cardinal principle of WTO. So, in the Indonesian autos case, the panel very clearly said that and I quote "On the basis of our reading of these measures applied by Indonesia under the 1993 and 1996 car programs, which have investment objectives and investment features and which refers to investment programs we find that these measures are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components in Indonesia…." So, the panel very clearly said that the Indonesian automotive policy was against the WTO-TRIMS Agreement.

Panel

- "[I]f these measures are local content requirements, they would necessarily be 'trade–related' because such requirements,
- by definition, always favour the use of domestic products over imported products,
- and therefore affect trade…. they are inconsistent with Article III:4 and thus in violation of Article 2.1 of the TRIMs Agreement."

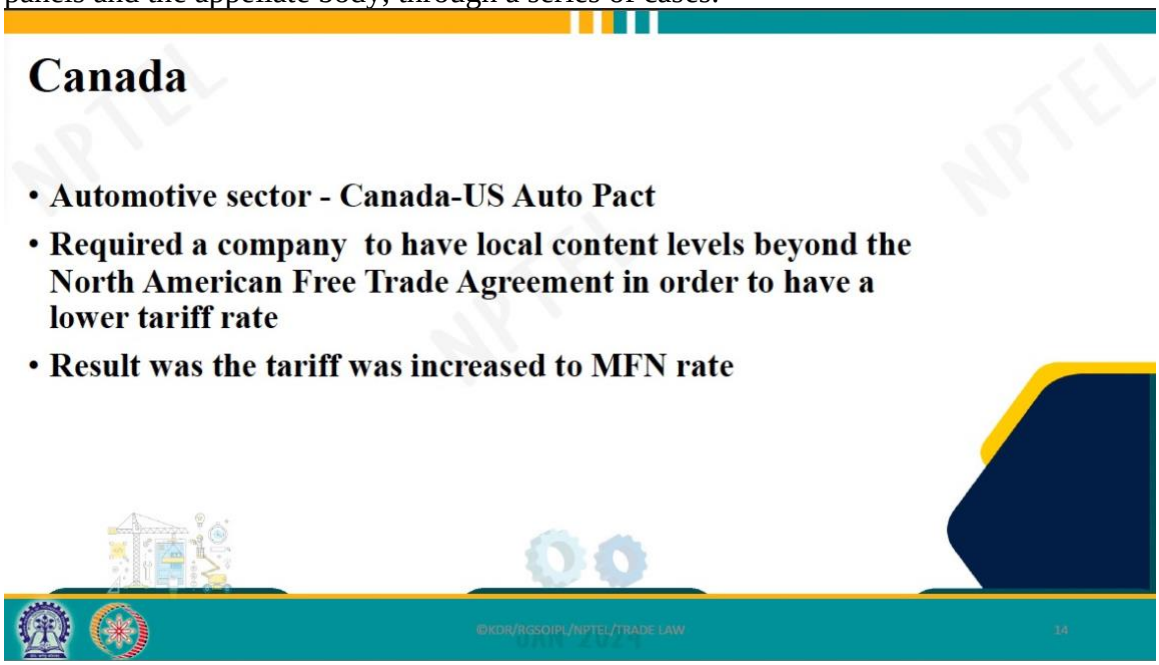
So, these local content, of course, the only question decided was whether this local content requirement was trade related. So, here, the local content requirement: the sourcing parts of a car from the domestic market itself is nothing but local content, and they also provided subsidies to domestic manufacturers. So, the panel said that this is inconsistent with Article 3.4, national treatment principle and in violation of Article 2.1 of the TRIMS Agreement. So, it is not only inconsistent with Article 3.4 of the GATT but also in violation of Article 2.1 of the TRIMS Agreement.

EC – Bananas III

- The Panel in *EC — Bananas III* found that the allocation of import licenses to a particular category of operators was inconsistent with Article III:4 of GATT 1994.
- With respect to the claim that this measure was also inconsistent with Article 2 of the TRIMs Agreement, the Panel, further to noting that the TRIMs Agreement essentially interprets and clarifies the provisions of Article III where trade-related investment measures are concerned

So, similarly, you can see some more cases as well as the *EC-Bananas III* case. So, here the question was with regard to the license. So, everybody knows that before 1995, the license Raj system was implemented in most countries, including India. So, with the advent of the WTO in 1995, the license Raj system was abolished. So, here, the

unreasonable license measures were held to be inconsistent with Articles 3.4 and Article 2 of the TRIMS Agreement. So, it is very clear under that the WTO regime, you cannot put unreasonable restrictions on trade. And this is reiterated by the dispute settlement panels and the appellate body, through a series of cases.



So, we saw the Indonesia automotive case, a similar case, you can find is the Canada automotive sector case. So, the dispute was between the US and Canada. So, here also Canada has made it clear that it is a local content. So, here is the NAFTA Agreement, the North American Free Trade Agreement, one of the largest regional trade Agreements between the US and Canada. So, the local content requirement imposed by Canada was held to be in violation of a regional trade agreement. So, you cannot put the local content requirement neither under the WTO Agreement nor under the regional trade Agreements. So, the panel very clearly said that this is also against the regional trade Agreement as well.

India Automotive Sector Dispute

PARTIES		AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainants	United States European Communities	GATT Arts. III, XI and XVIII:B DSU Art. 19.1	Establishment of Panel	27 July 2000 (US), 17 November 2000 (EC)
			Circulation of Panel Report	21 December 2001
Respondent	India		Circulation of AB Report[2]	19 March 2002
			Adoption	5 April 2002

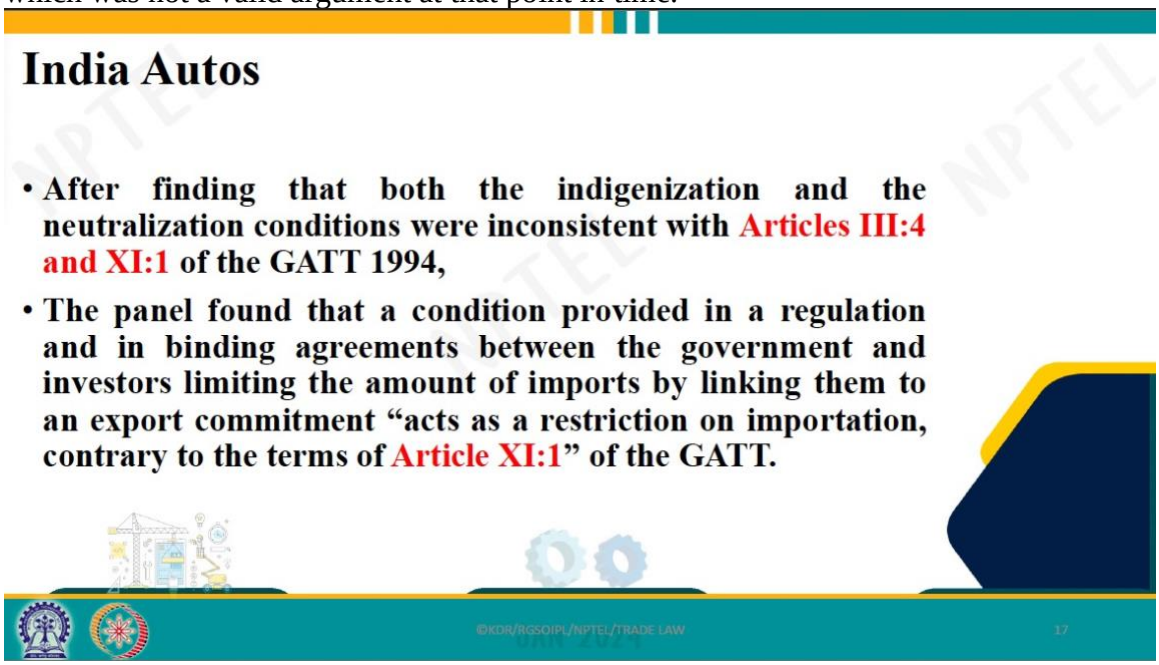
Now, we come to the automotive sector. So, in the automotive sector, India's automotive case is similar to the Indonesian case. So, we know that there were only a few brands in India, or I would say that only one brand was the *Ambassador*, which was operating in India since independence and till the opening up of the *Maruti* manufacturing centre in India. So, they had the monopoly. So, here, the complainants were the United States and the European Union, which alleged that India was in violation of GATT Article 3, Article 11 and Article 18b, in the year 2000 itself. The complaint was over by 2002, the reports were issued.

The Case

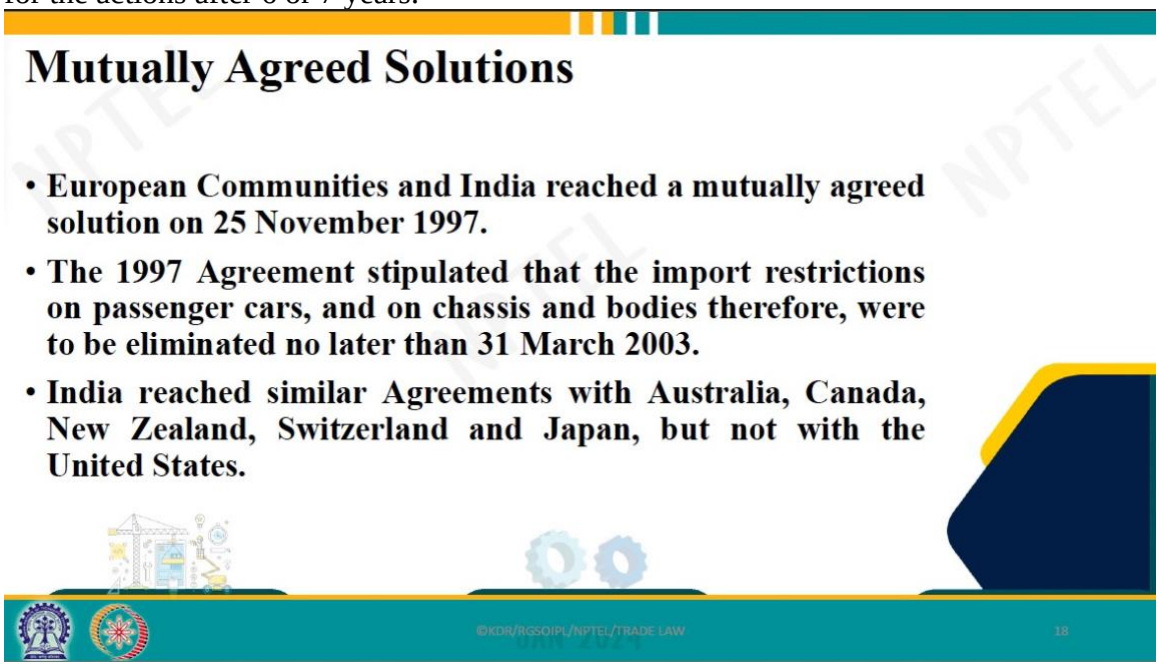
- **1998 United States (WT/DS175/4) requested the Dispute Settlement Body to establish a panel.**
- **European Communities (WT/DS146/4) also requested the DSB to establish a panel against Indian measures on automotive sector restrictions.**
- **India maintained number of restrictions on balance of payment grounds.**

And what was this case? You can see that. So, the panel was established in both the cases the US complaint as well as the EC complaint. So, the main complaint of these countries was that India maintained, at that point of time, a number of restrictions, and the

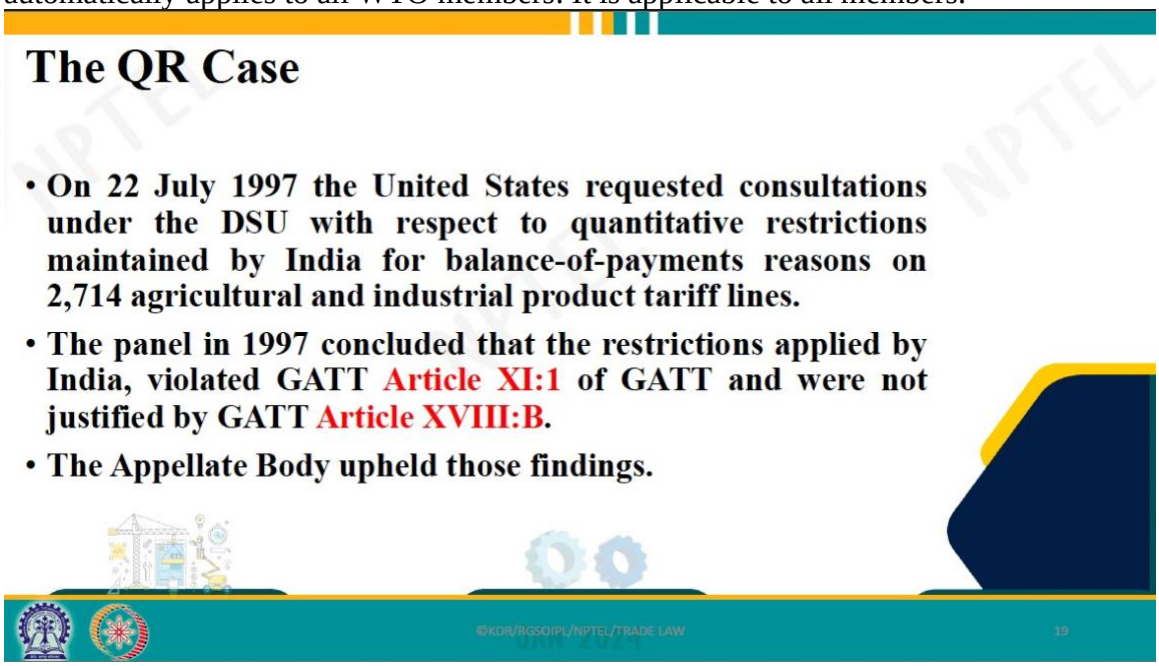
justification from India was that India faced a balance of payment problem in 1991. But you see that actually, India faced this balance of problem in 1991, but the cases were filed in 1998, but still, they were taking shelter under the 1991 balance of payment problems, which was not a valid argument at that point in time.



So, here, in this case, also, the panel very clearly found that these have nothing to do with the balance of payment problems and the Indian measures; restrictions on importation are contrary to Article 11.1: quantitative restrictions, Article 3.4: national treatment violation. So, you cannot take shelter under the old balance of payment problem, which happened in 1991, and you cannot blame the balance of payment problem, which happened in 1991 for the actions after 6 or 7 years.



So, finally, after a prolonged litigation between the countries, India has agreed to remove the restrictions with regard to passenger car manufacturing in India and ended into similar Agreements with other countries like Australia, Canada, New Zealand, Switzerland, Japan but India refused to enter into an Agreement with the United States. So, whether the US is signing or not, once India implements a single policy in India, it automatically applies to all WTO members. It is applicable to all members.



So India lost the automotive case in a panel and appellate body. And another case wherein India was a party was India QR case and here also India QR case is a quantitative restrictions case. So, mainly the agriculture Agreement was under question. So, India imposed quantitative restrictions on imports of agricultural goods and products and imposed restrictions again based on the 1991 balance of payment problems. Here also, a similar judgment was issued by the panel, and the appellate body confirmed it. So, the Indian measures were in violation of Article 11.1: quantitative restrictions and Article 18.B as well. So, it was not justified under Article 18.B which is the balance of payment exceptions exceptions. So, it was not justified again. India lost the QR case, also.

Indian Barriers

- According to the QR decision, India was required to eliminate the current system of non-automatic licenses for imports of passenger cars, and chassis and bodies therefore, no later than 1 April 2001.
- On 12 December 1997, the Indian Ministry of Commerce adopted Public Notice No. 60, the auto components licensing policy, issued under the Foreign Trade (Development and Regulation) Act of 1992

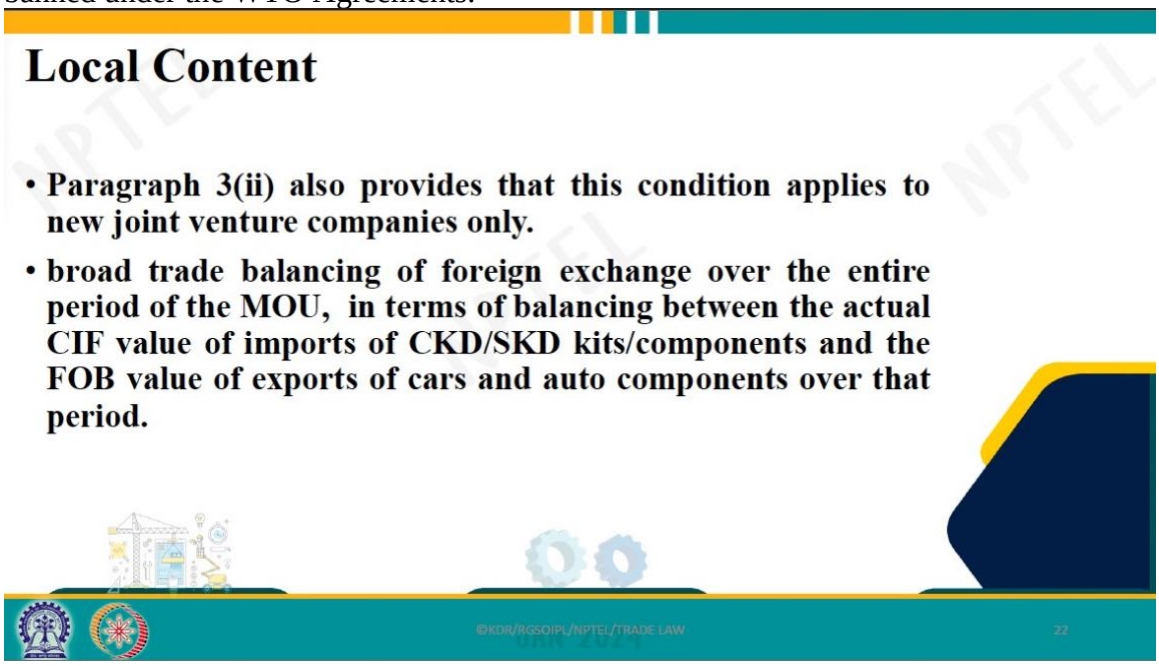
So, if you look into the Indian barriers to international trade after 26, 27 years also, India maintains barriers. I would say that India maintains barriers. So, even though India agreed to the WTO in 1995 when they signed the WTO Agreement that we would eliminate all barriers, including quantitative restrictions, including license raj system, and other barriers, many times India was questioned before the panel and appellate body. So, here you can see that India issued the auto component licensing policy in 1997. So, this policy will be applicable to every country, every WTO member country, irrespective of whether they are operating in India or not operating in India.

Barriers

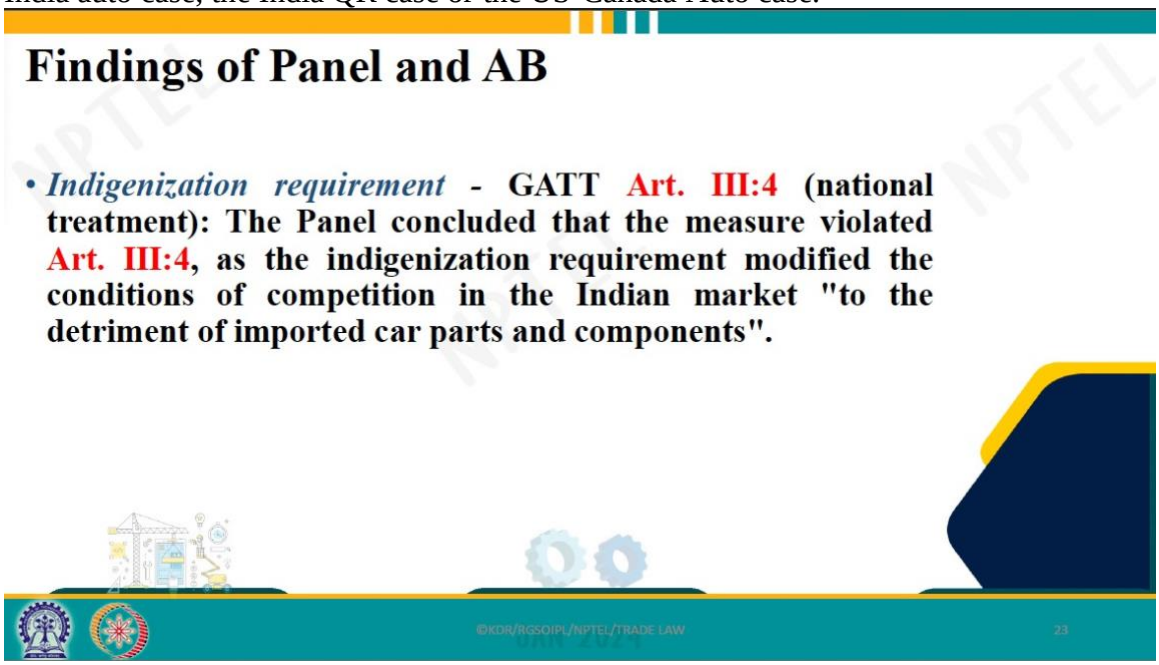
- Establishment of actual production facilities for manufacture of cars, and not for mere assembly.
- A minimum of foreign equity of US$50 million to be brought in by the foreign partner within the first three years of the start of operations, if the firm is a joint venture that involves majority foreign equity ownership.
- Indigenization (i.e. local content) of components up to a minimum level of 50% in the third year or earlier from the date of first import consignment of CKD/SKD kits/components, and 70% in the fifth year or earlier.

So, barriers sometimes become a great barrier to import or trade with other countries. So, whether it is imposed by Canada or India, it has the same effect. And also, indigenization policy is actually known as the local content. So, I always argue that, for example, now

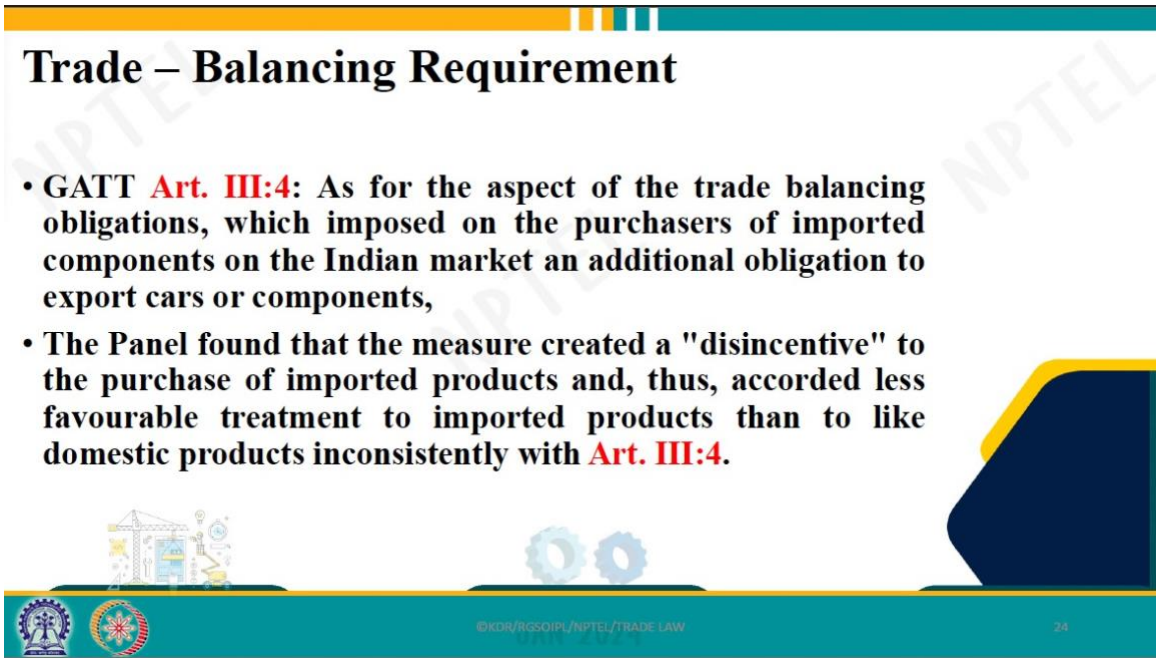
Indian Industrial policy guidelines say that Make In India program. I always argued that the Make In India program violates the TRIMS Agreement, the provisions of the TRIMS Agreement. So, by the Make in India program you insist that the manufacturers manufacture the product in your country, this is nothing but a violation of Article 2.1 of the TRIMS Agreement. This is nothing, but indigenisation, compulsion to indigenise. This is nothing but a local content requirement. So, the local content requirement is banned under the WTO Agreements.



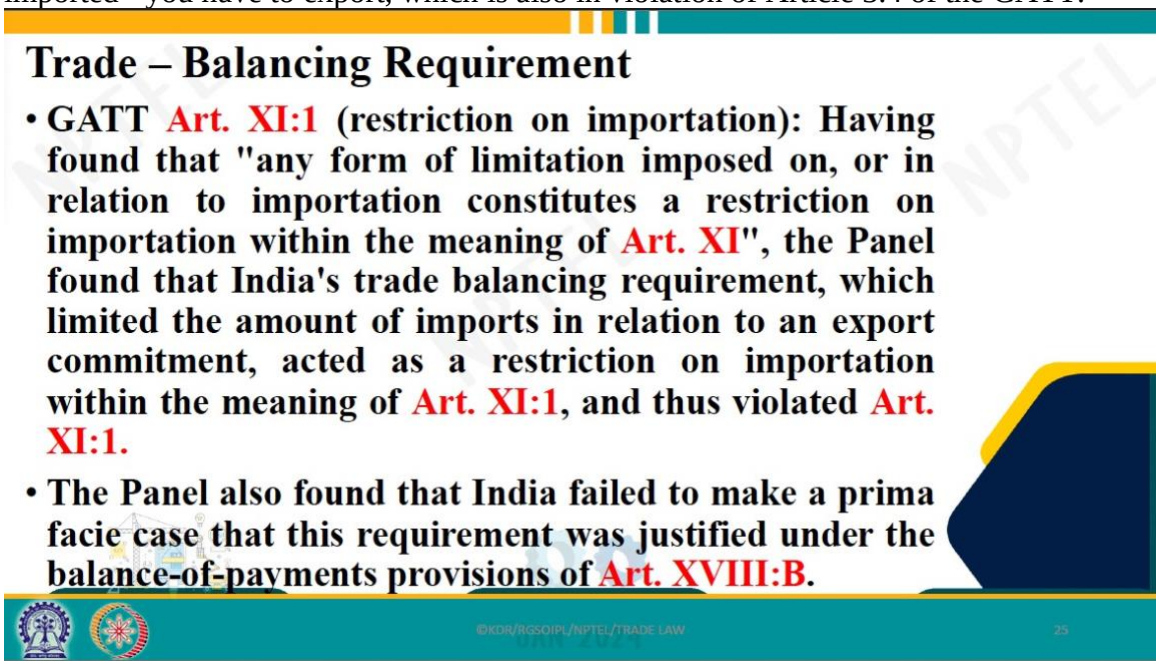
So, now, we see that there are a lot of cases, whether it is the Indonesia auto case, the India auto case, the India QR case or the US-Canada Auto case.



So, we can see that the panel and appellate body have many times very clearly held that the indigenisation requirement is against the GATT provisions and the TRIMS provisions as well.

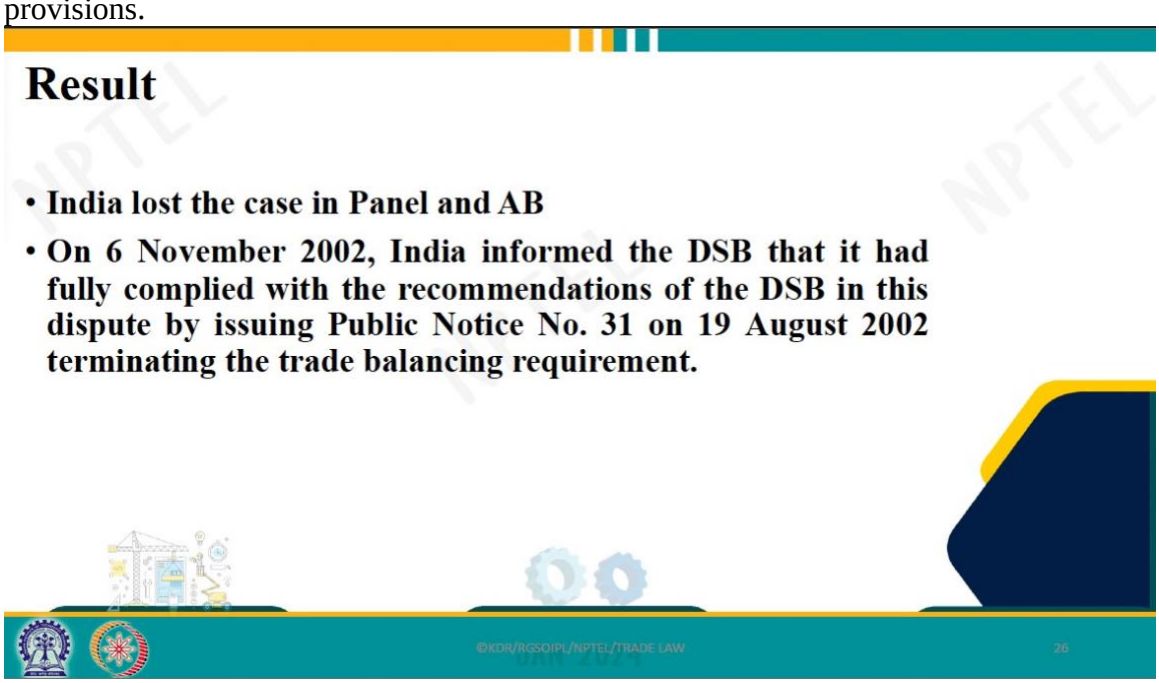


And trade balancing requirements: that export equals the import. So, whatever you export, an equal amount you should be importing, and vice versa: the value or the volume imported - you have to export, which is also in violation of Article 3.4 of the GATT.

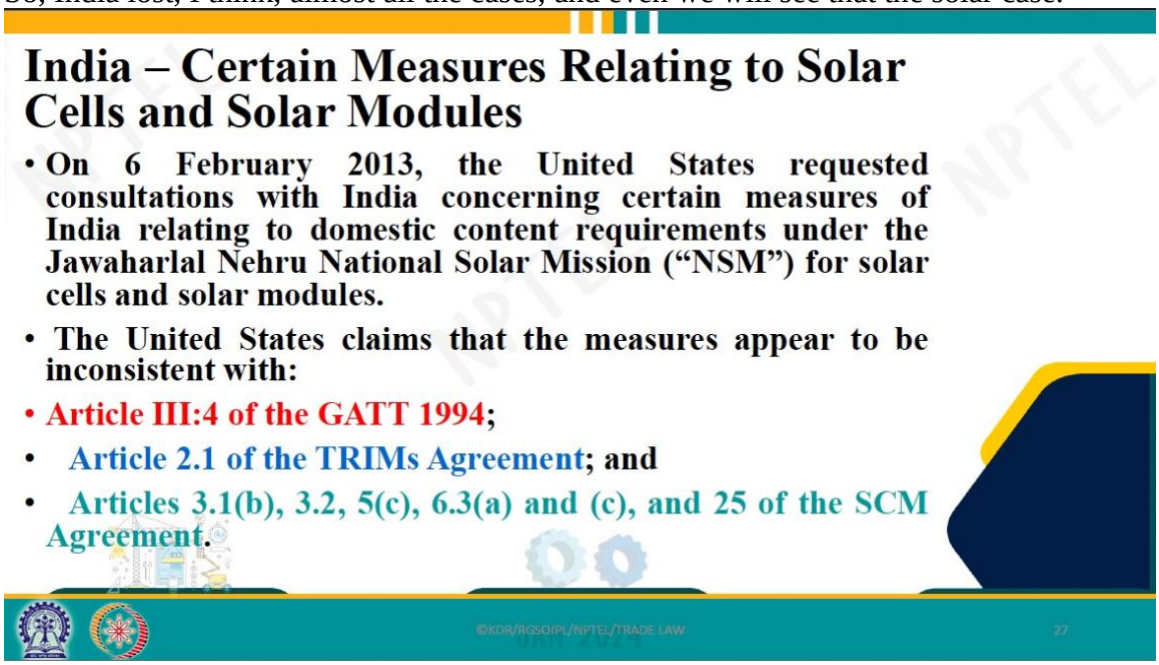


And trade balancing requirements, as I told you, are export restrictions on importation. Basically, this is nothing, but because every country feels more foreign direct investment will flow outwards rather than inwards. So, they were compelled to impose this particular restriction, and under Article 11.1, there is a restriction on such practices. So, if you put any kind of restrictions like a balancing requirement, it is in violation of Article 11.1 of

the GATT Agreement. So, India, prima facie, failed to prove that it will come under these measures under the exemptions under Article 18.B, which is the balance of payment provisions.

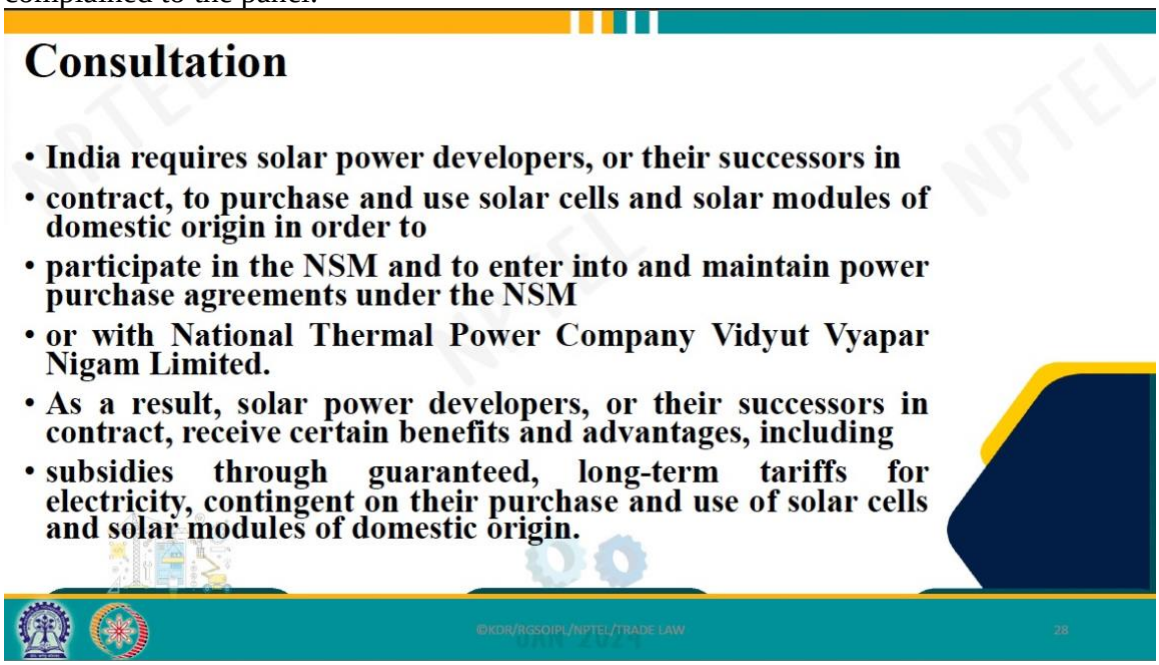


So, India lost, I think, almost all the cases, and even we will see that the solar case.

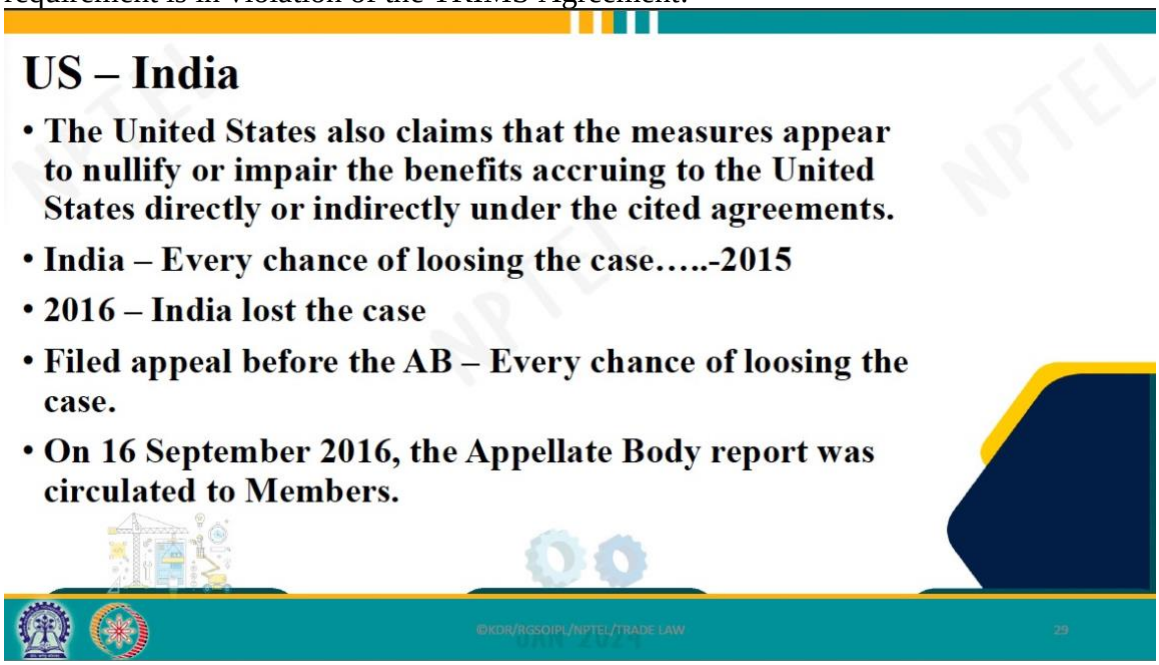


The solar case is nothing, but in India there is a solar program which is run by the government of India under the name of Jawaharlal Nehru National Solar Mission(NSM). And here, so everybody knows that people get some kind of subsidy for availing of this particular program. To avail of those particular subsidies, you have to source certain products locally. So, you cannot completely use the imported products. So, the US complained to the WTO dispute settlement system that this violates Article 2.1 of the TRIMS Agreement and other provisions because here it is a subsidised product. So,

Article 3.1(b), Article 3.2, 5(c), 6.3(a) and 6.3(c) and Article 25 of subsidies and countervailing measures(SCM) as well the violation of two Agreements. One is the TRIMS Agreement, and the other one is the Subsidies Agreement. So, the US complained to the panel.

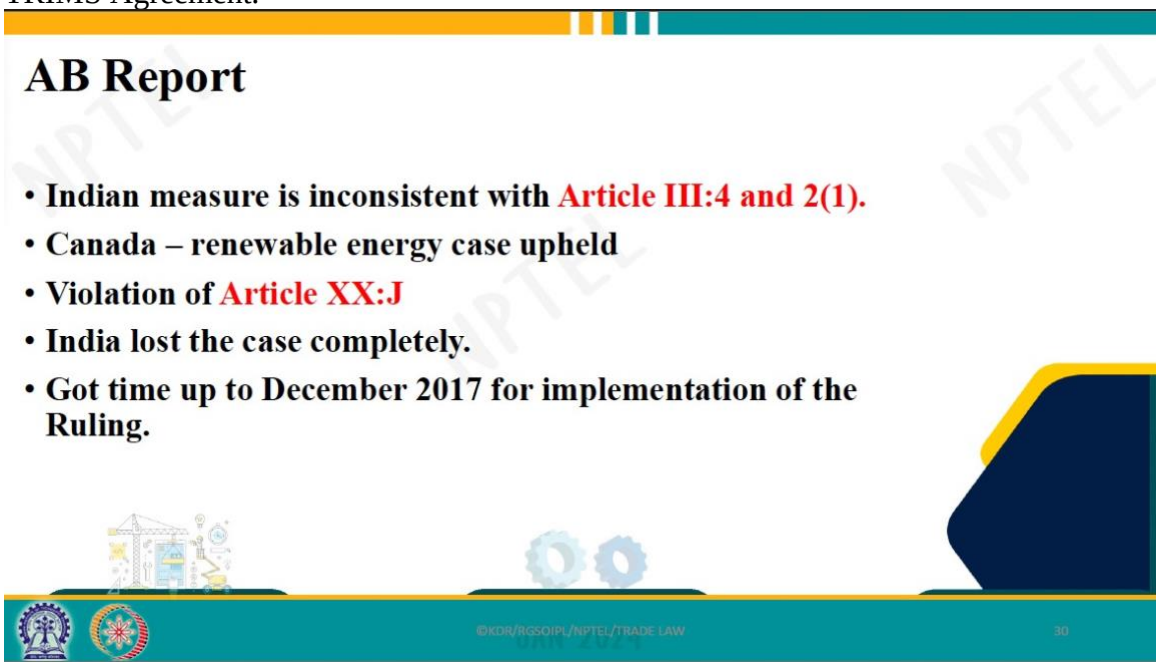


And India argued that, there is a power purchase agreement, and there are a lot of conditions to participate in this particular program and the solar modules. So, for the solar modules and equipment developers, they had to sign an Agreement, and the company. They said that this kind of Agreement insisting on localised products or the local content requirement is in violation of the TRIMS Agreement.

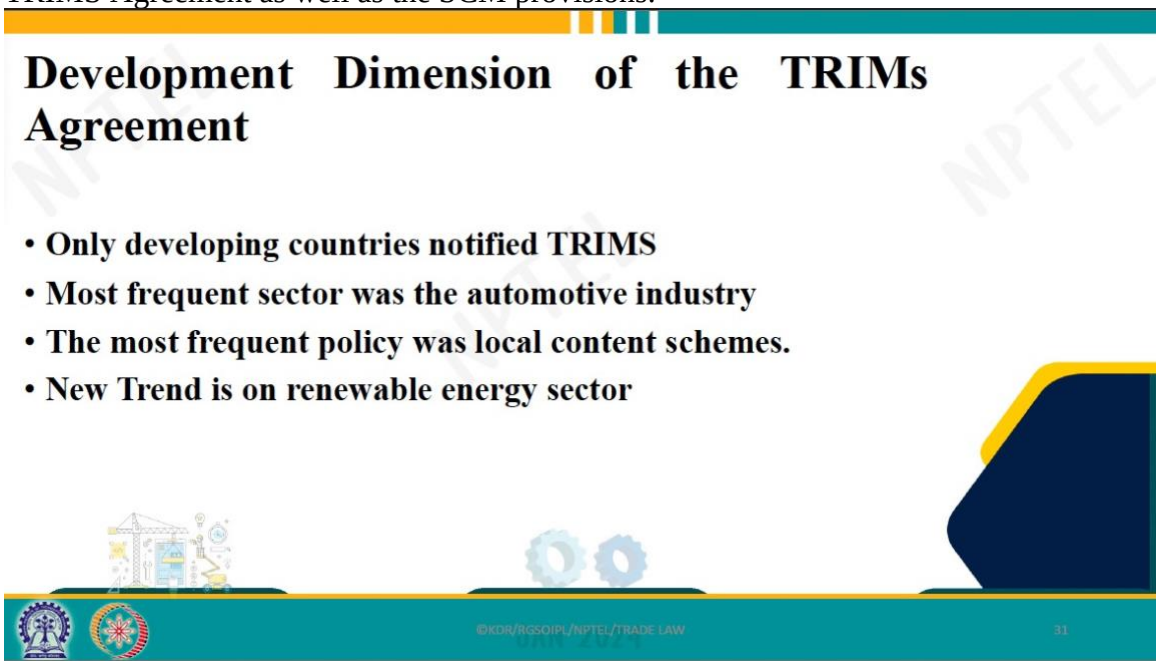


And the subsidies provided to companies, only those who comply with such conditions, again violate the SCM Agreement as well as the Subsidies and Countervailing Measures

Agreement as well. So, this is the case. So I had predicted that from the very beginning, India would lose this particular case because India did not have any arguments, and India lost the case in 2016 and appealed. In appeal also, India went on appeal to the appellate body, India lost the appeal as well because there is no point in appealing and because the law, the jurisprudence is very clear local content requirement is in violation of the TRIMS Agreement.

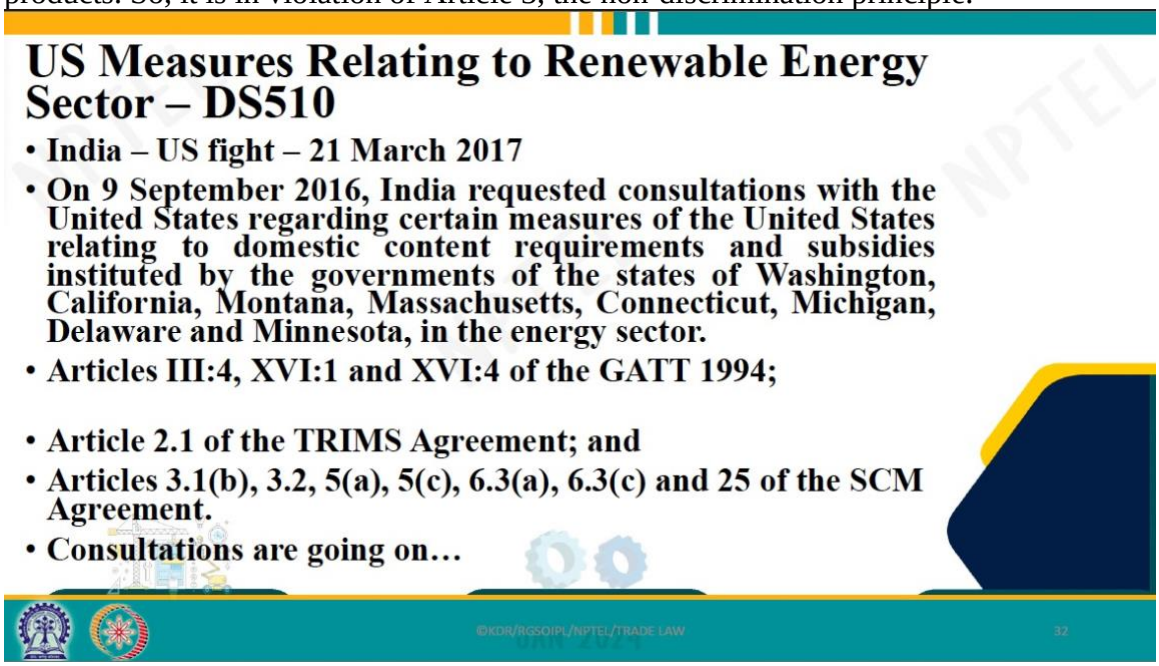


So, the Appellate Body (AB) report has mentioned the Indonesia case, the Canada case and other earlier cases and asked India to be in conformity with the provisions of the TRIMS Agreement as well as the SCM provisions.



And so you can see that, as I told you, the TRIMS, the trade-related investment measures, cannot be used as a tool or barrier in order to stop imports. So, the local content

requirement should not be used as a protectionist measure in the renewable energy sector. Everybody knows that the technology is with the developed countries, good technology is with the developed countries and we also import large quantities of renewable energy, solar panels from China as well. So, if the quality is very high, then the prices are going to be up. If it is not subsidised then the people are going to purchase only the subsidised products. So, it is in violation of Article 3, the non-discrimination principle.



So, what happened? So, in the renewable energy sector, India filed another case against the US on the same point in 2017. When we lost the earlier case, we immediately filed a case against the US, and not surprisingly, India found that the US also adopted the same policies and they are giving subsidised products through programs in the states of Washington, California, Montana, Massachusetts, Connecticut, Michigan, Delaware and Minnesota. So, these states are providing subsidies in the solar program, and India filed a dispute in the WTO alleging violations of Article 3.4, Article 16.1, Article 16.4 and other provisions of the Subsidies Agreement and Article 2.1 of the TRIMS provisions. So, after losing the first case, we filed the same case against the US.

Panel

- The Panel found that all of the measures at issue are inconsistent with Article III:4 of the GATT 1994 because they provide an advantage for the use of domestic products, which amounts to less favourable treatment for like imported products.
- On 15 August 2019, the United States notified the DSB of its decision to appeal to the Appellate Body certain issues of law and legal interpretations in the panel report. On 20 August 2019, India notified the DSB of its decision to cross-appeal.

And we got a judgment from the panel, a similar decision from the panel, and the appeal is pending before the appellate body because there is no appellate body presently to decide the appeal, but what happened? Nothing happened. So, the US got a judgment against India, and India got a judgment against the US. So, sometimes, the dispute settlement is a double-edged sword. So, if you file against me, I can file against you, and both the countries got the judgment.

Conclusion

- TRIMs Agreement applies to trade in goods, wherein, adequate measures under GATT, 1994 to prohibit the investment that are inconsistent with local content, trade balancing and export restrictions.
- It is also observed that consultations on implementation and S&D issues are still going-on.

And now both the countries are talking to each other to resolve the problem. So, the WTO dispute settlement system is very strong. So, every country has to comply with this. So, the TRIMS Agreement is the one area where the number of disputes is increasing day by day, and the reason is many countries are going to other countries for foreign direct investment, and India is one of the countries getting the largest foreign direct investment

in recent times. So, this Agreement is important for India, and it is also very important to remove all trade-related investment measures and all barriers to trade within India. So, more and more foreign direct investment will flow to India, which will help the Indian economy to grow very fast. So, I always argue that India is a protectionist country, and if you go ahead with giving more and more incentives to the domestic industry, it is not going to be competitive and that theory has proved to be correct immediately after the independence, whatever policies we followed since independence to 1991. So, our economy is fast growing only after the opening up of our markets, and not when it was a closed economy. So, going back to a closed economy is not a good idea, and that is bad for the Indian economy in the future. So, in conclusion, I would say that we should expect more number of TRIMS cases in the future, and we have to see, in order to avoid this, we have to remove all trade-related investment measures from India. So that the Indian economy can grow very fast. With this, I stop here about the TRIMS Agreement.
Thank you.