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## Agenda item 5. Economic development of under-developed countries and financing of economic development

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## DOCUMENT E/3492

## The promotion of the international flow of private capital: further report by the Secretary-General

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## Foreword

1. The present further report on the promotion of the international flow of private capital has been prepared in pursuance of Economic and Social Council resolution 762(XXIX) of 21 April 1960. It continues the discussion of measures for the promotion of the international flow of private capital begun in the progress report presented to the Council at its twenty-ninth session<sup>1</sup> in accordance with General Assembly resolution 1318(XIII) of 10 December 1958. The progress report sought to present an over-all review of major aspects of the problem, on the basis of an initial round of consultations with government officials and private bankers and industrialists.

2. In accordance with the express language of resolution 762(XXIX), these consultations have been continued. They were formalized in a questionnaire (reproduced as annex I) which was sent to member governments as well as to specialized agencies and "appropriate inter-governmental and non-governmental sources". The first part of this questionnaire related to "measures to facilitate the adjustment of disputes related to private investments", to which special reference had been made in the Council's resolution. This subject is discussed within the framework of the problem of the

protection of foreign investments (chapter III, section 2). The replies received to the second part of the questionnaire provided information on a number of investment incentive measures recently adopted or currently under consideration in capital-supplying and capital-receiving countries which are discussed in chapter II (see also annexes II and III).

3. In the course of the consultations, special interest was shown, apart from the points already mentioned, in the contributions which foreign enterprises could make to the stimulation of industrial development not only in terms of investment capital, but also in supplying technological know-how and training to domestic private and public enterprises. A special technical report on these new forms and techniques of co-operation between foreign and domestic enterprises in under-developed countries appears as chapter I.

4. In its resolution 1523(XIV) of 15 December 1960 on international credit insurance, the General Assembly requested the Secretary-General, when preparing his report on the promotion of the international flow of private capital, to examine the question of the feasibility of extending existing national credit insurance institutions, and of creating new national or international institutions for this purpose. This subject is discussed in chapter III, section 1.

<sup>1</sup> See *The Promotion of the International Flow of Private Capital* (progress report by the Secretary-General), E/3325.

## Summary

5. As indicated in the reports on the international flow of private capital<sup>2</sup> there has been a considerable rise in the international flow of private capital during the last few years. Most of this investment is in the form of foreign-owned or controlled branches and subsidiaries.

6. In countries where little or no domestic industrial enterprise exists, the foreign investor may be welcomed as a primary source of capital and management for new enterprises. As industrialization progresses, however, the problems of the relative position of the foreign private *entrepreneurs* and domestic private and public enterprises may require special attention.

7. Special facilities open to foreign investors have led to uneasiness about competition between local and foreign capital. A prime factor has been the exchange treatment of foreign capital imported in the form of equipment, where similar imports by local industry not financed from abroad are severely restricted or subject to heavy surcharges or tariffs. The relatively easy access of foreign capital to cheap sources of finance abroad is also a source of conflict, as is the ability of a foreign enterprise to obtain in many instances its local working capital on better terms than domestic

enterprises, owing to the assumed superior efficiency of the foreign enterprise.

8. Various ways can and have been found to deal with these problems. The exchange difficulties are likely to become of less importance as emergency measures adopted by under-developed countries to deal with their balance-of-payments difficulties are replaced by more permanent ones to deal with their monetary and exchange problems. The International Bank for Reconstruction and Development has taken the initiative in establishing development banks in the under-developed countries to serve as channels for the flow of financial assistance to private enterprise, and international institutions and other public and private lending institutions in the developed countries are extending an increasing volume of foreign currency loans to under-developed countries via such development banks and corporations. Within the United Nations, however, attention has recently been drawn to the need to ensure a larger flow of long-term, low-interest development loans to the under-developed countries.<sup>3</sup>

<sup>2</sup> See *The International Flow of Private Capital, 1956-1958* (United Nations publication, Sales No. 59.II.D.2), and document E/3313 below.

<sup>3</sup> See General Assembly resolution 1524(XV) of 15 December 1960. See also the conclusions of the consultant group recently set up by the Economic Commission for Latin America and the Organization of American States, in *Foreign Private Investment in the Latin-American Free Trade Area* (United Nations publication, Sales No. 60.II.G.5), especially chapter I, section 6.

9. At the same time, the development of effective working relationships between foreign and domestic enterprises is reflected in an increasing trend towards investment through joint ventures—i.e., the establishment of enterprises in which both local and foreign participants hold an equity interest.<sup>4</sup> Corporations in developed countries, while mostly still preferring ownership or majority control of their foreign operations, are increasingly adapting themselves to smaller ownership shares.<sup>5</sup> On the other hand, rigid rules inhibiting foreign majority control have been relaxed, in practice if not formally, by some under-developed countries.

10. From the point of view of the governments of under-developed countries, their demonstrated ability to subject the foreign private investor to national laws has no doubt been as important as their desire to secure the latter's contribution to the development of government-sponsored enterprises. From the point of view of the foreign investor, the attractions of securing the political benefits and familiarity with domestic markets, labour conditions, etc., which result from co-operation with local enterprise are increasingly evident. Local *entrepreneurs*, in turn, gain needed access to foreign capital and technical know-how by association with foreign enterprises instead of being placed in unequal competition with them. Such association is eased as similar "entrepreneurial" attitudes develop between the partners in such matters as the rate of reinvestment of profits, or the standards for selecting managerial staff.

11. Governments of under-developed countries and domestic private enterprises have not, of course, regarded joint ventures as unmixed blessings in all cases. Concern has been shown about the amount of scarce local risk capital which may be absorbed in this way, and in some countries there is a preference for the gradual transfer of part or all of the equity of enterprises initially established entirely with foreign capital to local ownership, over enterprises established as joint ventures from the outset.

12. On the other hand, shortages in international liquidity, which affect both private and public capital flows, greatly add to the desirability of promoting the transfer of know-how for the development of import-substituting and export-expanding industries, which is not tied to foreign capital investments.

13. Thus, governments and private investors in capital-supplying and capital-receiving countries are showing increasing interest in the transfer of technical and managerial skills by means of various contractual arrangements. These arrangements for the supply of know-how, which include licence agreements, technical services agreements, engineering and construction contracts, management contracts and agreements for the exploitation of mineral resources, may accompany and complement an investment of equity capital by the know-how-supplying enterprise or they may be made without such investment. They can be varied to meet a broad range of business and non-business needs and objectives on the part of know-how-supplying and know-how-receiving enterprises. An increase in the use of these particularly flexible devices could expand substantially the potential contribution of private enterprises in developed countries to the promotion of both private and public industry in less developed countries.

14. Contractual agreements with enterprises in under-developed countries for the supply of technical or managerial services are frequently negotiated in connexion with loans, often granted for the purchase of equipment. Such an arrangement may be in the interest of a know-how-supplying enterprise which is primarily concerned with increasing its export sales, and may also have the advantage of extending the range of sources of finance open to the recipient enterprise. A combination of know-how and loan capital confers on the capital-importing country most of the benefits of direct investment, yet it obviates one of the more frequently raised objections to direct private investment in the under-developed countries, namely, the persistence of foreign ownership or control beyond the period when local capital is ready to take over the direction of foreign initiated enterprises.<sup>6</sup>

15. These contractual arrangements under which technical or managerial know-how can be secured without according its supplier any ownership interest in the receiving enterprise have a particular utility in connexion with ventures involving collaboration between private enterprises from one or more foreign countries and enterprises owned by local nationals or by public authorities in under-developed countries. An interesting example is the Furnas hydro-electric project in Brazil, where two foreign private firms have entered into partnership with the governments of two Brazilian states. Financial aid has been provided by an agency of the Brazilian Federal Government and by the IBRD. In this way, it has been possible to obtain the collaboration of foreign private enterprise in a sector which would otherwise be closed to it, the development which nevertheless requires more resources and specialized know-how than governments, even with the help of

<sup>4</sup> See document E/3325, paras. 84-94, for an examination of some of the main features of joint ventures. See also *Joint International Business Ventures*, Friedmann and Kalmanoff, Eds. (Columbia University Press, 1961).

<sup>5</sup> Data on the percentage of United States ownership and date of establishment of foreign business enterprises are of interest in this connexion. Just over one-half of the 600 enterprises in which United States interests owned less than 50 per cent of the equity were established between 1951 and 1957, while only 40 per cent of the enterprises that are 50-100 per cent United States-owned were established during the same period (United States Department of Commerce, *U.S. Business Investments in Foreign Countries*, 1960, p. 102). Information on investments in "associated foreign enterprises", in which the United States equity interest is between 10 and 25 per cent, was made available for the first time in the same report, with the indication that such investments are likely to be of increasing significance.

<sup>6</sup> A recent Mexican law seeks to accelerate the shift of the largely foreign-owned mining industry to domestic control through tax rebates for complying companies, and the refusal of new concessions and the ultimate termination of existing concessions for non-complying enterprises. It is significant that the objective is not exclusive domestic ownership, but merely effective domestic control through ownership of at least 51 per cent of the equity.

public finance from abroad, could easily find. The foreign firms, in turn, are able to sell their know-how without incurring any capital risk.

16. As local industry in under-developed countries expands its ability to absorb foreign know-how under such contractual arrangements, interest in their varied potentialities is likely to spread. It may, therefore, be appropriate to devote continued attention to the study of the nature and uses of these arrangements.

17. The attitude of developing countries toward foreign private investors tends to become more favourable, as progress in industrial development widens the fields in which foreign capital can become operative, alone or in co-operation with domestic—private or public—enterprise. Especially where economic development programmes attribute a substantial role to such foreign investment, governments become interested in measures which will attract the attention of foreign enterprises to the investment potentialities thus opened to them and facilitate their making their contribution to the achievement of the development objectives.

18. In this connexion, governments of capital-receiving countries are opening investment centres both at home and in the major capital-supplying countries in order not only to provide information on domestic conditions, laws and regulations, but increasingly in order to bring to the attention of potential foreign investors specific areas or projects in which foreign capital and know-how are required and desired.

19. Economic overhead facilities, including specifically industrial estates,<sup>7</sup> and supplementary finance are made available by many governments in order to reduce the financing burdens and increase the operating efficiency of promising ventures. Here international financial institutions, most recently the Inter-American Development Bank, are available to provide loan capital, directly or through national development banks or similar institutions, for private investment projects.

20. Most of the industrialized countries also provide insurance for medium- and long-term equipment loans (five to ten years, sometimes for longer periods) through modifications and extensions of their existing facilities for export credit guarantee insurance. However, these schemes are specifically designed to promote national exports, and therefore cannot serve the needs of under-developed countries for untied credits that can be used for purchases in any country. There is therefore wide-spread interest in the feasibility of establishing an international credit insurance scheme. The creation of such a scheme would require broad agreement on complex problems of rates, coverage, etc., and would also raise the problem of the provision of the underlying credits. A first approach to these problems may be through bilateral and regional schemes, as indicated by the interest in this subject shown both within the European Common Market and the Economic Commission for Europe.

21. Tax concessions continue to be widely offered as relief and incentive measures both by capital-receiving and capital-supplying countries. In some of the latter, recent balance-of-payments difficulties have led to a narrowing-down of such tax concessions to foreign investments in under-developed countries, while denying them to operations in developed countries, thus greatly increasing their incentive value for the former.

22. The barrier to foreign investment which is perhaps the most difficult to overcome is that raised by the investor's apprehension of non-business risks. This is not a matter which can be defined in concrete terms. It resides chiefly in the estimate by individual investors of the future attitude of governments towards foreign capital. Here again, the existence of a development programme, setting out the role allotted to foreign private capital within the framework of long-range economic, and in particular industrial, development, may go far towards alleviating many of the foreign investor's uncertainties regarding his position vis-à-vis the domestic private and public industrial sectors. In addition, the development of a framework of modern commercial, financial and administrative laws and institutions within which industry can operate efficiently and securely can greatly enhance the attractiveness of investment projects by reducing the area in which business risks and potentialities are not amenable to advance calculation.

23. As regards the more specific risks of a political nature, many governments have proffered assurances, either unilaterally or through bilateral treaties, designed to reduce the likelihood of expropriation or of lesser impairments of investors' rights and to assure them of an adequate recourse if such impairment should occur. Foremost among the former are investment insurance schemes which are at present available for investors from the United States, Japan and the Federal Republic of Germany. While their possible adoption is currently being discussed in several other capital-supplying countries, their present geographical coverage remains so limited that a number of schemes for the establishment of an international guarantee fund possibly tied in with the IBRD have been put forward by public and private agencies.

24. Numerous proposals have also been made to negotiate multilateral investment charters, on a regional or world-wide basis, which would codify the basic guarantees under which foreign private investments could operate. Yet the obvious difficulties, not only of achieving broad agreement to a single set of meaningful rules but of securing treaty commitment to these rules by many governments, have so far prevented the implementation of any such proposal.

25. A more flexible approach has therefore been put forward which would avoid the problem of agreeing on a uniform set of substantive rules, and would instead provide an international forum before which the investor and the government could seek adjustment of disputes that might arise between them. Such a forum could provide facilities for conciliation as well as arbitration, in order to offer full opportunities for negotiated settlements before disputes are handed over for outside

<sup>7</sup> For a recent study of this subject, see *The Establishment of Industrial Estates in Under-developed Countries* (United Nations publication, Sales No. 60.11 B.4).

decision. Numerous proposals for the organization of such machinery have been formulated by intergovernmental and non-governmental organizations and are currently under discussion.

26. The inquiry undertaken by the Secretary-General on this question in pursuance of the underlying resolution has confirmed a widespread interest on the part of governments and private circles in examining the possibilities of such a recourse either to existing arbitral bodies, such as the Permanent Court of Arbitration, or to new facilities which could be made generally available, possibly under the aegis of the United Nations, without the need for the conclusion of a special multilateral treaty.

27. Evidently the time is not ready for final action in this field. What appears to be desired at this point is a systematic and co-ordinated study of the many pro-

posals put forward; an analysis of the technical problems involved; and an authoritative survey of the receptivity to the various possible solutions on the part of the various governments concerned.

28. For this task the United Nations appears to be widely considered as an appropriate forum. On the basis of the results of such a study, it may then be possible to consider an approach to the setting-up of facilities for conciliation and arbitration, at first perhaps simply by the composition of a panel of experts, to which parties could have free access as and when they wished. As the arrangement proved itself, it could be formalized and elaborated by those governments which wished to do so, as regards both the organization of the arbitration and conciliation facilities and the inclusion of advance commitments to their utilization in investment contracts, law and treaties.

## CHAPTER I

### Contractual devices for the channelling of technical and managerial know-how from enterprises in industrialized countries into enterprises in under-developed countries<sup>a</sup>

#### 1. INTRODUCTION

29. The industrialization drive in the under-developed countries, though primarily dependent on the mobilization of domestic resources, requires external contributions not only in investment capital, but also in advanced technological and managerial know-how. While traditionally both these factors have been supplied together through the establishment of local operations by foreign enterprises, increasing interest has developed in the possibilities of securing the know-how developed in the industrialized countries without necessarily according a major financial participation to the foreign enterprise furnishing the know-how. These possibilities are of interest as much to the latter enterprise, where it is not able or willing to add to its know-how contribution a financial investment which would give it a substantial or controlling equity participation, as to governments and *entrepreneurs* in under-developed countries who may be politically desirous and financially able to promote new industries without foreign equity control or even participation.

30. The purpose of the present report is to examine in a preliminary way some of the contractual devices which often play a key role in channelling managerial and technical know-how into the development of enterprises in the under-developed countries either in

conjunction with or independently of an equity investment.<sup>b</sup>

A greater understanding of these devices and the part they are capable of playing in stimulating industrial development is the necessary first stage of any comprehensive study of measures which may be adopted to promote and facilitate their use.

31. The categories of contractual arrangements for the flow of know-how to be discussed in this report include the following:

(a) *Technical services agreements*, under which technical information and services of technical personnel are made available by an enterprise in a developed country to an affiliated or independent enterprise in an under-developed country;

(b) *License agreements*, under which, typically, a know-how-supplying enterprise, the licensor, grants to a know-how-receiving enterprise, the licensee, certain rights to make use of patents, trademarks and/or unpatented inventions, processes and techniques in connexion with the manufacture and sale of products by the licensee in specified areas;

(c) *Engineering and construction agreements*, under which technical and managerial know-how relating to the design and construction of facilities required by an enterprise in an under-developed country is made available to it by an enterprise located abroad;

<sup>a</sup> The present chapter has been prepared by Professor Richard C. Pugh of Columbia University School of Law, acting as a consultant to the fiscal and financial branch of the Department of Economic and Social Affairs.

Professor Jack N. Behrman, of the University of Delaware, also acting as a consultant to the Secretariat, contributed materials used in the preparation of section 3 of this chapter.

<sup>b</sup> A considerable role in the transfer of such know-how is of course played by bilateral and multilateral technical assistance programmes, as well as by national and international development institutions. For a discussion of technological and managerial know-how provided under the United Nations technical assistance programme, see *Official Records of the Economic and Social Council, Thirty-second Session, Annexes, agenda item 11, document E/3474, paras. 55-71.*

(d) *Management contracts*, under which operational control of an enterprise (or one phase of an enterprise) which would otherwise be exercised by the board of directors or managers named by its owners is vested in an independent or affiliated foreign enterprise;

(e) *Contracts for the exploitation of mineral resources* between foreign enterprises and the governments of under-developed countries or their instrumentalities, under which the foreign enterprise makes available the know-how (and often the capital as well) required to carry out all or certain aspects of a programme for the exploration and development of local mineral resources.

32. While division of these contractual devices into categories under labels such as these is dictated by analytical requirements, it is essential to an understanding of the flexibility of these arrangements to emphasize that this division is, to some extent, an arbitrary one and that in practice it is impossible to draw hard-and-fast lines between these categories.

33. In fact, there is a spreading gamut of contractual devices which are almost infinitely flexible and which can be adapted with a high degree of efficiency to widely diverse circumstances. A particular agreement under which managerial or technical know-how is transferred may, and in many cases will, involve elements found in more than one of the categories here delineated for discussion purposes.

34. Thus, for example, it is common for a single agreement between a firm in an industrialized country and an independent or affiliated enterprise in an under-developed country to provide for the licensing of patents and other industrial property rights together with the furnishing of technical services in connexion with the installation of the necessary plant, the supervision of the manufacturing process, and the marketing of the manufactured product. Agreements covering the engineering, design and construction of manufacturing facilities also often provide for the furnishing of managerial services. A single agreement or a series of agreements may provide for the supervision and control over construction and equipping of a plant; the granting of patent, know-how and trademark licences; the supplying of related technical assistance; and the management of the know-how-receiving enterprise by the know-how-supplying enterprise under a management contract.

#### A. *Know-how contracts as alternatives to equity investment*

35. While it is probably correct to say that, in a majority of cases, contractual devices under which managerial and technical know-how is made available accompany and play a significant role in facilitating an investment of equity capital by the supplying enterprise in the receiving enterprise, often they have a special utility and importance because they serve independently of and as an alternative to such investment. Through these contractual arrangements, it is possible to achieve a flow of know-how to enterprises in under-developed areas in cases in which the know-how-receiving enterprise may be unwilling or unable

to accept foreign ownership or in which the know-how-supplying enterprise may be unwilling or unable to make an investment of equity capital.

36. From the point of view of the receiving enterprise, the use of contractual devices which permit tapping the know-how resources of a foreign enterprise without surrendering to it an ownership interest plays an important role in connexion with the establishment and operation of enterprises in sectors which are reserved to public ownership or ownership by local nationals. Thus, for example, such enterprises, through a licence and technical services agreement, can gain access to needed manufacturing processes and technical information, or, through a management contract, can obtain the services of skilled managerial personnel without violating the principle of local ownership and voting control. These contracts for the supply of know-how may be adopted in conjunction with loans from the know-how-supplying enterprise or other foreign sources with the result that know-how and capital are obtained from abroad but ownership is retained in local public or private hands. Similarly, the use of these devices may be important in cases in which the equity of the know-how-receiving enterprise is held by local investors or by local financing institutions which do not desire, or which lack the entrepreneurial talent and technical skills required, to manage the enterprise.

37. From the point of view of the supplier of know-how, a licensing arrangement is often the only alternative open to an enterprise which desires to develop or protect a market for its products in an under-developed area, but which lacks the capital or personnel required to make a direct investment in local manufacturing facilities. Through a licence and technical services agreement granting to a local enterprise the necessary rights to manufacture and sell and providing for the supply of technicians when needed, the know-how-supplying enterprise can gain its objectives without a substantial investment of capital or personnel.

38. The management contract may also be highly useful to a know-how-supplying enterprise in this context as, in the usual case, it permits a participation in the gross or net profits of the receiving enterprise without any investment of risk capital. Such a participation may also be provided for in the case of the technical services or the licence agreement, but in the case of the management contract, the know-how-supplying enterprise has the advantage of a significant degree of control over the management of the receiving enterprise, and is therefore in a much stronger position to influence enterprise profits than if it were supplying know-how under the typical services or licence agreement.

39. In a considerable number of under-developed countries, the use of contractual arrangements which divorce managerial control or the supplying of technical know-how from ownership have been particularly significant in satisfying political and economic needs in industries in which there is strong opposition to foreign domination.

40. Perhaps the best example is afforded by the mineral exploitation area, in which, as a result of popu-

lar sentiment against foreign domination, a growing number of under-developed countries have enacted legislation providing that all mineral deposits are the property of the State and that only the State, usually through a government-owned agency, may engage in exploitation. Because of the lack of local capital and know-how, however, there is in most cases no alternative open to the local government which desires to develop local mineral resources except to draw on the capital, managerial and marketing know-how of large foreign enterprises. Accordingly, the *modus vivendi* which has been developed by these governments has been to permit the governmental agency charged with the responsibility for exploitation of minerals to enter into contractual arrangements under which foreign mineral enterprises undertake to supply the capital and know-how required for a programme of mineral exploration and development in return for a participation with the local government in production or profits. In substance these arrangements often do not differ greatly from the traditional concession agreement. There is, however, one key difference — under these contractual arrangements, unlike the traditional concession agreement, ownership of the minerals extracted and the right of exploitation are reserved by the local government. This difference is of great practical importance, as it enables the local government to draw on foreign capital and know-how without conflicting with legislative requirements and popular sentiment in favour of local ownership and control over exploitation.

#### B. Contractual devices as concomitants of equity investment

41. Contractual arrangements for the supplying of know-how are commonly used in conjunction with an investment of risk capital by the supplying enterprise in the receiving enterprise, and these arrangements can have a significant role in facilitating the flow of such capital investment.

42. The considerations which tend to encourage the adoption of know-how agreements tend to differ depending upon whether the supplying enterprise holds a controlling or a non-controlling interest in the equity of the receiving enterprise. Most of the differences result from the fact that, although where the know-how-supplying enterprise enjoys voting control there tends to be an identity of interests between the supplying and the receiving enterprise, where the supplying enterprise is in a non-controlling position the interests and objectives of supplier and recipient of know-how are often divergent.

##### 1. Use when foreign enterprise holds controlling interest in local enterprise

43. There are a number of considerations which may favour the use of one or more contractual devices as the formal mechanism through which managerial or technical know-how is made available to an enterprise in whose equity the supplying foreign enterprise is to own a controlling interest.

44. For example, the supplying enterprise will often elect to make its patents and trademarks available to the new enterprise by means of a licence rather than by outright assignment, in order to gain greater protection against loss of control over such patents and trademarks in the event that it should lose control over the local enterprise, possibly as a result of its bankruptcy, seizure during hostilities, or a sale of the controlling equity to local interests.

45. A technical services agreement may be used because it offers an alternative to making technical personnel available to an enterprise in an under-developed country on a full-time basis. When the supplying enterprise cannot spare technicians full-time from its other operations and when the receiving enterprise needs such personnel only for limited periods, a technical services agreement under which the foreign enterprise makes available technical personnel only when needed by the receiving enterprise may provide maximum flexibility at least cost from the point of view of both parties.

46. Engineering and construction contracts are often employed because the foreign company which has established and which controls the local enterprise lacks the special skills required to design and build the facilities required, and must draw on the know-how of engineering and construction firms in one or more of the industrialized countries.

47. In cases in which a foreign enterprise owns all or a majority of the equity of an enterprise in an under-developed country, there may also be exchange control or tax factors which create an incentive to the utilization of one or more contractual arrangements for the supply of know-how. In cases in which local balance-of-payments deficits necessitate the imposition of restrictions on the amount of profits which can be remitted to the foreign shareholder as dividends, it may be that governmental approval for the remittance of fees for essential technical or managerial services or royalties for essential patent rights can be obtained with relative ease.

48. The tax incentives to the use of such contractual devices as licence agreements, technical services agreements and management contracts centre on the fact that licence royalties and fees for technical and managerial services are, as a general rule (provided they are reasonable in amount), deductible in determining the net income of the receiving enterprise subject to local corporate income taxes. Accordingly, to the extent that funds can be paid to a shareholder company in the form of royalties or fees rather than dividends, the local corporation corporate income tax may be avoided.<sup>10</sup>

<sup>10</sup> Such royalties or fees may be subject to income taxes withheld at the source in the under-developed country, but such taxes often are lower than the corporate income taxes and would often be imposed in any case as an additional tax upon remitted dividends. Furthermore, if there is a treaty for the avoidance of double taxation between the country in which the supplying enterprise is located and the country of the receiving enterprise, the effect of such treaty will often be to exempt the royalties or fees from the income taxes which would otherwise be withheld at the source provided the licensor has no permanent establishment in the source country.

49. The possible tax consequences of these contractual devices point up the fact that there may be a significant divergence of interest between, on the one hand, the foreign enterprise supplying know-how to, and controlling the operations of, the receiving enterprise and, on the other hand, the government of the capital-receiving country, which will normally act as the defender of the interests of any local minority shareholders as well as of its own direct interests. The local government will, through its appropriate screening body, object to any arrangement calling for the payment of unreasonably high fees or royalties which would have the effect of bleeding off as deductible expenses what would otherwise be profits subject to local taxes and available for distribution to local shareholders. Similarly, the local government will decline to give its approval to a contractual arrangement under which royalties or fees in foreign currency may be so large as to constitute an unwarranted burden on local foreign exchange resources and may insist that some or all of the payments be made in local currency or blocked foreign currency.

## 2. *Use when foreign enterprise holds a non-controlling interest in local enterprise*

50. Many of the considerations just discussed are also present where the know-how-supplying enterprise owns less than a controlling interest in the voting equity of the receiving enterprise. Here, however, there is more likely to be a divergence between the objectives of the enterprise.

51. For example, the know-how-supplying enterprise may wish to obtain a return on its investment in the know-how supplied regardless of the profits of the receiving enterprise, by making patents and know-how available to the receiving enterprise under a licence agreement which will provide for payment of substantial royalties geared to the latter's production or sales. Local participants owning 50 per cent or more of the equity, however, may be reluctant to have the enterprise incur royalty charges geared to the production or sales, rather than the net profits, of the receiving enterprise. On the other hand, in certain circumstances where the know-how-supplying enterprise seeks to obtain additional equity in consideration for its supplying patents or know-how, the know-how-receiving enterprise may prefer to pay royalties and fees under a licence or technical services agreement to the know-how-supplying enterprise rather than to pay for needed patent rights and know-how by granting to that enterprise a greater portion of equity and thus a greater participation in profits.

52. The management contract is often a particularly useful device where the local enterprise is in need of managerial assistance from a foreign enterprise which owns a minority of the voting equity. Through this device, day-to-day management over all or one phase of the enterprise may be vested in a foreign enterprise which has the necessary know-how without vesting ultimate voting control in the know-how-supplying enterprise.

53. Thus, where there are multiple participants, local and foreign, in a venture in which no participant enjoys voting control, the management contract may be a useful device for vesting clear control over the day-to-day management of the enterprise in one of the participants qualified to fulfil this function. Similarly, in a venture in which 50 per cent of the equity is owned by the know-how-supplying enterprise and 50 per cent by an investor or investors in the under-developed country, it may be desired to vest managerial control in the former through a management contract. Other devices, such as issuing two classes of shares, one class of shares having a single vote and the other class multiple votes, are available to grant voting control to a know-how-supplying enterprise which owns 50 per cent or less of the equity of the receiving enterprise, but the management contract is often preferred by local investors for the very reason that a specified degree of managerial control may be granted to the foreign manager without the necessity of surrendering the voting control held by local shareholders over the board of directors.

## C. *Role in training of local personnel*

54. One highly important feature of the contractual devices discussed in this report is the fact that in nearly every case provision is made for the training of local personnel in the technical or managerial skills called for under the agreement concerned. Thus, these contractual devices do much more than provide a means of access to reservoirs of experience and skills accumulated by foreign enterprises; they make possible the development of such reservoirs locally through the training afforded to an ever-growing number of local personnel in all phases of production, marketing and business administration.

55. The licence agreement and the technical services agreement typically provide for the training of local personnel by personnel of the know-how-supplying enterprise on the premises of the receiving enterprise and often at the plants of the supplying enterprise as well. The training normally covers the technical aspects of production and in many cases will provide for training of local personnel in various phases of marketing.

56. In engineering and construction contracts, heavy emphasis is often placed on the maximum utilization and training of local personnel. Excellent examples are afforded by the contractual arrangements relating to the design and construction of the three steel mills in India, one involving the supply of know-how from the Soviet Union, one from the Federal Republic of Germany, and one from the United Kingdom. In each case extensive provision was made for training of Indian personnel at the site and in the USSR, the Federal Republic of Germany and the United Kingdom.

57. Management contracts and mineral exploitation agreements also generally call for extensive training of local personnel and their utilization in positions of responsibility to the extent possible. In some cases, a management contract arrangement will be adopted only

for a limited period, with the thought that foreign managerial control will be dispensed with as soon as the local personnel have acquired sufficient knowledge and experience to be in a position to assume full managerial responsibility; even in the case of relatively long-term management contracts, there is a marked tendency to maximize the training of local personnel for key positions and to use them in such positions as early as possible. Through the training made available under a management contract, local personnel can become skilled in all aspects of running an effective business organization, including personnel administration, finance, advertising and all phases of marketing. Such personnel will not only rapidly acquire the skills required to occupy positions of responsibility in the enterprise concerned, but they will, as they gain experience, add to the reservoir of local entrepreneurial talent which can be drawn on to organize and manage other new and unrelated enterprises.

*D. Degree of influence exercised by know-how-supplying enterprises over managerial policies of know-how-receiving enterprises*

58. When an enterprise in an industrialized country supplies needed technical or managerial know-how to an enterprise in an under-developed country, the former, if it does not own a majority of the latter's voting equity, will generally seek to protect, and maximize the return on, its know-how by obtaining some degree of influence or control over the managerial policies of the receiving enterprise. Even if the supplying enterprise owns all or a majority of the equity, it will often seek to gain some contractual controls over the recipient enterprise as a means of securing protection should the latter at a later date dispose of its controlling interest to local interests or to others.

59. The receiving enterprise, if not controlled by the supplying firm, will normally seek to minimize the degree to which the supplying enterprise may influence or direct its managerial policies, although in some cases, for example, an enterprise owned by local investors having no interest in management, the receiving enterprise may be eager to surrender wide managerial functions to the foreign manager.

60. In a particular case the control relationships ultimately adopted will, of course, reflect the objectives and the relative bargaining positions of the parties. There are, however, some definite patterns of control arrangements which are commonly encountered in the contractual devices under discussion, and one of the major respects in which the categories of devices selected for discussion are distinguishable from each other is the degree to which, generally speaking, the party supplying the know-how is empowered under the terms of the agreement to exercise control or influence over the management of the recipient enterprise.

61. The terms of a particular contractual arrangement, however, do not necessarily, or even most frequently, tell the whole story. The problem of control exists on two levels, the formal and the practical. The controls provided as a formal matter in the agreement between

supplier and recipient of know-how may, but often do not, reflect the degree to which, as a practical matter, the supplier is in a position to influence or control the management of the receiving enterprise.

62. Of the devices discussed, the technical services agreement generally provides for the smallest degree of formal control by the supplier over the managerial policies of the recipient. On the practical side, however, some measure of influence over the management of the receiving enterprise almost necessarily follows from the fact that the technical services supplied are highly important to the recipient, and advice given by the supplier's technical personnel bearing on managerial decisions of the recipient will seldom be disregarded.

63. The licence agreement involves a considerable number of controls over the licensee's management, most of which are in the form of various sanctions which are brought to bear in the event that the licensee fails to utilize the licensed rights effectively or fails to fulfil other obligations imposed by the licence agreement. In some cases, limited positive controls are retained by the licensor—for example, the right to fix the licensee's prices. Where the licence grants rights to a process and a continuing flow of know-how with respect to improvements which are essential to the licensee's operations and where the licence agreement is terminable by the licensor, it is apparent that the licensor may, on the practical level, enjoy a very considerable influence over the management of the licensee.

64. In many engineering and construction contracts, the supplier of know-how is granted broad control and final decisional authority with respect to the design, construction and equipping of the facility. This control may be limited to the period of actual construction, but more commonly it will also extend at least to an initial period during which local personnel can be trained. In many cases, the foreign enterprise selected to supervise the engineering and construction will maintain a continuing relationship with the receiving enterprise as a supplier of technical and managerial know-how, and perhaps of capital as well.

65. Under the management contract, broad managerial control over all or certain phases of operations is often vested in the know-how-supplying enterprise on a semi-permanent basis. The degree of control varies from contract to contract. There is generally some sharing of managerial control between the know-how-supplying firm, which is the manager, and the directors or other representatives of the owners of the equity of the receiving enterprise.

66. The mineral exploitation agreement generally involves a grant to the know-how-supplying enterprise of broad managerial control over exploration and development operations on a relatively long-term basis. The party in the under-developed country benefiting from the foreign know-how—in most cases the local government or one of its instrumentalities—often owns the minerals removed and is ultimately responsible for all mineral exploitation, but retains little direct control over day-to-day management. The underlying

law or contract, however, typically provides a highly detailed framework of rights and duties within which the foreign company must operate under the watchful eye of the responsible government agency.

67. It is important to visualize clearly the control implications of these know-how arrangements, which exist quite independently from the controls normally associated with equity participation. Even where the foreign enterprise has no, or no decisive, capital participation, it may, through one or more of these arrangements, still exercise a substantial measure of control over the operations of the local enterprise. Thus, whatever objections may be felt to exist in the political and economic fields to foreign control over domestic enterprises are not wholly eliminated where a domestic majority is secured in the equity capital of the enterprise, but where foreign technical or managerial know-how is acquired under a contractual arrangement. Often, however, the desire of the parties or the requirements of local law or policy that a venture be identified as a "local enterprise" will be satisfied by local ownership of a controlling equity participation, while the know-how arrangement will serve as the device for reconciling this need for "localization" of the enterprise with the desire of the know-how-supplying enterprise (and often of the know-how-receiving enterprise as well) for a degree of control by the former over the latter's operations.

68. The controls over management of the receiving enterprise which are vested in the supplying enterprise under even the most far-reaching of these agreements, however, are distinguishable from the controls associated with a majority equity participation in at least three important respects. First, while the controls acquired by a supplying enterprise as a result of a controlling equity participation are a permanent feature of that participation, the controls provided in know-how agreements can be, and often are, set up to have a limited duration, perhaps to coincide with the period of time required to train local personnel to assume the technical and managerial responsibilities concerned. A second important difference is that, under these contractual arrangements for the supply of know-how, controls exercised by the supplying enterprise over the managerial policies of the recipient are limited in scope, and thus fall short of the virtually complete managerial control vested in the owners of the enterprise equity. Under the technical services agreement and the licence agreement, any controls exercised by the supplying over the receiving enterprise will usually be narrowly circumscribed and, even in management contracts, construction and engineering contracts and mineral exploitation agreements, in which broad managerial powers may be ceded by the receiving to the supplying enterprise, residual and ultimate powers of control rest with the board of directors or other representatives of the shareholders, who may at any time terminate the contractual arrangement, subject only to a possible liability for payment of damages to the supplying enterprise. A third difference between the controls associated with

provided for in a know-how contract is the high degree of flexibility afforded by the latter. The control mechanisms related to equity ownership, which are normally spelled out and regulated in detail by the applicable commercial law, are commonly quite inflexible and innovation is often discouraged by the applicable legal and administrative framework. Contractual arrangements for the supply of know-how are not so restricted and can, therefore, be individually fashioned to provide an allocation of managerial responsibility, in scope and duration, which will best suit the needs of the participants in the particular enterprise.

### Conclusion

69. Contractual arrangements for the supply of know-how by enterprises in industrialized countries have already proved in numerous cases to be highly effective means of channelling foreign managerial and technical skills into industrial enterprises in the developing countries. These arrangements have proved useful both in connexion with the acquisition by the supplying enterprise of a majority or minority participation in the equity of the receiving enterprise and independently of any such investment. In particular, these arrangements, under which the supply of know-how may be functionally and logically divorced from any ownership interest, may play an important role, both economically and politically, in helping to resolve the dilemma posed to the governments of many under-developed countries by the necessity for drawing on know-how and capital, which can in practice only be obtained from enterprises abroad, in order to establish local industries in areas of economic activity which are by law and public sentiment reserved to local ownership, public or private.

70. The categories of contractual arrangements discussed in the present report are by no means exhaustive. Rather, they have been selected with the objective of illustrating the remarkable flexibility of the devices which can be adopted to facilitate the flow of know-how into developing countries. We are not dealing with contractual arrangements which have become formalized in contents or use. These arrangements have thus far displayed a remarkable capacity to adapt to the myriad of complexities, permutations and special circumstances surrounding the founding of fledgling enterprises in under-developed areas. In this flexibility lies much of their promise for the future.

## 2. TECHNICAL SERVICES AGREEMENTS

### A. General considerations

71. Of the contractual devices for the transfer of technical know-how, the one which is most flexible and which has the widest range of utility is probably the technical services agreement. In the interest of simplifying analysis, the technical services agreement is treated as if it involved only the furnishing of technical services and data. It must be borne in mind, however, that in the great majority of cases agreements providing for technical services form part of broader arrangements.

For example, technical services are commonly called for in connexion with a sale or lease of machinery, a licence of patents or know-how, an engineering or construction agreement, and a management contract. Accordingly, there is in practice often a very considerable overlap between the technical services agreement and the other contractual devices examined in the present report.

72. The technical services agreement is utilized in every area of industrial activity. The types of services supplied and the purposes for which they are made available are almost limitless in their diversity. The services may be those of scientists, engineers, architects, production technicians, or market analysts, to name but a few. The purposes for which such services may be utilized cover all aspects of a business enterprise. Thus, a particular agreement may require the know-how-supplying enterprise to render technical services in connexion with the design and construction of plant and equipment; the purchase of raw materials, supplies and equipment; sales engineering, technical advertising and all other technical phases of marketing. The label "technical" services is used, but the range of the areas in which such services are utilized suggests the fact that such services are closely and often inextricably bound up with non-technical aspects of management and, accordingly, technical and managerial assistance are often part of a single know-how package made available to the recipient enterprise.

73. The extent to which technical services from a foreign enterprise may be necessary in various phases of an industrial operation established in an under-developed country will, of course, depend in considerable part upon the complexity of the manufacturing process involved. A plant for the manufacture of basic textiles should require far less initial and continuing technical assistance than a plant for the manufacture of electronics equipment. The extent of the need for technical assistance will also depend to a considerable degree upon whether the local economy has reached the stage of economic development which permits it to supply a substantial portion of the technical personnel required from its own labour resources. Even if there is an ample supply of well-trained technicians, however, the introduction of a new manufacturing process will inevitably require some technical assistance and training of local personnel by personnel of the enterprise which is supplying the patents or know-how with respect to the new process.

74. While a technical services agreement will often accompany an equity investment, it may be a particularly useful device for the drawing on the know-how resources of a firm having no equity participation in the receiving enterprise. Thus, the technical services agreement may be especially valuable in the case of an enterprise established in a sector which is reserved for ownership by the government or nationals of the under-developed country. An example is afforded by a technical services agreement entered into by a government-owned company in Colombia, *Empresa Colombiana de Petróleos*, formed to administer a petroleum concession

which, after operation for some thirty-two years by a foreign company, reverted in 1951 to the Colombian Government upon termination of the private concession. The agreement, executed with a Colombian subsidiary of the former concessionaire, provided for the supplying of technical personnel in return for reimbursement of the direct costs incurred plus a fixed percentage of those costs. Because the agreement afforded certain administrative powers to the know-how-supplying firm, this agreement also illustrates the common overlap between the technical services agreement and the management contract. Significantly, the agreement was terminated after three years by mutual agreement as a result of the receiving enterprise's ability to take over completely at that point.<sup>11</sup>

75. In addition, the technical services agreement may be useful to an enterprise in an under-developed country which has to draw on the technical services of a number of enterprises in one or more industrially developed countries. For example, a Mexican enterprise which manufactures textile machinery and home sewing machines and runs an iron and steel foundry was at one time party to three technical services agreements: one relating to manufacture of textile machinery with one Japanese company, another relating to sewing machine manufacture with another Japanese company and a third relating to the iron and steel operation with a United States company.<sup>12</sup>

76. While in some cases a technical services agreement will provide that the technical personnel will be supplied to the know-how-receiving enterprise as full-time employees for as long as they are needed, it is more common to find that the agreement provides for the furnishing for limited periods of technical personnel of the supplying enterprise whose employees they remain. Thus, in most cases, the supplying of technical personnel of an enterprise in an industrially developed country under such a contractual arrangement serves as an alternative to making such services available through employment of the personnel concerned by the receiving enterprise on a full-time basis. From the point of view of the supplying enterprise, technical personnel are often too valuable and are in too short supply to permit their becoming full-time employees of the receiving enterprise.

77. Furthermore, the need for services of such personnel on the part of the receiving enterprise can usually be met if such personnel are made available for relatively short periods, but on a flexible basis. The need for such technical services is, of course, particularly intensive during the beginning phase of a new project and while local personnel are being trained. In this situation, the needs of both parties can often best be met by a technical services agreement under which the receiving enterprise may call upon technical personnel of the supplying enterprise as and when there is a need for

<sup>11</sup> See Kalmanoff, *Country Studies No. 1, Joint International Business Ventures in Colombia*, 16-17 (New York, November 1957—not published), prepared for the Columbia University Project on Joint International Business Ventures.

<sup>12</sup> *Joint International Business Ventures*, Friedmann and Kalmanoff, Eds. (Columbia University Press, 1961), p. 319.

such services to solve particular problems. In this way, the supplying enterprise is enabled to make the maximum use of its technical personnel and the receiving enterprise is given access to technical assistance when it is most needed without having to bear the expense of paying the salaries of such technical personnel on a full-time basis.

78. There is the added advantage to the receiving enterprise that, since through the technical services agreement it has access to foreign technical personnel when needed, it can maximize the percentage of local nationals who are employed in positions of technical responsibility. This may be of special importance in certain under-developed countries in which legislation restricts to a small percentage of the total number of employees or to a small percentage of the total payroll the number of foreign employees who may be hired or the amount of the total payroll which may be paid to such employees. But, even in the absence of such legislation, there will normally be important benefits to both the know-how-supplying and know-how-receiving enterprises in staffing the local enterprise with as many local nationals as possible.

#### B. Contents of technical services agreements

79. *Scope of assistance.* The nature of the technical services to be supplied will be spelled out in varying degrees of detail in the agreements and may cover one or more of a wide range of different phases of an industrial operation, including the following:

- (a) Assistance in connexion with locating a site for a factory;
- (b) Assistance in connexion with the engineering and design of plant and equipment;
- (c) Assistance in connexion with the supervision of construction;
- (d) Advice and assistance with respect to the kind, type and best sources of supply for the purchase of raw materials, supplies and equipment. In some cases this assistance may take the form of having the supplying enterprise serve as an agent of the receiving enterprise in the purchase of raw materials, supplies and equipment;
- (e) Assistance in connexion with enlarging productive facilities;
- (f) Assistance relating to all phases of production;
- (g) Analysis by the supplying enterprise of products manufactured by the receiving enterprise;
- (h) Assistance in connexion with marketing analysis, sales engineering, technical aspects of advertising and all other phases of marketing;
- (i) Assistance in the form of the training of local personnel on the job and in the plants of the supplying enterprise.

80. The matter of the training of local personnel is of special importance. It is nearly always in the best interests of both parties to provide that the technical services concerned are to be supplied only to the extent that trained local personnel are unavailable and to make

provision in the agreement for the training of such personnel by the know-how-supplying enterprise. Thus, for example, the agreement between a west German firm and the automobile division of an Indian company provides that, during the period that adequately trained Indian personnel are not available, the German firm will, to the extent that it is able to do so, place at the disposal of the Indian company the required technical personnel who will train Indians in the technical aspects of production. The agreement also provides for the training in the German firm's plants of Indian trainees, to be compensated on the same basis as German trainees.<sup>13</sup>

81. *Payment.* The payment terms in technical services agreements differ considerably. Where the supplying enterprise has no equity in the receiving enterprise, it will often seek to have the agreement provide for a fee which will be geared in part to the production or sales or, alternatively, the net profits of the receiving enterprise. In this way, its compensation is linked to the increased earning power of the receiving enterprise, presumptively resulting from the assistance. The receiving enterprise may be reluctant to permit the know-how-supplying enterprise to participate in profits, but if the participation is modest it may be preferable to the payment of a substantial fee tied to production or sales, which burdens the cost structure and is payable even in the absence of profits. Often the formula adopted will provide for reimbursement to the supplying entity of its costs, plus a percentage of the net sales or a percentage of the net profits of the receiving enterprise.

82. When the supplying enterprise has an equity participation, it may be content with an arrangement under which it will be reimbursed for its costs, plus a fixed fee or a fee expressed as a percentage of those costs. In some cases, it will seek nothing beyond its costs and will rely for a participation in profits entirely on its rights as a shareholder. In other cases, there may be, as discussed above, tax or exchange control considerations which create an incentive towards maximizing the amount of the know-how-receiving enterprise's profits, which are drawn off by the supplying enterprise in the form of a fee for technical services. The appropriate local government screening body will, however, act to prevent abuses in the form of unreasonably high fees.

83. The technical services agreement will normally define rather carefully the ingredients of the fee. Where the arrangement is for compensation in the amount of cost plus a fee, cost may be defined as out-of-pocket expenditures incurred in furnishing the services and information plus a *pro rata* portion of the general overhead expenditures attributable to furnishing the services and data. In order to prevent exchange losses, the supplying enterprise will often insist that at least the cost portion of its compensation be repaid in the foreign currency in which such expenditures were made.

<sup>13</sup> *Joint International Business Ventures*, pp. 466-474.

When a percentage of net sales or net profits is also included, the supplying enterprise may also desire the agreement to provide protection against exchange losses with respect to this portion of the compensation, although it will be more inclined to accept the fixing of this portion in local currency than it would the costs incurred in foreign currency themselves.

84. *Influence over managerial policies of the receiving enterprise.* As a general rule, the pure technical services agreement will not vest in the supplying enterprise any significant controls, as a formal matter, over the managerial policies of the receiving enterprise. Where the arrangement provides simply for the furnishing of technical services on a basis of costs, plus a fixed fee or a stated percentage of those costs, the supplying enterprise will normally have no special interest in the management of the receiving enterprise or the extent to which it is profitable. Where the fee provides the supplying firm with a participation in the gross proceeds of sales or in net profits, the interest of the supplying enterprise in the managerial policies of the recipient is, of course, increased. Generally, however, in the situation the supplying enterprise will be satisfied with a minimum of formal controls over the management of the receiving enterprise aimed at ensuring that effective use will be made of the services supplied. The arrangement most often encountered is that under which the supplying enterprise has the option to terminate the agreement if the receiving enterprise's production or sales fall below specified levels.

85. The supplying enterprise may, however, be disposed to extend the arrangement beyond the furnishing of know-how and, in connexion with such an extension, may seek to exercise certain positive influence over the managerial decisions of the receiving enterprise. Where the supplying enterprise has a primary interest in the sale or leasing of products or machinery of its manufacture, it may seek to obligate the receiving enterprise to purchase or lease specified amounts of products or machinery over a period of years and, if not prohibited by applicable antitrust laws, to require it not to purchase or lease comparable products or machinery from another source. In some cases, particularly where the technical services are supplied in conjunction with patent, know-how or trademark licences, the supplying enterprise may seek to exercise certain controls over the marketing activities of the receiving enterprise. Thus, unless antitrust restrictions stand in the way, the supplying company may require the receiving enterprise to restrict its manufacture and sales to specified areas or to follow prescribed pricing policies.

86. While the formal controls vested in the supplying enterprise under a technical services agreement are often minimal, it by no means follows that the supplying firm does not in fact exercise considerable influence over the management of the receiving company. Many management decisions are so closely related to technical matters that those in managerial control of the receiving enterprise would often be slow to ignore the recommendations of the foreign technicians on the

ground that they involved matters falling within the formal responsibility of those in managerial control.

### 3. LICENSE AGREEMENTS

#### A. General considerations

87. One of the most widely used contractual devices under which technical know-how is made available by an enterprise in an industrialized country to an enterprise in an under-developed country is the licence agreement under which the licensee is granted certain rights to manufacture and sell products utilizing inventions, processes, techniques and other industrial property rights of the licensor. These inventions, processes, or techniques may be patented or unpatented. When unpatented, they are often referred to as falling within the broad classification of "know-how" and the agreements under which they are licensed are called "know-how" licences, as distinguished from "patent" licences. In some cases the agreement may involve a licence to use a patented machine leased to the licensee, or a licence to assemble or package, rather than a right to manufacture. In addition, a licence may be restricted to a grant of rights to manufacture with the licensor taking (and marketing) all of the licensee's production.

88. In most cases, a so-called patent licence will involve a considerable quantity of unpatented or unpatentable know-how. Indeed, it is probably a fair generalization that, except in certain fields in which there are basic patents which remain valid, the licensor's know-how is normally more important to the licensee than the licensor's patents rights. Patent and know-how licences also frequently involve the limited rights to use the licensor's trademarks in connexion with the marketing of the licensed products.

89. Where complex industrial processes are involved, the licensor's inventions could not, as a rule, be effectively utilized by the licensee unless he is also permitted to draw on the accumulated knowledge and experience of the licensor's technicians. The need for the services of such technicians is usually especially acute where the licensee is a new enterprise in an under-developed country. Accordingly, the great majority of licence agreements provide for the furnishing of extensive technical services to the licensee in connexion with the setting up of manufacturing operations, and relating to such matters as the design and installation of plant and equipment, the purchase of raw materials, and the training of the licensee's personnel in all aspects of production.

90. For example, a United States company owning a 30 per cent equity participation in an Indian enterprise for the manufacture of carbon black has entered into a comprehensive "collaboration agreement" with the Indian company under which the United States company agrees to supply exclusive patent and know-how licences with respect to the manufacturing process; a non-exclusive licence to sell the carbon black in India and certain other countries; the right to use the United States company's trademark; technical data on plant and process design; assistance in purchasing equipment

abroad; services of technical personnel in connexion with plant construction and plant operation during a start-up period; training in the United States for engineers of the receiving enterprise; and direction of operations for a one-year period.<sup>14</sup>

91. In addition, the licensor is often obligated under a licence agreement to provide technical support for the licensee in connexion with his marketing programme. For example, the licensor may be required to do the basic engineering for projects on which the licensee is bidding as a supplier of machinery, or to supply field technicians to participate directly in the licensee's sales and servicing programme.

92. Probably the most pervasive incentive from the point of view of the licensor company to enter a licensing arrangement with an unrelated enterprise located in an under-developed country is to participate in the profit resulting from production and marketing of its products in the country concerned without having to make the substantial commitment of personnel, capital and other resources which might be required for a direct equity investment. Another inducement derives from the licensor's desire to maximize the return on the investment represented by the research and development costs incurred to develop its inventions and know-how.

93. In some cases, the need to license a local manufacturer may stem from the fact that the enterprise in the industrialized country has been excluded from a market in an under-developed country previously developed by exports as a result of the imposition of import restrictions and duties. In other cases, licensing is a means of developing a new market for a product successfully marketed by the licensor elsewhere. A licensing arrangement may be particularly valuable as a means of enabling the licensor and licensee to develop a close working relationship, and it often serves as a prelude to a partnership in which the local and foreign companies replace the licence arrangement by a new company with joint equity participation.

94. From the point of view of the licensee, the licence agreement will provide access to the licensor's patents, know-how, trademarks and technical assistance without the licensee's having to expend substantial capital funds for development of the processes or promotion of a trademark and, in many cases, without necessarily having to surrender to the supplier a portion of the equity ownership, and thus a participation in the profits, of the licensee enterprise.

95. Often, however, the licence agreement is an adjunct to the obtaining of an equity participation by the licensor company in the licensee. The licensor may, indeed, obtain an equity participation in exchange for a patent or know-how licence agreement, either by receiving at the outset a portion of equity for the licence or by having royalties under the licence agreement apply against the gradual purchase of equity shares. It is not unusual for the licensor to obtain an equity participation as consideration for a contribution of patent rights and, at the same time, to enter into a

licence agreement with the recipient company covering the licensing of present and future developed know-how and the supplying of technical assistance in exchange for a continuing royalty or fee.

96. In the absence of a substantial equity participation in the licensee, there are, from the point of view of the licensor enterprise, certain risks in licensing know-how or patents. The most serious risk, and one which is especially acute in the case of a know-how licence, is that the licensee enterprise, after having mastered the licensor's techniques, will terminate the licence agreement but continue to make use of the know-how acquired without further payment of royalties to the licensor. While the licensor can gain some protection against this risk by including protective provisions in the agreement, it is no doubt in the most secure position when as a result of its research and development programme, it is able to supply continuing know-how of substantial value to the licensee. Another risk is that the licence will never produce sufficient royalties to enable the licensor to recover the very substantial costs which are normally involved in seeking out a suitable licensee, negotiating the agreement, and supplying the technical data and technical assistance required. Among the risks to the licensee enterprise are the danger that the royalty rate will prove too onerous to permit profitable operations, and the possibility that it will be contractually locked to the licensor and be thereby prevented during the term of the agreement from obtaining licences covering superior competing products from other licensors.

97. In most under-developed countries, licence agreements must be approved by one or more governmental screening agencies. The degree of control actually exercised by these agencies over the terms of a licence agreement varies widely. Typical of restrictions which may be encountered, but which are usually subject to frequent exceptions in the case of desired investments, are the following: minimum royalties (not related to actual production or sales) may not be provided for; royalty rates may not exceed a stated percentage—e.g., 5 per cent; no royalties may be paid, if the licensor holds a majority of the receiving enterprise's equity; exports by the licensee must be permitted at least to neighbouring countries; and purchase of required machinery, equipment or components may not be limited to the licensor.<sup>15</sup>

## B. Contents of licence agreements

98. It is difficult to generalize with respect to the provisions found in licence agreements. There are, however, certain basic elements which are found in most licensing arrangements and which play a key role in enabling the licence agreement to carry out efficiently its function as a conduit of technical know-how.

99. *Licensing on an exclusive or non-exclusive basis.* Under a licence agreement, the licensee may be granted rights to manufacture (or assemble or package), use and

<sup>14</sup> *Business International* (17 March 1961), p. 6.

<sup>15</sup> *Ibid.*

sell on an exclusive or non-exclusive basis. Often a particular agreement will combine an exclusive licence to manufacture (and possibly to sell) in a specified area with a non-exclusive licence to sell the products concerned in a wider area.

100. Where there are anti-trust-law restrictions on the activities of a licensor, the licensor may be reluctant to grant exclusive sales rights in an area not covered by a patent monopoly. Thus exclusive sales licences (not tied to trademark protection) in areas which are not covered by the licensor's patents, or exclusive sales licences under agreements in which know-how rather than patents is the dominant factor, often raise problems for United States licensors. Up to now the European licensor has been less restricted in granting exclusive sales rights, but such grants have been commonly restricted to the country of the licensee, any sales rights to any additional territory being granted on a non-exclusive basis.

101. Some major licensing companies follow a policy of licensing a number of licensees in a foreign country on a non-exclusive basis rather than licensing a single licensee exclusively. Under this approach, the licensors' objective is to maximize returns through licensing as many licensees as possible, usually under standardized licence agreements providing for low royalty rates. Licensing of multiple licensees in an under-developed country on a non-exclusive basis is generally limited to relatively simple products and processes where the cost of plant and equipment is low. In most under-developed countries there will be few potential licensees who will be in a position to incur major capital expenditures in connexion with a licence. Non-exclusive licensing may be attractive to a licensee and to the government of an under-developed country, as the licensee's royalty cost and the consequent burden on foreign exchange resources would be lower than the royalty rate which would be called for under an exclusive licence. Non-exclusive licensing may be attractive to the licensor as, in general, it leaves him free to develop marketing plans in the future without contractual restrictions. One United States company has joined another United States company in a joint venture to license parties throughout the world to produce and sell a shock-resistant paper under patents issued or applied for in thirty-two countries and a trademark registered in thirty-five. The standard licence agreements which are utilized provide for payment of royalties in the amount of 1.25 per cent of sales in United States dollars, plus payments in local currencies of travel and living costs of technical personnel made available by the licensor.<sup>16</sup>

102. In most cases, however, as a result of the limited number of potential licensees in the under-developed countries, and as a result of the strong desire of those licensees to be granted exclusive rights, there are strong pressures toward licensing on an exclusive basis. Where there is only one local enterprise capable of producing the licensed product, the local governmental screening

body will generally indicate a strong preference, if not impose an outright requirement, for an exclusive licence to protect the local enterprise from competition through imports of products manufactured abroad by the licensor or another of its licensees.

103. *Payment provisions.* The basic cash payment provided in the licence agreement is generally contingent in nature and is geared to the production or sales by the licensee of the product manufactured under the agreement. Thus, royalties are commonly expressed in terms of a fixed amount for each unit produced or of a percentage of the net selling price of products produced and sold under the agreement.<sup>17</sup> In some cases provision is made for a downward revision of the royalty rate as production during a particular year increases. An arrangement often sought by the licensor, but commonly opposed by the licensee and his government, is to provide for a fixed minimum annual royalty which must be paid regardless of the amount of the licensee's production or sales.

104. Often a licence agreement will provide for an initial lump-sum payment upon the execution of the agreement, which may be either a down payment to be charged against future royalties or a fixed payment to compensate the licensor for out-of-pocket costs incurred in negotiating the licence and for some of its research and development costs. A licence agreement may also provide for payments for raw materials, equipment, components for assembly or spare parts or for special payments, often on a cost or a cost-plus basis, for any specific technical services rendered by the licensor's personnel.

105. Governmental screening agencies in the under-developed countries will normally be particularly concerned with the royalty rate and will insist on the reduction of a rate which is deemed to be excessive. When the foreign licensor and local licensee are affiliated, the authorities of the under-developed country will usually scrutinize the royalty rate with particular care to ensure that it has not been set unreasonably high as a means of avoiding local profits taxation.

106. If the royalty is payable in a foreign currency, it may be felt that the royalty rate will constitute an unwarranted burden on the local foreign exchange reserves. The screening agency may object in particular to the payment of royalties for trademark rights on the ground that the use of a trademark is not directly related to the creation of manufacturing facilities. However, where a trademark is well known, the licensee's right to make use of it in its marketing programme may greatly increase the domestic and possibly the export market as well. Thus, the trademark rights may contribute directly to an expansion of manufacturing faci-

<sup>17</sup> Most frequently, royalties are expressed as a percentage of sales of the licensed products. The rates vary widely. One expert has suggested that "generally speaking, royalties range from 5 per cent for industrial products to 10 per cent for consumer products". See Eckstrom, "Foreign Licensing Business Considerations and Problems", in *Proceedings of the 1959 Institute on Private Investments Abroad*, The Southwestern Legal Foundation (Matthew Bender and Co., New York, 1959), p. 545.

<sup>16</sup> *Ibid.* (30 October 1960), p. 1.

lities to meet the increased demand and to an earning of foreign exchange. In some cases, the exchange authorities may insist that a portion of the royalty be paid in local currency or in foreign currency which must be retained in the country in a blocked account.

107. Where there is danger of local currency depreciation, the licensor may seek protection by asking that royalty payments be expressed in foreign currency or, more rarely, by retaining the right to be paid in kind out of the licensee's production. Where royalty payments must be in local currency, the licensor may also seek protection through such devices as gold clauses, gold equivalency clauses, or escalator clauses in the agreement.

108. *Division of sales territories.* In virtually every licence agreement there is, implicit or explicit, a division of sales territories resulting from restrictions on the freedom of the licensee to sell the licensed products in areas outside the exclusive or non-exclusive sales territory to which rights are conveyed in the agreement. Often where a licensee is granted the non-exclusive right to sell the licensed products in a wide territory, the licensor may wish to retain the right to grant an exclusive licence in part of this territory at a later date to another party, at which time the licensee's rights to sell within that area would cease.

109. The licensee in the under-developed country, while primarily interested in marketing the licensed products within his own country, will also in most cases seek the right to develop an export market. The government of the under-developed country may be particularly interested in promoting exports in order to earn needed foreign exchange, and may insist that the right to market the licensed products outside the country concerned be included in the licence agreement as a condition to granting the required governmental approval.

110. For licensors in some of the industrialized countries, and pre-eminently for those in the United States, anti-trust-law provisions may constitute a major obstacle to the imposition of restraints on sales by the licensee in certain areas. Where the United States licensor enjoys patent protection over the products concerned in the countries in which he wishes to exclude sales by a licensee, no anti-trust problems usually result from the exclusion. In the absence of such patent protection, however, definite United States anti-trust problems are often presented. In some cases, an effort is made to circumvent these problems by tying sales to trademark rights. When a trademark is essential to the marketing of a particular product, the licensor who owns the trademark rights in all countries of the world can effectively prohibit the licensee from selling in the excluded territory by denying him the right to use the trademark with respect to sales in that territory.

111. Licensors in developed countries other than the United States are generally considerably less limited by the law of their respective countries in dividing the sales territories in their various licence agreements, even in the absence of trademark or patent protection.

112. *Rights to improvements.* It is of great impor-

tance to a licensee in an under-developed country to obtain access to continuing know-how and improvements developed by the licensor. The licensor will also benefit from the increased market for improved products available if its licensees are empowered, or, as is not unusual, obligated, to incorporate all improvements or developments in the products it manufactures under the licence.

113. Most licence agreements provide that the licensee shall have the right to have included within the licence rights to improvements subsequently developed by the licensor with respect to the licensed inventions without the payment of additional royalty. Some agreements provide that the licensee shall be granted the benefits of all new developments by the licensor in a given field. Here much turns on the definition of "improvement" or "development" adopted in the contract.

114. A tendency among United States licensors seems to be to define very carefully the technical field covered by the licence, and to extend to the licensee rights to all relevant know-how and future developments in that field. Among European licensors, at least in so far as the larger companies are concerned, the practice tends to be that for forming pools of present and future patents within an industry. Extensive cross-licence agreements are also common. Primarily because of anti-trust problems, large United States companies tend to avoid patent pools or extensive cross-licensing arrangements.

115. *Influence of the licensor over the managerial policies of the licensee.* The typical licence agreement contains a substantial number of controls which the licensor may exercise over the management of the licensee. The great majority of these controls are negative rather than positive, in the sense that they restrict the freedom of action of the licensee rather than vest in the licensor the right to direct the licensee's managerial policies. Probably the most important of these negative controls are those restrictions commonly found in licence agreements on the rights of the licensee to sell the licensed product outside the exclusive or non-exclusive sales territory granted to it under the agreement.

116. In order to protect the licensor's interest against the licensee's failure to make effective use of the licensed product, contracts frequently reserve to the licensor the right to terminate the agreement and receive a reversion of the licensed rights if and when any of the following events occur:

The licensee's production falls below specified levels;

The licensee fails to manufacture products which fulfil the licensor's quality control requirements (this is especially important where the licensor's trademarks are involved);

The licensor fails to use its best efforts to develop markets within its territory for the products; or

The licensee manufactures or sells competing products.

To the same end, and often additionally to ensure that the licensee's marketing activities will not disrupt the licensor's world-wide marketing policies, the licensee

may be required to adhere to price policies fixed by the licensor.

117. Other provisions may extend the scope of the agreement to cover other objectives of the licensor. Thus, the licensee may be obligated to purchase raw materials from or components manufactured by the licensor or handle complementary products produced by the licensor. Anti-trust legislation in the United States tends to deter the United States licensor from imposing on the licensee controls such as these which are unrelated to a patent or trademark monopoly. Thus, while the United States licensor will provide materials, components, or complementary items at the request of the licensee, and it will frequently be in the best interest of the latter to take advantage of this opportunity, the licensor will seldom insist that requirements on these matters be written into the licence agreement. The United States licensor will also usually avoid fixing prices on the licensee's products although such arrangements are probably not unlawful if the products are covered by the licensors' patents. Licensors located in the industrialized countries of Europe, however, are generally not restricted from including provisions with respect to these matters.

118. It should be noted that, regardless of whether formal controls are granted to the licensor in the contract, there will be many cases, for example, where the licensed rights are indispensable to the licensee and the agreement is terminable on short notice by the licensor, or where a continuing flow of know-how from the licensor is of particular value to the licensee, in which the licensor will, as a practical matter, be in a position to exert a very considerable influence over the management of the know-how-receiving enterprise.

#### 4. ENGINEERING AND CONSTRUCTION AGREEMENTS

##### A. General considerations

119. One of the first requirements for the establishment of an enterprise in an under-developed country which requires a substantial investment in plant is technical and managerial know-how relating to the design and construction of the necessary facilities. In many cases, the know-how is not available locally and must be sought from enterprises abroad.

120. The required know-how may be supplied by the foreign enterprise which has a controlling equity participation in the recipient enterprise, and which thus controls the organization, engineering, construction and subsequent operation of the venture. In other cases, the source of know-how may be a foreign enterprise having a minority or no equity participation which will operate the enterprise under a management contract, possibly also supplying technical assistance and licences. A considerable number of hotels have been constructed in under-developed countries of the world under contractual arrangements providing for supervision of design and construction by a foreign hotel company which will also operate the hotel under a management contract for the local investors.<sup>18</sup>

121. The required know-how may also be obtained from a foreign enterprise with experience in the design, construction and operation of the facilities in question but which will have no equity participation or managerial role in the receiving enterprise after construction has been completed. Well-known examples of the latter are the three steel mills constructed for the government-owned Hindustan Steel Ltd. in India, with technical supervision of engineering and construction supplied in one case by the Soviet Union and in the other cases by private interests in the Federal Republic of Germany and the United Kingdom. In each of these projects the availability of the required know-how under a contractual arrangement consistent with the retention of full ownership by Hindustan Steel Ltd. was of profound political, as well as economic, importance.

122. The know-how needed for the design and construction of substantial industrial facilities is a complex mixture of constituent elements, including civil, mechanical and electrical engineering, technical knowledge and skills in various types of construction and in the selection, design and installation of machinery and equipment. Few enterprises are in a position to supply such a comprehensive range of know-how. Accordingly, it is usual for separate aspects, such as civil and mechanical engineering, to be supervised by different foreign firms or, alternatively, where a single foreign enterprise is charged with over-all supervision, for that firm to draw on the special skills and knowledge of independent consultants and contractors with respect to particular aspects of the project. In the case of an important joint venture for the extraction of iron ore in Liberia, the civil engineering work is being performed by one Swedish firm, the mechanical and electrical engineering by another, and the bulk of the actual construction by a Liberian subsidiary of an international construction company located in the United States.<sup>19</sup>

123. The primary objective of the know-how-receiving enterprise is to have the engineering and construction performed expeditiously and effectively so that the venture can commence efficient operations at as early a date as possible.

124. To achieve this objective, careful consideration must be given to adopting an organizational structure under which the responsibilities of the various participants in the engineering and construction phase are clearly delineated. Lack of clarity with respect to where ultimate responsibility for particular decisions lies may produce a frustrating progeny of confusion and discord. In addition, it is important to provide for the maximum training and utilization of local personnel in connexion with designing, building and equipping the facility. Local personnel who are trained and who participate in these earlier stages are often especially valuable when the operational phase is reached.

125. The motivations of the know-how-supplying enterprise will depend to a significant extent upon the nature of its over-all role in the project. If its function

<sup>18</sup> See section 5, "Management Contracts", paras. 141-157 below.

<sup>19</sup> This project is more fully discussed in its various aspects in section 7, paras. 185-197 below.

is purely that of supplying engineering know-how or of performing the actual construction work — possibly combined with the selling of the needed machinery — its primary interest will be in fulfilling its obligations under its contract and in earning the specified fee (and sales profit). If, however, its role is to supervise the engineering and construction as an initial phase of a long-term relationship under which it will manage the operations and participate in profits of the know-how-receiving enterprise, its interest becomes the broader one of maximizing the viability and the profitability of the enterprise in the long run.

126. This difference in objectives may persuade the know-how-receiving enterprise, even in the face of commercial considerations to the contrary, that its long-term interests will best be served by vesting supervisory control over engineering and construction in a foreign firm which will participate in all stages of the enterprise by supplying its know-how in various forms, and possibly its capital as well.

#### B. Contents of engineering and construction agreements

127. *Scope of services.* The contractual arrangements adopted with respect to supervising engineering and construction may be incorporated in a single agreement with a know-how-supplying enterprise, or in two or more agreements with separate firms which will supervise different aspects of the project.

128. The facilities to be designed and built may be exceedingly diverse. This is often particularly true in the case of an extractive venture in an under-developed area in which basic utilities and housing facilities are lacking. In addition to designing the equipment and installations required for the actual mining operations, it may be necessary to design and build communication systems, roads and railroads, seaport facilities, storage facilities, and whole communities to be inhabited by the needed personnel, complete with utilities, schools, hospitals and housing.

129. The agreement covering the engineering phase will normally provide that the supervisory firm will carry out necessary surveys and investigations required for the designing work; prepare general layouts with plans, drawings, preliminary cost estimates and progress schedules; prepare final general and detailed plans, construction drawings, specifications for all materials and equipment required; prepare tender documents and contract forms for the performance of the construction work and the supply of materials and equipment; prepare revised cost estimates and progress schedules; and supervise the work of independent contractors.

130. An important aspect of design and construction which probably in most cases falls within the responsibility of the engineering supervisor is to advise the know-how-receiving enterprise with respect to the selection and purchase of needed materials and equipment and the placing of construction contracts or to make such decisions under its own contractual authority.<sup>20</sup>

131. Frequently, some or all of the equipment and

machinery are purchased from firms independent of the enterprise supervising construction, in which cases it is customary for provision to be made for engineers and technicians employed by the firm supplying the machinery and equipment to advise the construction enterprise with respect to proper installation and later to advise the local operating personnel with respect to proper operation.

132. *Degree of managerial control by the supplying enterprise.* The contract between the know-how-supplying and know-how-receiving enterprises may provide for supervisory assistance by the former, either under an arrangement whereby the final decisions are to be made by the receiving enterprise on the basis of advice received from its foreign collaborator or whereby these decisions are to be made by the know-how-supplying firm. Retention of ultimate decisional responsibility by the know-how-receiving enterprise will usually prove to be the more efficacious approach only where it has at its disposal either local personnel who have acquired the necessary skills and experience or foreign technicians who are available as employees or under a technical services agreement or management contract.

133. Where a foreign enterprise with wide experience in the operations to be conducted owns a majority of the equity of the know-how-receiving enterprise or will subsequently manage it under a management contract, it is not uncommon for it to retain final responsibility for decisions in the engineering and construction sphere.

134. The power of decision on all matters covered by the contract may not be allocated to either the supplying or the receiving enterprise; more commonly ultimate authority may rest with the supplying enterprise on some matters and with the receiving enterprise on others. For example, in the case of the Indian steel mill constructed with British assistance, the consortium of British firms supplying the necessary know-how was granted final responsibility for erection of the plant, while the Indian Government retained responsibility with respect to works outside the perimeter of the plant.

135. While a clear formal allocation of responsibility is essential, such an allocation still often does not reflect the realities of the situation. Even though the receiving enterprise may be empowered to reject the plans and recommendations of the supplying enterprise, it will be a rare case when such power is exercised. Thus, in fact if not in form, the know-how-supplying enterprise will nearly always exercise broad influence over the management of engineering and construction.

<sup>20</sup> Sometimes the sale of such materials and equipment is the primary interest of the know-how-supplying company which will furnish the construction and engineering services to customers who would otherwise not be in a position to put this material and equipment to effective use. Examples are contracts for the construction of telephone exchanges by foreign companies producing and seeking markets for telephone equipment, and for the construction of textile plants by foreign companies whose principal business is the production of textile machinery.

136. The period of time during which the know-how-supplying firm exercises supervision and control will vary. Under a pure turn-key engineering and construction contract, its responsibilities will cease with the physical completion of the facility. Such arrangements are unusual in connexion with projects in under-developed countries. Because of the dearth of local technical and managerial talent, foreign know-how and assistance are needed for the training of local personnel and for the initial operation of the project as well as for the design and construction. Thus, it is common for the know-how-supplying concern to retain wide managerial responsibilities during at least the start-up phase and until the training of an adequate supply of local technicians and managers has been completed. In many cases, provision will be made for a continuing supply on a semi-permanent basis of know-how from abroad through equity participation by the foreign enterprise, or through contractual devices such as technical services agreements or management contracts.

137. *Payment provisions.* The usual method of compensating engineering and construction firms is through payments consisting of reimbursement of the costs incurred plus a fixed fee or a fee expressed as a percentage of those costs. Rarely, if ever, will an arrangement be encountered in which the compensation to be received by a know-how-supplying enterprise for engineering and construction services is geared to the profits or production of the receiving enterprise, except perhaps where these services form part of a broader agreement, providing also for the rendering of continuing managerial and technical services. An interesting variation from the common practice is presented by a Mexican venture for the manufacture of seamless steel pipe. Here a basic feature of the organizational framework was a contract with an Italian engineering firm for supervising the construction of the plant and the installation of equipment in exchange for an equity participation in the know-how-receiving enterprise.<sup>21</sup>

138. In cases in which the foreign enterprise supervising engineering and construction has purchased with its capital or other property a substantial equity participation in the receiving enterprise, it may be willing to forgo any fee for its supervisory services beyond reimbursement of its costs. This was true, for example, in the case of an Indian venture for the manufacture of dyestuffs by a company 50 per cent owned by an Indian company and 50 per cent owned by a subsidiary of a British company, which agreed to design the plant and equipment and to provide technical staffs to supervise construction in return merely for its out-of-pocket costs.<sup>22</sup>

139. Under the cost-plus compensation arrangements, detailed provisions with respect to the compensable costs will be contained in the agreement. In order to protect the supplying enterprise against exchange losses and to minimize the capital it must commit, the

agreement may provide for reimbursement for costs on a monthly basis in the currency in which incurred. A common arrangement in practice is to provide for payment of advances to the supplying enterprise to cover the following month's estimated expenses.

140. The fee, whether fixed or expressed as a percentage of costs, is normally payable in instalments which, in the case of an agreement covering construction, are related to the extent to which the construction has been completed. Since the receiving enterprise is interested in completion of the facility as early as possible, a bonus is often payable to the contractor, if the project is finished ahead of schedule. Inasmuch as construction under the conditions prevailing in many under-developed countries may entail any number of unexpected problems and a need for considerable pioneering, it is rare for provisions to be made for a penalization of the contractor for any but wilful failure to meet the construction schedule. If the fee is payable in whole or in part in local currency, the know-how-supplying enterprise will often insist on contractual protection against currency depreciation or devaluation.

## 5. MANAGEMENT CONTRACTS

### A. General considerations

141. One of the essential requirements for the establishment of a successful industrial enterprise in an under-developed country is managerial know-how, a shorthand term commonly applied to the complex of knowledge and experience required to organize and manage a business enterprise efficiently.

142. In many cases, the absence of a sufficient number of local nationals who have had managerial training or experience necessitates drawing on the reservoir of managerial talents which have been developed by enterprises in the industrialized countries of the world. A device which is widely used as a means of tapping this reservoir is the management contract. A management contract, like the other contractual arrangements examined in this report, is a highly flexible device and its nature and function will vary greatly from situation to situation. In essence, however, it typically takes the form of an arrangement under which operational control of an enterprise (or of one phase of an enterprise) which would otherwise be exercised by the board of directors or managers elected or appointed by its owners is vested by contract in a separate enterprise which performs the necessary managerial functions in return for a fee.

143. In many cases, the know-how-supplying enterprise will take a controlling equity participation in the receiving enterprise and will make its managerial experience available through the directors and officers which it is in a position to name as a result of its voting control. It is in those cases in which the supplying enterprise does not have voting control that the management contract plays its primary role in enabling the supplying enterprise to bring its managerial know-how to bear in directing one or more phases of the enterprise. Much of the particular importance of the

<sup>21</sup> See *Joint International Business Ventures*, Friedmann and Kalmanoff, Eds. (Columbia University Press, 1961), pp. 369-374.

<sup>22</sup> This venture is further discussed in section 7. See para. 186-190 below.

management contract derives from the fact that if it were not possible through this device to vest management functions in a foreign enterprise which supplies none or only a minority of the equity capital, the flow of foreign managerial know-how, beyond that available through hiring of experienced personnel by local enterprises, would tend to be limited to those cases in which the foreign participants supply a majority of the equity or are otherwise in voting control of the enterprise. The management contract therefore significantly enhances the ability of the under-developed countries to gain access to the managerial know-how needed for their economic development.

144. The management contract has a particular utility in the case of enterprises in under-developed countries which are engaged in activities reserved to public ownership or which are, because of local law or governmental policy, majority-owned by local interests. Through this contractual device, access to needed foreign managerial know-how is readily achieved notwithstanding local ownership of a controlling interest. For example, in Pakistan a company organized in 1954 for the exploitation of natural gas resources, with 51 per cent of the voting equity owned by the Pakistan Industrials Development Corporation and Pakistani nationals and 49 per cent owned equally by a privately owned British company, and the Commonwealth Development Finance Company owned in part by the Bank of England and in part by British private interests, is managed by a subsidiary of the privately owned British company under a twenty-year management contract in return for its costs, a fixed "office allowance" and a percentage participation in profits which decreases as the net profits increase.<sup>23</sup>

145. Management contracts have been utilized in virtually every area of business enterprise in under-developed countries. They are by no means limited in their utility to manufacturing operations. For example, they are particularly widely used in the hotel industry. A considerable number of hotels which have been constructed in under-developed areas are managed by experienced foreign enterprises under management contract. An excellent example is afforded by a successful hotel venture in Bogotá, Colombia. The venture was initiated by a United States hotel chain. The hotel is owned, however, by a Colombian corporation, all of whose capital is owned by Colombian interests, the great majority being held by the *Caja de Sueldos de Retiro de las Fuerzas Armadas*, the pension fund for Colombian military officers. In addition to being charged with responsibility for planning and constructing the hotel and playing a key role in obtaining a dollar loan from the Export-Import Bank of Washington, the United States hotel chain operates the hotel under a management contract which vests it with complete management responsibility. Under this contract, which was extended as of 1 January 1959 for fifteen years,

the managing enterprise receives a fixed fee plus a participation in profits.<sup>24</sup>

146. In this and other cases, the management contract has a special usefulness in ventures which are to be financed by local (and sometimes also by foreign) investors who have no wish actively to manage their investments themselves. It thus falls very neatly into the investment pattern of silent partners and hired managers, which is familiar in many under-developed countries.

#### B. Contents of management contracts

147. *Scope.* The management contract may grant to the managing enterprise virtually complete operational responsibility for all aspects of an industrial operation, from the purchase of raw materials through the sale of the manufactured product. The management contract may also be a part of a much more comprehensive agreement under which the managing enterprise agrees to plan the organization of the enterprise; design and construct the plant; design and install the equipment; direct all steps necessary to staff the plant and put it in operation; and manage and conduct a training programme for local personnel in all phases of the enterprise for a stated number of years. On the other hand, the management contract may be a much more limited arrangement involving control over only one phase of the operation, for example, managerial control over the enterprise's marketing programme.

148. Management contracts are in many cases intended as long-term, if not permanent, arrangements. In other cases, they are intended to be transitional only, and to provide a means of supplying foreign managerial talent during a start-up period, pending the training by personnel of the managing enterprise of local personnel to take over the managerial responsibilities.

149. *Degree of control by the managing enterprise.* The degree of control granted to the managing enterprise will differ considerably from case to case and will often depend to a significant extent on the phases of the business operation to which the powers of the managing enterprise extend, and on the desire and the capacity of the directors or other representatives of the owners of the equity in the enterprise to play an active role in management. The arrangement may grant full managerial control to the know-how-supplying enterprise or, as in true in the case of the natural gas venture in Pakistan mentioned above, the managing company may be charged with the direction of all the business and affairs of the company, subject, however, to the general control of the directors or resolution of a meeting of shareholders. Regardless of how wide the grant of authority to the managing enterprise may be, it must be borne in mind that the residual powers over management remain in the board of directors' or other owners' representatives and ultimately in the owners themselves. These holders of residual managerial powers have at all times the power to terminate the management con-

<sup>23</sup> The project is discussed in *Joint International Business Ventures*, Friedmann and Kalmanoff, Eds. (Columbia University Press, 1961), pp. 456-466.

<sup>24</sup> *Ibid.*, pp. 324-329.

tract subject only to the payment of damages to the discharged manager if such termination constitutes a breach of the agreement or if, under some civil law systems, the termination is deemed "abusive".

150. In cases in which the management contract covers all phases of the management of the recipient enterprise, the agreement will generally provide that the managing enterprise has full control over the conduct of all business operations (possibly subject to specified limitations, such as action by the board of directors or shareholders); is responsible for the maintenance and protection of all plant and equipment; has authority to execute contracts on behalf of the company; is responsible for the purchase of all raw materials, supplies, equipment and services required; is responsible for marketing the products produced; may make any and all expenditures considered necessary for the effective functioning of the enterprise; has full control over all litigation; is responsible for compliance with all laws and regulations and, generally, is responsible for doing all things that may be necessary or advisable for the efficient operation and development of the enterprise.

151. In an agreement of this kind, the managing enterprise will normally have full power with respect to the hiring and firing of employees in subordinate positions and, in some cases, of all employees. The handling of appointments, promotions and dismissals of personnel in high posts may be spelled out in detail in the management contract and is not uncommonly subject to the approval of the board of directors or shareholders.

152. Where the managing enterprise is vested with control over only a limited phase of the business operation, its powers are commonly more circumscribed in this area than the powers of the managing enterprise which is granted full control over all aspects of business operations. For example, if a managing agent is designated to handle all phases of a marketing programme as an exclusive marketing agent, it may be that the board of directors of the company will be granted powers of review with respect to prices and other aspects of the marketing programme, subject possibly to a prescribed area in which the managing agent has complete discretion.

153. *Responsibilities of the managing enterprise.* The managing enterprise is subject to the broad responsibility of directing the phase or phases of operations covered by the management contract to the end that the operations and development of the enterprise will be efficient and profitable. More specifically, the managing enterprise is normally obligated to supply such personnel from its own organization as may be required in order to run the operations of the know-how-receiving enterprise effectively until local personnel can be trained. The managing enterprise is also usually obligated to advise and supervise the local personnel as well as its own personnel and, in connexion with this supervision, to give the know-how-receiving company the benefit of methods and techniques of production, marketing and finance developed by the managing enterprise in its other operations.

154. The management contract will, as a rule, spell out the standard of care which must be exercised by the manager. The know-how-supplying enterprise will normally be reluctant to accept an obligation beyond that of using its best efforts, skill and judgement in directing the enterprise and in selecting competent employees, experts and advisers, but with no guarantee of results. The agreement may, moreover, specifically disclaim any liability on the part of the manager for losses to the enterprise or its owners resulting from errors in judgement and from any act or failure to act not involving the manager's negligence, or perhaps wilful misconduct or fraud, and may provide that the manager shall be indemnified for any loss incurred without bad faith on its part in connexion with the performance of its responsibilities. Specific grounds for removal of the managing enterprise may also be spelled out in the agreement.

155. *Training of local personnel.* Whether the management contract is conceived of as a permanent arrangement or simply as a transitional device, a key aspect of the arrangement is normally the provisions in the agreement covering the training of local personnel in order to prepare the latter to take over the management functions — either on behalf of the receiving enterprise (in the case of transitional contracts) or as employees of the supplying enterprise (in the case of a long-range management contract). It is perhaps this aspect of the management contract which is of greatest importance in its role as a channel through which managerial know-how can flow from the developed to the developing countries.

156. *Management fee.* The particular method of compensating the managing enterprise will differ considerably from case to case, and the formula agreed upon will reflect the respective bargaining power and the respective policies of the participants. The managing enterprise may seek to have the fee expressed as a percentage of the sales of the receiving enterprise. This arrangement entails a certain risk for the receiving enterprise, since it may impose a heavy burden on costs and may tend to encourage the managing enterprise to maximize sales rather than profits.

157. Where the management contract covers only the marketing aspect of the receiving enterprise's operations, it is not unusual to find the fee expressed in terms of a percentage of the sales made by the marketing agent. Where the managing enterprise is in charge of all aspects of the receiving enterprise's operations, it is generally appropriate to have its compensation at least partially geared to the primary indicator of the enterprise's success; namely, its net profits. Few potential managing enterprises, however, will find an arrangement under which compensation is to be paid solely out of profits sufficiently attractive to induce it to part with its valuable managerial know-how. Accordingly, it is common to find an arrangement adopted under which the foreign manager is granted a fixed minimum fee plus a bonus expressed as a percentage of profits. The fixed minimum may be geared to the costs incurred by the manager. In some cases, the compensation may be

three-fold: costs, plus a bonus consisting of a fixed fee or a percentage of costs and a participation in gross or net profits. The participation in profits may be on a sliding scale with the percentage decreasing as profits increase.

## 6. CONTRACTS FOR THE EXPLOITATION OF MINERAL RESOURCES

### A. General considerations

158. In the field of mineral—especially petroleum—exploitation, contractual arrangements for the supply of technical and managerial know-how have recently found a special application which has proved to be of considerable economic and political importance.

159. An indispensable ingredient in any programme for the exploitation of the mineral resources of an under-developed country is the geological and other technical know-how which has been developed primarily by large mineral enterprises, most of them privately owned, in the industrial countries of the world. In the majority of cases, such mineral enterprises will enter into a contractual arrangement with the government of the under-developed country or its instrumentality under which the foreign enterprise will supply the necessary know-how and capital and will carry out the exploration and development programme within a specified area at its own expense, subject to a prescribed formula for a sharing by the government and the foreign enterprise of any production or profits realized.

160. Under the traditional concession agreement, the foreign enterprise is granted exclusive rights of exploitation and ownership of all minerals extracted. In this case, the foreign enterprise carries out the mineral operations directly itself, and there is no know-how-receiving enterprise in the sense of a separate local enterprise which benefits from the know-how supplied. The local government receives a benefit from the know-how and capital supplied only through its participation in profits and its right to succeed to all properties of the enterprise upon termination of the concession.

161. In recent years, however, in a number of under-developed countries, legislation has been enacted establishing local governmental agencies which are granted exclusive rights to carry out mineral exploitation and which are authorized to draw on foreign capital and know-how through contractual arrangements. These arrangements differ widely. In some cases they are quite similar in many respects to the traditional concession and result in the foreign enterprise conducting the enterprise itself, although there are differences from the traditional concession which are of crucial importance. In other cases, the local governmental mineral monopoly will actually conduct the operations with technical and managerial assistance from abroad, and in this context the governmental agency is a know-how-receiving enterprise in the same manner as any local enterprise which is party to a technical services agreement or a management contract.

162. Although in most cases mineral exploitation agreements result in a vesting of managerial control

in the know-how-supplying enterprise, they are often distinguishable from the usual management contract discussed above in one or more important substantive aspects. The principal difference is that the mineral exploitation agreement usually requires a substantial investment of risk capital by the foreign enterprise which must conduct the mineral operations in return for compensation which is payable only if, and to the extent that, production is achieved. Although the typical management contract may accompany a direct investment of equity capital, the role of the management contract as a conduit of know-how is logically and functionally independent of such investment.

163. In addition to contractual arrangements under which the foreign enterprise conducts the mineral operation directly with its own capital in return for compensation which will be payable only out of production, there are also in the mineral exploitation area agreements under which foreign enterprises conduct exploration and development activities on a cost-plus basis, either for a local government or governmental instrumentality or for a privately owned enterprise holding a concession. Such arrangements which require no investment of risk capital by the supplying enterprise are common where additional drilling is required over proved areas or where, the location of the mineral deposit having been ascertained, the development stage is reached. There are also, of course, examples in the mineral field of technical services agreements under which technical personnel of a foreign enterprise are made available<sup>25</sup> and of pure management contracts under which a foreign mineral enterprise supplies managerial services to a mineral enterprise which may be owned by the local government, by local or foreign private interests, or by a combination of public and private interests.<sup>26</sup>

164. In those mineral exploitation agreements which require the foreign enterprise to provide both the know-how and the capital required to conduct an exploration programme, subject to compensation only out of production, the supplying enterprise will normally be unwilling to assume the very substantial risks involved unless it is assured of a large portion of any production or profits realized. Under the other contractual arrangements examined in this report, on the other hand, the risks for the know-how-supplying enterprise which result from its furnishing of the know-how are relatively slight.

165. Thus, while a mining company in an industrially developed country might be willing to furnish managerial services to an enterprise in an under-developed country under a management contract for a fee consisting of its costs plus 10 per cent of the receiving enterprise's profits, the same company may be expected to be willing to undertake the capital investment and the risks entailed in a mineral exploration project in the same country only for a much more substantial share of the profits or production realized.

166. Indeed, in many petroleum ventures, the risks

<sup>25</sup> See *supra*, para. 74.

<sup>26</sup> See *supra*, para. 144.

have often been greater than a single international oil company is willing to assume, and the result in many cases has been the creation of joint participation arrangements in which financial risks and marketing responsibilities have been shared by a number of large oil companies. Perhaps the best-known example is the Iranian Consortium, which is composed of seventeen oil companies from four countries.

167. In some of the under-developed countries there has been a history of domination by foreign interests of the exploitation of local mineral resources, and, even in the absence of such a history, in virtually every under-developed country there is strong popular sentiment against foreign domination of local mineral operations. In some cases this sentiment has resulted in legislation reserving all mineral exploitation to the local government or one of its agencies. In some countries, arrangements have been made for local financing and management of mineral exploitation with all profits retained for local economic development; in others, the dearth of local capital and know-how has led the government to draw on foreign capital and know-how.

168. In resolving the dilemma posed to the governments of such under-developed countries by the desire to maximize local control over and profit from exploitation of local mineral resources and the need for foreign capital and know-how, the contractual arrangements adopted between local governments or their agencies and foreign mineral enterprises have played a highly important role in enabling a drawing on foreign capital and know-how resources without impairing the local government's monopoly over exploitation and ownership of minerals.

169. There is no fixed pattern in these arrangements and what has been most evident has been a constant groping towards variations which will best satisfy the local government's demands for increased local participation in the ownership and control of, and profits from, mineral exploitation and the foreign company's demands for a profits margin commensurate with the risks involved.

#### *Common forms of agreement and their political significance*

170. Traditionally, the most common form of agreement has been the so-called concession agreement under which the foreign company is granted the exclusive right to conduct mineral exploration and exploitation within a specified area. The traditional concession agreement, while it may provide for some participation by local nationals or the local government in the operation of the enterprise, none the less typically vests not only complete managerial control, but also important rights of ownership in the foreign enterprise. The concessionaire obtains definite property rights of a possessory nature in the surface areas covered by the concessions and he becomes the owner of the minerals when they are removed.

171. The scope of the rights granted the foreign concessionaire has become a natural target for the

marked political and popular reaction in many under-developed countries against domination by foreign companies of the exploitation of local mineral resources. In some cases this reaction has reached proportions which have necessitated an abandonment of the traditional concession agreement, which has become intimately associated in the public mind with foreign domination of mineral exploitation, in favour of other more politically palatable contractual devices. The means which have been adopted in a number of countries to satisfy at the same time both the compelling need for foreign managerial and technical know-how and the popular demand that mineral exploitation not be dominated by foreign interests are contractual arrangements which effect a divorce between management and ownership by granting broad, but not unlimited, managerial control to the foreign enterprise without concomitant rights of ownership over the extracted minerals.

172. In these countries it is provided by law that all mineral deposits are the exclusive property of the State and that all private exploitation is prohibited. For example, in Mexico, under the Petroleum Law of 29 November 1958, all petroleum deposits may be exploited only by the official government agency, *Petróleos Mexicanos* (PEMEX). Under the Argentine Petroleum Nationalization Bill, all deposits of hydro-carbons are stated to be "the exclusive, imprescriptible, and inalienable property of the National State" and all "activities of the National State connected with the study, exploration, exploitation, industrialization, transportation and commercialization" of petroleum are reserved to *Yacimientos Petrolíferos Fiscales* (YPF), a governmental instrumentality. Similarly in Iran, after the nationalization in 1951, all rights to develop oil resources were granted under the Iranian Oil Nationalization Law of 1 May 1951 to the National Iranian Oil Company (NIOC), an organization wholly owned by the Government. Under the Mexican, Argentine and Iranian legislation, however, PEMEX, YPF and NIOC are authorized to enter into contractual arrangements with private enterprises, domestic or foreign, for the exploitation and development of mineral resources. Any minerals extracted, however, are to be the property of the governmental agency concerned.

173. The arrangements between YPF and various foreign companies illustrate particularly well the role which can be played by contractual arrangements which divorce broad managerial control from ownership in satisfying political and economic needs in those industries where foreign domination gives rise to a sensitive political issue.

174. Some of the contracts made by YPF are for drilling work over proved areas, under which the companies concerned are paid for the work done on a cost-plus basis, independently of the results achieved. Here the arrangement is a pure management-technical assistance contract, the contractor bearing no financial risk.

175. But in many cases the contract requires the contractor company to finance exploration and development operations and to bear the risk. Under these

contracts, the company is assigned an area—the areas range from pure exploration territory to semi-proved or even proved territory—to explore and develop. The company has specific obligations regarding the speed and amount of the work it must perform, the object being to reach the maximum rate of production consistent with sound technical practice as soon as reasonably possible.

176. The periods of the contracts vary from twenty to thirty years. In most cases the contractor company is required at intervals to surrender to YPF a certain percentage of the territory assigned to it. Also, YPF is to be kept closely informed of the operations as they progress. But generally, apart from the power of YPF to intervene if the work is not being carried out in accordance with prescribed rules of sound operating practices, the contractor company is free to operate as it thinks best.

177. When oil is produced, it is YPF's property<sup>27</sup> and in most cases the oil has to be delivered to YPF at stipulated points. For its part, YPF undertakes to take all the oil and to pay the companies in cash according to the prices laid down in the contracts. These prices vary from contract to contract, and in all cases provision is made for them to be adjusted upwards or downwards proportionately to the rise or fall in the average world price in certain predetermined markets for crude oil of a comparable quality. YPF undertakes to pay all royalties and taxes to which the contractors would otherwise be liable, including import duties on materials brought into the country for their operations. These are taken into account in the amount YPF pays for the oil.

178. Some variations on this approach are involved in an agreement, which provides that if production is attained, YPF will authorize the foreign-controlled company to hand over an amount of oil which is equivalent, at world prices, to the cost of operation (including depreciation, amortization, etc.) during any one year to the company's refining and marketing companies in Argentina. In return, these companies are required to pay the producing company for the oil at world market prices. Thus the latter company's production costs are paid for in oil which is retained by its refining and marketing companies. After recouping its production costs, it delivers 10 per cent of the remaining production as a bonus to YPF until oil in the amount of £1.5 million at world prices has been delivered. Half the balance of the oil goes to YPF free, and half to the refining and marketing companies, which are required to pay for the oil at world prices.

179. The agreements between private companies and PEMEX, the Mexican government oil monopoly, typically provide for the exploration and exploitation programme to be carried out at the expense of the contractor, with payment to be made to him out of 50 per cent of production until he recoups his investment, and

thereafter an amount equal to an agreed percentage of production, often between 15 per cent and 18 per cent for periods of between twenty and twenty-five years.<sup>28</sup>

180. Under the Iranian Consortium Agreement, the two Consortium operating companies are empowered to carry out all exploration, production and refining operations within the concession area "on behalf of Iran and NIOC". Consortium trading companies have the right to purchase from NIOC all oil produced and refined by the operating companies, except for royalty oil taken in kind and petroleum products required for internal consumption in Iran. The agreement places particular emphasis on the training of local personnel.<sup>29</sup>

181. Many of the differences between these agreements are related to the fact that in some of these countries the oil is essentially used domestically (where it can be distributed by the government oil agency, such as PEMEX), while in other countries, especially Iran, the oil is intended for export through the distribution channels of the foreign oil companies.

182. With the exception of the PEMEX arrangements, which involve a considerable scaling down of the share of profits realized by the foreign companies under the traditional concession agreements, from the point of view of substance some of these agreements do not differ greatly from the traditional concessions. The degree of control in the foreign companies may be somewhat more limited, but the effective control and the potential for substantial profit sought by the foreign enterprise are present and, indeed, foreign companies have apparently been quite willing to supply know-how and capital under these contractual arrangements with local government monopolies.

183. The formal differences between these arrangements and the traditional concession arrangements which centre on the vesting of ownership of extracted minerals and all rights of exploitation in the local government monopoly are, however, of great political and psychological importance. Through these agreements it has been possible to develop a politically acceptable and economically sound resolution to the conflict between an unavoidable need for foreign capital and know-how and a prohibition against foreign ownership and control.

184. Contractual arrangements of this kind, which can

<sup>28</sup> See W. Brudno, "Tax and Legal Aspects of Investment in Mexico", in *Proceedings of the 1960 Institute on Private Investments Abroad*, The Southwestern Legal Foundation (Matthew Bender & Co., New York, 1960), p. 428.

<sup>29</sup> Article 4(F) of the Iranian Oil Consortium Agreement provides that the operating companies shall have the obligations:

"(4) To minimize the employment of foreign personnel by ensuring, so far as reasonably practicable, that foreign personnel are engaged only to occupy positions for which the Operating Companies do not find available Iranians having the requisite qualifications and experience;

"(5) To prepare in consultation with NIOC plans and programmes for industrial and technical training and education and to co-operate in their execution with a view to training Iranians to replace foreign personnel as soon as reasonably practicable and to affording Iranians every possible opportunity for occupying responsible positions in the operations of the Operating Companies."

<sup>27</sup> For example, one of the YPF agreements provides that the foreign contracting company "shall not be able to exercise any right of ownership either over the oil extracted or over the land forming the area of the contract, or over the subsoil".

of course be tailored to fit virtually any set of special circumstances, may be expected to become increasingly more important in connexion with the effort to draw managerial know-how and capital into enterprises owned and operated by governmental agencies in under-developed countries, particularly in sectors in which local law and public sentiment preclude ownership and control by foreign interests.

## 7. ILLUSTRATIONS

185. In order to place the contractual devices discussed in this report in the perspective of the factual context in which they operate, it may be useful to examine, as practical examples of their utility, two ventures in under-developed countries, one in the industrial sphere and one in the extractive sphere. Both of these ventures afford illustrations of the flexibility and inter-relationships of the devices here discussed and the role they can plan in channelling know-how into the under-developed countries.

### A. Industrial venture

186. An enterprise which is now one of the leading producers of dyestuffs and pharmaceuticals in India was established in 1947 primarily through the efforts of a United States company, an Indian industrialist and the Government of India.<sup>30</sup> The Indian enterprise was from the outset controlled by Indian interests. Initially, the United States company owned 10 per cent of the equity of the enterprise. In addition, the United States company entered into an agreement with the local enterprise under which it was provided, in part, that the United States company would supply technical data and information with respect to plant layout, equipment specifications and the organization required to construct the plant and to purchase and install the equipment; grant licences under its manufacturing processes and provide necessary technical assistance, including the services of a chemist and staff; and train technicians on behalf of the receiving enterprise. The agreement provided for payment to the United States firm in United States dollars of the latter's costs of providing all services supplied and, as compensation for the licences and technical data, royalties in the amount of 2½ per cent of the "net sales value" of the products manufactured and sold by the recipient enterprise. The agreement further provided that the United States company would sell to the Indian enterprise, upon mutually agreed terms, chemicals of its own manufacture required for the operation of the Indian plants. The Indian enterprise was permitted to use the United States company's name and goodwill in advertising, subject to the latter's right to inspect the manufactured products to insure their compliance with its quality standards. Subsequent agreements covering the manufacture of other products developed by one of the United States company's subsidiaries have also been entered into.

187. In July 1948, the Indian company entered a general agreement with a Swiss company covering the collaboration of the two companies in the manufacture of various pharmaceuticals and chemicals, each to be covered by a specific agreement. The first product to be manufactured by the Indian company under this arrangement was sulfathiazole. The applicable specific agreement provided for the construction by the Indian company of the necessary manufacturing facilities and for the furnishing by the Swiss firm of all technical information necessary in connexion with the construction and equipping of the plant and for a licence to the receiving enterprise to manufacture under the secret processes concerned. Here the entire production of the Indian licensee was to be purchased and marketed by the Swiss firm. The agreement specifically provided that the Indian company would not sell the sulfathiazole to third parties or through its own marketing facilities without the consent of the Swiss company and subject to the payment to it of a royalty to be agreed upon. The agreement provided that the sulfathiazole manufactured would be sold to the Swiss company or its nominee at the full cost of production plus 15 per cent, provided that the total price would not be unreasonably in excess of the delivered world price, in which case the Swiss company reserved the right to purchase elsewhere. If, moreover, the Indian company could produce and deliver at a price computed in accordance with the agreement which proved to be more than 10 per cent below the delivered world price from other sources, the two companies would divide the price differential in a proportion to be agreed upon. The manufacture by the Indian company of other products of the Swiss company has been covered by subsequent specific agreements.

188. In 1955, an agreement was entered into between the Indian company, a British chemical company and an Indian subsidiary of the latter, which provided for the organization of a new joint venture company, owned 50 per cent by the Indian company and 50 per cent by the Indian subsidiary of the British company, for the manufacture of dyes. Subsequently, a technical agreement was entered into between the British company and the Indian joint venture company which provided that the former would design the plant and equipment, supervise the construction of the plant, provide all information necessary for the operation of the plant, and make arrangements for the training of personnel for the management of the operation. For this assistance, it was to be paid the cost incurred by it in the design work, ordering, inspection, shipping and erection of the plant. No royalties were provided, but the joint venture company agreed to make contributions to the British company's research in the field in question in the amount of 2 per cent of the net sales value of certain products produced and sold by the joint venture company. It was also agreed that the British company's Indian subsidiary would process and pack the joint venture company's production as long as desired and would be offered, subject to terms to be agreed upon, 70 per cent of such production for purchase and marketing.

<sup>30</sup> This venture is described in detail in *Joint International Business Ventures*, Friedmann and Kalmanoff, Eds. (Columbia University Press, 1961), pp. 380-392.

189. The day-to-day management of the Indian company involved in these various arrangements is handled by an Indian firm of managing agents, under a management contract. This is a deviation from the normal pattern of management contracts with enterprises of the industrialized countries, no doubt attributable to the fact that a very substantial reservoir of managerial talent has been developed in India in the firms of managing agents which have played a key role in Indian business for many years. Under the twenty-year management contract, the managing agent is vested with control over the general conduct and management of the business of the company, subject to the supervision and direction of the board of directors. The managing agent is represented on the eight-man board by two directors. The agreement provides that the managing agent cannot be removed during the term of the agreement unless found guilty of fraud or wilful misconduct in management of the business. The compensation received by the managing agent consists of (1) reimbursement for all expenses incidental to formation of the company and incurred in the management of the business; (2) Rs. 3,000 per month; and (3) a commission of 10 per cent of the net annual profits of the company.

190. Thus we find, in connexion with this successful venture, contractual arrangements between the know-how-receiving enterprise and three large companies in three different highly industrialized countries under which technical assistance and information with respect to plant design and construction, production and marketing are made available, and licences to manufacture under the technical processes concerned are granted.

#### B. Extractive venture

191. An illustration of the operation of some of the contractual devices here discussed in the extractive sphere is afforded by a \$200 million venture for the mining of iron ore in Liberia. This venture involves the channelling of capital from Canada, Sweden, the United States and the Federal Republic of Germany and of know-how from Sweden and the United States into an enterprise for extracting of Liberian iron ore, large quantities of which will be shipped to the Federal Republic of Germany and the United States for processing.

192. Undivided interests of 25 per cent and 75 per cent in the concession from the Liberian Government are held respectively by a United States steel company and a Liberian company (50 per cent owned by the Liberian Government) which have formed a joint venture (in which their respective interests are also 25 per cent and 75 per cent) to operate the concession. The concession involves a feature which distinguishes it from the traditional concession agreement. The arrangement basically calls for a 50-50 split of profits between the Liberian Government and the foreign participants but, instead of obtaining its full participation in profits through the payment of royalties or taxes by the foreign concessionaires, the bulk of the Liberian Government's profit participation

results from its ownership of 50 per cent of the equity capital of the Liberian company<sup>31</sup> which holds a 75 per cent interest in the profits of the Joint Venture. The Liberian Government's 50 per cent participation in the 25 per cent of the joint venture profits to be received by the United States steel company is effected under a tax agreement providing for payment by the United States steel company of taxes to the Liberian Government at the rate of 50 per cent of its net profits.

193. The project is being managed by a Swedish syndicate, consisting of six Swedish companies under a management contract with the joint venture participants. Under the management contract the Swedish syndicate is granted supervisory control over all aspects of the extraction operations, including all construction work, in return for a management fee consisting of its costs, plus, until commercial production commences, a fixed annual fee payable quarterly and, after production begins, amounts payable monthly which are geared to production.

194. All operations relating to the marketing of the ore produced, including advising on proper production and stockpiling schedules in the light of market conditions and handling all shipping arrangements are to be managed by one of the Swedish companies participating in the syndicate under an agreement appointing this company as exclusive world-wide sales representative and providing for payment of a stated sales commission. The scope of the discretion vested in the Swedish sales representative is subject to the limitation that it must act within a framework of general sales policies, including a price range, approved by the Liberian company and that long-term contracts must be submitted to the Liberian company for approval.

195. Since virtually all basic utilities are lacking, a wide range of engineering and construction must be carried out. In addition to designing and installing the machinery and equipment required for the actual mining operations, it is necessary to design and build a 160-mile railroad from the deposit to the nearest harbour where extensive port facilities must be constructed. In addition, road, airport and storage facilities and entire town sites must be designed and constructed. The civil engineering is being handled by one Swedish company and the mechanical and electrical engineering by another, both of which are participants in the Swedish syndicate. The construction of the port and other facilities is being carried out by a Liberian subsidiary of a large international construction company controlled by United States interests.

196. The deposit is estimated to contain 235 million tons of high quality ore and up to 500 million tons of indicated reserves. The major financing arrangements include the sale of \$50 million of 6½ per cent first lien collateral bonds due in 1980 to a government institution of the Federal Republic of Germany, the sale of

<sup>31</sup> The Liberian Government owns one million class A shares which are entitled to elect five directors. One million class B shares, entitled to elect six directors, are owned by a Canadian company, a majority of the shares of which are owned by the Swedish syndicate which is managing the project.

\$30 million of 5% per cent first lien collateral bonds due in 1980 to the Export-Import Bank of the United States and the sale of \$38 million of 6% per cent subordinated debentures due in 1985 to the Swedish syndicate. Shipments of ore are expected to commence in 1963.

197. This Liberian venture illustrates the role that some of the highly flexible arrangements discussed in the present report, including mineral exploitation agree-

ments, engineering and construction contracts and management contracts, can play in marshalling capital and know-how from industrialized countries, in this case Canada, Sweden, the Federal Republic of Germany and the United States, for the carrying out in an underdeveloped country of a mineral extraction project which requires capital and know-how far beyond the capacity of local resources.

## CHAPTER II

### Incentive measures

198. A wide range of measures designed to promote the international flow of private capital have been adopted by the governments of both capital-supplying and capital-receiving countries. They include the provision of information on investment opportunities and assistance in their implementation; the provision of economic and social overhead facilities and of supplementary finance; fiscal measures (including broad tax concession schemes, import duty concessions, other special reliefs, and unilateral or bilateral provisions for the avoidance of double taxation); and measures for the protection of foreign investments.

199. Incentive measures were discussed in detail in the progress report.<sup>32</sup> Recent innovations and changes brought to the attention of the Secretary-General, largely in response to his recent inquiry,<sup>33</sup> are summarized in the following paragraphs.<sup>34</sup>

#### Information centres

200. Investment information centres are usually designed to promote domestic investment as well as to encourage the inflow of foreign capital. Where the capital-receiving country has a development programme which defines the particular role assigned to the private sector, the centre will often have special responsibilities for directing private capital to the industries, and even specific ventures, contemplated in the plan, so as to secure maximum benefits from available investment capital. Thus, the Investment Promotion Bureau of Pakistan, which was set up in 1959 with the object of giving "maximum scope to private enterprise in the development of the resources of the country", has as its main task "to promote foreign and local private investment in industry, with a view to realizing the targets of the country's development plans in the private sector". The Bureau has distributed the Government's "Industrial Investment Schedule for the private sector within the framework of the Second Year Plan"; this Schedule lists in detail the different industries selected and the investment contemplated in each of them. In assisting the implementation of this part of the Plan, the Bureau will provide not only investment advice and

information but will also receive and expedite all applications from potential investors for necessary permits, facilities, etc.<sup>35</sup>

201. Similarly in Ghana the announced economic development policy expressly recognizes the private enterprise sector as one of five different sectors in the country's structure. The Industrial Promotion Division of the Development Secretariat not only gives advice to prospective investors, but also examines and makes recommendations on their projects, and co-ordinates the activities of different ministries in providing tax relief, licences, priority allocations, etc. The Division provides these services not only to new investors but equally to established investors, in recognition of the fact "that one of the best ways to persuade newcomers to invest in Ghana is to earn the goodwill and appreciation of investors who are already in Ghana".<sup>36</sup>

202. The Development Centre of Ecuador, recently established by the Government under an agreement with the Inter-American Co-operative Development Service, has important advisory and research functions in economic development planning, and on that basis is responsible for promoting domestic and foreign investment in high priority fields. It seeks out appropriate investment opportunities, undertakes studies on the adaptation of advanced industrial technologies to the conditions prevailing in Ecuador and, generally, lends technical and administrative assistance to prospective investors in the establishment, financing and execution of industrial projects.<sup>37</sup>

203. The newly opened Indian Investment Centre, sponsored by the Government with the help of funds from the United States Technical Co-operation Mission, will serve as "a catalyst for foreign investment". Under the Government's industrial policy, the development of all industries not specifically assigned to the exclusive or primary responsibility of the State is left to the private sector and will be facilitated and encouraged by the "Government in accordance with the

<sup>32</sup> E/3325 and Corr.1 and 2, chapters III and IV.

<sup>33</sup> See annex I.

<sup>34</sup> Measures for the protection of foreign investments are discussed in chapter III below.

<sup>35</sup> *Guide to Investment in Pakistan* (Investment Promotion Bureau, Ministry of Industries, Government of Pakistan, Karachi, 1960), p. 1.

<sup>36</sup> Reply by the Government of Ghana to the inquiry of the Secretary-General.

<sup>37</sup> Reply by the Government of Ecuador to the inquiry of the Secretary-General.

programmes formulated in successive five year plans". In this connexion, it is the task of the Investment Centre to disseminate information on relevant laws, policies and procedures and, generally, to advise and assist investors on all matters relating to the establishment of approved industrial enterprises in India. It will also play a part in the encouragement of joint ventures between Indian and foreign business men.<sup>38</sup>

204. The Government of the Republic of China advised the Secretary-General in reply to his inquiry that assistance to domestic and foreign investors is provided by the Investment Service Group of the Research Centre for Industrial Development Investments, which helps potential investors by answering specific inquiries, and providing other facilities for their undertakings.

#### *Supplementary finance*

205. International and regional financial institutions, as well as national institutions established within the capital-supplying countries and development banks and corporations established in under-developed countries, are designed to provide supplementary finance in connexion with foreign (and domestic) private capital investments in under-developed countries.

206. A special type of national institution, which started operations in 1960, is the Industrial Promotion Corporation of Rhodesia and Nyasaland (IPCORN). IPCORN is privately financed, but is government-backed and is expected to play the part in the Federation which in many other countries is played by government-sponsored development corporations. To this end, it acts both as a financial institution and as an investment centre. It will provide financing for industrial projects out of its subscribed capital and out of additional funds it may borrow with the possibility of government guarantees for borrowing from abroad; it will give, especially to foreign investors, needed information and advice on legal, economic and technical matters; and it is empowered to assist investors in their negotiations with government agencies and private parties.<sup>39</sup>

207. The year 1960 saw the establishment of two new regional institutions in Latin America: the Inter-American Development Bank and the Central-American Economic Integration Bank. The IDB became operative on 1 October 1960, with total authorized capital stock of \$850 million, subscribed by twenty Latin American countries and the United States. The Bank has under consideration the possibility of supplementing its financial resources by the sale of its bonds. It also seeks direct private capital participation in its operations, and has obtained such participation by private banks in the United States in its very first financing project, in Peru. The Bank has indicated its readiness to supply technical assistance to private enterprises as well as to public bodies in the preparation,

financing and execution of projects including the making of pre-investment surveys. In particular, the Bank may directly provide or guarantee loan financing to private enterprise or assist in the establishment, reorganization and financing of national development banks and corporations and put funds at their disposal for the financing of individual projects.

208. One of the most important of these intermediate financial institutions which will enjoy the Bank's technical and financial support is the Central-American Economic Integration Bank, established by a multilateral treaty between Guatemala, El Salvador, Honduras and Nicaragua of 13 December 1960, for the financing of public and private investment projects which will serve the economic integration and balanced economic development of the four countries.

#### *Tax measures*

209. *Measures of capital-supplying countries.* The broad measures, discussed in the Progress Report,<sup>40</sup> by which most major capital-supplying countries have reduced or even withdrawn their tax demands on foreign income, apply equally to income from developed as from under-developed countries.

210. The intervening period, however, has seen a number of measures adopted or put forward which tend to favour foreign investments in the under-developed countries over such investments in the industrialized countries. In the case of the United States, the proposals recently addressed by the President to Congress<sup>41</sup> are designed, *inter alia*, to counteract the recent strains on the balance of payments, by withdrawing some of the most important tax incentives from investments in the developed countries. Their retention solely for investments in under-developed countries is expected to "enhance the relative attraction of investment in the less developed countries".<sup>42</sup>

211. There are two tax incentives which are proposed to be limited to income from under-developed countries: the more important of these is the privilege of deferring United States tax liability on profits of foreign subsidiaries until their repatriation in the form of dividends;<sup>43</sup> this privilege is particularly interesting from the point of view of the capital-receiving country, since by encouraging retention of profits it decreases the demand for foreign exchange and promotes reinvestment and expansion. It should, however, be noted that the retention of the deferral privilege for income from under-developed countries is to be limited to

<sup>38</sup> E/3325 and Corr.1 and 2, paras. 135-145.

<sup>41</sup> *Our Federal Tax System*, Message submitted by the President to Congress on 20 April 1961 (Part III, *Tax Treatment of Foreign Income* (Congressional Record, Proceedings and Debates of the 87th Congress, First Session, vol. 107, No. 140, House of Representatives)).

<sup>42</sup> *Ibid.*, paras. 1 and 3.

<sup>43</sup> See Progress Report, paras. 138-139. As there explained, previous legislative proposals had contemplated on the contrary extending the deferral privilege still further, especially to profits of qualified foreign branch operations (e.g. through the use of so-called Foreign Business Corporations).

<sup>39</sup> Reply by the Government of India to the inquiry of the Secretary-General.

<sup>40</sup> Reply by the United Kingdom to the inquiry of the Secretary-General.

income from direct (capital) investment, and would not extend to income derived from the licensing of patents and know-how to foreign enterprises.

212. The other tax concession involved is the outright exemption of earned income, within certain limits, received by United States citizens during their residence or extended stay abroad. The retention of this privilege for such income earned in under-developed countries only should provide an added incentive for managerial and technical specialists serving in these countries, especially where the latter in turn offer concessions against their own tax or the salaries of such technicians.<sup>44</sup>

213. The Tax Amendment Act of 3 May 1961 of the Federal Republic of Germany grants special tax privileges on account of capital investments in under-developed countries if they qualify as "contributions to economic development justifying special incentives".<sup>45</sup> Under this privilege, the investor may credit up to one-third of the cost of the investment to a reserve which is fully deductible from taxable profits in the year when the investment is made. Beginning with the third subsequent year, the reserve is to be dissolved by adding one-fifth of it to the taxable profits of each of the following five years. A corresponding privilege is provided for the purposes of the Fortune Tax.<sup>46</sup>

214. A similar development favouring investment in under-developed countries is apparently taking place in the United Kingdom. Here recent demands by the business community for an extension of the general tax deferral privilege, through a liberalization of the Overseas Trade Corporation concept,<sup>47</sup> were not accepted by the Government. It instead has proposed to include in existing and future tax agreements with under-developed countries the so-called tax-sparing provision under which the United Kingdom would allow as a credit against its tax on income from the co-contracting country not only the foreign tax actually paid thereon, but also the amount of such tax which was abated as a special investment incentive.<sup>48</sup> This provision has already been implemented in the tax agreement concluded with Pakistan on 26 April 1961.

215. *International Tax Agreements.* Tax-sparing privileges had previously been included in a number of

recent income tax agreements between other countries. These are the agreement signed on 5 January 1960 between India and Japan, which has already gone into effect, and the treaties concluded by the United States with India on 10 November 1959, Israel on 20 September 1960 and the United Arab Republic on 21 December 1960, which, however, have not as yet been ratified. Tax-sparing is also provided under the Israel-Sweden treaty of 22 December 1959 (ratified on 5 June 1960), though for dividends received by Swedish individuals and for interest income only, since all other categories of income derived from Israel which remain taxable in Israel will be altogether exempt from Swedish tax.

216. The treaty between India and Japan, as well as a treaty signed by India with Norway on 20 July 1959, embodies some of the significant departures from the traditional pattern established in treaties between developed countries which were described in the progress report.<sup>49</sup> Thus, not only profits from foreign branch operations (as in the traditional treaty scheme) but income from capital (dividends, interest and royalties) as well remain fully taxable at source, while relief from double taxation is provided wholly through concessions on the tax in the investor's home country—by exemption in the case of the treaty with Norway and by a credit under the treaty with Japan. Similarly, profits derived in one country by a shipping company of the other country are not wholly exempt in the latter, as required in most other treaties; instead double taxation is avoided by a reduction in the tax claims of both countries.

217. In addition to the treaties already mentioned, general income tax agreements were further concluded recently by Sweden with Israel on 22 December 1959 and Tunisia on 6 September 1960, and by Pakistan with Japan on 12 February 1959 and Switzerland on 30 December 1960. All these follow largely the traditional pattern of such agreements, except that in the two Swedish agreements dividends derived by Swedish companies from the other country are exempt from Swedish tax.<sup>50</sup>

218. France concluded an agreement with Madagascar on 30 April and 8 June 1959 under which dividends paid out of profits from the latter country are exempt from the French proportional tax. An up-to-date table of all general income tax agreements covering under-developed countries and territories is contained in annex III.

#### *Measures adopted by capital-receiving countries*

219. Tax incentives continue to be offered by most under-developed countries to attract foreign—and domestic—capital into useful channels of investment.<sup>51</sup> Among the newly independent countries, Cameroun adopted an Investment Code on 11 June 1960, which

<sup>44</sup> This is the case, for example, in India and Pakistan (see paras. 222-223).

<sup>45</sup> New paragraph 34(d) of the Income Tax Law and paragraph 19(b) of the Company Profits Tax Law.

<sup>46</sup> New paragraph 9(a) of the Fortune Tax Law.

<sup>47</sup> E/3325 and Corr.1 and 2, para. 140. The liberalization would have deferred the United Kingdom tax not only—as at present—on profits from direct (branch) operations abroad but also on profits in the nature of dividends received from foreign subsidiaries of the Overseas Trade Corporation, until the latter in turn distributed these profits to its stockholders in the United Kingdom.

<sup>48</sup> Budget Speech of the Chancellor of the Exchequer, 17 April 1961 (*House of Commons, Parliamentary Debates, Weekly Hansard No. 519*, 17 April 1961, columns 811-812). In this speech the Chancellor also proposed the extension of the unilateral tax credit, currently given only for foreign central government taxes, to taxes of foreign provincial and local authorities; this added privilege would be available with regard to industrialized as well as under-developed countries.

<sup>49</sup> E/3325 and Corr.1 and 2, para. 143.

<sup>50</sup> In the case of Switzerland, the same rule applies, under domestic Swiss law, in the case of dividends received from qualified foreign subsidiaries.

<sup>51</sup> See also progress report, document E/3325 and Corr.1 and 2, paras. 146-159. A selected list of relevant legislation is included in annex II.

classifies enterprises in four categories according to their importance to economic development and varies tax concessions accordingly. The latter may include a five-year tax holiday to qualified investments with a deferral of the depreciation charges, normally deductible during that period, to the five-year period following the tax-free years. For high-priority enterprises immunity from tax increases may be guaranteed for up to twenty-five years. This latter privilege is also provided under the new Private Investment Law of the Ivory Coast<sup>52</sup> and —for a ten-year period covering customs and direct taxes only—under the recent Foreign Investments Law of Somalia.<sup>53</sup>

220. The Industrial Development Ordinance of 1958 in Nigeria broadens the tax holiday concept for "pioneer industries" by counting as part of the exemption period (which may go up to five years) only those years during which taxable profits were earned, thus excluding from the calculation the years in which the enterprise suffered a loss—a liberalization which is particularly interesting during the early years of a new enterprise.

221. Several capital-receiving countries which have had tax concessions in effect for many years proceeded to revise their legislation in the light of the experience accumulated in their operation. Thus, the 1959 revision of the Israeli Law for the Encouragement of Capital Investment was the third version of this legislation, which had been introduced in 1950 and revised in 1955. The latest enactment "offers considerably greater benefits to investors, especially in regard to tax exemptions and currency exchange regulations. The administrative machinery was also streamlined."<sup>54</sup>

222. The new legislation in Pakistan, which replaces and broadens earlier provisions that had been suspended as of 31 March 1958, is especially addressed to the Second Development Plan in that it applies only to undertakings established no later than June 1965, the end of the Plan period. In order to qualify, industries must be operated by companies with a minimum capital, must be primarily based on Pakistani raw materials and must set aside for expansion and development at least 60 per cent of the profits earned during the tax holiday. The tax exemption period is in principle four years, and depreciation charges may be postponed until after the expiration of this period. In addition, dividends paid by companies enjoying tax holidays are exempt from income and super-tax (totalling 45 per cent) and remain subject only to the 15 per cent dividend tax. Other tax concessions include a two-year tax exemption for the salaries paid to foreign technicians.<sup>55</sup>

223. Similar tax concessions in India have also re-

cently been expanded<sup>56</sup> by a reduction in the tax on dividends paid by non-subsidiary Indian companies to foreign companies from 63 per cent to 50 per cent; the tax on dividends paid by Indian subsidiaries to foreign parent companies had earlier been reduced from 63 per cent to 30 per cent. Special concessions are provided in the 1961 Finance Bill for royalties payable to foreign suppliers of patents and know-how to Indian enterprises, through the reduction of the tax from the ordinary rate of 63 per cent to 50 per cent. These various reductions are particularly valuable for recipients in those major capital-supplying countries which allow foreign income taxes to be credited against their own taxes on the foreign income. Since the reduction will bring the Indian tax down to a level close to that prevailing in most of these countries, the latter can now be fully absorbed by the tax credit, so that foreign capital and know-how can be supplied to Indian enterprises at a tax cost which will not constitute an effective burden on the recipient. The same purpose is served by the extension, in the 1961 Finance Bill, of the exemption of the remuneration of foreign technicians to a maximum, in certain cases, of five fiscal years.

224. The Republic of China, which had had earlier investment legislation since 1954, adopted a new Statute for the Encouragement of Investment on 31 August 1960 which, *inter alia*, extends the tax holiday period from three to five years, reduces the business income tax, gives tax privileges to certain types of savings and investment in industrial shares, and provides for the periodic revaluation of fixed assets.<sup>57</sup> Similar periodic revaluation privileges are contained in the new industrial promotion laws of Bolivia<sup>58</sup> and Chile<sup>59</sup> under which qualified enterprises may in addition secure an assurance against increases in direct taxes (whether by law or by regulatory interpretation), and various concessions against existing taxes.

225. Guatemala also replaced an earlier Investment Promotion Law of 1947, which had been modified in 1952, by a new Law<sup>60</sup> which grants broader concessions against import duties and direct taxes for up to ten years, but carefully controls allocation of these tax privileges by requiring a technological and economic analysis of the potential value and efficiency of every investment proposal.

226. The new Peruvian Industrial Promotion Law<sup>61</sup> seeks to stimulate investment in the less developed regions of the country by steeply graduating the tax concessions according to the place where the new enterprise is to be established. Tax concessions available are quite broad and may extend to direct and indirect central and local taxes. Limited tax holidays as regards import

<sup>52</sup> Reply by the Government of India to the inquiry of the Secretary-General.

<sup>53</sup> Reply by the Government of the Republic of China to the inquiry of the Secretary-General.

<sup>54</sup> Investment Promotion Law of 16 December 1960.

<sup>55</sup> Foreign Capital Investment Law (Decree-Law No. 258 of 30 March 1960).

<sup>56</sup> Industrial Promotion Law (Decree No. 1317) of 30 September 1959.

<sup>57</sup> Industrial Promotion Law (Law No. 13270) of 30 November 1959.

<sup>58</sup> Law No. 59-134 of 3 September 1959, article 6.

<sup>59</sup> Law No. 10 of 18 February 1960, article 13.

<sup>60</sup> *Law for the Encouragement of Capital Investments*, introduction, p. 3; published by the Investment Centre, Ministry of Commerce and Industry, Jerusalem, 1959.

<sup>61</sup> See *Guide to Investment in Pakistan* (Investment Promotion Bureau, Ministry of Industries, Government of Pakistan, Karachi, 1960, p. 1).

duties and income taxes are also available under new laws in Burma<sup>62</sup> and Thailand.<sup>63</sup>

227. It may be interesting to note that more advanced capital-importing countries also use tax incentives to attract foreign capital though chiefly in order to direct investment into a particular type of favoured activity. Thus, Ireland informed the Secretary-General, in its reply to this inquiry, that companies engaged in manufacture for exports will, in addition to con-

cessions on local taxes, receive full exemption from income and profits taxes for ten years with a reduction in these taxes for an additional five-year "tapering off" period. This exemption is extended until 1983 for export industries established in the Shannon Free Airport area. This directional tax incentive, which is quite closely defined in its scope of applicability, may be considered characteristic for the use of the tax incentive technique in the more advanced tax systems, as discussed in the progress report.<sup>64</sup>

<sup>62</sup> Union of Burma Investment Act (Law No. 41) of 1959.

<sup>63</sup> Industrial Investment Act of 17 October of the year 2503 of the Buddhist Era (1960).

<sup>64</sup> E/3325 and Corr.1 and 2, paras. 157-159.

## CHAPTER III

### Measures for the protection of foreign investments

#### 1. INTERNATIONAL CREDIT INSURANCE

228. At its fifteenth session, the General Assembly requested a report on the feasibility of extending the scope of existing national credit insurance institutions, of creating new institutions or arrangements of this kind and of establishing international credit insurance organizations.<sup>65</sup> During the discussion in the Second Committee<sup>66</sup> which preceded the adoption of this resolution, it was made clear that its sponsors were concerned with a gap in the existing range of facilities for the foreign private financing of economic development, namely, the granting of medium- and long-term (i.e., upwards of five years) loans not tied to purchases from any particular country.

229. Most countries exporting manufactured and capital goods operate export credit insurance schemes covering short- and medium-term credits tied to export sales. Some of the schemes have recently been expanded to provide coverage for medium- and long-term loans granted by financial institutions, which are, however, still tied to purchases of equipment in a particular country, if not from a specifically named firm.<sup>67</sup> In addition, a few countries make available to private investors facilities for the insurance of equity investments,<sup>68</sup> and under at least one of these schemes (the United States Investment Guaranty Program) insurance is also available for loans, though it appears that little use has been made of this provision. But no national or international schemes for the insurance of untied medium- and long-term credits exist at present, still less any form of guarantee for bond issues of under-developed countries.

#### A. Existing national credit insurance schemes

230. Government operated or controlled export credit insurance schemes exist in most of the major industrial countries and in a few of the less industrialized

countries.<sup>69</sup> These schemes have been reviewed in considerable detail in a study by the United Nations Economic Commission for Europe published in September 1960.<sup>70</sup> The following paragraphs therefore refer chiefly to developments since that date.

231. Under the "ordinary" schemes of most western European countries export credit insurance cover is available for commercial, political and transfer risks for between 70 and 90 per cent of the total value of the transaction. This cover may be extended for periods of up to five years, though it would appear that in most western European countries the bulk of insurance policies written are short-term, for periods of eighteen months or less. Since 1959, however, the period for which insurance cover is available has been extended in a number of countries.

232. In July 1959 the *Federal Republic of Germany* adopted a "capital export" scheme for the insurance of longer-term credits (up to ten and, exceptionally, fifteen years) against non-commercial risks, and since then several other countries have extended the period for which coverage is available.

233. In July 1960 the period for which insurance cover could be obtained under the *Austrian* scheme was extended from five to eight years by allowing for a three-year "production period".<sup>71</sup>

234. In October 1960 the *United Kingdom* Government announced that in future the Board of Trade's Export Credits Guarantee Department (ECGD) would "insure credit on longer terms than the normal maximum (of five years) in particular cases where this is necessary

<sup>65</sup> General Assembly resolution 1523 (XV) of 15 December 1960.

<sup>66</sup> Official Records of the General Assembly, Fifteenth Session, Second Committee, 706th meeting.

<sup>67</sup> See below, sub-section A.

<sup>68</sup> See section 2 of the present chapter, paras. 269 et seq.

<sup>69</sup> Among the countries in which export credit guarantee insurance schemes are known to exist are Australia, Austria, Belgium, Canada, Denmark, the Federal Republic of Germany, France, India, Ireland, Israel, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the Union of South Africa, the United Kingdom and the United States.

<sup>70</sup> "A Note on Recent Developments and Problems of Export-Credit Guarantees (with special reference to Western Europe)" *United Nations Economic Bulletin for Europe*, vol. 12, No. 2, September 1960.

<sup>71</sup> Reply by the Government of Austria to the inquiry of the Secretary-General.

to allow a United Kingdom exporter to match terms offered by a foreign competitor...with official support".<sup>72</sup> A few months later, in April 1961, it was announced that the ECGD would henceforward guarantee loans made by financial institutions (including banks, insurance companies and pension funds) to "credit-worthy overseas purchasers" for periods longer than five years, the proceeds to be used for making payments to United Kingdom exporters. This scheme is intended to provide finance for large capital projects costing more than £2 million (\$5.6 million), and will not be available for smaller loans except loans for the purchase of ships.<sup>73</sup>

235. In February 1961 the Government of Italy adopted a new export insurance law extending the coverage on contracts for work abroad by Italian construction enterprises.<sup>74</sup> Further legislation to provide guarantees for credits of up to ten years' duration granted by financial institutions is currently under consideration.<sup>75</sup>

236. The Government of France had recently decided to extend in certain cases and under certain conditions the term for which commercial credit insurance is available from five to ten years.<sup>76</sup>

237. There is no institution in the United States comparable to the export credit guarantee organizations found in most western European countries. Some insurance facilities are made available by the Export-Import Bank which, however, greatly reduces the need for export credit and insurance facilities by the provision of long-term loans and lines of credit to banks abroad to finance the purchase of capital goods and commodities from the United States. Until recently, the Eximbank would only guarantee medium-term (not short-term) transactions against commercial and political risks under its "comprehensive guarantee" system or, in certain cases, by buying for cash from the exporter up to 85 per cent of the financed portion of the transaction.

238. Short-term (180 days or less) export credit guarantees were first made available through the Eximbank in May 1960. Coverage was restricted to political risks, as it was held that adequate facilities for the insurance of commercial risks were available through private sources. In March 1961, as part of "a new export financing and guarantee program designed to place American exporters on a basis of full equality with their competitors in other countries,"<sup>77</sup> it was announced that comprehensive short-term guarantees, covering all types of business and non-business risks, would henceforward be made available. The policies will be written by private banks and others offering

financial assistance to exporters, which will themselves be issued guarantees by the Eximbank.

239. At the same time, the Bank announced an extension of its medium-term export financing and insurance facilities. In future, financing and insurance will be available for exports of semi-finished goods and consumer durables at medium-term, and for goods held, exhibited or leased abroad. Advance commitments, where appropriate, may also be obtained to place United States sellers of equipment and contractors for services in a competitive bidding position with foreign sellers and contractors. The Bank will also offer, for the first time, financing and guarantees for equipment, sold to public as well as private oil companies.<sup>78</sup>

#### B. *The possibility of extending the scope of existing national credit insurance institutions and creating new national institutions*

240. As noted above, several of the most important national credit insurance schemes have recently undergone or are currently undergoing substantial extension and modification. But the existing schemes and those under contemplation still fall short of the needs of the under-developed countries in two main respects:

(a) Under-developed countries may require credits for periods up to twenty years, while insurance is currently only available, in a limited number of cases, for periods up to ten or fifteen years;

(b) Under-developed countries require untied credits that can be used for purchases in any country.

241. It is generally accepted by the members of the Berne Union<sup>79</sup> that the maximum period for which export credits should be made available is five years. Recently, however, as noted above, government-owned or sponsored export credit insurance agencies have shown themselves increasingly ready to insure credits extended for more than five years. One of the results of this export credit insurance "race"—which has affected the extent of coverage available and the type of risks covered as well as the period—has been to bring about an increasing degree of standardization among existing insurance schemes, and to oblige new schemes to match if not exceed the range of facilities offered elsewhere. Thus the Government of Italy has indicated that one of the objects of the draft export insurance law presently under discussion is to consolidate existing export credit insurance provisions and bring them into line with the schemes in operation elsewhere.<sup>80</sup>

242. This extension and broadening of the terms on which export credit insurance is available raises the question of the availability of the underlying credits. Few exporters are likely by themselves to be able to extend credits for ten years or longer, and a financial intermediary would have to take over the claim. In

<sup>72</sup> Speech by the President of the Board of Trade quoted in *The Economist*, 29 October 1960.

<sup>73</sup> *The Times* (London), 13 April 1961.

<sup>74</sup> Law No. 68 of 17 February 1961.

<sup>75</sup> Reply by the Government of Italy to the inquiry of the Secretary-General; see also para. 243 below.

<sup>76</sup> *Official Records of the General Assembly, Fifteenth Session, Second Committee*, 706th meeting, statement by the representative of France.

<sup>77</sup> Export-Import Bank of Washington, Press Release No. 733 of 24 March 1961.

<sup>78</sup> *Ibid.*

<sup>79</sup> An international organization of export credit insurers in which all the main export credit insurance institutions are represented, with the exception of the Export-Import Bank, which has the status of an observer.

<sup>80</sup> Reply to the Secretary-General's inquiry.

most capital-exporting countries, however, it might be difficult to raise a sufficient volume of five- to twenty-year credits from private financial institutions on terms acceptable to the under-developed countries, even with a government guarantee. It therefore appears likely that any general shift towards the longer-term financing of exports of capital goods would probably be accompanied by the establishment of new financial institutions. These institutions, which if not government-owned would presumably operate under government guarantees, might adopt policies similar to those of the Eximbank, which not only finances individual export transactions but also grants to foreign governments of enterprises lines of credit for purchases of United States goods.<sup>81</sup>

243. The provision of guaranteed export finance through special institutions would go some way towards "untying" credits internally. It would not, however, affect the existing competition between different exporting countries. Uncontrolled competition among suppliers of capital goods with respect to the terms on which export sales are financed is not of unmixed advantage to importers, as it distorts the normal competitive pattern of export markets and may ultimately result in an increased external debt burden. The provision, as envisaged by the sponsors of the General Assembly resolution, of an untied "international" line of credit, available to private and public importers in under-developed countries for the purchase of capital goods from any supplying countries, would have considerable advantages for under-developed countries. On the exporting side it must be borne in mind that, while excessive international competition in export credit finance may have undesirable external and internal effects, the existing export credit guarantee schemes have all been established to promote the expansion of the individual countries' exports, and are not readily adaptable to multilateral purposes. One step in the direction of multilateralization may be taken by Italy in connexion with the above-mentioned draft legislation (para. 235) for the insurance of ten-year export credits which would be made available to developing countries on a multilateral (untied) basis so as to facilitate Italian participation in international financial consortia: a special provision of the new scheme would permit Italian insurance companies to co-operate at the international level with similar foreign institutions for the co-insurance and re-insurance of these multilateral credits.

### C. The internationalization of credit insurance

244. Loans and lines of credit provided or guaranteed by governmental institutions in the capital-supplying countries are likely to continue to be the main source of finance for imports of capital equipment by the under-developed countries. There is already substantial private participation in official multilateral and governmental loans (e.g., in the early maturities of

IBRD loans, finance supplied by United States private institutions in conjunction with Eximbank loans, etc.); it is, however, appropriate to inquire whether it is possible to create an international insurance scheme which would attract a larger volume of private capital for the provision of medium- to long-term equipment loans for development.

245. It has been pointed out above that existing export credit insurance schemes have all been established to promote the exports of particular countries, and thus do not readily lend themselves to multilateralization. In any truly multilateral export scheme the initiative in obtaining the insurance and the underlying credit would shift to the importer. This approach is common to the several schemes for the multilateralization of export credits and export credit insurance schemes that have recently been proposed.<sup>82</sup>

246. The creation of an export (or import) credit insurance scheme presupposes that broad agreement can be reached on highly complex problems of financing, coverage, rates, etc. The problem of the provision of the underlying credits on reasonable terms also remains. A first approach to the solution of these problems may be made within the framework of existing regional organizations. The Executive Secretary of the United Nations Economic Commission for Europe has initiated expert consultations on this subject (see paragraph 272 below). Within the European Common Market a group for the co-ordination of policy on credit insurance has already been established. This group will attempt to formulate suggestions on how the member states of the Community could harmonize their export credit insurance, financial credits and investment guarantees in the light of the Berne Union rule, and will seek suitable means to encourage the multilateral handling of the financial resources placed at the disposal of the development countries.<sup>83</sup>

247. The extension of any such international credit insurance to the insurance of bond issues, which has been sometimes discussed, would present additional problems, especially where these issues were not tied to specific investment projects. However, the successful establishment of a multilateral credit guarantee scheme, even if restricted at first to the insurance of credits granted by groups of countries for specific projects, would represent a step towards the revival of the international bond market. In fact, the proposal for a regional International Guarantee Fund, prepared by the Economic Committee of the Council of Europe contemplates the extension of what is essentially an investment insurance scheme to the insurance of security issues of African public bodies (see paragraphs 273 et seq. below).

<sup>81</sup> See, for example, Segré, C., *Medium-Term Export Finance* in the *Banco Nazionale del Lavoro, Quarterly Review*, June 1958, and Errezero, *Export Credits to Under-Developed Countries on a Multilateral Basis*, op. cit., September 1959. Errezero describes his proposal as an "import credit insurance scheme". A proposal by Mr. X. Zolotas, Governor of the Bank of Greece, has also received attention.

<sup>82</sup> *Bulletin of the European Economic Community*, October/November 1960, p. 31.

<sup>83</sup> Thus, the further Italian export insurance legislation presently under consideration (see para. 235 above) would make provision for the granting of credits to foreign governments and banks by *Medio Credito*, a government financial institution.

248. Within the United Nations a careful study would be needed of the technical problems involved in the establishment of an international credit insurance scheme, and in particular of its relationship with medium-term export credit insurance and equity investment insurance schemes. A survey of the views of capital-supplying and capital-receiving countries regarding possible schemes is needed before a more substantial report can be submitted to the Economic and Social Council, on the basis of which it might consider whether any action by it to promote an international scheme on a regional or worldwide basis would be practicable or desirable at this time.

## 2. ADJUSTMENT OF DISPUTES RELATED TO PRIVATE INVESTMENTS

249. The progress report submitted at the twenty-ninth session of the Council discussed the manner in which fears of expropriation and of lesser non-business or political risks might act to deter foreign enterprises from taking advantage of promising investment opportunities in under-developed countries.<sup>84</sup> The intervening period has seen increased attention paid by governments and the investing community to this element in the so-called investment climate of under-developed countries and to ways and means of strengthening investors' confidence. Efforts in this respect are directed on the one hand to providing adequate assurances against the occurrence of the apprehended non-business risks, and on the other to opening effective means of redress to the investor whose rights or assets have been impaired by a political act. These two approaches are closely interrelated, since the effectiveness of assurances—and thus their value in the eyes of potential investors—is greatly strengthened by their enforceability, while the effectiveness of means of redress for the impairment of investors' rights depends in good measure on the manner in which these rights have been defined and established.

### *Assurances against the occurrence of risks*

250. In discussing the different methods by which such assurances may be given, reference was made in the progress report to those which are granted unilaterally by governments of capital-supplying countries or of capital-receiving countries, as well as to those which are included in bilateral or multilateral instruments concluded or contemplated between the various governments.

251. There is no question but that recently the unilateral and bilateral approaches have made considerable headway. In their response to the Secretary-General's inquiry, several governments emphasized the assurances proffered to foreign investors. The Government of Ecuador drew attention to the fact that nationalization of industry required prior indemnification. The Government of India stated that it "does not propose, as a matter of policy, to nationalize any industry merely for the sake of nationalization" and affirmed that its

policy is still governed by the Prime Minister's 1949 statement in Parliament that: "If any foreign concern is compulsorily acquired, Government will pay compensation on a fair and equitable basis."

252. The Government of Pakistan restated its earlier announcement that it "has no intention of nationalizing industries involving foreign investment. Should circumstances or an emergency necessitate nationalization, just and fair compensation will be paid in the currency of the country from where the foreign investment originated".<sup>85</sup> The promulgation of a Foreign Investment Law which would presumably incorporate these assurances is currently under consideration.<sup>86</sup>

253. Other governments referred to assurances incorporated in their investment legislation. In the Republic of China, the scope of these assurances depends on whether the foreign investor holds a majority or minority interest in the protected enterprise: in the former case the law contains an outright commitment against any nationalization or expropriation of the enterprise for the first twenty years of operations;<sup>87</sup> in the latter case there is no such undertaking, but the foreign investor is assured of reasonable compensation, if the enterprise is nationalized or expropriated "because of national defence needs".<sup>88</sup>

254. Similar assurances are contained in the new investment laws recently adopted by a number of countries in various regions of the world. Thus the Investment Law of Burma provides assurances against nationalization of a new enterprise during its first ten to twenty years. Compensation of a nationalized enterprise, moreover, is to be paid in the currency of the original investment.<sup>89</sup> Under the Bolivian law qualified foreign investments may in principle not be expropriated; if in exceptional cases, and for reasons of superior national interest, such expropriation becomes unavoidable, it may be effected only after the investor has been reimbursed in the currency in which the investment was originally made.<sup>90</sup> The Investment Law of Guinea generally assures foreign investment against "all spoliation" and provides that where it has to be taken over by the government because of "vital necessity for the national economy", the price to be paid will be "freely agreed by the parties".<sup>91</sup>

255. The Somali Foreign Investment Law provides guarantees, especially for non-discrimination and for a limitation of the admissible cases of expropriation.<sup>92</sup> Disputes which cannot be settled by negotiation are to be arbitrated, the umpire, in case of disagreement,

<sup>85</sup> Statement of Industrial Policy of 20 February 1959, published in *Investment opportunities in Pakistan*, p. 91 (issued by the Investment Promotion Bureau, Ministry of Industries, 1960).

<sup>86</sup> *Ibid.*, p. 19.

<sup>87</sup> Law on Investment by Foreign Nationals of 14 July 1954, as amended on 14 December 1959, article 15.

<sup>88</sup> *Ibid.*, article 14.

<sup>89</sup> Law No. 41 of 1959, article 6.

<sup>90</sup> Law of 16 December 1960, article 3.

<sup>91</sup> Investment Code (Ordinance 24) of 11 May 1960, article 4.

<sup>92</sup> Foreign Investment Law (Law No. 10) of 18 February 1960, article 15.

being selected by the President of the Court of Justice of Somalia.<sup>93</sup> The new Thai Promotion of Industrial Investment Act, which applies to both domestic and foreign investments, contains a flat guarantee against nationalization for approved investments.<sup>94</sup>

256. The status of foreign investments constituted the subject of a policy speech made by the President of Ghana on 9 October 1960.<sup>95</sup> Pointing to the role assigned to the private sector in the Government's development programme, the President rejected the possibility of nationalizing foreign enterprises, and added that the need to encourage foreign investment required a guarantee of a reasonable return on such investment. To this statement he added an invitation to foreign firms to submit suggestions on measures which they would consider appropriate to ensure the safety of their investments. If a mutually satisfactory arrangement should be worked out in response to this invitation, this direct approach by a government to the foreign investment community, established in, and familiar with the conditions and institutions of, the country, might well set a significant precedent for future handling of this difficult issue.

257. Where a government seeks to proffer assurances to foreign investors, much may depend on the form in which they are made. A formal policy statement issued by a government enjoying stable popular support undoubtedly will be given considerable weight by potential investors. Additional strength is lent these assurances where they are laid down in national legislation or in individual investment contracts, not only because the rights involved are more often defined with more detail and precision in such legal instruments, but also because governments, and especially successor governments, will consider themselves more surely bound by such instruments, and domestic courts will find them more readily enforceable, than policy statements. This enforceability, as pointed out above, is indeed an important factor in the evaluation of such assurances by the investor.

258. For the same reason, special interest attaches to the inclusion of these assurances in treaties under which the protection pledged to foreign investors by the signatory governments becomes enforceable in international law. Such treaties whose provisions were examined in the progress report<sup>96</sup> have been concluded with under-developed countries by the United Kingdom, the United States, the Federal Republic of Germany and, more recently, Japan. Recently the number of agreements of this type has been greatly increased. Among the new agreements which must be added to the list contained in the progress report are the Treaties of Friendship and Commerce concluded by Japan with the Philippines on 9 December 1960 and with Pakistan on 18 December 1960, the Treaties of Amity and Economic Relations concluded by the United States with Muscat and Oman on 20 December 1958

and with the Republic of Viet-Nam on 3 April 1961,<sup>97</sup> and the Treaties for the Promotion and Mutual Protection of Capital Investments, concluded by the Federal Republic of Germany with Pakistan on 25 November 1959, with the Federation of Malaya on 22 February 1960, with Greece on 23 March 1961, with Togo on 16 May 1961 and initialled with Iran on 28 February 1961. The Government of Pakistan has stated in its reply to the Secretary-General's inquiry that it is "endeavouring to negotiate with other countries bilateral agreements for the protection of foreign investments".

259. While the conclusion of this substantial number of treaties, largely in the course of one year, demonstrates the vitality of the bilateral approach, the number and geographical scope of such bilateral agreements is bound to remain limited for quite some time to come. As a result, interest has continued to be shown in the possibility of negotiating a multilateral charter for the protection of foreign investments. Three charter projects are currently under active consideration, two before regional inter-governmental organizations, the Organization for European Economic Co-operation and the Council of Europe,<sup>98</sup> and one within a non-governmental group, the Parliamentary Group for World Government.<sup>99</sup> All three proposals are still in a rather preliminary stage. Only one, the Draft Convention on the Protection of Foreign Property of the Organization for European Economic Co-operation has, in fact, been put into the form of a treaty text. The other two consist of reports outlining the basic features which are to be included in the proposed conventions.

260. All three proposals agree that the convention should be limited to the formulation of a few general rules considered basic for the protection of foreign investment. These general rules, moreover, are substantially the same in all proposals—namely, they relate to respect for contracts and agreements, non-discrimination and payment of full and transferable compensation in case of a taking of the investor's property.

261. There is one important difference between the projects: while the draft of the Organization for European Economic Co-operation is designed solely for the protection of foreign investments, the reports of the Council of Europe and the Parliamentary Group for World Government would combine assurances to foreign investors with an affirmation of the rights of the capital-receiving countries to adopt safeguards against outside interference and to exercise appropriate controls over the operation of foreign enterprises.

262. Because of the intentional limitation of the substantive provisions to what are considered to be minimum assurances, an important role is assigned in

<sup>93</sup> See also paragraphs 269 and 270 below concerning agreements concluded under the United States investment guarantee insurance scheme.

<sup>94</sup> See the *Report on an Investment Statute and a Guarantee Fund Against Political Risks* prepared by the Economic Committee of the Consultative Assembly (document 1027, 8 September 1959) and resolution 211 on the development of Africa adopted by the Consultative Assembly on 17 September 1959.

<sup>95</sup> *A World Investment Convention*, prepared by the Commission on a World Investment Code, July 1959.

<sup>96</sup> *Ibid.*, article 16.

<sup>97</sup> Law of 17 October 1960, Section 18 (2).

<sup>98</sup> *The Financial Times*, London, 10 October 1960.

<sup>99</sup> E/3325 and Corr.1 and 2, paras. 187-190.

all three projects to the establishment of arbitral procedures for the settlement of disputes arising between the investor and the government of the country of investment. In addition, the Parliamentary Group for World Government report contemplates the preparation of a series of additional standard clauses (dealing with such matters as repatriation of capital and profits, employment of aliens, scope of foreign capital control and participation in domestic enterprises) which governments could adopt bilaterally or on which they and the investors could draw in the formulation of individual investment contracts.

263. Clearly, if any kind of effective charter is to be adopted, its substance could hardly be reduced to less than what is proposed in these three projects. Yet, the fact remains that so far very little progress has been made toward the implementation of these—or earlier—proposals (see document E/3325, paras. 191-199).<sup>100</sup> What is more, the two inter-governmental projects have been prepared by regional organizations of developed countries: no doubt these governments of neighbouring countries which enjoy a common high level of development and have closely similar private enterprise patterns may find it easier to reach broad agreement on the provisions of such a charter than a world-wide selection of countries with widely varying economic structures and approaches. Indeed, while a multilateral charter will more effectively and more promptly secure the foreign investors' rights laid down in it than a gradually expanding system of bilateral investment treaties, the former's chances of acceptance are correspondingly reduced as the geographical net is sought to be spread more widely. Thus the draft Charter of the Organization for European Economic Co-operation, which is the only fully formulated project, is initially to be brought into operation only as between the European member countries of the Organization, with the expectation of subsequent accession by under-developed countries.

264. The Council of Europe's outline similarly has been prepared by representatives of European governments only, though the actual charter is to be formulated at a Conference on African Development which would bring together both developed (European) and developing (African) countries.<sup>101</sup>

265. The difficulty is generally understood to be not of disagreement in principle on the part of capital-receiving countries with the basic rules incorporated in these proposals—most of them indeed have consistently abided by them—but, rather, one of political reservations regarding formal commitments on the conditions of private foreign investments, especially when it comes to assuming fixed long-term commitments generally toward investors from all capital-supplying countries. If this understanding is correct, a first conclusion would be to

expect that such charter proposals, rather than to mature into full-fledged multilateral treaties, would more readily serve as models for the conclusion of specially tailored bilateral investment treaties, such as those mentioned above (para. 258) or for the drafting of individual contracts between governments and private investors who offer to establish enterprises of value to the country's economic development programme.

266. Significantly, this appears to be, in certain respects, the approach followed in the report of the Parliamentary Group for World Government.<sup>102</sup> It has also been the expressed role of the International Code of Fair Treatment for Foreign Investments, which was drafted by the International Chamber of Commerce in 1949,<sup>103</sup> and which is about to be revised and reactivated upon the recommendation of the International Businessmen's Conference held under the Chamber's auspices at Karachi, Pakistan, in December 1960 as "a forum for a frank exchange of views" between capital-importing and capital-exporting countries.<sup>104</sup>

267. There is thus considerable likelihood that, at least for quite some time, investors contemplating opportunities in foreign countries will find that the majority of governments of capital-receiving countries are not prepared to sign international commitments which would be enforceable by the foreign investors' home governments, even though the former may consistently follow policies in substantial accord with the principles of these charter proposals.<sup>105</sup> Investors confronted with the contrary record of a small minority of governments, and especially with the lack of any record of past attitudes on the part of many new coun-

<sup>102</sup> *A World Investment Convention*, prepared by the Commission on a World Investment Code, July 1959, paras. 54 *et seq.*

<sup>103</sup> See "Resolution on International Agreements on Private Investments" of 3 May 1957 (XVIIth Congress of the International Chamber of Commerce, *Statements and Resolutions*, 1959, p. 16) and "Statement adopted by the Council of the International Chamber of Commerce on the United Nations Report on the Promotion of the International Flow of Private Capital" (ICC Document No. 111/1009 of 20 May 1960).

<sup>104</sup> See "Conclusions Unanimously Adopted by the International Businessmen's Conference", document E/C.2/568, para. 15.

<sup>105</sup> It may be of interest to quote here the relevant part of a draft resolution dated 22 May 1961 which the United Nations Commission on Permanent Sovereignty over Natural Resources has requested the Economic and Social Council to recommend to the General Assembly for adoption. This draft resolution contains, *inter alia*, the following declaration with reference to the exploration, development and disposition of natural resources:

"4. Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases, the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, national jurisdiction should be resorted to. Upon agreement by the parties concerned settlement of the dispute may be made through arbitration or international adjudication" (*Official Records of the Economic and Social Council, Thirty-Second Session, Annexes*, agenda item 9, document E/3511, annex, resolution I A).

<sup>100</sup> It is understood that the draft of the Organization for European Economic Co-operation is being studied by its Committee for Invisible Transactions. The proposal of the Council of Europe is under consideration before its Council of Ministers, which in the meantime also transmitted it to OEEC.

<sup>101</sup> Recommendation 223 (B.1) on the development of Africa, adopted by the Consultative Assembly on 18 January 1960.

tries, may then look to other guarantees against the non-business risks of contemplated ventures.

#### *Measures for relief from non-business losses*

268. One possible solution which is receiving considerable attention is that of a guarantee under which the investor will be compensated for any loss he may suffer from other than normal business causes. While business men are of course interested more in preserving and expanding profitable ventures than in salvaging their investment, the latter assurance provides a minimum protection which may substantially reduce the weight of political apprehensions as a factor determining foreign investment decisions.

269. Such a guarantee will presumably serve its purpose of a reliable advance assurance only if it is provided by a party other than the government of the country of investment whose acts would give rise to its implementation. Guarantees so far available have been provided in the form of insurance coverage by the Governments of the United States, Japan and the Federal Republic of Germany for qualifying foreign investments of their nationals (see E/3325 and Corr.1 and 2, paras. 179-185). The geographic scope of the United States and German schemes was broadened by the conclusion of a number of additional bilateral agreements which, under these schemes, are a condition precedent to the insurance of investments in the countries concerned. Such further agreements were signed by the United States with Chile, Liberia, Morocco and Nepal, and by the Federal Republic of Germany with Pakistan, the Federation of Malaya, Greece and Togo, and initialled with Iran.

270. Some support has also been expressed for the introduction of similar schemes in other major capital-supplying countries.<sup>106</sup> For its part the Government of India, which had earlier signed a guarantee insurance agreement with the United States, in its reply to the Secretary-General's inquiry stated that "if any other country has a scheme of this kind, they would be prepared to become parties to it."

271. Yet, as indicated in the progress report (E/3325, and Corr.1 and 2, para. 185), this remains a highly selective process, both as regards the capital-supplying countries which are in a position to provide such insurance to their investors, and the capital-receiving countries which are prepared to conclude the requisite agreements. These, it will be recalled, provide for the subrogation of the insuring government to any private claims which it has satisfied under the guarantee, and for the international adjudication and

arbitration of such claims, if they cannot be settled by negotiation. As a result, the government of the country of investment will be confronted, in case of an insured loss, by a foreign government claimant, instead of the private investor originally involved. Under the German type of agreement, the co-contracting country subscribes in addition to a number of substantive assurances regarding the protection of the German investors' rights which, of course, have a value in themselves apart from the guarantee insurance scheme. The persistent limitation in the geographic coverage of the existing schemes has led the United States Government to announce that it is considering the possibility of abandoning its requirement of supporting agreements and of offering its guarantee insurance to investments in all under-developed countries.<sup>107</sup> This has from the beginning been the approach of the Japanese guarantee insurance scheme.

272. At the same time, there has been growing interest in the possibilities of international insurance and re-insurance schemes. These would have the added advantages of spreading not only the coverage, but the risk—and cost—of the insurance and of largely removing the hesitations which the possible intervention of the investor's home government as champion of his claims would arouse in governments of certain capital-importing countries. The International Bank for Reconstruction and Development is currently studying within its staff various international investment insurance proposals which have come to its attention. On a regional level, the Executive Secretary of the United Nations Economic Commission for Europe has initiated consultations with experts on the possibility of considering an international system for the insurance and re-insurance of investments and export credits as regards both commercial and political risks.

273. A specific regional insurance scheme has been outlined in considerable detail by the Economic Committee of the Council of Europe, whose Consultative Assembly recommended its consideration by interested European and African Governments at the proposed Conference on African Development.<sup>108</sup>

274. The scheme entitled an International Guarantee Fund has been put forward as a regional project and "as a means of implementing the policy of co-operation between European and African countries" (para. 62). Since it is the only one of its kind which has been formally recommended by an inter-governmental body (though as an outline, rather than as a draft charter), it may be worthwhile to examine the solutions there offered for the major technical problems which are

<sup>106</sup> The question has been raised in the Parliaments of France (see *Le Monde*, 17-18 July 1960) and Switzerland (see *Tribune de Genève*, 2-3 July 1960). Considerable investor interest was also reported in the United Kingdom (see *The Financial Times*, 17 February 1961). In addition, the scope of the export credit insurance schemes which most capital-goods supplying countries provide for the promotion of their exports is currently being expanded to cover also longer-term credits—thus insuring what amounts to indirect investments in the form of equipment credits (see discussion of International Credit Insurance in section I of the present chapter).

<sup>107</sup> Speech by Secretary of Commerce Luther Hodges before the United States Chamber of Commerce, 1 May 1961. In this connexion it may be noted that the President of the International Telephone and Telegraph Corporation has announced that his company would be ready to increase its South-American investments by 50 per cent, or \$250 million over the next five years, if it could secure United States Government insurance against non-business risks in countries which had not signed the type of agreement required under current United States legislation (*New York Times*, 8 April 1961, p. 23).

<sup>108</sup> See footnote 98 above.

likely to arise in setting up such an international insurance fund.<sup>109</sup>

275. The risks to be covered include losses resulting from lack or delay in transfer facilities (paras. 70-73), dispossession or complete or partial spoliation, including government measures assimilated to such spoliation, e.g. in the tax or price regulation fields, which prevent "the investment from operating in the conditions originally prevailing" (paras. 74-76), and war, insurrection, riot or civil war (para. 77). While both equity and loan investments may qualify (paras. 67 with 32, 33), they must be approved by the host government (para. 73). The premium rate is to be uniform in order to avoid "any discrimination within the framework of a European-African policy of co-operation" (para. 84). In case of loss the Guarantee Fund would be subrogated to the claims of the investor who had been indemnified (para. 82). Since the government whose act had given rise to this claim would itself be a member of the Guarantee Fund, such subrogation may avoid some of the difficult problems (relating, for example, to the Calvo clause) which might arise where the claim passed to the investor's home government.

276. Most significant are the provisions for the financing of the Fund: this is to be supplied by an initial endowment contributed by all participating (capital-supplying and capital-receiving) countries, only a part of which need be paid in at the outset and by the insurance premiums. The latter are either to be shared by the investor and the country of investment, or to be paid in full by the investor, with a further contribution to be collected from the capital-receiving countries, in proportion to the total amount of guaranteed investments received by each (paras. 83-86). Consideration is also given to the possibility of insuring security issues of African public bodies (paras. 90-93).<sup>110</sup>

277. Clearly, a project of this kind depends on the willingness and ability of governments, including those of capital-receiving under-developed countries, to shoulder the burden of providing the requisite substantial initial endowment (or corresponding financial commitment). It also implies a willingness of one capital-supplying country to lend encouragement to investors of other countries, and the readiness of capital-receiving countries to pool, as it were, their widely varying investment risks. The latter difficulty is to be mitigated in the Council of Europe proposal by the assumption that the participating countries will agree on "the rights and duties of investors and borrowers", either *de facto* or by subscribing to a multilateral investment charter (para. 62). This requirement, however, may subject this insurance project to the same difficulties which con-

front the negotiation of the investment charter. It is significant in this connexion that the Consultative Assembly of the Council of Europe apparently expects the Guarantee Fund project to be more readily realizable than the Investment Charter, by stressing the benefits to be gained from the former, "even if it should appear that an investment statute cannot be adopted within a short time."<sup>111</sup>

#### *Adjustment of investment disputes*

278. In calling for a further report on the promotion of the international flow of private capital, the Economic and Social Council specifically referred to "measures to facilitate the adjustment of disputes related to private investments".<sup>112</sup> In effect, the consultations carried out in the course of the preparation of the present report tend towards the conclusion that apprehension of non-business risks constitutes an impediment to foreign private investment which may be substantially lessened by the assurance of an effective machinery for the adjustment of investors' claims arising from disputes with the government of the country of investment. In order to be effective, such machinery should be international in character, so as to assure complete independence in interest from both parties to the dispute.

279. Several proposals for such international machinery, in the form of an investment tribunal or arbitral body, have recently been put forward and are under active consideration by various public and private agencies. Some of these proposals are included in the above-discussed investment charter projects of the Organization for European Economic Co-operation, the Council of Europe and the Parliamentary Group for World Government, all of which provide for the establishment of arbitral tribunals or panels for the adjustment of disputes arising from their operation. In addition, a number of non-governmental organizations active in the field have put forward plans for setting up arbitral bodies to which investment disputes could be submitted without awaiting a prior agreed formulation of the governing rules of substantive law.<sup>113</sup> It is significant that one of these organizations, the International Association for the Promotion and Protection of Private Foreign Investments, which was established in 1959 for the broad purpose of co-ordinating the various non-governmental activities in the field of the protection of private foreign investments, has so far concentrated its efforts on the preparation of specific proposals for

<sup>111</sup> Resolution 211 (7) adopted by the Consultative Assembly on 17 September 1959.

<sup>112</sup> Economic and Social Council resolution 762 (XXIX) of 21 April 1960 on the international flow of private capital.

<sup>113</sup> These include the Draft Regulations for an International Institute for the Arbitration of Investment Disputes, currently in preparation by the International Association for the Promotion and Protection of Private Foreign Investments; the resolution on the establishment of a new international procedure for the settlement of disputes adopted in 1960 by the Committee for Court and Court Procedure for Protection of Investments Abroad of the International Bar Association; and the Draft Statutes of the Arbitral Tribunal for Foreign Investment, and the Draft Statutes of the Foreign Investment Court prepared in 1960 by the Committee on Nationalization and Foreign Property of the International Law Association.

<sup>110</sup> The recent International Businessmen's Conference sponsored by the International Chamber of Commerce in Karachi in December 1960, called on the ICC to study the question of international investment guarantee insurance, especially proposals made at the Conference for the establishment of "an international investment guarantee institution for this purpose, with a membership roughly the same as that of the World Bank". See "Conclusions Unanimously Adopted by the International Businessmen's Conference" (E/C.2/568, para. 12).

<sup>111</sup> See the discussion of this and similar international credit insurance schemes in section I of the present chapter.

the organization of international arbitration facilities and procedures.<sup>114</sup>

280. Several of the proposals stress the necessity of making provision for conciliation procedures. This may often prove to be more valuable to the parties than arbitration itself, since in all cases other than that of final expropriation both parties will normally be more interested in exploring avenues for the effective continuation of the venture than in adjudicating claims for damages. The Council of Europe's proposal, which specifically contemplates the re-negotiation of long-term contracts between governments and foreign investors, provides for the use of its proposed arbitration machinery to adjust disagreements arising in the course of such re-negotiation.<sup>115</sup> This possibility might make it more acceptable to some governments to extend a commitment to arbitrate disputes not only to new investment contracts—entered into with this provision in mind—but also to old established contracts which they might otherwise not be ready to confirm for the future in their entirety.

281. The principles underlying these various proposals do not differ widely. All contemplate the possibility of direct access by the investor to the arbitral body, as a party in interest, thus avoiding the political and practical complications of requiring him to seek espousal of his claim by his home government. This possibility may be considered as providing strong assurance to the investor, while at the same time offering to the governments of investment countries a ready alternative to the intervention of the investor's home government—a contingency rejected by the laws and constitutions of many of these countries.

282. The issue of the law to be applied by the arbitrators is solved at least in part where arbitration is provided within a draft investment charter, which contains its own substantive rules. The independent arbitration proposals leave the choice of the law generally to the agreement of the parties, especially as embodied in individual investment contracts; in the absence of such agreement the arbitrators may refer to the established rules of international law or, in some cases where the parties so prescribe, they may rule *ex aequo et bono*.

283. There is some variation in the rules governing the composition of the proposed arbitral body. These may provide for an arbitral tribunal of fixed membership which will sit on all disputes brought before it, or for a panel of names from which the parties may select the arbitrators, or they may allow freedom for the parties to select their arbitrators. Most of the projects contemplate that they should be embodied in a multilateral convention. Some of these would make resort to arbitration compulsory upon the signatories; others provide for the compulsory jurisdiction of the Inter-

national Court of Justice, as an alternative to voluntary arbitration.

284. All the current proposals contemplate the establishment of new arbitral facilities, rather than the reliance on such existing tribunals as the Permanent Court of Arbitration in The Hague<sup>116</sup> or the Court of Arbitration of the International Chamber of Commerce. In so far as this preference is expressly discussed, it appears to derive, in the case of the Court of the International Chamber of Commerce, from its identification with commercial arbitration, chiefly between private business men, and its wholly non-governmental character. Nevertheless, it is a fact that its jurisdiction has been accepted in many commercial contracts between parties and government agencies.

285. In the case of the Permanent Court of Arbitration, the reverse point has been noted, namely, that it is not specialized in the commercial or investment field, inasmuch as it was established under the Hague Conventions for the Pacific Settlement of International Disputes of 1899 and 1907 for the purpose of "obviating as far as possible recourse to force in the relations between States" (article 1). Yet while the Court's regular procedures are reserved for disputes between its member governments, its Administrative Council has recently announced that the offices and organization of its secretariat may be placed at the disposal of governments for any arbitral procedure to which they are parties, including those with private companies. In fact such an arbitration proceeding took place in 1935 between the Chinese Government and the Radio Corporation of America in the offices of the secretariat of the Permanent Court of Arbitration, even though none of the arbitrators on its Panel was used.<sup>117</sup> Presumably also, as indicated in the reply of the Netherlands Government to the inquiry of the Secretary-General, the usefulness of the Court could be enhanced by the adherence of additional States to the Hague Conventions of 1899 and 1907,<sup>118</sup> by the appointment to the existing panel of arbitrators of persons especially qualified for dealing with investment disputes and by the issuance of special rules of procedure for investment arbitrations, to supplement the rules laid down for the arbitration of state conflicts in the Hague Conventions.<sup>119</sup>

286. In pursuance of the mandate contained in resolution 762 (XXIX), the Secretary-General circulated an inquiry among Member States, specialized agencies and appropriate inter-governmental and non-governmental sources in order to secure their views on the "measures to facilitate the adjustment of disputes related to private investments".<sup>120</sup> The inquiry posed essentially two questions, namely, whether the expansion and institutionalization of the arbitration (or conciliation) of investment disputes were likely to add substantially to

<sup>114</sup> See, however, footnote 127 below.

<sup>117</sup> Reply by the Secretary-General of the Permanent Court of Arbitration to the inquiry of the Secretary-General.

<sup>118</sup> The Netherlands Government is the depositary of these treaties.

<sup>119</sup> It is understood that the secretariat of the Court is currently preparing such rules.

<sup>120</sup> See annex I, part 1.

<sup>114</sup> Strong support for the implementation of arbitration procedures, possibly independently of action on an international investment charter, has also been expressed by Lord Shawcross, one of the leaders in the movement for the adoption of such a charter.

<sup>115</sup> *Loc. cit.*, see footnote 98 above; document 1027, para. 42.

the security of foreign investments, and thus to encourage the flow of such investments; and if so, what role might usefully be played by the United Nations in this connexion.

287. Most of the governments replying to the first question expressed interest in the possibilities of international arbitration as a means not only of adjusting investment disputes but also of forestalling their occurrence and thereby improving the international climate for private foreign investments. Several governments also stressed the importance of conciliation procedures. Reservations on the part of some governments in their support for efforts in this direction were due chiefly to the view that other matters, e.g., the over-all policies and attitude of the country of investment and its general economic prospects, were more important to the effective attraction of foreign investment than protection against business risks; to hesitations as to the effectiveness of arbitral procedures—except in minor disputes—or as to the likelihood of achieving broad commitments to their use, and in some cases to the conviction that the safeguards provided in investment laws and bilateral treaties did “not appear to leave any room for disputes”.

288. Several governments, without directly discussing this issue, stated that in their countries disputes pertaining to foreign investments were settled under their domestic laws.<sup>121</sup> This had also been the position taken during the discussion of this question at the twenty-ninth session of the Economic and Social Council by the representatives of two of the four Latin-American governments represented on the Council, who expressed certain reservations regarding the question of reconciling international arbitral machinery with relevant national constitutional and statutory provisions.<sup>122</sup>

289. The other two governments, however, took a more positive view in their replies to the Secretary-General: one stated its “belief in the necessity of the expansion and institutionalization of arbitration as a means for stimulating investments”. The other government expressed its interest in discussing the establishment of international mediation and arbitration machinery, possibly under the aegis of the United Nations, and pointed out that, although the assurance of such fair and impartial recourse would primarily benefit the foreign investor, the under-developed coun-

tries would also benefit indirectly to the extent to which its availability would stimulate a greater inflow of foreign capital.

290. On the other hand, the governments of two countries with centrally planned economies stated that “there is no need for the establishment of any international institutions to regulate the relations between foreign investors and the governments of under-developed countries which attract foreign capital. Still less is there any need to burden the machinery of the United Nations with any tasks connected with the establishment of such institutions or to set them up under United Nations auspices.” Such a proposal “was not in the interest of the under-developed countries”. Its object was “to force the under-developed countries to accept a settlement, since at present such disputes were not always resolved to the advantage of foreign monopolies”. “The very idea of establishing a system of international arbitration to settle disputes connected with foreign private investment puts foreign investors and the governments of the receiving countries on an unequal footing and infringes the sovereignty of the country concerned.”<sup>123</sup> They further expressed the view “that the settlement of disagreements and disputes between foreign investors and governments of countries which import private foreign capital is a matter which lies exclusively within the internal jurisdiction of those countries”. Moreover, “foreign investors were not entitled to raise the question of compensation in view of the fact that their initial investment had been more than adequately repaid by the profits they had derived”.

291. One government, that of Cuba, notified the Secretary-General expressly that it had “renounced the acceptance of private foreign investments”, while the Government of Hungary stated that it “does not intend to seek foreign private capital investment for the economic development of the Hungarian national economy.”

292. The government of one European country, referring in general to the issue of the protection of private foreign investments, saw a danger to the progress of the regional investment charter proposals of the Organization for European Economic Co-operation in the initiation of multilateral negotiations on a worldwide basis in any other forum.

293. In reply to the second question, regarding the possible role of the United Nations in this context, several governments stressed the advances which had been achieved more recently under the impulsion of the United Nations in the arbitration of international commercial disputes.<sup>124</sup> Reference was made in this connexion to recent agreements, including the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 adopted by the United Nations Conference on International Commer-

<sup>121</sup> The primacy of national jurisdiction was also provided in the above-quoted draft resolution of the United Nations Commission on Permanent Sovereignty over Natural Resources (see footnote 105 above).

<sup>122</sup> See E/AC.6/SR.283. In the Second Committee, at the fifteenth session of the General Assembly, the representatives of two other Latin-American countries had stated that they “saw no need to accord further guarantees to foreign private investors, such as, for example, recourse to a system of arbitration to settle disputes between governments and foreign private investors. Such disputes were of a domestic nature and ought to be settled under national law...” (*Official Records of the General Assembly, Fifteenth Session, Second Committee*, 662nd meeting, para. 34). If they were submitted to international arbitration, “foreign investors would be granted a status to which they were not entitled under international law and would be given privileges not enjoyed by national investors.” (*Ibid.*, 671st meeting, para. 16). See also footnote 123 below.

<sup>123</sup> The same position had been taken by the representatives of these two countries in the Second Committee at the fifteenth session of the General Assembly (*Ibid.*, 670th meeting, para. 33; 706th meeting, para. 8).

<sup>124</sup> See Economic and Social Council resolution 708 (XXVII).

cial Arbitration on 10 June 1958<sup>125</sup> which, though not expressly concerned with investment disputes, could be applied to them.<sup>126</sup> The governments which expressed interest in the availability of international machinery for the adjustment of investment disputes felt that the United Nations provided an appropriate forum for examining the desirability and appropriate forms of such arbitral machinery. Some governments specifically referred to the possibility of placing such machinery under United Nations auspices. Others drew attention to the desirability of making use also of the existing facilities for the adjudication of international disputes, such as the International Court of Justice, and especially the Permanent Court of Arbitration, though one of them referred to limitations under which these older bodies laboured, especially their lack of compulsory jurisdiction. In discussing the potentialities of new machinery under United Nations auspices, this government considered a compulsory clause essential to the effectiveness of any arbitration procedure, while another government felt that, if the United Nations were to assume a role in this field, recourse to its services should be on a voluntary basis, so as to protect the Organization from excessive involvement.

294. Considerable emphasis was placed on the desirability of a thorough study and discussion of the question of establishing international arbitral machinery either *de novo* or in connexion with existing bodies. In the view of the governments which discussed this point, the United Nations was considered to be particularly suited to inquiring into the degree of general acceptance for such a project, since it included a wide membership of both capital-supplying and capital-receiving countries. One government, however, felt that the subject was of such technical complexity that it might be more effectively dealt with by an international organization more directly concerned with foreign investments.

295. Among specialized agencies and inter-governmental organizations, the managements of the International Bank for Reconstruction and Development and the International Finance Corporation supported the idea of the expansion and institutionalization of arbitration and conciliation of investment disputes. In fact, the Bank had itself been instrumental in arriving at a solution of what might be termed investment disputes, namely the question of compensation for the nationalization of the Suez Canal, and the question of the French *tranche* of the City of Tokyo Loan of 1922. The Bank had also made extensive use of arbitration clauses in its loan and guarantee agreements, which provided that umpires might be appointed by the President of the International Court of Justice, or failing him, by the Secretary-General of the United Nations. Significantly, none of these clauses had so far had to be invoked. The Bank stated that the time was ripe for the discussion and establishment of international arbitration

and conciliation machinery to which parties could resort for the adjustment of investment disputes. The choice of an appropriate forum for such discussion was an important matter and deserved careful consideration.

296. The recently established Inter-American Development Bank, though it had not as yet acquired practical experience in this field, expressed the view that the creation and institutionalization of arbitration machinery under the auspices of the United Nations would help to encourage the flow of private investments.

297. The interest in the idea of international arbitration and conciliation of investment disputes on the part of those inter-governmental and non-governmental organizations whose draft proposals in this field were examined above is also on record. In their replies to the inquiry of the Secretary-General, those organizations which discussed the possible role of the United Nations in this area stressed its usefulness as a forum for the discussion and promotion of investment arbitration.<sup>127</sup>

298. The conclusion that emerges from this examination of the replies to the Secretary-General's inquiry, as well as of the various projects currently under public discussion, is that, while few governments and organizations have as yet formally committed themselves to this concept, there is wide interest in the potentialities of international arbitration and conciliation for strengthening investors' confidence, and thereby their readiness, to take advantage of promising opportunities in the developing countries. The very fact that, in addition to the old-established arbitral facilities, numerous governmental and non-governmental agencies have recently put forward proposals for new international arbitral machinery confirms the need for systematic and co-ordinated study of the basic issues involved, the potentialities of the existing facilities and the different proposals and possibilities for the creation of new machinery. One government of a capital-receiving country expressly proposed a meeting of delegations of all interested parties, under United Nations sponsorship, for this purpose.

299. There are as yet various reservations and hesitations among some governments and investors regarding the extent to which any new or existing international arbitration facility may properly take over functions normally reserved to national courts; the form and auspices under which such arbitration machinery could become widely acceptable; and the effect which its availability might have in actually increasing the international flow of private capital. Some of these reservations appear, expressly or by implication, to be addressed to the difficulty of achieving wide-spread adherence to existing or projected multilateral treaties setting up arbitral machinery and possibly making its

<sup>127</sup> In the projects published by two of these organizations reference is in addition made to the possible role of the International Bank for Reconstruction and Development, the General Agreement on Tariffs and Trade or the Permanent Court of Arbitration, for the purpose of affiliating the proposed new institution or at least its secretariat with an existing agency in the field.

<sup>125</sup> United Nations publication, Sales No. 58.V.6.

<sup>126</sup> A European Convention on International Commercial Arbitration, prepared under the auspices of the United Nations Economic Commission for Europe, was signed on 21 April 1961.

use compulsory, though some governments and organizations felt that this was essential to the effectiveness of the recourse.

300. It is with this difficulty in view that the Secretary-General's inquiry directed special attention to the role which could be played by the United Nations in facilitating resort to arbitration in the first place through means other than treaty commitments. Specifically, the United Nations could serve as a forum for the study and discussion of the problems and potentialities of investment arbitration, could encourage the use of existing machinery and could assist in the development of *ad hoc* facilities, e.g., by the drafting of model arbitration clauses and rules of procedure and by the establishment of a panel of experts from which conciliators and arbitrators could be selected and, where needed, umpires appointed.<sup>128</sup> Such facilities could be

<sup>128</sup> The United Nations has undertaken various projects and measures to improve the climate and facilities for arbitration and thereby to encourage the use of arbitration in disputes arising out of international business transactions. In 1959, the Economic and Social Council adopted resolution 708 (XXVII) which set

provided upon the initiative of appropriate United Nations organs, and would then become available to all Member Governments without requiring any specific new treaty commitment from them, or the establishment of any new administrative machinery to service them. In this way arbitration would be accessible to all, yet each country could consult its own policies and experience before committing itself to its use, at first perhaps only on an *ad hoc* basis, but subsequently, as the machinery proved itself, by advance undertakings in investment contracts, laws and treaties.

out a broad framework of measures for international co-operation in the promotion of more effective uses of arbitration. The Economic Commissions for Asia and the Far East (ECAFE) and for Europe (ECE) have for some years been engaged in arbitration projects: reference has already been made to the European Convention on International Commercial Arbitration (see footnote 126 above). In the ECAFE region a working group on arbitration will meet in Bangkok early in 1962. The working group's agenda includes consideration of the possible establishment of an arbitration centre in the region and the examination of certain draft model rules of arbitral procedure that have been prepared by the Office of Legal Affairs of the United Nations Secretariat.

## ANNEX I

### Inquiry on measures for the promotion of the International flow of private capital, attached to the Secretary-General's circular letter of 26 October 1960, under resolution 762 (XXIX) of the Economic and Social Council

#### Part I

##### ADJUSTMENT OF DISPUTES RELATED TO PRIVATE INVESTMENTS: VIEWS ON INTERNATIONAL ARBITRATION AND CONCILIATION

##### Background

1. As indicated in document E/3325 the availability of international facilities for "...adjustment of disputes related to private investments" may contribute to promoting the international flow of private capital by offering increased protection against non-business risks to foreign investors. Such facilities could take the form...principally of arbitration and conciliation (the difference being that arbitration would result in binding awards, while conciliation would develop possible solutions for the consideration of the parties).

2. The United Nations has been active for some time in the field of commercial arbitration both through the promotion of international conventions and through the provision of technical assistance, as indicated in the Secretary-General's statement on the economic development of under-developed countries<sup>129</sup> of the Economic and Social Council (see resolution 708 (XXVII) on international commercial arbitration, and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards).

3. Arbitration of investment disputes between the governments involved is increasingly provided in bilateral treaties between capital-supplying and capital-receiving countries. Provision for arbitration directly between the investor and the government of the country of investment is incorporated in some investment

promotion laws and in individual concession agreements concluded between governments and foreign enterprises (see paras. 200 *et seq.* of document E/3325 and Corr.1 and 2).

##### Inquiry

4. The questions on which authoritative views are now sought under the above-mentioned resolution of the Economic and Social Council may be formulated as follows:

(a) Is the expansion and institutionalization of the arbitration (or conciliation) of investment disputes likely to add substantially to the security of foreign investments, and thus to encourage the flow of such investments?

(b) If so, what role may usefully be played by the United Nations in this connexion, specifically by:

- (i) Promoting recourse to existing arbitral machinery for the adjustment of investment disputes;
- (ii) Assisting in the implementation of arbitral procedures, where desired by the parties, e.g., through the appointment of neutral arbitrators (umpires);
- (iii) Providing a forum for the discussion and establishment, possibly under United Nations auspices, of international arbitral machinery (*de novo* or in connexion with existing machinery) to which parties may resort for the adjustment of investment disputes.

#### Part II

##### INFORMATION ON MEASURES

Information is requested on measures aimed at, or having the effect of, promoting, controlling, directing or regulating the import or export of private investment capital. Information on

<sup>129</sup> Official Records of the Economic and Social Council, Thirtieth Session, Annexes, agenda items 2 and 4, document E/3394.

measures affecting both direct and portfolio investments is requested.

Notes. 1. The inquiry covers measures applicable to foreign investments both new and existing, and their yields, irrespective of whether such measures are directed specifically towards foreign investments or refer generally to both domestic and foreign enterprises and investors (e.g., "investment laws", and measures affecting foreign investments included in general legislation such as tax laws).

2. Relevant texts (policy statements, laws, treaties (other than international tax agreements), special concession agreements with foreign enterprises, regulations, administrative rules, etc.) or extracts thereof should be communicated, together with any available reports on the operation of such measures (e.g., reports of development corporations, etc.).

3. A list of the laws and other official texts of which the Secretary-General has so far been informed in the course of the present inquiry is attached (Appendix).

#### A. Measures applicable to foreign enterprises or investors

##### I. Measures controlling foreign investments:

- Authorizations or permits required for the establishment of different types of enterprises;
- Prohibited and restricted fields of operations;
- Requirements regarding the employment of local capital and local managerial control;
- Provisions concerning the use of domestic and foreign skilled and unskilled labour or other domestic resources (excluding capital), and the training of domestic labour;
- Rules governing the grant of exploratory and development concessions (for minerals, petroleum, etc.);
- Other obligations or restrictions.

##### II. Measures promoting or facilitating the inflow of foreign investment capital:

- Assistance to potential investors in securing background information (economic and other), in providing information on specific investment opportunities and in obtaining needed administrative permits and clearances, etc.;
- Special provisions facilitating the repatriation of foreign capital and of its income, and the payment of royalties and other licence fees. (If such provisions are limited to certain forms of investment and/or to investments in specified fields of activity this should be indicated).
- Facilities for the importation of raw materials and equipment and for the exportation of local products, especially manufactured goods;
- Financial facilities for foreign investors (e.g. through government lending agencies);
- Existence of government-sponsored industrial sites and factories;
- Other special provisions or facilities.

##### III. Fiscal measures:

- Broad tax concession schemes for the encouragement of desired new investments (e.g. exemption or reduction for a specified initial period with regard to direct and/or indirect taxes);
- Special tax concessions:
  - Import duty concessions for qualifying machinery, raw materials, construction materials, etc.;
  - Special income and profits tax concessions in the form of reinvestment allowances, accelerated depreciation allowances, etc.;
  - Special concessions on account of royalty payments for patents and know-how; salaries of foreign technicians; research outlays; loans incurred for the import of needed foreign machinery, etc.;
- Use of import tariffs or related measures for the protection of domestic manufactures.

##### IV. Measures for the protection of foreign investments:

- Guarantees against nationalization (for an initial period); guarantees of compensation in the event of nationalization, including special foreign exchange provisions for the payment of such compensation;
- Provisions for arbitration of disputes related to private investments;
- Other measures.

#### B. Measures applicable to national enterprises operating or individuals investing abroad

##### I. Conditions and formalities (e.g. control of capital issues for foreign account).

##### II. Special facilities made available to individuals or enterprises investing abroad (e.g. loan facilities).

##### III. Fiscal measures:

- Exemptions or reductions of tax, or foreign tax credits granted, with respect to:
  - Foreign income in general;
  - Profits earned by foreign branches;
  - Dividends or interest paid by foreign subsidiaries;
  - Special types of foreign business corporations or investment companies;
  - Profits reinvested abroad.

(Indicate whether the above measures apply on a world-wide basis or are limited to certain regions, countries or dependencies).

##### IV. Protective measures:

- Insurance of investments abroad against risks of expropriation, inconvertibility of currency or war;
- Insurance of foreign debts against risks of inability to pay or inconvertibility of currency;
- Other systems.

## ANNEX II

### Selected list of laws and official texts concerning foreign private investments in under-developed countries<sup>130</sup>

#### AFGHANISTAN

Law of 13 May 1959 for the encouragement of investment of private capital in Afghanistan.

#### ARGENTINA

Decree-Law No. 14630/44 of 5 June 1944 on development and defence of national industry (*Boletín Oficial*, 10 June 1944).

Law No. 13273 of 30 September 1948 (forestry legislation).

<sup>130</sup> This list contains the information available to the Secretariat at the present time. It is based on the list contained in the progress report on *The Promotion of the International Flow of Private Capital* (E/3325 and Corr.1 and 2) which has been revised and expanded chiefly with the help of information supplied by governments in response to the Secretary-General's inquiry. See also *Official Records of the Economic and Social Council, Thirtieth Session, Annexes*, agenda items 2 and 4, document E/3369, appendix.

Law No. 14222 of 26 August 1953 on the entry of foreign capital for investment in industry and mining (*ibid.*, 28 August 1953).

Resolution No. 1018/59, Ministry of Finance, on deductions provided in the general income tax (articles 82 to 84 T.O. 1956).

Decree-Law No. 8590 of 28 October 1958 on the organization of the electrical industry in Argentina.

Law No. 14780 of 22 December 1958 on the regulations for the investment of foreign capital (*ibid.*, 30 December 1958).

Law No. 14781 of December 1958 on industrial development.

Decree No. 1421 of 12 February 1959 on "Regulations concerning domestic production of tractors".

Decree No. 3693 of 25 March 1959 on "Regulations concerning domestic production of motor-cars".

Petroleum Law No. 14773 of 10 November 1958.

#### BOLIVIA

Law of 17 October 1945 on the Regime of foreign investment, amended on 19 August 1954 by *Decreto Supremo* No. 3812 and on 15 December 1956 by *Decreto Supremo* No. 4538.

Law of 16 December 1960, Investment Law.

Petroleum Code of 26 October 1955.

Regulations to the Petroleum Code, *Decreto Supremo* No. 4298 of 24 January 1956.

#### BRAZIL

Law No. 1807 of 7 January 1953, on exchange control.

Law No. 1942 of 12 August 1953, authorizing the Executive to grant concessions for the establishment of cement factories in the country.

Law No. 2132 of 11 December 1953 granting tax exemptions for aluminium companies.

Instruction No. 113 of the exchange authorities of 15 January 1955, relating to imports of capital goods financed by foreign capital.

Law No. 2993 of 6 December 1956 granting tax benefits to automobile companies.

Decree No. 41019 of 26 February 1957 on electric utility companies, issued as regulations under the Water Code of 1934.

Decree No. 42820 of 16 December 1957 containing regulations to the laws on exchange operations (*Diario Oficial*, 16 December 1957).

Mining Code, Decree-Law No. 1985 of 27 January 1940, as amended up to 1946.

Petroleum Law No. 2004 of October 1953.

Law No. 2597 of 12 September 1955 relating to ownership of natural resources.

#### BRUNEI

The Mining Enactment of 1920, as amended.

Oil Mining Enactment, 1955 (*Government Gazette*, 31 December 1955).

#### BURMA

Transfer of Immovable Property (Restriction) Act of 1947.

Income Tax (Second Amendment) Act of 1954.

Investment policy statement of 8 June 1955 (*Burma Weekly Bulletin*, 23 June 1955).

Investment Act (No. 41) of 1959.

The Upper Burma Ruby Regulations Manual, 1928.

The Burma Oilfields Manual, 1938 (corrected to 1 July 1946).

Metalliferous Mines Manual (corrected to 1 May 1941).

Mineral Concessions Directions, 1947.

Union Mineral Resources (Grants of Rights of Exploitation) Enabling Act, 1949.

Mineral Resources Development Corporation Act, 1952.

Mineral Concessions Rules (Notification of the Ministry of Finance of 18 November 1957).

#### CAMBODIA

Law No. 220-NS of 13 September 1957 fixing rules regarding foreign capital invested in Cambodia before 31 May 1956.

Law No. 221-NS of 13 September 1957 fixing rules regarding foreign capital invested in Cambodia after 31 May 1956.

#### CAMEROON

Investment code (adopted 11 June 1960).

#### CEYLON

Government policy in respect of private foreign investment in Ceylon, Government Publications Bureau, Colombo, July 1955.

Income Tax (Amendment) Act No. 3 of 1956.

Press communiqué No. 41/58 of 21 May 1958 on "Government policy towards foreign private investment in Ceylon", appendices I and II setting out tax concessions as incentives to development.

#### CHILE

Law No. 11.151 of 5 February 1953.

Decree-Law No. 375 of 27 July 1953 authorizing the industry department of the Ministry of Economy and Commerce to approve the establishment of new industries subject to the conditions specified therein (*Diario Oficial*, 4 August 1953).

Decree-Law No. 439 of 4 February 1954 on exemptions for the entry and investment of foreign capital to increase immigration of agricultural settlers (*ibid.*, 4 February 1954).

Decree No. 194 of 20 February 1954 of the Ministry of Economy and Commerce regulating the formation, enlarging and changing the location of industries.

Law No. 12861 (*ibid.*, 7 February 1958) and Decree No. 10815 (*ibid.*, 17 September 1958) on the "Encouragement of Export Industries".

Decree-Law No. 258 of 30 March 1960, establishing rules relating to the investment of foreign capital in Chile (*ibid.*, 4 April 1960).

Mining Code, Decree-Law No. 488 of 24 August 1932.

Decree No. 1080 of 24 June 1936 relating to coal deposits.

Law No. 11.828 of 3 May 1955 on Mining (*ibid.*, 5 May 1955).

#### CHINA (REPUBLIC OF)

Law for encouragement of investment, promulgated 10 September 1960.

Law for investment by foreign nationals, promulgated on 14 July 1954, as amended 14 December 1959.

Statute for investment by overseas Chinese, promulgated on 19 November 1955, as amended on 26 March 1960.

Regulations governing deferment under bond of payment of import duty and tax on equipment and machinery imported by productive enterprises, promulgated on 4 August 1960.

Regulations governing rebate of taxes and duties on export products, promulgated 27 July 1955. Revised on 26 December 1958 and the revision promulgated on 3 September 1959.

Mining law of 26 May 1950 as amended up to 30 July 1959.

Regulations governing exploration, development and production of petroleum, promulgated in November 1954.

## COLOMBIA

Law No. 8 of 18 July on the status of foreign capital (*Diario Oficial*, 5 August 1952) as amended by Law No. 107 of 1957 (*ibid.*, 16 July 1957).

Decree No. 65 of 12 March 1953 on power companies.  
Petroleum Code, Decree No. 1056 of 20 April 1953.

## COSTA RICA

Decree No. 2 of 4 September 1930 introducing unit tax on the export of bananas and abolishing all other taxes.

Law encouraging establishment of new industries No. 36 of 21 December 1940 amended by No. 502 of 26 April 1949 and No. 1651 of 29 September 1953. Repealed subsequently by Law No. 2426 of 9 September 1959 except for article 7 of No. 36, which was promulgated by Decree No. 2231 of 23 August 1958.

Law on international payments of 1951 amended on 4 October 1956.

Law No. 2426 of 9 September 1959 on industrial protection and development (*La Gaceta*, 9 September 1959).

Law on Combustible Minerals of 9 May 1938.

Law No. 797 of 17 August 1946 extending mining concessions in favour of *La Compañía Minas de Abangares, Sociedad Anónima* (*Diario Oficial*, 14 September 1946).

## CYPRUS

Cement Industry (Encouragement and Control) Law No. 25 of 1952.

## DOMINICAN REPUBLIC

Law No. 2236 of 11 January 1950 on industrial and agricultural concessions (*Gaceta Oficial*, 11 January 1950) as supplemented by Law No. 2643 of 28 December 1950 (*ibid.*, 28 December 1950).

## ECUADOR

Emergency Decree-Law No. 15 of 21 June 1957 on industrial encouragement (*Registro Oficial*, 27 June 1957).

Petroleum Law of 6 August 1937.

## EL SALVADOR

Decree No. 188 of 4 July 1949 on the development of the cement industry (*Diario Oficial* No. 147, 5 July 1949), as amended by Decree No. 727 of 8 August 1950 (*Diario Oficial* No. 170, 8 August 1950).

Decree-Law No. 661 of 22 May 1952 on the development of manufacturing industries (*ibid.*, 30 May 1952), as amended by Decree-Law No. 1719 of 7 January 1955 (*ibid.*, 17 January 1955).

Decree No. 1039 of 19 May 1953 on the development of hotel industry (*ibid.*, No. 96, vol. No. 159, 29 May 1953), as amended by Decree No. 1828 of 11 May 1955 (*ibid.*, No. 91, vol. No. 167, 18 May 1955).

Decree No. 1620 of 13 October 1954 on the development of theatres and motion picture houses (*ibid.*, No. 197, vol. No. 165, 26 October 1954).

Mining Code and Complementary Law on Mining, August 1957.

## ETHIOPIA

Statement on policy for the encouragement of foreign capital investment in Ethiopia, issued by the Minister of Finance in February 1950.

Agricultural and Industrial Proclamation No. 145 of 1954, which provides tax exemption for the import of agricultural and industrial machinery and equipment.

Government Proclamation of 30 November 1954, effective in February 1955, exempting from import duties all agricultural and industrial machines and parts therefor.

## FEDERATION OF MALAYA

Revised Statute for investment by foreign nationals, promulgated 14 July 1954 as amended 14 December 1959.

Interim statement on Industrial Development Policy, No. 30 of 1957.

Statement on the setting up of the Tariff Advisory Committee, July 1958.

Pioneer Industries (Relief from Income Tax) Ordinance No. 31 of 28 August 1958.

Customs (Dumping and Subsidies) Ordinance No. 16 of 1959, Schedule of Pioneer Industries and Products dated 11 February 1960.

Mining Enactment and Rules No. 19 of 1928, as amended to 19 February 1953.

## FIJI

Fiji Income Tax Ordinance of 1 July 1920 amended up to ordinance of 1955: sections 11-15 (Laws of Fiji, vol. 111, Ordinance).

Mining Ordinance of 29 October 1937, and Amendment Ordinance No. 4 of 1957 and No. 29 of 1960.

Ordinance No. 3 of 13 May 1957 to amend the income tax ordinance, dealing with gold and silver mining companies only.

Law No. 28 of 1958, the Hotels Aid Ordinance and Amendment Ordinance No. 28 of 1960.

## GAMBIA

Income Tax (Amendment) Ordinance, 1955, third schedule (Pioneer Companies Relief).

## GHANA

Income Tax Act No. 27 of 1943, Fourth Schedule, Pioneer Companies Relief.

Mineral Oil Taxation Ordinance 1956 (*Supplement to the Gold Coast Gazette* dated 17 March 1956).

Income Tax Amendment Act, 1958 (*Supplement to Ghana Gazette* No. 84 of 1958).

Pioneer Industries and Companies Act of December 1958.

Local Industries (Customs Duties Relief) Act 1958.

## GREECE

Legislative Decree No. 2687 of 31 October 1953 on Investment and Protection of Foreign Capital in Greece (*Official Gazette* No. 317, of 10 November 1953).

Petroleum Law No. 3948 of 1959.

## GUATEMALA

Legislative Decree No. 1317 of 30 September 1959 on industrial development.

Decree No. 345 of 7 July 1955, Petroleum Code.

## GUINEA

Ordinance 24 of 11 May 1960 promulgating the investment code (*Journal Officiel de la République de Guinée*).

## HAITI

Law of 8 October 1949 on encouragement of the establishment of wholly new industries (*Moniteur*, 24 October 1949).

- Law of 19 September 1952, relating to the percentage of Haitian nationals to be employed in foreign enterprises.  
 Law of 8 August 1955 protecting agriculture and national industry (*Moniteur*, 25 August 1955).

## HONDURAS

- Decree No. 57 of 6 May 1958. Law for the Promotion of Industry.  
 Regulation, to Decree No. 57, *Acuerdo* No. 1325 of 25 November 1958.  
 Decree No. 171 of 16 October 1957, Petroleum Law (*La Gaceta*, 11 January 1958).

## INDIA

- Industries Development and Regulation Act No. 65 of 1951.  
 Industrial Policy Resolution of 30 April 1956 (*Reserve Bank of India Bulletin* of May 1956).  
 Section 15 C of the Income Tax Act of 1922, as amended by subsequent Finance Acts (Tax relief for new enterprises).  
 Mines and Minerals (Regulation and Development) Act No. 53 of 1948.  
 Mineral Concession Rules of 1960.  
 Mines and Mineral (Regulation and Development) Act No. 67 of 1957.  
 Petroleum and Natural Gas Rules, 1959.

## INDONESIA

- Act No. 78 of 27 October 1958 concerning foreign capital investment (*Government Gazette* No. 138 of 1958).  
 Law No. 15 of 1960 providing for the establishment of a Foreign Capital Investments Council.

## IRAN

- Treaty of Amity, Economic Relations and Consular Rights with the United States, signed on 15 August 1955.  
 Law of 29 November 1955, effective 14 April 1956, concerning the encouragement and protection of foreign capital investments in Iran.  
 Old Nationalization Act of 1 May 1951.  
 Mining Law of 18 May 1957.  
 Petroleum Law of 31 July 1957.

## IR. Q

- Law No. 72 of 1955 for the encouragement of industrial undertakings (*Official Gazette* No. 3636, 9 June 1955) amended by Law No. 51 of 18 June 1956 and by Law No. 18 of 1957 amending Law No. 72 of 1955.

## IRELAND

- Industrial Development (Encouragement of External Investment) Act of 1958.  
 Finance Act 1956, Sections 23-26 and 28; Finance Act 1957, Section 17 (initial allowances for new plant and machinery).  
 Finance Act 1936, Section 5; Finance Act 1949, Sections 3 and 32(5); Finance Act 1956, Section 24; Finance Act 1957, Section 2 (depreciation and obsolescence allowances in respect of plant and machinery).  
 Finance (Miscellaneous Provisions) Act 1956, Sections 16-19 (industrial building allowance).  
 Undeveloped Areas Acts, 1952 and 1957.  
 Industrial Development (Encouragement of External Investment) Act 1958.  
 Industrial Grants Act 1959.

- Finance Act 1960 (relief on tax from profits on new exports).  
 Minerals Development Act 1940 (minerals other than oil and natural gas).  
 Minerals Development Act 1960 (minerals other than oil and natural gas).  
 The Petroleum and Other Minerals Development Act 1960.  
 The Finance Act 1946 (tax allowances for capital expenditure in mining).  
 The Finance (Profits of Certain Mines) (Temporary Relief from Taxation) Act 1956 as amended by Section 77 of the Finance Act, 1959 (relief from income and corporations tax of profits arising from the operations of new mining enterprises).  
 The Finance (Miscellaneous Provisions) Act 1956 (relief from income and corporation profits tax for coal mines; increased depreciation allowances for equipment in a mine, quarry or smelter).

## ISRAEL

- Law for the Encouragement of Capital Investments, No. 5719 of 1959.  
 Income Tax (Depreciation) Regulations of 1941.  
 Petroleum Law No. 5712 of 1952 as amended by the Law of 17 January 1957.  
 Income Tax (Deduction from Income of Holders of Petroleum Interests) Regulations 5716 of 1956.

## IVORY COAST

- Law No. 59-134 of 3 September 1959 determining rules regarding private investment in the Republic (*Journal Officiel de la République de Côte d'Ivoire*, 10 September 1959).  
 Decree No. 60-09 of 6 January 1960 fixing regulations for the Law No. 59-134 (*ibid.*, 10 January 1960).

## JAMAICA

- Hotels Aid Law 1944, as amended by Law No. 51 of 11 December 1953, Law No. 67 of 16 November 1954, Law No. 58 of 22 December 1955, Law No. 63 of 13 December 1956 and Law No. 19 of 12 March 1958.  
 Law No. 52 of 30 December 1947, the Textile Industry (Encouragement) Law, as amended by Law No. 50 of 9 December 1955.  
 Law No. 29 of 15 November 1948, the Cement Industry (Encouragement and Control) Law.  
 Law No. 4 of 17 February 1949, the Buttons (Manufacture Encouragement) Law.  
 Law No. 13 of 21 February 1949, the Pioneer Industries (Encouragement) Law, as amended by Law No. 57 of 22 December 1955 and Law No. 42 of 17 August 1956.  
 Law No. 50 of 8 November 1954, the Exchange Control Law.  
 Income Tax Law of 1954 as amended by Law No. 7 of 1956, Law No. 29 of 1957, Law No. 42 of 1958 and Law No. 41 of 1959.  
 Law No. 36 of 3 August 1956, the International Business Companies (Exemption from Income Tax) Law.  
 Law No. 45 of 16 August 1956, the Industrial Incentives Law.  
 Law No. 49 of 13 October 1956, the Export Industry Encouragement Law.  
 Law No. 12 of 12 June 1950, the Bauxite and Alumina Industries (Encouragement) Law.

## JORDAN

- Law No. 27 of 21 April 1955 on the encouragement and guidance of industry (*Official Gazette* No. 1225, 1 May 1955).

Law No. 28 of 21 April 1955 on the encouragement of foreign capital investment (*ibid.*, No. 1225, 1 May 1955).  
Mining Law of 1926 (*ibid.*, No. 134, 15 August 1926).

## KENYA

The Kenya (Constitution) (Amendment No. 2) Order in Council, 1960.

## KOREA (REPUBLIC OF)

Foreign Investment Encouragement Law No. 532 of 1960, promulgated on 1 January 1960.

## LAOS

Communication of the *Direction de Finances Extérieures* on provisional measures relative to foreign investments, September 1956.

## LEBANON

Law of 29 December 1953, promulgated on 5 February 1954, exempting new corporations from income tax.  
Decree No. 113/LR of 9 August 1933 and Decree No. 113/LR of 23 June 1936 regulating Oil Exploration and Exploitation.

## LIBERIA

Law of Mines of 1956, Title 24 Liberian Code of Laws (section 165).

## LIBYA

Law No. 51 of 23 September 1956 on the development of national industries.  
Customs Law of 1 January 1957.  
Executive Regulations of 7 April 1957 under the Law No. 51 of 1956 on the development of national industries.  
Law of 30 January 1958 on the investment of foreign capital (*Official Gazette*, 26 April 1958).  
Petroleum Law No. 25 of 1955.  
Royal Decree of 21 May 1955 amending the Petroleum Law of 1955.  
Royal Decree of 21 May 1955 forming the Petroleum Commission.

## MALTA

Aids to Industries Emergency Ordinance, 1959.

## MAURITIUS

Law No. 84 of 1950. The Income Tax Ordinance, and Amendment Ordinances No. 11 and No. 57 of 1956.

## MEXICO

Law of 31 December 1954 for the development of new and necessary industries (*Diario Oficial*, 4 January 1955) and regulations thereunder of 30 November 1955 (*ibid.*, 2 December 1955).  
Mining Law of 1930 (*ibid.*, 7 August 1930).  
Expropriation Law of 23 November 1936.  
Decree of Expropriation of Certain Oil Companies of 18 March 1938.  
New regulations (under article 27 of the Constitutions) relating to petroleum (*ibid.*, 30 December 1941).  
Petroleum Tax Law of February 1948.  
Amendments to Petroleum Law (*ibid.*, 31 December 1955).  
Law of Taxes and Promotion of Mining in Mexico of 31 December 1955 (*ibid.*, 31 December 1955).

## MOROCCO

Law of 13 September 1958 instituting measures to encourage private investment, promulgated by Dahir (Royal Decree) No. 1-58-263 of 13 September 1958 (*Bulletin Officiel* of the Kingdom of Morocco, No. 2395, 19 September 1958).  
Arrêté of the Vice-President of the Council, Minister of National Economy and Agriculture of 13 September 1958 fixing the composition and rules of procedure of the investment commission (*ibid.*, No. 2395, 19 September 1958).  
Arrêté of the Vice-President of the Council, Minister of Economy and Agriculture of 13 September 1958 defining the industrial sectors that may benefit from the provisions of the above law of 13 September 1958 (Dahir No. 1-58-263).  
Petroleum Code (Dahir No. 1-58-227) of 21 July 1958, as amended.

## NICARAGUA

Law of 11 March 1955 on foreign capital investments (*La Gaceta*, 10 March 1955).  
Legislative Decree No. 317 of 20 March 1958 on the encouragement of industrial development (*ibid.*, 24 April 1958).

## NIGERIA

Aid to Pioneer Industries Ordinance, 1952 (No. 10 of 1 April 1952).  
Statement by the Federal and Regional Governments, *Opportunities for Overseas Investment in the Federation of Nigeria* (July 1958, reprinted in the *Economic Survey of Nigeria* 1959, published by the National Economic Council, Lagos, 1959, pp. 119-121).  
Industrial Development (Import Duties Relief) Ordinance, 1957.  
Industrial Development (Income Tax Relief) Ordinance.  
Dumped and Subsidised Goods Ordinance, 1958.  
Drawback (Customs) Regulations, 1959.  
Petroleum (Profits Tax) Ordinance, 1959.

## PAKISTAN

Industrial Policy Statement of 20 February 1959.  
The Companies Act, 1913 (Section 277).  
The Capital Issue (continuance of control) Act, 1947.  
The Income Tax Act, 1922, as amended by subsequent Finance Acts, Section 15 B (tax relief for new enterprises).  
Development of Industries Act, 1949.  
The Income Tax Act, 1922, as amended by subsequent Finance Acts, Section 10(8) and Second Schedule (taxation of petroleum profits).  
Regulations of Mines and Oil Fields and Mineral Development (Federal Control) Act of 1948.  
Petroleum (Production) Rules of 1949.  
Mining Concession Rules of 1958.

## PANAMA

Decree-Law No. 12 of 10 May 1950 on measures relating to investment for exploitation of natural resources, etc. (*Gaceta Oficial*, 24 May 1950).  
Decree-Law No. 22 of 28 September 1950 for the encouragement of the development of natural resources and the establishment of public utilities (*ibid.*, 9 October 1950).  
Law No. 25 of 7 February 1957 for the encouragement of production (*ibid.*, 8 February 1957).

## PARAGUAY

Decree-Law No. 30 of 31 March 1952 establishing rules for the

development of new industries (*Gaceta Oficial*, 31 March 1952).

Decree-Law No. 38 of 31 March 1954 for the stimulation of production of coffee (tax concessions, etc.) (*ibid.*, 31 March 1954).

Law No. 246 of 25 February 1955 establishing a system for the incorporation of foreign capital (*ibid.*, 25 February 1955).

Petroleum Law No. 1755 of 8 June 1940.

#### PERU

Law No. 12378 of 6 July 1955 establishing rules regarding the operations of the electric power industry in the country (*El Peruano*, No. 4304, 14 July 1955).

Law No. 12663 of 26 October 1956 on textile industry incentives.

Law No. 13270 of 30 November 1959 on Industrial Promotion. Decree Supremo No. 4 of 26 April 1960 promulgating regulations pertaining to Law No. 13270 on Peruvian Industrial Promotion (*ibid.*, 29 April 1960).

Mining Code, Decree-Law No. 11357 of 12 May 1950 as modified.

Petroleum Law No. 11780 of 12 March 1952 (*ibid.*, 14 March 1952).

Petroleum Regulations of 16 June 1952.

Law No. 12376 of 8 July 1955 establishing conditions for granting concessions in the zone of the Oriente.

#### PHILIPPINES

Republic Act No. 35 of 30 September 1946 authorizing exemption of new and necessary industries from the payment of internal revenue taxes, as amended by Republic Act No. 901 of June 1953 (*Official Gazette*, vol. 49, No. 7) and Department of Finance Order No. 185 of October 1953.

Coal Lands Act No. 2719 of 14 May 1917, amended by Republic Act No. 240 of 18 June 1952.

Mining Act No. 137 of 7 November 1936 (as amended).

Petroleum Act of 1949 (Republic Act No. 387).

#### PUERTO RICO

Industrial Incentive Act of 1954 (Act No. 105) as amended 28 June 1956.

#### RHODESIA AND NYASALAND (FEDERATION OF)

Statement of foreign investment policy of 1956.

Federal Income Tax Act of 1954, as amended on 31 December 1959 and Law No. 21 of 1960.

Customs and Excise Act, 1955, as amended by Law No. 24 of 1955, Law No. 10 of 1956, Law No. 15 of 1958 and Law No. 25 of 1958.

#### SARAWAK

Ordinance No. 13 of 16 September 1957, the Pioneer Industries (Encouragement) Ordinance.

Ordinance No. 14 of 1949, the Mining Ordinance.

Mining rules of 1949.

Ordinance No. 4 of 1958, the Oil Mining Ordinance.

#### SAUDI ARABIA

Law of April 1957 regulating the investment of foreign capital.

#### SENEGAL

Foreign Investment Law No. 10 of 13 February 1960 (*Official Bulletin* of 19 February 1960).

#### SPAIN

Decree-Law 16/1959 of 27 July 1959 on foreign capital invested in Spanish enterprises. (*Boletín Oficial*, 28 July 1959).

Decree of 30 September 1959 implementing decree-law on investment of foreign capital in Spanish enterprises.

Decree of 24 December 1959, complementary to the decree-law on the investment of foreign capital in Spanish enterprises.

Order of 24 December 1959 on acquisition of Spanish securities by foreigners.

Order of 10 February 1960 relating to special registration by foreigners of securities and shares in industries.

Order of 12 March 1960 extending the time for declaration by foreigners of shares and securities in Spanish enterprises established in Art. 2 of the order of 10 February 1960.

#### SUDAN

Act. No. 8 of 1956 on concessions for approved enterprises (*Legislative Supplement to Sudan Government Gazette* No. 892 of 15 March 1956).

#### THAILAND

Exchange Control Act of 1942.

Notification of October 1955 of the Ministry of Industry.

Decree No. 23 of 6 December 1958.

Promotion of Industrial Investment Act of 17 October B.E. 2503 (1960).

Ministerial Regulation No. 1, B.E. 2503 (1960) issued in accordance with the provisions of the Promotion of Industrial Investment Act B.E. 2503 (1960).

Communiqué of the Bank of Thailand dated 17 July B.E. 2502 (1959) concerning facilities for investors in Thailand.

Notice of the competent offices of the Exchange Control No. 2/2503.

Exchange Control Act B.E. 2485 (1942) and Ministerial Regulations No. 13 B.E. 2497 (1954) issued thereunder.

Communiqué of the Bank of Thailand dated 4 October 1960 (B.E. 2503) concerning relaxation of Exchange Control.

Mining Law of 1918 (B.E. 2461), as amended 1950.

#### TRINIDAD

"Regulations and Policy Concerning Investment of Foreign Capital in Trinidad."

Aid to Pioneer Industries Ordinance of 16 March 1950, and Amending Ordinances No. 16 and No. 32 of 1956.

Income Tax (in Aid of Industry) Ordinance, Ch. 33, No. 2, and Amending Ordinance No. 48 of 1955.

Hotels (Development Encouragement) Ordinance, Ch. 32, No. 15 and Amending Ordinance No. 33 of 1952 and No. 25 of 1959.

Income Tax (Amendment) Ordinance No. 30 of 1954, relating to investment in hotel construction and equipment.

Cement Industry (Development) Ordinance, 1 December 1951.

Oil Mining Regulations of 1939 and 1945.

#### TUNISIA

Decree of 4 June 1957 on the Guarantee Fund for the repatriation of capital and profits derived from foreign investments (*Journal Officiel*, 4 June 1957).

Laws for the Encouragement of Investments: 19 September 1946, 18 September 1947, 30 March 1953, 27 June 1954 (Certificate of Establishment); 17 December 1942, 1 October 1945 (Certificate of Agreement); 1 January 1948, 22 March 1956, 30 March 1957 (Guarantees of equipment loans), 29 December 1955 (special tax reliefs).

Basic decree of 13 December 1948 on petroleum exploration and exploitation in Tunisia; amended by decree of 1 January 1953, further modified by Law No. 58-36 of 15 March 1958 (*Journal Officiel tunisien*, 21 March 1948, and *Journal Officiel de la République Tunisienne*, No. 22 of 18 March 1958).

#### TURKEY

Law No. 6224 of 18 January 1954 on the encouragement of foreign investment (*Official Gazette* No. 8615 of 23 January 1954).

Law No. 6791 of 9 July 1956 on expropriation or confiscation guarantees.

Ordinance No. 53 of 6 September 1956 enumerating activities forbidden to foreign nationals, enterprises and institutions.

Law No. 6309 of 3 March 1954 on mining (*ibid.*, No. 8655, 11 March 1954).

Law No. 6326 of 7 March 1954 on petroleum (*Official Gazette* No. 8658, 16 March 1954), as amended by Law No. 6558 of 13 May 1955 (*Official Gazette* No. 9011, 21 May 1955) and by Law No. 6987 enacted on 29 May 1957 (*ibid.*, No. 9626 of 6 June 1957).

Regulations for Administration of the Petroleum Law of 7 March 1954 approved by Decree No. 4-5633 of 28 July 1955.

#### UNITED ARAB REPUBLIC (Egyptian region)

Law No. 169 of 1952 regarding the exemption of foreign aviation companies from some taxes, as amended by Law No. 588 of 1953.

Law No. 156 of 1 April 1953 on the investment of foreign capital in economic development projects, amended by Law No. 475 of 2 September 1954.

Law No. 430 of 3 September 1953 establishing tax exemptions for the strengthening and development of the national economy (*Journal Officiel* No. 712, 3 September 1953).

Ministerial decree No. 6 of 25 January 1954 concerning the execution of Law No. 430 of 3 September 1954.

Law No. 20 of 13 January 1957, as amended by Law No. 138 of 29 June 1957 relating to the appointment of a representative to the boards of companies of national interest.

Decree of 12 August 1948 regarding investments requiring nationals to be on board of directors.

Law No. 66 of 19 February 1953 on Mines and Quarries, as amended by Law No. 86 of 14 March 1956, and Law No. 98 of 3 May 1959.

Decree No. 69 of 28 February 1959 concerning the application of the Law No. 86 of 14 March 1956.

#### UNITED ARAB REPUBLIC (Syrian region)

Legislative decree No. 47 of 7 August 1952 regulating Syrian industry.

Legislative decree No. 103 of 27 September 1952 on the encouragement of industry.

Mining Law, Decree No. 151 of 2 March 1952.

Mining Law No. 7 of 21 December 1953.

#### URUGUAY

Law No. 10079 of November 1941 on new industries.

#### VENEZUELA

Resolution No. 95 of 6 June 1939 relating to import duties on equipment and raw materials.

Decree No. 173 of 21 April 1958 simplifying the procedure contained in Decree No. 315 of 24 September 1951 granting of total or partial exemptions for materials imported for use in industries (*Gaceta Oficial*, 22 April 1958).

Decree No. 255 of 18 March 1960 concerning exemptions from tariffs of machinery, equipment and raw materials imported for use in industry or agriculture (*ibid.*, 8 April 1960).

Law on Hydrocarbons and regulations of 1943 (*ibid.*, 13 March 1943 and 31 August 1943).

Mining Law of 29 December 1944, as amended.

Law on Hydrocarbons of 1955 (*ibid.*, 13 October 1955).

#### VIET-NAM (REPUBLIC OF)

Presidential declaration of 5 March 1957 on the policy of investment in Viet-Nam.

Circular on the application of the presidential declaration of 5 March 1957 relative to new investments.

Decree No. 478-KT of 16 November 1957 creating an Industrial Development Centre.

## ANNEX III

## General agreements for the avoidance of double taxation with respect to taxes on income covering under-developed countries and territories

## I. COUNTRIES MEMBERS OF THE UNITED NATIONS

	Canada	Central African Rep.	Ceylon	Chad	Congo (Brazzaville)	Denmark	Fed. of Malaya	Finland	France	Gabon	Germany (Fed. Rep.)	Ghana	Greece	India	Italy	Japan	Netherlands	New Zealand	Nigeria	Norway	Pakistan	Sierra Leone	Sweden	Switzerland	United Kingdom	United States a	
Burma	.	.	.	.	.	.	.	.	N	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	.
Cambodia	.	.	.	.	.	.	.	.	N	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.
Central African Rep.	.	.	.	E <sup>b</sup>	E <sup>b</sup>	.	.	.	E <sup>c</sup>	E <sup>b</sup>	N	.	.	E	N	.	N	.	.	N	N	.	E	N	E	N	
Ceylon	.	E <sup>b</sup>	.	.	.	N	N	.	E <sup>c</sup>	E <sup>b</sup>	.	.	.	.	.	.	N	.	.	.	.	.	.	.	E	N	
Chad	.	E <sup>b</sup>	.	E <sup>b</sup>	.	.	.	.	E <sup>c</sup>	E <sup>b</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	
Congo (Brazzaville)	E	E <sup>b</sup>	.	E <sup>b</sup>	.	.	.	.	E <sup>c</sup>	E <sup>b</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	
Congo (Leopoldville)	E	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	E	.	.	.	.	E	.	E	E	
Cyprus	E	.	.	.	.	E	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	E	.	E	.	.	E	.	E	E	
Dahomey	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	
Fed. of Malaya	.	.	.	.	.	E	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	E	.	.	E	.	E	E	
Gabon	.	E <sup>b</sup>	.	E <sup>b</sup>	E <sup>b</sup>	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	E	.	.	E	.	E	E	N	
Ghana	E	.	.	.	.	E	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	E	E	.	E	E	.	E	E	E	
Guinea	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	E	.	E	E	E	
Honduras	.	.	E	.	.	E	.	N	.	.	E	.	N	.	.	E	.	.	.	E	E	.	E	N	.	E	
India	.	.	E	.	.	E	.	.	.	.	E	.	N	.	.	E	.	.	.	E	E	.	E	N	.	E	
Indonesia	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	S	.	.	.	.	.	.	E	N	E	
Israel	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	N	E	S	
Ivory Coast	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	E	
Laos	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	E	
Madagascar	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	
Mali	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	
Niger	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	E	
Nigeria <sup>d</sup>	E	.	.	.	.	E	.	.	E <sup>c</sup>	.	E	E	N	E	.	E	.	E	.	E	.	E	E	E	E	E	
Pakistan	.	.	.	.	.	S	.	.	.	.	E	.	N	E	.	E	.	E	.	.	.	E	E	E	E	E	
Senegal	.	.	.	.	.	.	.	.	E <sup>b</sup>	.	.	.	.	.	.	.	.	E	.	.	.	.	.	.	E	E	
Sierra Leone <sup>e</sup>	E	.	.	.	.	E	.	.	.	.	.	E	.	.	.	.	.	E	E	E	.	.	E	S	E	E	
Tunisia	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	S	.	E	
United Arab Republic	.	.	.	.	.	.	.	.	E <sup>c</sup>	E	.	.	.	.	.	.	.	.	.	.	.	.	E	.	.	S	
Upper Volta	.	.	.	.	.	.	.	.	E <sup>c</sup>	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	

E — Agreements in effect

S — Agreements signed but not yet in effect

N — Agreements under negotiation

<sup>a</sup> In addition to the countries listed in the table the United States is also negotiating general income tax agreements with the following countries: Argentina, Brazil, Ceylon, Chile, China, Colombia, Costa Rica, Mexico, Paraguay, Peru, Philippines, Thailand, Uruguay, Venezuela.

<sup>b</sup> This agreement was jointly concluded by the Central African Republic, Chad, Congo (Brazzaville) and Gabon.

<sup>c</sup> Agreement relating to taxes on income from movable capital only.  
<sup>d</sup> The agreements applicable to Nigeria also apply to Cameroun under United Kingdom trusteeship.

<sup>e</sup> Application for membership in the United Nations made on 27 April 1961.

## II. OVERSEAS TERRITORIES

(i) Income tax agreements concluded between the United Kingdom and:

Aden Colony	Federation of Rhodesia and Nyasaland
Antigua	
Barbados	Fiji
Basutoland Protectorate	Gambia
Bechuanaland Protectorate	Gilbert and Ellice Islands Colony
British Guiana	Grenada
British Honduras	Guernsey
British Solomon Islands Protectorate	Isle of Man
Brunei	Jamaica
Dominica	Jersey
Falkland Islands	Kenya

Mauritius	Singapore
Montserrat	Swaziland
North Borneo	Tanganyika
St. Christopher and Nevis	Trinidad
St. Lucia	Uganda
St. Vincent	Virgin Islands (British)
Sarawak	Zanzibar
Seychelles	

(ii) Income tax agreements concluded between the Federation of Rhodesia and Nyasaland and:

Kenya	Tanganyika
Uganda	Zanzibar

(iii) Income tax agreement concluded between: Jersey and Guernsey

(iv) Income tax agreement concluded between:  
Mauritius and Seychelles

(v) Income tax agreements concluded by Gambia with Ghana and Nigeria.

(vi) Income tax agreement between Canada and the United Kingdom of 5 June 1946 extended to:

Aden Colony	Grenada
Antigua	Jamaica
Barbados	Mauritius
British Guiana	Montserrat
British Honduras	St. Christopher and Nevis
Dominica	St. Lucia
Falkland Islands	St. Vincent
Federation of Rhodesia and Nyasaland	Seychelles
Fiji	Trinidad
Gambia	Virgin Islands
	Zanzibar

(vii) Income tax agreement between New Zealand and the United Kingdom of 27 May 1947 extended to:

Aden Colony	Nyasaland
Antigua	St. Christopher and Nevis
Falkland Islands	St. Vincent
Gambia	Seychelles
Grenada	Sierra Leone
Jamaica	Trinidad
Mauritius	Virgin Islands
Montserrat	

(viii) Income tax agreement between Sweden and the United Kingdom of 30 March 1949 extended to:

Aden Colony	Mauritius
Antigua	Montserrat
Barbados	North Borneo
British Honduras	St. Christopher and Nevis
British Solomon Islands	St. Lucia
Dominica	St. Vincent
Falkland Islands	Seychelles
Federation of Malaya	Sierra Leone
Federation of Rhodesia and Nyasaland	Singapore
Fiji	Tanganyika
Gambia	Trinidad
Gilbert and Ellice Islands	Uganda
Jamaica	Virgin Islands
Kenya	Zanzibar

(ix) Income tax agreement between Denmark and the United Kingdom of 27 March 1950 extended to:

Aden Colony	Fiji
Antigua	Gambia
Barbados	Gilbert and Ellice Islands
British Honduras	Jamaica
British Solomon Islands	Kenya
Dominica	Mauritius
Falkland Islands	Montserrat
Federation of Malaya	North Borneo
Federation of Rhodesia and Nyasaland	St. Christopher and Nevis
	St. Lucia

St. Vincent  
Seychelles  
Sierra Leone  
Singapore  
Tanganyika

Trinidad  
Uganda  
Virgin Islands  
Zanzibar

(x) Income tax agreement between Norway and the United Kingdom of 2 May 1951 extended to:

Aden Colony	Grenada
Antigua	Jamaica
Barbados	Mauritius
British Honduras	Montserrat
British Solomon Islands	North Borneo
Dominica	St. Christopher and Nevis
Falkland Islands	St. Lucia
Federation of Rhodesia and Nyasaland	St. Vincent
Fiji	Seychelles
Gambia	Singapore
Gilbert and Ellice Islands	Trinidad
	Virgin Islands

(xi) Income tax agreement between the United States and the United Kingdom of 16 April 1945 extended to:

Aden Colony	Jamaica
Antigua	Montserrat
Barbados	St. Christopher, Nevis and Anguilla
British Honduras	St. Lucia
Dominica	St. Vincent
Falkland Islands	Seychelles
Federation of Rhodesia and Nyasaland	Trinidad and Tobago
Gambia	Virgin Islands
Grenada	

(xii) Income tax agreement between the Netherlands and the United States of 29 April 1948 extended to the Netherlands Antilles.

(xiii) Income tax agreement between the Netherlands and the United Kingdom of 15 October 1948 extended to the Netherlands Antilles and Fiji.

(xiv) Income tax agreement between Belgium and Sweden of 1 April 1953 extended to Ruanda-Urundi.

(xv) Income tax agreement between Belgium and the United States of 28 October 1948, as modified on 9 September 1952, extended to Ruanda-Urundi.

(xvi) Income tax agreement between Belgium and Canada of 10 April 1958 extended to Ruanda-Urundi.

(xvii) Income tax agreement between the Union of South Africa and the Federation of Rhodesia and Nyasaland of 22 May 1956.

(xviii) Agreement relating to taxes on income from movable capital concluded by France with French Oceania (of 28 March and 26 May 1957) and Comoro Islands (12 December 1958).

(xix) Income tax agreement between Union of South Africa and Zanzibar of 18 February 1958.

(xx) Income tax agreements between the United Kingdom and the Union of South Africa of 18 June 1959 concerning Basutoland, Bechuanaland Protectorate and Swaziland.