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METHODS OF FINANCING ECONOMIC DEVELOPMENT OF UNDER-DEVELOPED COUNTRIES

Survey of Policies Affecting Private Foreign Investment

Prepared by the Secretariat

SURVEY OF POLICIES AFFECTING PRIVATE FOREIGN INVESTMENT

Contents

Contents
(Cont'd)

Page

Part II

LAWS, REGULATIONS AND POLICIES IN SELECTED LESS DEVELOPED COUNTRIES

SURVEY OF POLICIES AFFECTING PRIVATE FOREIGN INVESTMENT

(Prepared by the Secretariat)

INTRODUCTION

The present report has been prepared pursuant to resolution 222 (IX) D of the Economic and Social Council, dated 14 August 1949. Recognizing "that the economic development of under-developed areas requires not only expanded efforts in technical assistance, but also assurances of an expanded rate of international capital flow for the purpose of financing economic development", the Council state its belief "that consideration of measures to expedite such an expanded flow requires careful study and discussion by the Council of many problems, such as the effective mobilization of national savings, the creation of a favourable investment climate, the fuller utilization of existing sources of international funds, measures to avoid extreme fluctuations in earnings of foreign exchange, and others ...". Accordingly, it requested the Secretary-General to prepare several studies in anticipation of the discussion at its tenth session, including:

> "A survey of the more important types of laws, regulations, and economic policies affecting the operations of foreign private capital which are most prevalent in capital-exporting countries on the one side, and in less developed countries on the other, with a view to evaluating the extent to which such laws, regulations, and policies affect the international flow of private capital; ..."

The position of private foreign capital in less developed countries is also under consideration by the Economic Commission for Latin America and the Economic Commission for Asia and the Far East. Pursuant to resolutions by these two bodies comprehensive reports on the legal and economic status of private foreign capital in the countries in the two regions covered by these Commissions are now in preparation.[1] These regional studies are expected to throw much light on the subject of the present report, but in view of the Council's request, the

1/ See Resolution of the Economic Commission for Latin America on "Studies on Conditions Affecting Capital Investments", 10 June 1949 (E/CN.12/132), and Resolution of the Economic Commission for Asia and the Far East on "Measures to Promote Trade", 10 December 1948 (E/CN.11/172).

Secretariat has prepared the present survey before their completion. It should be regarded, accordingly, as an interim statement, subject to amplification and revision in the light of further information.

Attention may be called also to two publications prepared by the Secretariat which are closely related to the present report:

1. International Capital Movements during the Inter-War Period, United Nations Publications Sales No.: 1949.II.D.2.

2. Methods of Financing Economic Development in Under-Developed Countries, United Nations Publications Sales No.: 1949.II.B.4.

The following report is divided into two parts. Part I offers a survey of the main types of laws, regulations and economic policies of both capital-exporting and less developed countries with reference to foreign investments. Part II illustrates the general discussion of Part I by brief summaries of the laws, regulations and policies in selected less developed countries.

/Part I

Part I

MAIN TYPES OF POLICY

A. General Considerations

A distinctive feature of the post-war period has been the small amount of private long-term foreign investment in relation not only to the outflow of long-term capital through governmental channels but also, particularly in the United States, to the volume of private domestic investment.[1/] Such private capital flow as has occurred has been concentrated in relatively few areas and in extractive industries producing for export, mainly petroleum. The flotation of securities for foreign account, whether in the form of bonds or shares, has been negligible, and the bulk of the outflow of new capital has been in the form of direct investments by existing enterprises, financed from the reinvestment of income earned by the parent concern in the capital-exporting country or by its branch or subsidiary abroad.

In the case of many countries which in the past have been traditional sources of long-term international investment the immediate causes of the limited outflow are not far to seek. Their economies were adversely affected by the war, and they have deliberately curbed the outflow of domestic capital in order to conserve their limited resources and mitigate the pressure on their balance of payments. Where no such curbs have been imposed, however, as in the United States, the explanation must be sought elsewhere.

A full explanation of the reduced level of private foreign investment in recent years would require consideration of not only laws, regulations and policies affecting foreign investment, as called for in the resolution set out above, but of all factors bearing upon private investment generally (and thus also foreign investment), including the supply of private savings available for foreign investment in capital-exporting countries and the prospective yields of foreign as compared with domestic investment. The present report is limited,

1/ Detailed information on post-war private foreign investment is contained in several reports issued by the United Nations. See particularly World Economic Report, 1948, and Methods of Financing Economic Development in Under-Developed Countries.

/however,

however, largely to an examination of governmental measures and policies which have a special incidence on private foreign investment.

This limitation of the study should not obscure the importance of certain elements of an essentially international character which influence the international flow of capital. The security of an investment made in an area under foreign jurisdiction and the transferability of investment yields must necessarily be of primary concern to the private investor. So long as the investor considers the special risk connected with investment abroad relatively small, he may be induced to make such investment by the prospect of a higher yield than that obtained from the domestic investment. When the risk appears greater than can be compensated for by the anticipated higher yield, private foreign capital will not flow to the country concerned; in fact, existing investments (including domestic investments) may be liquidated and capital thus flow from countries where the yield is high to countries where it is low. At the present time, apprehension of political instability and the lack of equilibrium generally in economic relations among countries constitute serious obstacles to the resumption of normal capital movements on a large scale.

Insecurity resulting either from external political tension or from internal strife in an under-developed country naturally discourages foreign investors. The fear of a shift in the governmental regime of capital-importing countries that may be coupled with a deterioration in the "climate" under which foreign investments operate also acts as a deterrent to investments in certain parts of the world.

The present lack of international economic equilibrium is reflected in a pressure on the balance of payments in the majority of under-developed countries and also in some of the countries that used to be capital-exporting. The transfer of the yield of foreign investments from the former is thus rendered difficult and the capital available in the latter for investments abroad is reduced. It should not be assumed that the balance of payments difficulties that have resulted from World War II have been the main cause of the reduced flow of capital to the under-developed countries. The international economy had broken down around 1930, and from 1931 capital tended to flow from under-developed countries to creditor countries. The breakdown and the resulting problem of transfer have been briefly discussed in a companion publication.1/ Before the

1/ United Nations, International Capital Movements during the Inter-War Period, 1949 (United Nations Publications Sales No. 1949.II.D.2).

/breakdown,

breakdown, foreign investment yields were seldom paid through bilateral transactions between debtor and creditor countries, but the transfer took place in triangular or multilateral trade through "third" countries which had a net import from the under-developed countries and a net export to the creditor country (or to countries which in their turn had such a net export to the creditor country). The investments and the payments to which the investments gave rise thus facilitated international trade and payments generally and their influence was not confined to debtor and creditor countries alone. The breakdown of the international economy, manifest at the time in reduced prices, deteriorated terms of trade of the under-developed countries, reversed capital movement and widespread balance of payments disequilibria, rendered it imperative for numerous countries to equilibrate their foreign transactions with the aid of exchange controls and trade restrictions. Largely because of fear of retaliation,[1/] these controls and restrictions tended to eliminate the triangular and multilateral trade on which depended the international transfer of investment yields. The resulting curtailment in international markets of the demand of "third" countries contributed to keeping the prices of the export products of under-developed countries at abnormally low levels and discouraged foreign investments generally. While price relations since the war in some cases have changed in favour of under-developed countries, the majority of these countries continue to suffer from difficulties in their balance of payments and hence find it necessary to apply stringent trade and payments restrictions which hamper the development of triangular trade. The orientation of economic activities in numerous countries thus still does not permit of an international economic integration that would facilitate the revival of private foreign investments of the kind which occurred, for example, during the 1920's.

The exchange stringency in some countries, it will be observed, is not always or wholly due to the general disequilibrium in international economic relations referred to above. Current methods of financing programmes of

1/ Each country normally has export balances with certain countries and import balances with others. It is usually least exposed to retaliation when reducing imports from the latter. The restrictions thus tended to curtail bilateral balances of trade.

development frequently tend to generate inflationary pressures causing balance of payments difficulties which are met by means of trade restrictions and exchange controls.

It is not possible in this study to analyze in detail the effect on international investments of the exchange and trade controls just referred to. Brief reference will be made to the use which a number of capital-importing and capital-exporting countries make of exchange controls for the regulation of the outflow of investment yields and of long-term capital for investment purposes, but this study can deal only with the immediate effect of the controls on the external private financial transactions of the country applying the controls. In fact the controls and trade regulations in different countries have become part of the "climate" for international investment all over the world, and the capital movements and transfer of yields between any two countries are influenced not only by their own exchange and trade regulations but also, and probably to a much larger extent, by those of other countries.

/B. <u>Policies of</u>

B. Policies of Capital-Exporting Countries

The capital-exporting countries to be considered are those which may be expected to invest private long-term capital in less developed countries.[1] The United States is by far the most important source of such capital and is likely to remain so for some time to come; the policies of that country are accordingly of particular interest. Long-term investments abroad may be made, however, (and have been made) even by countries which are capital importers on balance. Certain European countries, for instance, have recently been net importers of capital as the result of an inflow of funds from the United States, at the same time as they have invested in oversea areas linked to them by political and economic ties.

Objectives of policy

A capital-exporting country may leave the private investor free to invest at home or abroad according to the same criteria as determine a decision to invest in one or another domestic investment. While it is frequently difficult to specify the precise object of many policies affecting the investment abroad it may be said that in practice governmental measures in capital-exporting countries operate in some degree either to restrain or to stimulate the export of capital.

Most European capital-exporting countries have placed direct restrictions on the outflow of capital. The objects of these restrictions vary. The principal object is usually to relieve or prevent pressure on the balance of payments. Frequently, the restraints also serve the purpose of limiting the volume of total investments (at home and abroad) by domestic concerns, as part of an anti-inflationary policy. The maintenance of a fluid domestic capital market may also be aimed at, more particularly with a view to reducing the rate at which the

1/ Policies affecting the export of short-term capital or the export of capital which results in the reduction of outstanding liabilities (for instance, the liquidation of blocked "sterling balances"), or which represents the liquidation of existing equity investments are therefore not directly considered.

/government

government may borrow in that market. Such a policy was widely applied during the 1930's.[1] But the intention has frequently been to reduce the cost of capital to domestic industry and thus facilitate domestic private investment, sometimes on the assumption that this would contribute more to domestic prosperity than investment abroad.

Controls of the type mentioned usually aim at the limitation of aggregate capital exports and to that extent, in principle if not in practice, are not concerned with the nature of the capital in question, nor with its geographic destination. Controls on the direction and type of foreign investments have also been imposed for both political and economic reasons. The most important instance of such controls at present is the restriction of capital exports to particular countries on account of balance of payments difficulties. Another instance of some importance, at least in the past, is the policy of "tied" loans (obliging the borrower to spend the proceeds of the loan in the lending country) aimed at promoting domestic employment.

A policy of stimulating foreign investments may likewise apply either to the aggregate volume or only to certain types of foreign investment. Such a policy may be based on a wide range of political and economic considerations. Recently attention has been directed to the fostering of capital exports with a view to stimulating exports and thus employment and domestic property generally.[2]

1/ It will be recalled, for instance, that during the early 1930's the United Kingdom, after having placed an embargo on foreign lending, succeeded in converting her outstanding 5 per cent war loan of over £2,000 million to a 3 per cent basis.

2/ In 1948 the United Nations Secretariat, acting in pursuance of a resolution of the Economic and Social Council of 3 March 1948, submitted a questionnaire to governments concerning their policies in regard to the maintenance of full employment. One of the questions asked was whether any programmes to offset unemployment included measures to increase net exports by government loans and grants or by encouragement of private loans or direct investments abroad. Only one country, New Zealand, mentioned that it would consider financing some of its exports by grants of credits to importing countries, adding, however, that such a measure would be of relatively small importance. It may be noted that a number of countries did not list the specific measures which they might use to eliminate unemployment. See Maintenance of Full Employment, United Nations, July 1949.

Capital-exporting countries may also wish to stimulate exports to under-developed areas as a consequence of a deliberate policy of promoting the economic advancement of such areas. Recent expressions of such a policy may be found in the official plans for the development of dependent territories announced by several European countries and in the programme for the promotion of the economic development of under-developed areas recently proposed by the United States Government.

The objectives pursued through the stimulation of capital exports may frequently be reached by governmental as well as private financing. It may be expected, however, that countries in which domestic investments are largely private will seek to reserve at least a portion of their capital exports for private investors.1/ An example of concern about private investment is afforded by the Articles of Agreement of the International Bank for Reconstruction and Development. Among the purposes of the Bank, as stated in the preamble, is the following:

> "to promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment..."

Among the conditions to which the Bank's loans are subject is the following:

> "The Bank (must be) satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower."

In addition, the Articles of Agreement of the Bank require that the bulk of the resources for the Bank's own lending operations is to be derived from funds raised in the capital market of a member country or otherwise borrowed by the Bank. Alternatively, the Bank may guarantee loans made directly by private investors. In the case of the United States a preference for private investment is also contained

1/ This position has been expressed by Mr. Collado, a member of the Sub-Commission on Economic Development, in the following terms: "It is ... I believe, the right of a great capital-exporting nation, always adhering to the principles of the United Nations Charter, to parallel in its external activities the pattern of its internal economy. I therefore believe strongly that the United States should co-operate fully in sound economic development of under-developed countries, that it should look primarily to American private enterprise to provide abroad investment of capital and technique and that it should rely fundamentally on the International Bank for Reconstruction and Development for financing or collaborating in financing closely circumscribed types of project basic to development not readily susceptible of implementation by purely private financing." See report of the Sub-Commission on Economic Development (Third Session).

/in the

in the statute authorizing the establishment of the Export-Import Bank.[1]

Direct controls

The measures employed to give effect to governmental policies concerning the outflow of capital may be divided into two types: (1) direct controls restraining such outflow and (2) indirect measures which may restrain or stimulate investments through their effect on the expected yield or security of the capital invested.

Exchange control is currently the most important instrument of direct control on the outflow of private capital from countries other than the United States and Switzerland. Such control not only limits the aggregate capital export of the country concerned but also determines the areas to which capital may flow and in some cases the types of investment which may be made. The limitations placed on outward capital movements according to areas are determined in present circumstance largely by balance of payments considerations. Thus exchange controls on capital movements from the countries of the Sterling Area (Scheduled Territories) usually permit a relatively free movement of long-term capital within the area but not between countries of the area and the outside world.

It may be expected that controls on the outward movement of capital will continue to be employed by most European countries which in the past have been important sources of financing for economic development. The Articles of Agreement of the International Monetary Fund envisage the possible continuation of controls on capital movements even after the "transition" period following which members of the Fund are required to remove restrictions on current transactions.[2] It is true that the primary purpose of this provision is to permit governments to control so-called disequilibrating capital movements or capital "flight" motivated by the hope for speculative gain (or avoidance of loss) of principal rather than for higher yield. Nevertheless, Article VI (3) of the Fund Agreement provides that members may exercise such controls as are necessary to regulate international capita movements, subject only to the qualification that "no member may exercise those

1/ Public Law 173, 79th Congress: Section 2(b) reads: "It is the policy of the Congress that the (Export-Import) Bank in the exercise of its functions should supplement and encourage and not compete with private capital ..."

2/ The possibility of controlling capital transfers without controlling all external transactions presents difficult problems, however. In particular, the control of capital outflows usually involves the licensing of exports in order to prevent exporters from exporting capital by leaving their exchange proceeds abroad.

/controls

controls in a manner which will restrict payments for current transactions or whic[h] will unduly delay transfers of funds in settlement of commitments". From the poin[t] of view of a potential capital-exporting country there may be little difference in the immediate strain on the balance of payments that would result from the flight of speculative capital, the liquidation of foreign debt or new investment of capital on long-term abroad. Many countries which have been capital exporters in the past are likely, therefore, to continue for some time the control of outward capital movements which are regarded as imposing excessive strains on their aggregate resources. The incidence of such controls on the supply of foreign capital available to less developed countries will depend on the complex of forces affecting the balance of payments of the potential capital-exporting countries, including the volume and direction of capital exports from other countries, particularly the United States.

Export restrictions can also be employed as a method of direct control over capital exports. In practice, exchange control and export control are intimately connected, since the operation of exchange controls implies an obligation of exporters to turn over their foreign exchange proceeds to the controlling authorities. In most countries the export control at present appears to be an adjunct of the more comprehensive exchange control rather than an independent measure to restrict or guide the outflow of capital.

In the inter-war period creditor countries as a rule did not apply exchange control and the direct control of capital exports from these countries took the form mainly of administrative measures, formal or informal, controlling the flotation of issues for foreign account[1]. This form of control has become of reduced importance because of the more widespread application of exchange control and because of the fact that private capital exports nowadays usually take the form of direct investment abroad by domestic enterprises rather than loans floate[d] for foreign account. Effective formal control of direct investments abroad would have to be in the form of exchange control, export control or specific legislatio[n] relating to the acquisition of foreign assets. In the past governments of some countries have relied on informal consultation with issuing houses as a means of controlling capital issues for foreign account. Undoubtedly similar informal

1/ See International Capital Movements in the Inter-War Period, United Nations, 1949, pp. 53-55.

/consultation is

consultation is practised in respect of direct investments, at least in cases involving sizable amounts of capital.

In many countries there are formal controls of the types of assets which may be acquired by domestic life insurance companies, banks, trust funds and other so-called institutional investors. Although such controls are not usually intende to affect foreign investment as such, they assume importance in the present connexion in view of the tendency in many countries for a larger portion of the private savings of individuals than formerly to flow through institutional investment channels. Since institutional investors are concerned more with the security of their funds than with yields, there would be a tendency, even in the absence of formal controls, to avoid investments in equities, whether domestic or foreign, and also in most foreign bonds except those carrying the equivalent of a government guarantee as do the debentures of the International Bank. These circumstances influence not only the amount of private foreign investment that ma; occur but also the type, since to the extent that institutional investors do not provide a channel for the outflow of capital, greater reliance would probably be placed on direct investments.[1]

Taxation[2]

The outflow of capital is naturally affected by differences in the incidence of taxation on foreign and domestic investment in capital-exporting countries.

1/ The extent of formal controls in the United States of the purchase of foreign securities by institutional investors has been revealed by the measures required to make the debentures of the International Bank eligible for purcha by life insurance companies, banks, and trust funds in that country. When th Bank commenced active operations there were only a few states in the United States in which institutional investors could legally invest in the Bank's securities. However, by mid-1949 this situation had been overcome by special legislative and administrative action making the Bank's securities legally authorized investments for all national banks, most commercial banks, savings banks, insurance companies and trust funds together holding the bulk of institutional savings in the United States. Similar controls exist in other countries, although the exchange controls render them of little practical significance for the outflow of capital.

2/ Certain aspects of the subject of taxation of foreign investments are discuss generally in Methods of Foreign Financing, pp. 27-28, and in greater detail i a forthcoming report of the Secretariat on the effects of taxation on foreign trade and investment being prepared pursuant to a resolution of the Fiscal Commission of the Economic and Social Council.

/In some

In some cases, capital-exporting countries accord less favourable treatment to foreign than to domestic investments. While this is generally not the result of a deliberate policy, it naturally tends to discourage the outflow of capital or to put an additional burden on investors who, as a result of transfer difficulties, have frequently been in a less favourable position than if they had invested domestically.

Thus, a capital-importing country, because of balance of payments difficulties may not permit the transfer of investment yields to the capital-exporting country. The yield of a portfolio investment, while credited to the investors' account, may be blocked, and that of a direct investment may have to be reinvested in the enterprise concerned. If the creditor country, as is sometimes the case, taxes this income as if it had been transferred, it requests a payment which cannot be made out of income received. Moreover, in such cases the taxable income in the creditor country has frequently to be computed according to official exchange rates which, in the case of transfer difficulties so serious that they affect investment yields, are likely to imply an overvaluation of the debtor country's currency. It is interesting to note that at least one capital-exporting country (Switzerland) attempts systematically to avoid the resulting overtaxation by allowing computation of the non-transferable taxable income according to "fiscal" exchange rates which attribute a lower value to the foreign currencies concerned than do the official exchange rates.1/

The fact that income from foreign investment (or the investment as such) may be subject to taxation in both capital-importing and capital-exporting countries frequently puts foreign investment at a disadvantage which has grown with increases in the rates and scope of taxation in creditor and debitor countries alike. Both groups of countries have become aware of the desirability of avoiding double taxation; but even the possibility of being taxed at the higher of the rates prevailing in two countries may discourage the foreign investor, who is likely to be less concerned with double taxation as such than with the incidence of all taxes to which a foreign investment may be exposed compared with the tax burden on alternative investments.

1/ Under instructions of the Fiscal Commission, a special study is at present being made by the Secretariat in co-operation with the International Monetary Fund on the subject of "Financial Transfers for the Payment of Foreign Taxes".

This and other risks connected with taxation usually apply to investments in equities as well as in loans, and to direct as well as portfolio investments. Their deterring effect is probably most pronounced in the case of the small investor who as late as in the 1920's supplied a substantial share of the capital made available from creditor countries in the form of subscription to foreign loans floated publicly or purchases of foreign shares. The disadvantages now referred to, however, may be regarded as only one of the factors involving special uncertainties and risks to minor investors who in recent years have contributed little to the export of capital. Direct investments, involving a considerable outlay (usually by a corporation), are frequently, though not always, in a more favourable position with regard to taxation. They appear to have profited more from the special measures taken by capital-exporting countries either to equalize the burden of taxation on foreign as compared with domestic investments (due account being taken of taxes paid in the capital-importing country) or to stimulate an outflow of capital by preferential treatment of income from foreign investments.

The policy of stimulation may relate to foreign investments generally but frequently affects investments in particular areas or in particular industries. The extent to which a capital-exporting country can equalize the tax burden of domestic and foreign investment or provide differential relief to foreign investment depends upon the level of taxation to which the investment is subject in the capital-importing country. The policies of capital-exporting and capital-importing countries therefore exert a mutual effect on each other. If a capital-exporting country levies taxes on income earned abroad but permits deduction of taxes paid abroad in determining the domestic tax liability, an incentive exists for the capital-importing country to tax foreign investments up to the level of the tax liability in the capital-exporting country, though for reasons of domestic fiscal policy it may not be prepared to do so. On the other hand, if taxes imposed in the capital-importing country are at a level approximating that in the capital-exporting country -- a situation which appears to be approached in many less developed countries so far as taxes on business incomes are concerned -- there is no way by which the capital-exporting country can provide tax inducement unilaterally, unless it grants a subsidy to reduce the tax burden on foreign investments.

/In the United

In the United States and in most other countries which in the past have been important sources of foreign investments, present tax policies eliminate international double taxation, or mitigate its effects either by crediting the domestic taxpayer with the amount of taxes paid abroad as a unilateral undertaking or through bilateral treaties with capital-importing countries. In addition, some countries, for example Belgium and the Netherlands, have accorded preferential tax treatment either by ignoring income earned abroad by their nationals and enterprises (which is thus taxable only abroad, often at lower rates than at home) or by establishing lower tax rates on income earned abroad than on domestic income.

In view of the importance of the United States as a source of private foreign investments the tax policies of that country are of particular interest. Subject to some important exceptions, mainly intended to stimulate investments in Latin America and certain other areas, the United States levies the same taxes on income earned abroad and at home. This is accomplished by crediting the taxpayer for taxes paid abroad, thus eliminating double taxation to the extent that foreign tax liabilities so credited are equal to or less than the liabilities to the United States. In addition, preferential treatment of varying degree is granted to United States investments in countries in the Western Hemisphere, in United States possessions, notably Puerto Rico, and in China.1/

In addition to the general provisions mentioned certain technical features of the United States tax laws are favourable to foreign investments. Thus, foreign

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1/ Under the so-called Western Hemisphere Corporation Act United States corporations operating in the Western Hemisphere are exempted from the surtax on corporate profits in addition to receiving the normal foreign tax credit. In most cases this eliminates any tax liabilities to the United States.

Individuals and United States corporations whose operations are substantially confined to United States possessions, including Puerto Rico and the Philippines prior to the latter's independence, are taxed by the United States Government only on income derived from sources within the continental United States. This is the basis for the legislation enacted by Puerto Rico in May 1948 authorizing a "tax holiday" until 1962 for United States investments in Puerto Rico in a wide range of industrial enterprises. In effect the tax holiday would permit enterprises earning $50,000 or more income before taxes to increase their net income after taxes by 61 per cent. In the event that the Puerto Rican subsidiary of a United States concern cannot qualify for exemption from United States taxes because the income of the parent concern from the United States is too high, the earnings may be reinvested in Puerto Rico without payment of either United States or Puerto Rican taxes. At the end of a period the profits can be remitted without payment of taxation by liquidating the subsidiary. (See Puerto Rico Industrial Development Company, Annual Report for the year ending 30 June 1948, page 7.)

/net losses

net losses can be deducted from taxable income earned in the United States. Special tax relief is also accorded to United States nationals who are exempted from personal income taxes on income earned abroad if they qualify as foreign residents for a full taxable year. This provision may facilitate the movement of personnel required for the operations of direct investment or connected with programmes of technical assistance to the extent that it is not offset by taxation in the country of temporary residence.

At least in the case of direct investments, the net effect of the United States system of foreign tax credits and special relief in certain cases is that only a minor proportion of the income abroad is absorbed by United States taxes. Thus there may not be much scope for unilateral action by the United States to stimulate direct investment abroad, unless this action is accompanied by reductions in taxation in the capital-importing countries. At the same time, as noted above, the United States system does not provide much scope for less developed countries to offer tax incentives should they wish to do so.

According to a recent publication of the United States Department of State "Investigations of the subject indicate that United States taxes have little weight in the corporate investors' appraisal of foreign investment opportunities".1/ Nevertheless, certain features of this system have so far prevented a complete equalization of tax liability of domestic and foreign income, and remedies to eliminate them have been proposed recently by the Government. Under the system of tax credits certain taxes paid abroad do not qualify as offsets to United States tax liabilities; the definition of net income employed in the capital-importing country may be different from that in the United States; or there may be conflicting definitions of the source of taxable income. Accordingly, the United States is proceeding to supplement its national tax legislation with bilateral treaties to reduce further the double

1/ See Point Four, United States Department of State Publication 3719, January 1950, p. 69.

/taxation

taxation of foreign income.[1] It is also proposed to remove certain limitations on such allowances of taxes paid to foreign countries as are offset against United States tax liabilities when some foreign activities of an enterprise result in net profits and others in net losses. Another proposed revision of the present tax laws would exempt from taxation the reinvested profits of branches abroad of United States corporations. This change would mean that such branches would in one important aspect be accorded the same tax treatment as subsidiaries incorporated abroad. A tax exemption or relief granted by the capital-importing country for re-invested profits of branches would thus represent an incentive and not be offset by a rise in the tax payable in the United States. Another step under consideration is the liberalization of the foreign tax credit to apply if a United States corporation owns less than a majority control of a foreign corporation. This would facilitate investments in countries limiting foreign participation in domestic enterprises to minority holdings.

Stimulation of direct investments

At present investment in foreign securities (when permitted by exchange controls) does not seem attractive to private investors. Potential lenders - whether individual savers or agencies of collective savings like savings banks and insurance companies - are aware of the general political and economic difficulties

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1/ The elimination or mitigation of double taxation by bilateral agreement may be achieved by mutual exemption (applying to all or part of the tax concerned) or by permitting the deduction of taxes levied by one country in determining those which have to be paid in the other; in some cases the method applied varies with the type of income concerned, differing, for example, as between taxes on business incomes and taxes on real property. Although many bilateral agreements have been negotiated between the more advanced countries, relatively few have been negotiated thus far between advanced and less developed countries. So far as taxes on the income of foreign investments are concerned, it may be expected that revenue considerations will lead less developed countries to favour the principle of collecting taxes in the capital-importing country rather than in the country of the investor's domicile. From this point of view bilateral treaties involving less developed countries would be likely to follow the principle by which the capital-exporting country either employs the method of tax offset or agrees to exempt from taxation certain types of income earned in the less developed country.

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referred to above and fear the repetition of the defaults which affected many international loans during the 1930's. In some countries which were once important as sources of international loans, the virtual disappearance of large incomes of individuals, if nothing else, tends to reduce the possibility of floating foreign loans in the capital market.

In the absence of large foreign portfolio investments, so-called direct investments (which involve entrepreneurial control by the investor) have assumed an increased importance. Such investments are frequently of value for development purposes since technical knowledge and managerial ability are transmitted through them.

In this connexion attention may be called to recent action taken and proposed by the United States Government for the purpose of encouraging the outflow of direct investments for the purpose of facilitating economic development.[1/] This involves, among other measures, the negotiation with less developed countries of bilateral agreements concerning the status of United States investments in their territories, the revision of certain features of United States tax legislation affecting foreign investments and the extension to private United States investments abroad of United States Government guarantees against certain risks peculiar to such investments, in particular risks arising from inability to remit earnings. Some general aspects of these policies may be discussed briefly.

(i) International agreements

Capital-exporting countries may seek to reduce certain risks facing their investors in ventures abroad through the negotiation of bilateral or multilateral agreements which establish a favourable legal framework within which private investments operate in capital-importing countries. At present most existing or proposed agreements of this nature relate to the establishment of principles

1/ See in particular, the Special Message of the President to the Congress of the United States, 24 June 1949. A further description of the proposed measures may be found in a document entitled Point Four, prepared by the United States Department of State and issued as Department of State Publication 3719, January 1950.

relating to equity capital, principally in the form of direct investments.[1] As was pointed out above, the conclusion of such agreements on a bilateral basis is part of a programme to foster foreign investments recently initiated by the United States Government. Since the primary purpose of such agreements is to eliminate actual or potential measures in less developed countries which are regarded by the capital-exporting country as discriminatory and unreasonable, it appears desirable to reserve a discussion of their main provisions until consideration has been given in the following section to the policies of less developed countries. It may then be seen to what extent the treaties proposed by capital-exporting countries would involve modifications in the policies of less developed countries.

(ii) Investment guarantees

A capital-exporting country wishing to stimulate private investment abroad may guarantee private foreign investors against specific risks faced by them. The general aspects of this subject have been discussed in Methods of Financing Economic Development in Under-Developed Countries (pages 32-34).

In the United States specific legislation has recently been introduced authorizing the extension of such guarantees. The considerations leading to the proposed legislation have been stated in a recent publication of the United States Department of State in the following terms:

> "The deterrents to private investment abroad cannot be completely removed by investment treaties, by tax incentives, or by technical advance alone. Certain risks peculiar to investment abroad, particularly in the world economic and political situation of today, will remain excessive from the point of view of United States investors. For example, although a treaty may assure no discrimination against United States investors seeking to remit profits, it cannot assure that sufficient dollars for that purpose will actually be available. Similarly, although there may be a completely faithful intention to refrain from expropriation, or, in the event that expropriation becomes unavoidable in the public interest, to pay promptly for expropriated property, dollars may, nevertheless, not be available to permit prompt and adequate payment. Also, risks of confiscation of seizure cannot be fully eliminated through treaties so long as the possibility exists of a change in government in the foreign country

1/ International agreements relating to certain aspects of international loan contracts involving private lenders are also possible, but are of little interest at present.

/through revolution

> through revolution or war. Consequently the elimination, or at least a significant reduction, of these difficulties should stimulate a substantial additional flow of private investment funds abroad." 1/

Although the legislation introduced in the United States does not define the "risks peculiar to foreign investment" which are to be covered, it has been indicated that the guarantees would protect against (1) loss through the inability of the capital-importing country to transfer investment yields or capital withdrawals, and (2) capital loss resulting from expropriation without "prompt, adequate, and effective" compensation.2/ The question of charges and other aspects of the administration of the guarantees is left to administrative discretion, but it has been indicated that the guarantees would be extended only to new investments. Administration of the programme would be entrusted to the Export-Import Bank, and the maximum amount of guarantees authorized for the present would be limited to the uncommitted capital of the Export-Import Bank, amounting to $889 million as of 31 December 1949.

Other measures and policies

Only brief reference will be made to certain types of governmental policy in capital-exporting countries that have a less direct, but not necessarily smaller, effect on their private investments abroad than the factors analyzed in the preceding pages.

Through their commercial policy, the capital-exporting countries naturally influence the ability of debtor countries to find a ready market for their export products. It is frequently overlooked that the capital-exporting countries are themselves to a large extent responsible for the tranfer from debtor countries of investment yields and capital withdrawals. The greater a capital-exporting country's receipts from foreign investments in relation to its capital exports, the more imperative is a policy of admitting the imports that are a corollary to its status as a creditor nation. Some domestic interests are likely to oppose such a policy, in particular when the income from foreign investments cannot be transferred through the import of primary products from the under-developed country in which the investments were made, but requires increased admittance of

1/ See Point Four, Department of State Publication 3719, January 1950, p. 73.
2/ Op. cit., p. 74.

/manufactured

manufactured goods in competition with domestic industry.

Intergovernmental financial assistance, in the form of either grants or loans, is likely to affect private foreign investments in various ways. The purposes for which such assistance is granted, such as public works and other basic capital facilities, are usually not such that the funds involved enter into direct competition with private capital available for foreign investment. The chances are that the openings for private investment are increased rather than reduced by the governmental assistance if it is effectively used. Such assistance is likely eventually to enhance productivity and profitability of investments generally in the receiving country; it may, at least so long as it lasts, increase liquidity in the external transactions of that country and thus facilitate the transfer of income from private investments.

The provision of technical assistance to less developed countries may also contribute in numerous ways to raise productivity in these countries and thus ultimately enhance the opportunities for foreign investment.

Finally, attention may be drawn to the fact that violent changes in international capital movements such as accompany fluctuations in domestic prosperity in capital-exporting countries are apt to have grave repercussions on the economy of under-developed countries and thus on the income from investments in these countries. The promotion in capital-exporting countries of economic stability is thus of basic importance for the creation of conditions favourable for investment to countries where capital is relatively scarce.[1/]

1/ For further discussion of this question see National and International Measures for Full Employment, a report by a group of experts appointed by the Secretary-General, December 1949 (Sales No.: 1949.II.A.3), particularly pp. 54-58.

/C. Policies of less

C. Policies of less developed countries

Objectives of Policy

The less developed countries afford examples both of policies aimed at stimulating and at restricting the inflow of capital for private investment. These countries are short of domestic savings and in principle welcome foreign capital which helps to promote economic development and to relieve the strain on their balance of payments usually associated with economic development. As a general rule, the under-developed countries would undoubtedly prefer portfolio investments through the sale of securities (usually bonds) in the market of the countries able to export capital, to the inflow of capital for direct investment in a manner that subjects domestic economic life to direct foreign influence. In the present situation, however, the flotation of loans in foreign capital markets (except through risk-bearing agencies such as the International Bank for Reconstruction and Development) appears generally out of the question; in the near future any substantial private foreign capital would have to be in the form of direct investments. The fact that foreign direct investments may provide technical or managerial skills is of obvious advantage to countries in the early stages of economic development. While such countries are often very apprehensive of foreign influences in their economic life, they may thus sometimes prefer foreign direct investments to loans raised abroad.

There are several reasons why under-developed countries may restrict the import of private capital.

One reason, applying to loans and equity capital alike, is the desire to avoid a heavy future burden on the balance of payments or on the economy generally arising from the transfer of yields or repayment of capital. This may reflect uncertainty regarding the degree to which an increase in production will be reflected in larger earnings of foreign currency available for payments abroad of dividends and debt service, particularly when exports depend to an unusual degree on factors outside the country's control.

In countries where the nationalization of industry is declared policy, capital inflow for direct investment in the affected industries is out of the question. Elsewhere the restrictive measures are taken chiefly with a view to controlling the entry or operation of equity capital in which foreign investors have a controlling interest.

/Some of the preoccupations

Some of the preoccupations leading to specific restrictions on the entry of foreign capital in less developed countries have been stated by the Sub-Commission on Economic Development in the following terms:

> "Public opinion in the under-developed countries, ... urges the imposition of certain conditions on the entry of private foreign capital. Among the more important of these conditions which are usually mentioned are provisions for domestic participation in the capital structure of enterprises promoted by foreign concerns within the country, for effective domestic participation in policy making and management of these concerns when operating within their boundaries, the imposition of an obligation on such concerns to reinvest within the country at least a portion of the profits that they make within the country and of an obligation on these concerns to give adequate technical training, in the working of these concerns, to the nationals of the country, and the provision of facilities for the acquisition by such nationals of the technical know-how possessed by these concerns." 1/

Many of the measures controlling the entry and operation of capital for direct investment appear to arise from the fact that direct investments have been attracted in large measure into natural monopolies, as in the case of public utilities, and into extractive industries in which the scale of operations required gives to the foreign enterprise a substantial degree of monopolistic control.2/ Such quasi-monopolistic status may also characterize certain types of financial, manufacturing and other foreign enterprises, particularly in the early stages of development. It is true that the investment of domestic private capital in monopolistic enterprises may be open to objections on the same grounds as investment of foreign capital. When monopolistic enterprises are foreign-owned, however, special measures are frequently taken with a view to sharing the profits earned or at least limiting the profits remitted abroad or to excluding or limiting the foreign control.

In general, tendencies to nationalize foreign investments or subject them to special controls frequently deter foreign investments not only in the industries

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1/ Report of the Sub-Commission on Economic Development (Third Session), reproduced in Methods of Financing Economic Development in Under-Developed Countries, pp. 113-132, United Nations, 1949.

2/ At the end of 1948 about 40 per cent of United States direct investments abroad were in extractive industries and a substantial additional amount in railways and electric utilities. About one-third of such investments were in manufacturing, but the bulk of these were in developed and semi-developed countries.

concerned but in other sectors of the economy. The effect may be cumulative since to the extent that the inflow of foreign capital is prevented, the lack of domestic private capital may lead to the nationalization of a steadily growing sector of the economy. A similar cumulative effect may arise from the fact that high yields are required by potential investors in order to overcome the many risks attendant on foreign investments, while at the same time the existence of high yields may lead to restrictive measures in the capital-importing country which tend futher to increase the risks.

Considerations of national security or similar objectives may also lead countries in various stages of development to exclude or severely limit the operation of foreign enterprises in particular sectors of the economy as well as the employment of foreign citizens.

Policies in less developed countries which aim at controlling investments according to criteria of "essentiality" in a programme of economic development are bound to restrict the entry of direct foreign investments in "non-essential" industries. Furthermore, development programmes in many less developed countries call for the financing of roads, harbour facilities, irrigation projects and other public facilities of a kind that is inherently unsuitable for direct investments; they also often assign a high priority to the establishment of industries which are either not attractive to foreign direct investments on economic grounds or are reserved for governmental enterprises as a matter of public policy.

The object of restrictions may also be to protect existing or potential investments in industries the competitive position of which may be impaired. Another object may be to prevent inflationary pressure which may result when certain types of foreign investments entail or stimulate domestic investments.1/

1/ This consideration underlies the concern with which some less developed countries regard governmental loans, the foreign exchange proceeds of which can be used only for "specific projects". Such loans cannot finance imports resulting indirectly from domestic investment outlays associated with the project concerned. If such domestic investments are financed through inflationary measures, a pressure on the balance of payments is likely to arise. The same consideration applies equally to direct investments to the extent that the domestic outlays associated with such investments are financed by inflationary borrowing in the less developed country. Private direct investments may, in addition, require or stimulate substantial investments of related "social capital" (roads, housing projects, etc.) which, if financed in an inflationary manner, may cause balance of payments and other difficulties. The complementary role of inter-governmental financial assistance in these circumstances has been referred to on page 23 above. See also Methods of Increasing Domestic Savings, Document E/1562, Part I.

Finally, mention should be made of considerations leading to the imposition of exchange controls regulating the outflow of yields and of capital movements generally.

The present study is concerned with conditions in capital-importing countries which are less developed, but it may be noted that their policy towards foreign investments in many respects differs little from that of various more developed countries. In some instances, however, the limitations upon the operations of foreign capital in less developed countries are more far-reaching than those applied elsewhere. The practices affecting foreign capital in less developed countries - and in more advanced countries as well - cover a wide range. Without attempting an exhaustive study, it is possible at least to make a general analysis of these practices, illustrated by reference to the summaries of conditions in selected countries which are provided in Part II.

Restrictions on entry and control

The entry of foreign equity investments may be subject to absolute limitation or may be allowed on certain conditions. For this purpose, the foreign capital entering the country may be subject to licensing, or other measures may be taken to control the investment of such capital in industry generally or in specific industries.

When the entry of foreign capital is restricted, limits are usually set according to the industry concerned. In many countries more advanced as well as less developed, prohibition of entry is confined to a narrow range of activities such as coastal shipping, aviation, communications, land acquisition, particularly in border areas, and publishing.

In a number of less developed countries limitations on entry extend to public utilities, extractive industries, particularly petroleum, banking and insurance, and occasionally distribution. In extractive industries and public utilities limitations on entry are usually accompanied by restrictions on the operation of enterprises admitted pursuant to the terms of specific concession contracts. Public regulation of such industries is, of course, not confined to the less developed countries, but it appears that an unusual amount of friction has arisen between foreign investors and the governments of these countries over the administration of such regulation. In the case of public utilities this friction has apparently been intensified by difficulties of adjusting rates charged for

/services

services in the face of a general rise in the price level in the countries concerned.

In respect of the last mentioned group of industries, less developed countries frequently impose various degrees of limitation on the extent of foreign ownership and control rather than absolute barriers. Of particular importance are regulations limiting foreign participation to a minority interest, usually 49 per cent of the shares of an enterprise. Such requirements may be mandatory but in many cases are discretionary with exceptions permitted in the national interest. If foreign majority ownership is permitted, it may be stipulated that a specified portion of the capital be domestic either initially or within a prescribed period, or that domestic capital, private or governmental, be given an option to invest in the enterprise up to specified amounts. Another type of restriction is that found, for example, in the petroleum industry in Venezuela, where new concessions for production are contingent upon investments in refining facilities in specified amounts.

If foreign capital is willing to accept minority status, any investment of such capital depends on the ability of domestic interests to provide the bulk of the capital outlay. It is interesting to note that the Government of Pakistan, in a recent statement of policy, proposes to overcome difficulties due to the scarcity or unwillingness of local capital in such cases. Such capital will be given an option to subscribe a minimum of 51 per cent of the share capital in certain industries and 30 per cent in others, but if these limits are not reached, foreign capital may, with governmental approval, take a majority interest.[1/]

Limitations are sometimes placed on the voting rights of foreign shareholders in domestic corporations. A similar type of restriction is the requirement that foreign corporations or domestic corporations controlled by foreign interest must

1/ Instances have been reported of difficulties encountered by foreign enterprises, particularly in public utilities, seeking to obtain capital through the sale of shares in the local capital market of less developed countries. The preference of local investors in less developed countries may be for investments in industries yielding higher returns than those in which foreign capital is willing to participate. In this connexion see Methods of Increasing Domestic Savings, document E/1562, Part I.

/have a minimum

have a minimum number of domestic stockholders or members on the board of directors. In some cases foreign investments are not allowed, for instance, in the form of a branch of a foreign enterprise, but a subsidiary concern incorporated locally has to be established. Such "domestication" may affect the tax status of the enterprise. In many cases exclusion of foreign capital is accomplished in two steps, the first being a requirement for local incorporation, and the second limiting participation in locally incorporated enterprises wholly or partly to domestic nationals. Even if foreign enterprises are not legally "domesticated", they may be required to consider themselves subject only to the laws of the country in which they operate.[1/] The less developed countries were not able, however, to secure the acceptance by capital-exporting countries of this principle in the negotiations preceding the establishment in 1948 of the Havana Charter for an International Trade Organization and of the Economic Agreement of Bogota signed by the Ninth International Conference of American States.

Restrictions on the employment of foreign personnel are common in less developed countries. Usually they are contained in special laws; but the immigration laws may also be administered with the same general objectives. The special legislation often takes the form of a requirement that a minimum proportion of employees be domestic nationals or that a minimum proportion of the payroll be disbursed to such persons. The effect of such a requirement on the operation of a foreign enterprise depends largely on the degree to which it requires skilled labour. In many cases exceptions are permitted if skilled labour cannot be locally recruited.

In several less developed countries the establishment of foreign enterprise is contingent upon an undertaking to train local personnel to replace such foreign personnel as are initially employed. In some instances foreign technicians may be employed only when the employer can demonstrate that local personnel of equivalent skill is not available. Such provisions, it may be noted are frequently coupled with the statutory requirement that domestic and foreign nationals shall receive equal pay for equal work.

1/ This requirement, the so-called Calvo doctrine, is found in Mexico, Venezuela, and several other Latin American countries.

The effect on the inflow of capital of the measures described cannot be fully appraised on the basis of available information. Direct operation by government of industrial enterprises has undoubtedly increased in recent years in under-developed countries as well as elsewhere, and to that extent has reduced the field of private equity investments, domestic and foreign. On the other hand, with the exception of investments in petroleum, other extractive industries and to some extent public utilities, it appears that absolute restrictions on entry of foreign enterprises, other than those resulting directly from government operation, are not a major factor accounting for the absence of large-scale equity investment at present. Moreover, as indicated in Part II, below, there is a tendency in some countries to reduce or at least set a definite limit to the scope of such restrictions.

The effect of policies limiting foreign participation to minority interests and limiting employment of foreign personnel is also difficult to measure, owing partly to the lack of information on the specific application of enabling legislation or general pronouncements of policy. Restrictions on the use of foreign personnel and requirements to train domestic personnel, while perhaps raising costs in certain types of industry, do not appear to offer a major obstacle. On the other hand, the prospect of attracting new equity capital in amounts providing less than a controlling interest would appear to be limited in most countries, owing both to the attitude of potential investors in the capital-exporting countries and to the difficulty of mobilizing domestic private capital in the less developed countries. Participation by domestic capital as a minority interest in established foreign enterprises has been observed on a limited scale in several less developed countries.1/ An opposite tendency can be found in some countries where foreign enterprises have entered into so-called management contracts with either privately owned or governmental enterprises. Under such contracts foreign participation is limited to the performance of specific services or the furnishing of managerial and technical personnel and sometimes patents and other technical data. Such arrangements may involve a fixed fee or a share in the profits of the enterprise or a combination of the two.2/

Before leaving this discussion of specific policies affecting the entry and control of foreign capital, it may be useful to call attention to the fact that governments and business groups in some less developed countries have sought to

1/ 2/ See following page for footnotes.

Footnotes to preceding page:

1/ Several recent ventures in less developed countries involving some degree of joint participation of foreign and domestic capital are of interest in this connexion. In 1947 there was organized in the United States the International Basic Economy Corporation, a closely-held private enterprise with a capital of $7 million. This company has organized subsidiaries in Venezuela and Brazil for the promotion of specific projects in agriculture and food processing and distribution. In Venezuela the parent company has furnished $2 million to which has been added $14.5 million of non-voting preferred shares, of which $10 million have been subscribed by private foreign petroleum companies operating in Venezuela and $4.5 million by the Corporacion Venezolana de Fomento (Venezuelan Development Corporation), an agency of the Venezuelan Government. In Brazil a subsidiary has been established with a capital of $3 million, the bulk of which is owned by the parent company. In Venezuela it is the policy of the parent company to offer by the end of ten years at the latest the majority ownership of the subsidiary enterprises for subscription by Venezuelan capital. In Brazil, also, the policy is to seek participation by local capital.

A somewhat similar enterprise is the Liberia Company, chartered by the Liberian Government in 1947, with share capital of $1 million. Sixty-five per cent of the shares are owned by the Stettinius Associates-Liberia, Inc., a United States enterprise, 25 per cent by the Government of Liberia, and 10 per cent by the Liberia Foundation, a philanthropic organization. Pursuant to its charter, the Liberia Company has exclusive rights to explore and develop natural resources other than rubber and iron ore. Among other projected activities are the construction of a railway and the development of public utilities. The latter are expected to be transferred to the ownership of the Liberian Government or Liberian nationals at a later stage. The operations of the Liberia Company are expected to be financed chiefly by governmental and international lending agencies and, as the possibility arises, private lenders.

2/ This type of arrangement is exemplified by contracts recently concluded between several United States oil companies and the Petroleum Administration of the Mexican Government; see statement on Mexico in Part II. Another example is a long-term licensing agreement made in 1949 between Westinghouse Electric International Company, a United States enterprise, and Eletromar, a Brazilian-owned concern, engaged in the production of electric lamps and other electrical equipment. Under this arrangement the United States enterprise will license the use of its patents for certain electrical products, furnish managerial and technical personnel, and train domestic technicians.

stimulate the entry of direct investments through policies aimed at overcoming ignorance of investment opportunities or an inaccurate appraisal of the conditions confronting potential foreign investors in the country concerned. Governments of capital-exporting countries also perform this function to some extent through various channels of commercial intelligence. Governmental financing agencies such as the International Bank for Reconstruction and Development and the United States Export-Import Bank may act in a similar fashion in view of their obligation to explore the possibility of private financing before granting loans, although the requests for assistance received by these agencies may usually be of a type not likely to attract direct investment. In this connexion reference may be made also to a resolution of the ninth session of the Economic and Social Council relating to methods of financing economic development,1/ requesting the Secretary-General to undertake "a study of the possibilities of establishing an international clearing-house of information by which potential investing entities or private investors can be brought together with entities or private persons requiring funds in under-developed countires."

Fiscal measures

The effect of taxation in a capital-importing country on foreign investments has been considered above in connexion with the tax policies of capital-exporting countries. It was noted that account must be taken not only of the extent to which double taxation is eliminated but also of the method by which this is done, since this method will determine whether the effective rete of taxation will be that of the capital-exporting country or the capital-importing country or some combination of the two. If double taxation is not fully eliminated or if the investor's tax liability is affected in other ways by taxes in the capital-importing country, the tax policies of that country become of direct concern to the investor. It is of interest, therefore, to consider the main types of fiscal measures in less developed countries which have a special incidence on foreign investments or on industries to which foreign investments have been attracted.

The use of tax incentives and, in some cases, direct subsidies is characteristic of the fiscal policies of many less developed countries. Such

1/ Resolution No. 222 (IX) D of 14 August 1949.

/incentives are

incentives are usually accorded on a non-discriminatory basis to both domestic and foreign investments; but the scarcity of domestic capital available for investment in many lines of industry frequently means that the inducements apply particularly to foreign capital. In addition, some countries have accorded special fiscal privileges to foreign investments, notably in connexion with concession contracts involving public utilities and other large-scale enterprises. These exemptions apply frequently not only to taxes on business incomes and assets but also to tariffs on imports required for the operation of the enterprise as well as to export duties.[1/]

Some less developed countries tax business incomes at a specially low rate if profits are reinvested.[2/] Such measures may also attract additional investments. It may be observed that even without such incentive, successful enterprises normally reinvest a substantial portion of earnings, especially in their early stages.

Special fiscal measures limiting yields may explicitly discriminate against foreign investment or may apply to industries in which foreign investments predominate. In the former category are additional taxes on income or assets of foreign enterprises generally or in specific industries.[3/] A similar case is taxation on remittances of dividends.[4/] In some cases dividends remitted are not taxed as such but the taxation results from a levy on all foreign remittances.[5/]

1/ Reference has been made previously to the Puerto Rican "tax holiday". A similar policy has been announced by Haiti under which new industrial enterprises will be granted the following privileges for five years: (1) reduction in the income tax of 50 per cent in the first year and 20 per cent in the succeeding four years; (2) exemption of the product from export duties; (3) freedom from import duties on imports required for business operations. Tax exemptions for various types of manufacturing enterprise have been granted by Argentina, Chile and Mexico. Pakistan and Israel have announced special tax measures to attract investments. (See statements on these countries in Part II, below.)

2/ See statement on Venezuela.

3/ See statements on Argentina and Chile.

4/ See statements on Argentina and Brazil.

5/ See statement on Cuba.

Apart from discriminatory tax legislation, the administration of tax laws has occasioned allegations of discrimination.1/ This is often the result of disagreement as regards the definition of taxable income, particularly when the income has to be estimated as the proportion of the total income of an enterprise that is allocable to the operations of a branch or subsidiary within the taxing country. The latter country is naturally opposed to the understatement of income as may result from the manner of accounting for intra-company transactions in the case of enterprises producing for the export market or importing merchandise for sale in the less developed country. In bilateral treaties concluded between certain countries, providing for "national" and most-favoured-nation treatment in respect of taxation, there are clauses aiming at the elimination of both statutory and administrative tax discrimination.2/

Special measures of taxation have been introduced in many less developed countries to limit the profits of enterprises in specific industries which are largely or exclusively in the hands of foreign investors, particularly mining and petroleum industries. If the enterprises produce for export, a similar result may be achieved by taxing exports (unless the exporter is able to pass on the tax to the foreign buyer by raising the price, which is frequently not the case). Another type of control is the establishment of a government export monopoly which purchases the commodity at a price related to, but lower than, that obtainable in the export market.3/ In many less developed countries the government has vested in itself ownership of the subsoil and charges royalties based on the rate of operations pursuant to general fiscal legislation or to specific concession contracts.4/ In addition the tax rates on incomes of such

1/ See statement on China.

2/ See statement below on "International Agreements".

3/ See description of the Chilean Iodine and Nitrate Sales Corporation in statement on Chile.

4/ This practice is not confined to less developed countries, although it appears to be more common in such countries. In addition to the effects on rates of return, royalties also have important effects on the rate of operation of extractive industries. The economic effects of royalty payments are beyond the scope of this report, but it may be noted, for example, that the assessment of a standard rate of royalty on all operations may result in under-exploitation of low grade ores. Accordingly, some less developed countries have been reported to be considering basing royalties on the rate of profits on capital employed. Cf. United Kingdom Colonial Office, Memorandum on Colonial Mining Policy, Colonial No. 206, 1946, page 8.

/enterprises

enterprises are generally higher than on other types of enterprise in the country.1/

An alternative or additional form of fiscal control is the application of so-called penalty export rates of exchange in countries with a system of multiple exchange rates.2/ The foreign enterprise must in such cases purchase the currency it requires for local expenditure (in excess of local receipts) at a less favourable rate than that applied on the average to imports. This policy may have certain incidental effects on the economy of the capital-importing country, since foreign enterprises may prefer to import supplies which they might otherwise purchase locally.

The above comments on taxes having a special incidence on foreign investments, particularly in extractive industries, do not imply a judgment on their merits or on their effect on the inflow of foreign capital. Although revenue considerations are important, the interest of the capital-importing country does not lie primarily in a high absolute level of taxation but in regulating the rate at which exhaustible resources are utilized and obtaining an adequate share of the gain resulting from the operations of the enterprise concerned.3/ If the general conditions under which such enterprises operate are favourable, taxation may be relatively heavy; but there is always a limit beyond which taxation tends to discourage new investment. The reaction of potential investors will depend not on the absolute level of taxes in the less developed country but on the alternative outlets for their capital. Revenue consideration apart, the more anxious the country is to attract foreign capital for development purposes, the more reticent it is likely to be in raising the incidence of taxation.

1/ See statements on Chile, Mexico and Venezuela, among others.

2/ See statements on Chile and Iran (Middle East).

3/ The observations on taxation in the United Kingdom's Memorandum on Colonial Mining Policy referred to above are of interest in this connexion. Starting from the premise that it is in a Colony's interest to maximize the total of local expenditures by mining companies and receipts from taxation and royalties, consistent with otherwise satisfactory operations of the enterprise, the statement recommends that export duties should be levied in order to secure a share of the proceeds for the community in the event that the government obtains no royalties. In addition it states that it is undesirable to include in any concessions any exemption from income tax or other taxes applicable to industry generally (op. cit., p. 8).

It may be observed that in less developed countries tax policies frequently vary according to industries: inducements tend to apply mainly to manufacturing industries and restrictive practices to extractive industries. Post-war experience indicates that tax inducements have thus far had little if any effect in overcoming other obstacles to direct investments in manufacturing. This may be due, however, to the fact that the scope for tax incentives in less developed countries is limited, as was observed above, by the tax policies of creditor countries (notably the United States). On the other hand, in spite of the tendency to restrict extractive industries through a high incidence of taxation and royalties, the petroleum industry has been attracting foreign capital in sizable amounts.1/

Exchange control

Whereas fiscal measures may be fairly predictable, at least in the short run, this is not always true of exchange regulations, which accordingly introduce in many cases a high degree of uncertainty in the investor's calculations.

Exchange control is a symptom rather than a cause of the international economic disequilibrium to which reference was made in the introduction. In this section only the effects of exchange control on the direct relations between the capital-exporting and capital-importing countries can be taken into account. The wider and, from some points of view, more important effects on international investments are disregarded.2/

1/ Should the high profitability of the petroleum industry in the past few years not continue, however, the incidence of taxes might well affect the expansion of operations in particular countries.

2/ It may be observed that at least over short periods exchange control may be an alternative to currency depreciation and that anticipation of depreciation or instability of exchange rates generally may also have adverse effects on foreign investments. So far as anticipations of exchange depreciation over the longer run are concerned, the effect varies according to the kind of investment. The deterring effects are most obvious in the case of industries producing for the local market in the capital-importing country, particularly public utilities the rates of which are not easily increased in step with a decline in the purchasing power of money.

/Most less

Most less developed countries exercise some degree of exchange control.[1/] As a supplement, or in a few cases as an alternative, such countries also maintain import controls, which may have an indirectly favourable effect on remittances for foreign investments to the extent that they reduce competing demands for foreign exchange.

Exchange controls usually do not permit the liquidation of foreign loans through the sale by the investor of bonds in the capital market of the borrowing country and the subsequent transfer of the proceeds. As to the service of loans according to the stipulations of the loan contract, it will be recalled that most privately held foreign long-term loans are in the form of government bonds, denominated in the currency of the creditor country. Failure to make remittance (or remittance of only part of the amount due) may therefore usually be regarded as default rather than the effect of exchange control.[2/] At present most governments maintaining exchange control accord a high priority to remittances for debt service on obligations which are not in default. In many such cases, however, the debt on which service is paid has been substantially scaled down from its original amount.

The extent to which the transfer of investment yields and capital is authorized is frequently subject to substantial variations depending on the availability of foreign exchange. In several less developed countries formal regulations specify maximum remittances which may be made on account of equity investments within a given period. The establishment of a maximum does not necessarily assure that remittances will be made, however, since the regulations are usually coupled with provisions assigning available exchange to specified categories of requirements according to essentiality. The operation of such controls may imply discrimination not only between investments from different countries whose currencies are scarce to varying degrees but also between

1/ Among the exceptions are Cuba, Haiti, Guatemala, the Dominican Republic, Mexico, Panama and, until recently, the Philippines.

2/ In some instances governments failing to remit service on external debt have deposited the equivalent amount in blocked accounts in the debtor country.

/investments in

investments in different industries.[1]

Various problems of policy arise in connexion with the control of remittances on investments pursuant to rules such as those outlined above. Since the remittances permitted are usually computed as a percentage of the investment, the question arises as to the value of the investment, and in particular whether reinvested earnings are to be included.[2] In determining the maximum amount which may be remitted on account of both income and capital, the regulations in Brazil allow for the effect of possible currency depreciation by permitting the incoming capital to be registered in terms of the currency of the investor's home country. If two or more exchange rates apply simultaneously to different types of transactions, the question may arise at which rate remittances of foreign investment yields are to be made. Countries with established ceilings on transfers usually extend the privilege of remittance at the official selling rate[3] only to investments which are registered on entry, at which time an agreed value of the investment is determined.[4] In some cases countries with multiple exchange rates limit remittances which may be made at the official rate but permit unrestricted transfers at the "free" rate.

The administration of exchange control in the case of foreign investments in extractive industries producing largely for export frequently has special features, some of which have been noted in the previous section. The capital-importing country may agree not to interfere with the export as such, and

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1/ Thus, a special commission of the Brazilian Government has recently recommended that special quotas for the withdrawal of capital and higher than average limits on remittances of earnings be established for favoured investments. See Report of the Joint Brazil-United States Technical Commission, United States Department of State Publication 3487, June 1949, p. 305.

2/ The present Brazilian regulations allow for reinvested earnings. The Argentine regulations announced in July 1948 did not make such allowance but were subsequently modified to include reinvested earnings.

3/ A "selling" rate is the rate applied by the exchange control authorities when selling foreign exchange against domestic.

4/ This valuation may have some bearing on the determination of compensation in the event of expropriation.

/may waive

may waive its right to purchase the foreign exchange proceeds of the exports. (When the goods are absorbed, for processing or sale, by the parent company of the producing enterprise, no foreign exchange transaction proper may be involved.) The enterprise may then, in a way, be regarded as detached from the economy of the capital-importing country. But it will have to purchase from the exchange authorities its local currency requirements (including royalties payable in local currency and taxes due), usually at a special rate of exchange. Such arrangements have proved capable of alleviating the concern of foreign investors faced by transfer difficulties, and a considerable proportion of the investments which operate successfully in countries with exchange control are of the kind indicated.

Since most less developed countries are members of the International Monetary Fund, the position of remittances on investments under the Fund's Articles of Agreement is of interest. Under normal circumstances members of the Fund are required to avoid restrictions on payments and transfers for current international transactions. The latter are defined to include "without limitation ... payments due as interest on loans and as net income from other investments" and "payments of moderate amount for amortization of loans or for depreciation of direct investments". These obligations may, however, be suspended with the approval of the Fund in certain circumstances of exchange stringency, including a specified "post-war transitional period".

Principles governing the administration of exchange controls have been included in several bilateral treaties relating to foreign investments. The recent United States-Uruguay Treaty relating to foreign investments, which is discussed below, establishes the principle of freedom from control of remittances arising from foreign investments (including compensation in the event of expropriation) except in periods of "exchange stringency", during which the capital-importing country may apply restrictions to assure the availability of foreign exchange for payments of goods and services "essential to the health and welfare" of its people.

In the event of an "exchange stringency" the Treaty provides that the capital-importing country is under the obligation to "make reasonable and specific provision" for transfers arising from foreign investments and to consult with the capital-exporting country regarding these provisions. If multiple rates of exchange are in effect, the rate applied to transfers related to foreign

/investments shall

investments shall be "just and reasonable", and in any event shall be based on the principles of both "national" and most-favoured-nation treatment. In some respects these obligations, especially regarding capital transfers, exceed those under the Articles of Agreement of the International Monetary Fund. In this connexion attention may be drawn to the fact that the Sub-Commission on Economic Development has opposed the suggestion of facilities for transfer being provided by a less developed country by way of a guaranteed utilization of its foreign exchange resources.1/

Apart from their effect on remittances, exchange controls may have certain indirect effects on equity investments. In the first place, inability to transfer earnings may lead to involuntary reinvestment of earnings in the country concerned.2/ Secondly, the operation of foreign enterprises may be adversely affected by inability to obtain foreign exchange for imports of needed equipment and raw materials. Such inability may or may not result from discrimination against foreign enterprises. On the other hand, to the extent that exchange control limits imports into the country concerned, it offers a measure of protection similar to tariffs or quantitative restrictions on imports and may thus tend to stimulate foreign investment in the protected industry.

In countries which in recent years have severely curtailed the remittance of foreign investment yields, exchange control presents a formidable barrier which could be overcome only to the extent that investors anticipated future relaxation.3/ On the other hand there are countries in which remittances of

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1/ Report of the Sub-Commission on Economic Development (Third Session), paragraph 32.

2/ This appears to have occurred during the 1930's in some countries. See International Capital Movements during the Inter-War Period, page 46. In one or two cases, for example, Chile, compulsory reinvestment of earnings is enforced by specific legislation apart from exchange controls. Such legislation, however, generally allows for exemption by administrative discretion.

3/ An example appears to be Argentina. Dividend payments of a sample of United States enterprises in that country declined from $11.3 million in the first half of 1947 to $7.3 million in the second half of the year and to $4.9 million and to $0.1 million in the first and second halves of 1948 respectively. See United States Department of Commerce, Survey of Current Business, November 1949, page 23.

/yields of

yields of existing investments have been free or comparatively free of control but which have nevertheless failed to attract substantial amounts of foreign investments in recent years.[1] Figures for remittances on United States direct investments in general in recent years suggest that in many countries investors were able to obtain sufficient dollar exchange to meet immediate requirements[2]; yet the amount of investments has continued to be comparatively small. Factors other than transfer difficulties may account for the lack of investment in some less developed countries; but it may be suggested that even when exchange control has not prevented remittances in the past, potential investors are under prevailing conditions frequently deterred by the fear that a future pressure on the balance of payments of the capital-importing country may induce it to introduce exchange control or tighten controls already existing. The reasons for this fear are obvious enough: the foreign exchange reserves of many less developed countries have declined rapidly during the post-war years, and the decline has in several cases been accompanied by the tightening of exchange and import controls; further, the supply of dollars to a number of less developed countries has depended directly or indirectly on the maintenance of a large volume of United States Government grants and credits, the future size of which cannot be estimated by the potential investor.

Under-developed countries which are anxious to maintain their credit abroad and which seek to attract foreign capital, avoid blocking the transfer of the yield on foreign investments, except in cases of considerable emergency or when yields are considered abnormally high. The policy applied with regard to the withdrawal of principal (other than regular amortization according to loan

1/ For example, Cuba, Mexico, Haiti, Venezuela (other than petroleum) and the Philippines.

2/ United States Department of Commerce, op. cit. Income from United States direct investments in 1948 amounted to 1,552 million after foreign taxes, but including reinvested earnings of both branch plants and foreign subsidiaries, the latter amounting to $569 million. After deducting the reinvested earnings it would appear that the amount actually transferred to the United States (not allowing for price changes) exceeded that in 1938.

/contract) is

contract) is more stringent.[1] In Fact, one of the chief objects of exchange control is usually the prevention of an unforeseen outflow of foreign-owned as well as domestic capital which may result in a sudden pressure on the balance of payments. This greatly narrows the market in which the foreign investor can liquidate an investment once made and is likely to be of particular importance for portfolio investments.[2]

Thus the plight of the foreign investor on account of exchange control is frequently considerable. Before venturing his funds, he will have to consider the extent of the actual exchange stringency of which the control is symptomatic. He will have to consider the likelihood of a future tightening of the control in the case that stringency should become more acute. He will also have to be guided in his decisions by the policy applied by the authorities in allocating available foreign exchange among competing demands.

Nationalization and expropriation

The policy adopted by certain countries of "nationalizing" existing enterprises is bound to affect existing and potential foreign investment. This applies also to policies of "naturalizing" foreign enterprises through compulsory transfer to private domestic ownership. Formal nationalization and naturalization

1/ A relaxation of exchange controls with a view to attracting private investments is indicated in recent changes in the regulations affecting the withdrawal of foreign capital in British and French colonial territories as well as in the metropolitan area of these countries. Prior to January 1950 the British authorities would not undertake to allow repayment of foreign capital invested in new enterprises for at least ten years after the investment was made or to permit the withdrawal of other non-resident capital upon liquidation. Under the amended regulations, withdrawal of the capital of approved new investments will be permitted at any time, subject to certain conditions. (See statement on British colonial territories in Part II). A regulation of the French exchange control authorities of 2 September 1949 stipulates that, under certain conditions, non-residents of the Franc Zone investing capital in approved projects in that zone after 31 August 1949 will be authorized to transfer abroad sums realized through the liquidation or sale of the investments.

2/ In any case, the small resources of the domestic capital market in a less developed country would limit the liquidity of investments, both foreign and domestic. Under normal conditions a large-scale liquidation of foreign equity investments, particularly direct investments, is not likely to be contemplated by investors or, for that matter, even practicable; but for the individual investor liquidity is an important consideration.

/may or

may or may not be accompanied by what is regarded as adequate compensation to the foreign investor. Existing foreign investments may also be exposed to various other measures which are frequently considered confiscatory with consequent effects on the attitude of potential investors. The competition of government enterprises with foreign concerns, the regulation of public utility and railway rates, and certain fiscal measures are sometimes regarded by the investors concerned as involving a measure of confiscation, depending on the extent to which the yield of the investments is affected.

The chief issues arising directly from the compulsory transfer of ownership from foreign investors relate to the definition of compensation, if any, and whether such compensation will be made promptly and effectively transferred. A special complication arises when, as has occurred in some less developed countries certain industries are designated for nationalization either at some specified date in the future or before the end of a certain period. This is bound to affect the action of the enterprises concerned in matters such as maintenance of capital equipment and new investment for expansion; in the case of extractive industries, the rate of operation may be accelerated, to the extent that it is not regulated by outside authority. In general there would be a tendency to maximize returns and withdraw capital rather than add to the amount invested within the period of expected operations. A different situation arises when a government invites foreign interests to establish a new enterprise on the understanding that it may or will be nationalized within a specified period.[1/] In these circumstances the potential investor will have to weigh the possible consequences of nationalization against the expected rate of return. In view of the difficulty of evaluating in advance all aspects of compensation, the investor may take past experience with nationalization measures as a guide to the degree of risk involved.

Naturalization policies may be limited to requirements that foreign investors divest themselves of a part of their interest in the enterprise. Frequently the intention is to transfer control of the enterprise to domestic interests; but when the foreign investor remains in control his attitude towards the investment may not be greatly affected. In some cases the question of compensation may be settled not by negotiations with a governmental authority

1/ See statement on India in Part II.

but by sale of the assets directly to local private investors. Though this is likely to be preferred by the foreign investor, he may be at a disadvantage on account of the necessity of disposing of his property within a given time; in addition he may encounter difficulties if the capital required is not available to domestic investors or alternative local investment is more attractive to them.

Under any circumstances the prospect of nationalization or naturalization gives rise to uncertainties. Apart from well-recognized technical difficulties in determining the value of an investment for purposes of compensation, the foreign investor and the authorities of the capital-importing country are unlikely to be guided by the same considerations.[1] The latter may be inclined to regard profits already received in excess of normal yield as a factor tending to reduce the amount due as compensation, whereas the investor will consider that a high yield determines the present value of the investment, irrespective of original outlay.

Constitutional provisions in under-developed countries often allow for fair compensation and the observance of appropriate legal procedure in the event of measures of nationalization affecting domestic and foreign nationals.[2] In addition, some countries have declared their intention of according fair compensation to foreign investors for nationalized property.[3] Further commitments relating to compensation have been incorporated in bilateral treaties and drafts of multilateral agreements negotiated between capital-exporting and less developed countries. In particular, attention may be called to the recent bilateral treaties between the United States and China, Italy and Uruguay respectively, discussed below, which incorporate provisions relating to procedure and policy in respect of taking of property of foreign enterprises. Such agreements, however, do not remove all the difficulties of the problem of compensation, since there is no agreed definition of terms such as "just" and "adequate", which usually are employed. Furthermore, if the capital-importing country applies exchange control, as is usually the case, the problems connected

1/ Some of these problems arise also in connexion with the administration of guarantees extended to foreign investors by the government of a capital-exporting country.

2/ See, for example, statements on Argentina, Brazil and Colombia.

3/ See statements on India and Pakistan.

/with the

with the transfer of compensation abroad introduce additional uncertainty as regards the rate of exchange which will apply and the priority which will be accorded to the transfer. Nevertheless, such agreements provide a procedural framework through which disputes may be aired and, in some cases, arbitrated. It may be noted, however, that certain less developed countries have strongly opposed formal commitments to negotiate with the government of the capital-exporting country in the case of nationalization or to submit disputes to an international arbitration tribunal.

International agreements

Attempts to negotiate international agreements affecting foreign investments have confirmed the existence of a substantial area of conflict between the policies of capital-exporting and capital-importing countries. The emphasis of the former tends to fall on commitments by the debtor country relating to the non-discriminatory treatment of foreign investors through assurances of "national" or "most-favoured-nation" treatment, to transfer of income and capital, and to equitable compensation in the event of expropriation.1/ The less developed countries tend to be concerned primarily with maintaining control over the entry and operations of direct investments in order to safeguard their economies against what is regarded as exploitation, and to achieve various positive objectives of economic development.

In Methods of Financing Economic Development reference was made to several provisions of two draft multilateral agreements, in the negotiation of which both capital-exporting and less developed countries participated.2/ Thus far, however, these multilateral agreements have not entered into force. On the other hand, bilateral treaties regulating the status of private foreign investment have been concluded between the United States and China (1946), Italy (1948) and most recently Uruguay (Treaty of Friendship, Commerce and Economic Development signed on 23 November 1949).3/ These treaties are similar in most respects, and it appears useful to examine here the main provisions of the United States-Uruguay treaty as an indication of the legal framework regarded by the signatories as conducive to a flow of private foreign capital, particularly in the form of direct investments.

1/ 2/ 3/ See following page for footnotes.

/Footnotes

Footnotes to preceding page:

1/ Recognition has also been given in official statements by the United States Government, however, to the impact of private investments on the economies of the less developed countries. Thus, the following statement appears in the Annual Economic Report of the President of the United States to Congress for the year 1949:

> "It will ... continue to be the policy of the Government to encourage American investment abroad only when it is carried on in a way that protects the interests of the people in the foreign countries concerned".

Attention may be drawn to the following statement by the United States Department of State concerning the impact of private investments on the political life of countries in which United States enterprises operate:

> "The Department of State disapproves of and opposes most strongly any interference or participation by American businessmen or companies in the local political affairs of other American Republics ... On the other hand, the Department and American diplomatic and consular officers abroad will extend 100 per cent cooperation in protecting the legitimate rights and in advancing the legitimate interests of American business." (See International Reference Service, Vol. VI, No. 25, United States Department of Commerce, May 1949.)

2/ The multilateral agreements referred to are the Havana Charter for an International Trade Organization (ITO) of April 1948 and the Economic Agreement of Bogota (Colombia) signed at the Ninth International Conference of American States in May 1948.

3/ The United States-Uruguay Treaty awaits ratification by the legislatures of the two countries. In May 1949 the governments of Brazil and the United States jointly announced their intention to begin negotiation of a treaty relating to foreign investments. In a special message to Congress in June 1949 the President of the United States announced the intention of initiating negotiations with a number of less developed countries with a view to concluding such treaties.

In addition to provisions referring explicitly to foreign investments, the treaty includes clauses relating to the civil rights of nationals, to shipping and to various aspects of commercial policy, the last being similar to corresponding provisions of the Havana Charter for an International Trade Organization (ITO). The provisions relating to foreign investment, however, are more specific than those of the Havana Charter and the Economic Agreement of Bogota and, particularly in comparison with the Havana Charter, contain greater commitments on the part of the capital-importing country with respect to the right of entry and the scope of operations and the rights of foreign investors. The most important clauses cover (1) general principles governing the operations of foreign capital; (2) entry, control and management of foreign investments; (3) nationalization and expropriation; and (4) foreign exchange restrictions.

General Principles. The basic principles governing the treatment of foreign capital are contained in Article IV which is in many respects similar to Article 12 of the Havana Charter. The capital-importing country undertakes to "take no unreasonable or discriminatory measures that would impair the legally acquired rights or interests" of the nationals and companies of the capital-exporting country, and not to deny opportunities and facilities for investments "without appropriate reason". With several exceptions, the entry and operations of foreign investments are governed by the principle of "national" treatment.1/ Where such treatment is not accorded, most-favoured-nation-treatment is the governing principle.2/

1/ The following definition of "national" treatment is contained in the treaty: "The term 'national treatment' means treatment accorded within the territories of a High Contracting Party upon terms no less favourable than the treatment accorded therein, in like situations, to nationals, companies, products, vessels or other objects, as the case may be, of such Party."

2/ In the United States-Italian Treaty provisions for "national" treatment are, in most cases, paralleled by provisions for most-favoured-nation treatment, implying that any special concession granted to foreign investors from a third country more favourable than national treatment shall also be accorded to the other signatory. In the United States-Uruguay Treaty, however, the general rule is "national" treatment, with most-favoured-nation treatment as an alternative principle in only a relatively few cases.

Entry, Control and Management of Foreign Investments. Nationals and companies of the capital-exporting country are accorded national treatment in respect of entry into commerce, manufacturing, processing, finance (other than deposit banking), construction and publishing. In addition nationals and companies of the capital-exporting country may organize subsidiary companies under the laws of the capital-importing country in these industries as well as in mining and have the right to control and manage such enterprises and operate them on the basis of "national" treatment. In these industries the requirement of a minimum percentage of domestic ownership is prohibited if such requirement interferes with effective control and management of the enterprise. The major sectors of the economy in which entry of foreign capital on the same terms as national capital is not provided by the treaty are agriculture, public utilities, transportation and deposit banking. As noted above, entry into mining may be limited to locally organized companies, but participation by foreign capital in such companies is not limited. Foreign enterprises are explicitly accorded the right to employ technical experts, executive personnel and other "specialized employees" regardless of nationality. These provisions put foreign-owned enterprise on the same footing as enterprises owned by domestic nationals in practically all important aspects of ownership and operation.

Nationalization and Expropriation. In the event of nationalization or other forms of expropriation, foreign investors are accorded no less than "national" treatment and it is provided in addition that "any expropriation shall be made in accordance with the applicable laws, which shall at least assure the payment of just compensation in a prompt, adequate, and effective manner". These principles apply not only to enterprises in which there is a majority foreign interest but also to a "substantial" foreign interest. While no definitions are included of what is to be considered "just", "prompt", "adequate", and "effective", specific provision is contained in a clause relating to exchange restrictions for favourable treatment of the transfer of amounts payable as compensation for nationalized or expropriated property.

Taxation. Taxation of foreign investments is generally governed by the principles of "national" treatment. It is explicitly provided that no taxes shall be levied on foreign enterprises except those reasonably allocable to operations in the territory of the capital-importing country. The tax provisions are subject, however, to the right of the capital-importing country

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to accord preferential tax treatment to nationals and companies of foreign countries with which special agreements have been made on the basis of reciprocity or through treaties for the avoidance of double taxation. The treaty itself does not deal with double taxation.

<u>Other Provisions</u>. Several exceptions to the general rule of non-discrimination are contained in the treaty. These include the right to apply measures regulating the production of military supplies, measures necessary to fulfill the country's obligations for the maintenance or restoration of international peace and security, or necessary to protect its "essential security interests". An arbitration clause provides that any dispute between the signatories as to the interpretation or application of the treaty not satisfactorily adjusted by diplomacy or other pacific means shall be submitted to the International Court of Justice. The provisions relating to remittances arising from foreign investments have been discussed above in the section on exchange control.

International agreements embodying principles similar to those in the United States-Uruguay Treaty would tend to reduce some of the uncertainties now confronting private investors, at least so far as direct investments are concerned. However, since private investors may be encouraged but cannot be coerced to invest abroad, the effect of such agreements will depend on the expectations which they generate in the minds of potential investors. It would appear that a fairly long period of experience would be required before the investors will assume the "climate" aimed at by such agreements to be enduring. In any case, such agreements would have little effect in overcoming the two basic obstacles of inconvertibility of currencies and fear of capital loss arising from domestic or international political instability.

/D. CONCLUDING

D. CONCLUDING REMARKS

It is generally agreed that at present the export of private long-term capital from the economically advanced countries is not adequate, in size and nature, to contribute greatly to the economic growth of under-developed countries. Many factors are responsible for this state of affairs, which is not due only to the policies pursued by individual countries.

Thus, potential investors are deterred by political tension affecting capital-importing countries and by uncertainty as to the future conversion into the currency of the capital-exporting country of the income from investments and the proceeds from the repayment or liquidation of capital. The risk which is considered involved in foreign investments is perhaps most evident in the case of loans. Fearing a repetition of the defaults of many international loans that occurred during the 1930's, individual savers are no longer willing to subscribe to foreign loans.

It would be erroneous to attribute the transfer difficulties that hamper foreign lending to the existence of exchange controls. Such controls are essentially a symptom of foreign exchange stringency, due to widespread disequilibria manifest in the elimination of much of the multilateral trade that up to the 1930's facilitated transfer of the bulk of the payments arising from foreign investments, and frequently also to local inflationary pressures generated by investment programmes. At the present time the major part of the foreign investments that are still being made in under-developed countries is concentrated in extractive export industries controlled by foreign interests. In many cases the enterprises concerned are more or less detached from the economy of the countries in which the investments are made, and contribute only indirectly to the economic development of these countries. New foreign investments in government loans, and in public utilities and industries that play a more direct role in the economic life of these countries are on a very small scale.

The deterioration in the general "climate" for foreign investment would be counteracted, however, at least up to a point, by the mere revival of such investment, could it be brought about. A flow of capital, private or governmental, to under-developed countries would tend to reduce the immediate pressure on the balance of payments of these countries that now limits convertibility, quite irrespective of the more sustained beneficial effect on

/the balance

the balance of payments that might result from the increase in productivity to which the investments would be likely to contribute. Even the political instability which now frequently stands in the way of new private investment might be corrected to a certain extent by such a revival.

The elimination of the obstacles that hamper private international financing is all the more important in view of the community of interests that exists in this matter between capital-exporting and capital-importing countries. It is true that the capital available for export from several European creditor countries has been severely reduced, but the indications are that capacity of the United States to invest private capital abroad has greatly increased. The economic plans of many under-developed countries frequently demand more capital than can easily be saved domestically, and on the whole these countries welcome an inflow of capital.

Declared policies and legislative measures taken by both groups of countries confirm this community of interests to a certain extent. So far, however, the encouragement of foreign investments through legislative action has had little success. The measures which attract attention, therefore, are largely controls implying varying degrees of restriction, particularly on the part of the under-developed countries. In many respects these controls differ little from similar controls which restrict the use of foreign capital in the countries which are more advanced economically. To a considerable extent, however, the controls reflect a different attitude of the under-developed countries and the capital-exporting countries (or rather, of investors in these countries), not concerning the desirability of private foreign investment, but concerning the forms which such investment should take.

As a general rule, the under-developed countries regulate private foreign investments with two principal objects in view - to develop their economy as rapidly as possible, and to maintain domestic control over their economy to the largest possible extent. If no other considerations were involved, foreign capital would be chiefly in the form of portfolio investment in government bonds or in securities of enterprises directly serving economic development, particularly manufacturing industries. As it is, little foreign capital is available for portfolio investment; both this fact and the frequent lack of technical and managerial ability in the under-developed countries render it necessary for them to consider the alternative of accepting foreign direct

investment, which implies entrepreneurial control by the investor.

The chief legislation affecting direct investment - disregarding restrictions introduced with a view to national security or for similar purposes - aims at preventing the entreprises concerned from being entirely foreign ventures which utilize national resources without contributing adequately to national welfare or giving adquate impetus to economic progress. The spirit of these controls is reflected in the absence in most countries of formal discrimination against foreign enterprises, except when national security is involved or when the general economic policy pursued is such as to reserve certain fields of activity for domestic enterprise. Stress is laid in most under-developed countries on the employment and training of domestic personnel. In the case of concessions for extractive export industries, more importance is attributed to the financial benefits accruing to the country granting the concession. It is only natural that the exploitation by foreign enterprise of national resources, frequently exhaustible, that makes little direct contribution to a balanced development of the country granting the concession should be the object of arrangements which permit that country to share in the profits realized.

When more radical steps affecting foreign investments are taken, as in the case of nationalization of industries, this is usually the result of changes in economic policy that have a very far-reaching effect on private investment, irrespective of the source of the capital involved. In recent measures of nationalization, the principle of compensation to foreign investors has usually been accepted, but it would be futile to disregard the difficulty of obtaining an arrangement satisfactory to both partners as to the adequacy and promptness of compensation the payment of which involves the transfer to the investing country of the principal of the investment.

Although the objectives pursued by the less developed countries with regard to foreign private investment are understandable, these countries and those which are potential capital exporters frequently do not see eye to eye in the matter of such investment. While factors outside the control of the under-developed countries represent a major reason for the failure of private capital to be attracted to them in sufficient amount and in the forms they desire, there can be no doubt about the deterrent effect of certain of the regulations to which foreign investment is subject. It is true that all the regulations do not

/appear equally

appear equally serious to the foreign investor - apprehensions regarding the effect of certain measures, such as taxation, labour regulations and related controls may frequently be offset by the expectation of substantial profits. The investor may think himself well advised also to allow for future changes in laws and regulations, and the possibility of expropriation without adequate compensation may not always be ruled out. To these uncertainties are added those due to transfer difficulties and political instability.

There is hardly any simple formula that will assure a revival of private foreign investment. The laws and regulations of the under-developed countries are the product of considered policy which in many cases has been developed over a considerable period of time; and it would be futile to expect sweeping changes in this policy. Up to a point, changes are possible and may be achieved, particularly by international agreements, bilateral or multilateral, between the countries concerned. The agreements might also lead to the establishment of mutually acceptable principles reducing the risk of what the investor may regard as arbitrary changes in policy. Risks may also be offset through guarantees to the investor by the governments of the capital-exporting countries, and to a more limited extent through tax incentives offered by these governments.

Little can be done to revive the market for international loans in the near future. In fact, such loans are not subject to substantial governmental restrictions, except by certain creditor countries which are anxious to prevent a capital export that would expose their balance of payments to pressure. Under present conditions, the rate of interest and the maturities of loans likely to be acceptable to under-developed countries are considered too unfavourable by potential foreign subscribers. It appears that a protracted period of successful experience with other forms of international investment, both private and governmental, is required before there will be a resumption of private international lending on a large scale - except possibly through a risk-bearing intermediary like the International Bank for Reconstruction and Development.

The effect of guarantees of direct investment by the governments of capital-exporting countries against risks peculiar to foreign investment may be far-reaching; but such guarantees only imply a transfer of risk from the individual investor to the government. If carried into effect, however, the

/guarantees

guarantees may well serve as a pump-primer, encouraging investments during a period of experience required before the potential investors would assume any improvement in the "climate" of foreign investments to be enduring.

In the long run, a more important stimulus to private international financing might result from the modification of policies which are not determined primarily by considerations of foreign investments. It has been pointed out above that a liberal commercial policy pursued by capital-exporting countries is in the long run a corollary to their status as creditor nations; such a policy would do much, not only to facilitate the direct transfer of payments due from capital-importing countries, but to revive multilateral trade and thus bring about the international economic integration that in the last instance determines the general "climate" for foreign investment. In the capital-importing countries, the pursuance of policies which mitigate the pressure on the balance of payments appears of particular importance. A debtor country with an overvalued currency sustained by exchange controls is not likely to attract foreign capital.

Part II

LAWS, REGULATIONS AND POLICIES IN SELECTED LESS DEVELOPED COUNTRIES

It has been thought useful to illustrate the general discussion in the preceding pages with a series of brief accounts of the laws, regulations and - to a more limited extent - the economic policies affecting foreign investments in selected less-developed countries. It is believed that the statements included offer a reasonably accurate indication of the range of policies directly affecting private foreign investments in less-developed countries in which private enterprise plays an important role. The statements refer for the most part to laws, regulations and policies relating to equity investments and more particularly to direct investments. It should be borne in mind that in several of the countries in question there is a wide range of administrative discretion, and that accordingly the treatment of foreign investments may sometimes be at variance with policies expressed and even with regulations officially adopted.

The information summarized is derived in most cases from official sources but has not been checked for accuracy by the governments concerned. Furthermore, in the case of several countries in Asia and the Far East the information refers to statements of policy which in some respects have not as yet been implemented by legislative and executive action.

A. ASIA AND THE FAR EAST

Burma

In August 1949 the Government of Burma issued a statement on the policy towards private enterprise in general and private foreign investments in particular.[1/] This statement embodied principles contained in a resolution previously adopted by the Economic Council of the Government on 2 March 1949. The main features of this policy may be outlined as follows:

Governmental and private enterprise

Apart from the manufacture of arms and other military equipment, which is reserved as a state monopoly, the Government regards certain industries as normally within its exclusive sphere but would permit private enterprise to engage in them, either independently, or jointly with the Government, so long as the Government is unable to do so alone. There are ten industries within this category, most of which are now in Burma.[2/]

Further, Section 219 of the Burmese Constitution stipulates that the exploitation of "all timber and mineral lands, forests, water, fisheries, minerals, coal, petroleum and other mineral oils, all sources of potential and other natural resources" is to be undertaken by the State, while private enterprise may operate in these fields only in so far as exemption from the general rule is granted by act of Parliament. One of these exceptions is provided by the Union Mineral Resources (Grant of Right of Exploitation Enabling) Act of 1949, giving the government the power to waive the restrictions imposed by the Constitution with regard to the mining industry.

Outside the reserved sectors of the economy, private enterprise is free to operate, subject, however, to the control and direction of the Government as implied in the country's two-year plan, which was first promulgated on 1 April 1948 and constitutes the groundwork for the establishment of a planned

1/ See Press Release of the Embassy of Burma, Washington, D.C., 16 August 1949.

2/ These ten industries are (1) railway transport and the manufacture of locomotives, (2) inland water transport on "main water routes", (3) electric power generation, (4) commercial radio transmission, (5) manufacture of sulfuric acid, (6) iron and steel, (7) coal mining, (8) paper and pulp, (9) sugar, and (10) the "extraction and milling" of teak.

/economy. The nature

economy. The nature and scope of control envisaged have not yet been elaborated, but, among other matters, the plan calls for legislation on the "adoption of processes and means of production suited to the genius of the people, the avoidance of over-concentration in certain areas leading to unbalanced development, and the prevention of undue competition to the detriment of the interests of the country".[1/]

Special obligations of foreign enterprises

Foreign enterprises which either operate in the fields open to private enterprise in general or are permitted to engage in activities normally within the governmental sector are subject to the following conditions:

1. to be "self-sufficient as regards foreign exchange required for capital expenditure",[2/]
2. to "take adequate measures for training sufficient Burmans in both the administrative and technical fields",[3/] and
3. not to import unskilled labour from abroad.

Generally speaking, there is no rigid requirement regarding the participation of domestic capital and of Burmese nationals in management and control. An exception to this is found in Section 219 of the constitution which stipulates that at least 60 per cent of the capital in enterprises especially permitted to operate in the state sector by parliamentary sanction must be owned by Burmese nationals.

Inducements to foreign investments

Within the sectors of the economy open to private enterprise three major concessions may be offered to attract foreign investments. First, foreign investors establishing joint undertakings with the Government or with private domestic interests are offered special facilities in marketing their products. Secondly, the Burmese Government will undertake not to nationalize a foreign concern within a period of time to be determined by individual negotiation. Finally, the Government is also willing to discuss other methods of assuring a foreign enterprise security of tenure for a definite length of time which will be sufficient to enable the latter "to earn a reasonable return on the capital"

1/ Two-Year Plan of Economic Development for Burma, p. 21.

2/ Resolution of the Economic Council, 2 March 1949.

3/ Resolution of the Economic Council, 2 March 1949.

/invested.

invested. Although the admission of foreign capital into Burma does not require in principle the examination of every individual case on its own merits, as is the case in India, individual foreign enterprises have to negotiate separately with the Burmese Government with respect to the special security guarantee mentioned above.

There is no explicit undertaking that foreign investment will enjoy non-discriminatory treatment in other respects, but no official statements to the contrary have been made.

The recent application of the Government's policy on nationalization does not appear to have been without difficulties. In June 1948 the Burmese Prime Minister, Mr. Takin Nu, stated in connexion with the Anglo-Burmese Treaty that the payment of equitable compensation for nationalized foreign property was in Burma's national interest. However, negotiations in connexion with the nationalization of the teak consortium in which four British companies and one British-managed concern were involved were reported in the middle of 1949 to be still in process, the Government reportedly having offered some 30 million rupees as against the evaluation of about 60 million by the companies concerned. Similarly, the compensation to former Indian landowners as a result of the nationalization of land still remains to be settled. One point of dispute arises out of the Government's alleged desire to pay compensation in the form of government bonds. An interesting case involving assurance against nationalization is offered by the Burma Oil Company, a foreign enterprise, which, having spent £8 million by late 1948 on the reconstruction of its refinery installments, sought from the Government a 25-year guarantee of private operation in addition to certain financial assistance.

Exchange control

According to the official statement, foreign enterprises will be allowed to remit dividends abroad and "to take money out of the country for the purchase of foreign equipment and renewal". The question of withdrawal of capital, as distinct from transfers for purchase of equipment, is not clear, however. Nor is it clear if there would be an upper limit to the yield transferable abroad. The exchange control, which is all-embracing, was generally tightened in the latter half of 1948, but information is lacking as to the specific policies applied with reference to existing investments.

/Similarly there

Similarly there has been no definite announcement regarding the remittances which may be expected in connexion with future investments.

China

Despite the present unsettled conditions which may render a discussion of China's recent policy toward foreign investments of little practical significance, the case of China offers a useful example of the evolution of policy toward foreign investment in a less-developed country. Under the old system of extraterritoriality the Government was most reluctant both to increase foreign indebtedness and to grant liberal conditions for foreign direct investment insofar as the latter was subject to Chinese law. With the abolition of extraterritoriality in 1943, however, the Chinese Government became increasingly aware of the urgency of establishing a system of laws defining the status of foreign investments.

New regulations amended a Government resolution of 1930 which had imposed certain restrictions on direct foreign investment. Purely foreign enterprises as well as joint foreign and domestic enterprises were admitted into many areas of economic activity. In 1944 the Government adopted the "Principles Governing the First Stage of Post-war Economic Reconstruction" in which a policy of welcoming foreign enterprise was reaffirmed and the areas open to such enterprise were defined. A new Company Law and other related laws promulgated between 1943 and 1947, as well as a Treaty of Friendship, Commerce and Navigation with the United States in 1946, sought further to establish a legal framework favourable to foreign investments.

Under the new arrangements foreign nationals (including "juridical persons" in the form of foreign corporations) became free to engage in business activities, subject to a few specific limitations. Administrative discretion in controlling these activities was retained by the Government, however, through a provision of the Company Law authorizing the Government to impose restrictions on the localities in which foreign-owned concerns might operate and on the activities in which they might participate. The construction and operation of railways were reserved to Chinese-owned enterprises except under special concessions. Inland navigation and coastal shipping were also reserved for Chinese nationals. Although air transport between domestic points was reserved to domestic airlines, other air transport operations by foreign enterprises were

/permitted, subject to

permitted, subject to certain arrangements defining the scope of such activities.

The area of permissible foreign activity in other industries in China was defined in the "Principles" adopted in 1944 and was further specified in an official statement in August 1947. A number of industries were designated for exclusive operation by the Government, including the main railway lines, large-scale hydroelectric power plants, mining (including petroleum) and arsenals. The mining code provided, however, that foreign capital might participate jointly with domestic capital in certain types of state-operated enterprise in the form of joint-stock corporations, although it is not clear whether it was contemplated that foreign capital should have more than a minority interest in such cases. It may be observed that with the exception of mining and petroleum the sectors designated for Government operation are not types of activity which are likely to attract private direct investment at present. Borrowing from foreign private or governmental sources to finance Chinese Government activities in these spheres was, of course, not excluded.

A second category of industries was reserved exclusively for operation by Chinese nationals, including fisheries, forestry, public utilities in certain cases, and under certain circumstances other "enterprises of a monopolistic nature". The latter provision derived from the following clause in Article 144 of the Chinese Constitution:

> "Public utilities and other enterprises of monopolistic nature shall, as a principle, be under public operation. The same may, if permitted by law, be operated by citizens."

All remaining industries formed a third category open to foreign investments, and the Government stated explicitly that investments would be welcomed particularly in large-scale manufacturing, more especially of motive-power machinery, tool-making machines, automobiles, locomotives, aircraft and steamships.

The scope of foreign enterprise in banking and finance was also changed by the Banking Law of 1947, under which foreign banks were permitted the same scope of operations as native banks, except that the former were prohibited from conducting business as trust companies. The new law also provided that foreign banks could not receive deposits in foreign currencies or deal in foreign exchange without special permission by the Central Bank of China; but in practice foreign banks were permitted to deal in foreign exchange, subject to the general regulations of the Central Bank.

/The legal status of foreign

The legal status of foreign nationals with respect to real property rights also underwent a substantial change following the treaties of 1943. Prior to this date foreign nationals had the right to rent or own real property only in the concessions and settlements. In other areas aliens had no right to acquire or purchase land, although they could purchase a residential dwelling. They were permitted, however, to acquire a "lease in perpetuity" in land. Under the new position after 1943 foreign nationals enjoyed the right to acquire and hold real property throughout the country and existing leases in perpetuity were replaced by new deeds of ownership. The right to acquire land was made conditional, however, on the extension of reciprocal treatment by the country of origin of the enterprise concerned. Land tenure also remained subject to a law of 1930 providing that aliens may not own or lease agricultural land, forest areas, pastures, fishing waters, mining areas, salt fields, and land designated as a "military zone".

The Chinese Company Law of 1946 imposed certain restrictions on the participation of foreign capital in Chinese companies. The main feature was the requirement of domicile. Thus, in a limited-liability company (with five or more shareholders) more than half of the stockholders, half the directors, all the managing directors and the chairman of the board of directors were required to be residents of China. The chairman of the board also was required to be a Chinese citizen. Similar restrictions applied also to other forms of organization under the Chinese Company Law.

Prior to 1943 foreign investments in the concessions and foreign settlements enjoyed virtually tax-free status. Following the abolition of extraterritoriality, the prevailing principle became "national" treatment of foreign enterprises. There have been some reports, however, to the effect that the administration of the income tax subjected foreign enterprises in the form of branches to discrimination by computing the rates of taxation of such enterprises solely according to the amount of income, whereas in the case of Chinese companies the rates were determined by the rate of return on capital. Under the prevalent inflationary conditions Chinese concerns were permitted to readjust their capitalization, thus falling into lower surtax brackets than foreign branches. It may be added that the Sino-American Treaty of 1946, in addition to establishing the principle of national treatment with respect to taxation also contained a provision that taxes or other fiscal charges levied

on foreign enterprises shall not be imposed upon or measured by any income, property or other criterion of measurement in excess of that reasonably allocable to foreign enterprises operating in the territory of each country.

In respect of the remittance of yields or return of the principle of foreign investments the Chinese Government's declaration of August 1947 on the policy toward foreign investments contained the following statement:

> "In principle, profits yielded by foreign investments in industrial enterprises in China may be remitted abroad. During the period of foreign exchange control such remittance, of course, is subject to restrictions. However, the Chinese Government is drawing up regulations whereby an appropriate proportion of profits realized from foreign investments in industrial enterprises may be remitted to the country where such capital originates."

Because of the pressure on the country's balance of payments the Chinese Government found it necessary to impose stringent foreign exchange and trade controls at the end of the war. Under this regime remittances on foreign investments since the end of the war were negligible. At the end of 1947 it was reported that it was impossible for foreign firms to remit profits or to withdraw their capital.

The Sino-American Treaty of Friendship, Commerce, and Navigation, signed in November 1946, contains numerous provisions relating to the status of foreign investments. In most respects these are similar to those in the more recent treaty between the United States and Uruguay which has been described in a previous section.

India

The basic policies of the Indian Government relating to foreign investments have been expressed in a statement on industrial policy issued by the Ministry of Industry and Supply on 6 April 1948 and a statement by the Prime Minister to Parliament on 6 April 1949. The position, as indicated by these official statements, is the following:

Governmental and private enterprise

According to the statement on industrial policy, the Indian Government reserves exclusively to itself two major fields of activities, both of which are presently in the hands of governmental enterprises: the manufacture of military equipment and the ownership and management of railways. In addition, the Government alone will be responsible for the establishment of new enterprises

/in the following industries,

in the following industries, allowing private operation only when it is considered to be in the national interest to do so: (1) coal production, (2) iron and steel production, (3) aircraft manufacture, (4) ship-building, (5) the manufacture of radio and tele-communication equipment, and (6) mineral oil production. These provisions are not aimed at foreign capital as such, but the general exclusion of private enterprise from these particular fields appears to imply that foreign capital or, at any rate, foreign direct investment, should not consider these fields as open to it except possibly to a very limited extent.

Existing enterprises in the six industries mentioned above will be allowed to continue operation for a period of ten years at the end of which the whole situation is to be reviewed. Should the Government then decide upon the nationalization of any particular enterprise, fair and equitable compensation would be paid to the private owners.

All industries other than those mentioned above will normally be open to private enterprise. Subject to the conditions described below, foreign investors may engage in the same activities as domestic private enterprise. It is the expressed intention of the Indian Government, however, that governmental enterprises should play an active role in a number of industries such as the manufacture of fertilizers, drugs and synthetic petrol; certain governmental enterprises in these industries are already in existence. The State, which already controls the generation and distribution of electric energy, will also exercise control over a number of industries which are regarded as "basic" in view of the national significance of their location or the high degree of technical skill or large capital investment required. The nature of control the Government will exercise is not described in detail in the official statements and is still being evolved.[1]

[1] The list of industries in this category, to which others may be added later, now consists of the following: (1) salt, (2) automobiles and tractors, (3) prime movers, (4) electric engineering, (5) other heavy machinery, (6) machine tools, (7) heavy chemicals, fertilizers, and pharmaceuticals and drugs, (8) electro-chemical industries, (9) non-ferrous metals, (10) rubber manufactures, (11) power and industrial alcohol, (12) cotton and woolen textiles, (13) cement, (14) sugar, (15) newsprint and paper, (16) air and sea transport, (17) minerals, and (18) industries related to defence.

/Control of entry

Control of entry of foreign capital

The division of the economy into several sectors, within each of which private enterprise is assigned a different role, may serve to indicate to the foreign investor whether any contemplated venture is likely to meet with acceptance on the part of the Indian Government. In this connexion, one characteristic of official policy towards foreign investment which has been given great emphasis is especially relevant. This is the policy of judging on its own merits every individual application by foreign investors seeking to establish an enterprise. The criteria by which such applications for entry will be scrutinized are not yet known. But some light may be thrown on this question by the statement that, at this stage of the country's economic development, particular emphasis will be given to "the production of capital equipment, of goods satisfying the basic needs of the people, and of commodities the export of which will increase earnings of foreign exchange".

Policy affecting ownership, control and personnel of foreign enterprises

Foreign enterprises admitted into India pursuant to the conditions discussed above are subject to certain further requirements. First of all, foreign concerns are required as are Indian private enterprises, to observe the conditions laid down in the general statement on industrial policy. In addition to this, the official attitude is that "as a rule, the major interest in ownership and effective control should always be in Indian hands". In this connexion it may be of interest to note that in the case of shipping only companies which are owned by Indians to the extent of 75 per cent of their equity capital are considered by the Indian Government as "Indian shipping companies", and that a licensing system was introduced in 1947 with the ultimate objective of reserving coastal shipping to Indian companies. However, as was pointed out by the Indian Prime Minister on 6 April 1949, there would be no objection to "foreign capital having control of a concern for a limited period, if it is found to be in the national interest, and each individual case will be dealt with on its merits".

Although no "hard and fast rules" have been prescribed on the question of ownership and control, the Indian Government does appear to insist upon "the training of suitable Indian personnel for the purpose of eventually replacing foreign experts" whose employment, where Indian personnel is not available would be permitted. It would seem that this requirement applies to existing as

/well as

well as new enterprises.

Apart from the above restrictions, neither the 1948 statement on industrial policy, nor the later statement by the Prime Minister, contemplates anything other than "national" treatment both to existing and to new foreign enterprises which have been duly admitted.

Exchange control

Foreign investors were assured by the Prime Minister's statement of August 1949 that remittance of profits and capital withdrawals would be allowed, the exact extent to be determined by the foreign exchange position of the country. It was also stated that reasonable facilities of transfer would be provided in the case of compensation proceeds from any act of nationalization involving foreign investors. It would seem from this statement that the latter type of transfer may be given a high priority if exchange control regulations are in force at the time.

All remittances from India are subject to approval by the Exchange Control authorities. Until recently, at any rate, foreign enterprises, whether branches or locally incorporated companies, have been able to remit profits and dividends.[1/] On the other hand remittances of interest and dividends on securities owned by non-resident individuals in the dollar area have been limited. Furthermore, remittances of capital of all types to the dollar area have been rarely permitted in recent months.

Pakistan

Based partly on the recommendations of the Industries Conference convened by the Government in December 1947, the Pakistan Ministry of Commerce, Industry and Works issued a statement in April 1948, which expresses the current policy of the Pakistan Government on the subject. The position of private enterprise in general, and of foreign capital in particular, within the framework of this policy, may be described as follows:

Governmental and private enterprise

In common with the governments of a number of other less-developed countries,

1/ It is reported, however, that a recent law limits the dividends of public limited liability companies to the average annual amount during the period from April 1946 to March 1948 or 6 per cent of paid up capital, whichever is higher. As yet this regulation is reported not to have been applied to private limited liability companies.

that of Pakistan approaches the problem of organizing the national economy with the premise that centralized planning is best suited to the requirements of a less developed country. The Government has decided, however, to limit its own activities in the following manner:

1. "For the present" the Government will undertake to own and operate only four industries: the manufacture of arms, the generation of electric energy, the manufacture of railway wagons, and the production of telecommunication equipment.

2. In addition to the above group of industries, the Government owns and manages the country's railway lines; the nationalization of road and air transport is still in process; and the nationalization of river transport will be examined at a later stage.

3. The Government undertakes to exercise its power of control and planning, for the present, in regard to 27 industries, covering public utilities, the extraction of raw materials, and most branches of manufacturing.1/ The control will relate to such matters as the establishment of production targets, industrial location, the allocation of materials in short supply and the maintenance of fair labour standards.

4. If private initiative is not readily forthcoming, the Government will "set up a limited number of standard units more as a means of attracting private enterprise than for any other purpose".

The above policy has found practical expression in a number of electric power generation projects undertaken by the Government, the contemplated establishment of jute and paper plants, as well as some other manufacturing undertakings, and the projected establishment of an Industries Promotion Corporation to operate these enterprises. As for any possible extension of the nationalization process, an indication may be found in the statement that "there is general agreement that monopolies and public utilities are particularly suitable for nationalization".

Limitations on foreign enterprise

The above demarcation of the respective spheres of private and State activities may serve as a general indication of the scope within which private foreign direct investment may expect to play a part. While foreign capital is

1/ Authority to control these industries was conferred by the passage in 1949 of the Development of Industries (Federal Control) Act.

/welcome,

welcome, in the industries not reserved for state operation, certain conditions have been laid down by the Pakistan Government which must be observed by foreign enterprises. These are briefly as follows:

1. Foreign enterprises must refrain from establishing monopolies which, in the opinion of the Pakistan authorities, are "particularly suitable for nationalization". No attempt, however, seems to have been made so far in defining the term "monopoly".

2. Training facilities must be provided for Pakistan nationals by foreign firms.

3. Foreign enterprises must provide for the participation of indigenous personnel on both the administrative and technical levels. In a supplementary official statement in December 1948, this ruling has been somewhat relaxed, and foreign control in the form of management agreements will be allowed for the next ten years so long as foreign enterprises undertake to provide the training facilities for Pakistan nationals.

4. Apart from existing foreign enterprises and any future transfers in ownership of the same, to which this regulation does not apply, all new investment projects, including the extension of existing foreign firms, must provide for the participation of indigenous capital. In the case of thirteen specified industries, an option to subscribe 51 per cent of all classes of share capital and debentures should ordinarily be offered to Pakistan nationals.[1] In the case of all other industries, the percentage is to be 30 per cent. In both cases, however, if domestic capital is not forthcoming, foreign capital may, with the approval of the government, take up the balance as well. It has further been officially stated that there would not be any undue delay on the part of the government in examining any particular case claiming exemption from the above rule and in giving its approval when this is deemed justified.

It seems from the above description that the Pakistan Government envisaged the participation of foreign capital in the country's economic development chiefly in the form of joint enterprises with domestic capital. Enterprises of exclusive

1/ The industries are listed as follows: cement, coal, cotton spinning and weaving, fish canning and fish oils, generation of electric power (other than hydro-electric), glass and ceramics, heavy chemicals and dye stuffs, minerals, preserved and prepared foods, power alcohol, shipbuilding, sugar and leather.

foreign ownership will be allowed, but only as a result of the exigencies of the present stage of economic development. The requirement of the participation of domestic capital, as far as the present policy is concerned, applies equally to all classes of debentures and shares irrespective of their voting power.

Inducements to new investments

The Pakistan Government is prepared to offer a number of inducements to foreign as well as domestic enterprises. The measures may include:

1. Government surveys of resources which, in a number of cases, have already been conducted with the help of British, American and other foreign corporations;
2. Port development;
3. Government purchase of Pakistan-produced supplies;
4. Government help in securing factory sites, power and other facilities;
5. Government promise of giving consideration to claims for tariff protection; and
6. Tax relief.

Regarding tax relief, the special provisions are (1) for new industrial undertakings, exemption for the first five years from income tax, super-tax and business profits tax "on so much of their profits as does not exceed 5 per cent of the capital employed", (2) permission to make an initial special depreciation allowance of 15 per cent on new buildings erected before the end of March 1953, and (3) permission to make an initial special depreciation allowance of 20 per cent on plant and machinery.

Exchange control

In its statement on industrial policy of April 1948, the Pakistan Government undertook to "allow facilities for the remittance of a reasonable proportion of profits to countries from which capital is drawn". No announcement has been made on the question of capital transfers. There is as yet no official interpretation of the term "a reasonable proportion of profits", nor of the priority which would be accorded such transfers in the event of exchange stringency.

/Conclusion

Conclusion

Commenting on the effectiveness of the Government's policy to induce foreign capital to enter Pakistan, the Pakistan Prime Minister remarked in his address to the first session of the Council of Industries in September 1949: "Advantage has been taken of this policy, but not to the extent which was expected. Conditions abroad which would induce investors to export capital in large blocks for investment in productive enterprises here have not so far been all created". From this statement, it would seem that, in the opinion of the Pakistan authorities, the existing policy towards foreign capital should be sufficiently effective if only conditions in the capital-exporting countries were more favourable.

Philippines

Although there are a number of restrictive features in the official policy of the Philippine Government affecting foreign investments, most, if not all, of them have been eliminated in the case of investments by United States nationals and enterprises. Prior to the establishment of the country's independence, United States investments in the Philippines were accorded equal treatment since the country was a United States possession. The 1935 Constitution, however, which affected other than United States nationals and enterprises, stipulated that a minimum of 60 per cent of the ownership of enterprises engaged in the exploitation of all natural resources and in the operation of public utilities should be in the hands of Philippine nationals or Philippine-owned enterprises. Following the establishment of Philippine independence in 1946, an executive agreement was concluded with the United States by which the constitution was amended, following a plebiscite, to provide that the exploitation of all natural resources and the operation of public utilities should be open to United States nationals and enterprises on the basis of equality with Philippine nationals and enterprises as well as on the basis of most-favoured-nation treatment. Under the same agreement trade between the two countries is on a reciprocally free basis for a period of eight years beginning in July 1946, with decreasing trade preferences for another twenty years thereafter. It was also agreed that no exchange control should be introduced in the Philippines affecting transfers to the United States without the prior approval of the United States, and the Philippine peso was to be stabilized in relation to the United States dollar.

/The constitutional

The constitutional restrictions referred to above, which have been removed in the case of United States nationals and business firms, remain effective in the case of all other foreign enterprises, except presumably when the latter assume the role of minority interests in joint operation with United States capital. Thus, generally speaking, non-American foreign direct investments are excluded from the extractive and mining industries, the generation of electric energy and the operation of other public utilities. Other restrictions refer to the ownership and lease of private and public agricultural land and, though not entirely directed at foreign investors, nevertheless affect them to a large degree. Apart from the constitutional provisions, several different land bills are now before the Philippine Congress. One of these would empower the Government to sell land belonging to foreigners by auction without the consent of the owners. Another would give the foreign land owners one year's grace to dispose of their property.

In addition to the restrictions on the ownership and utilization of public and private land which tend to militate against the operation by foreign enterprise of large plantations, the Philippine law also excludes from the retail trade all enterprises which are not owned by Filipinos to the extent of 75 per cent of their capital. While this may affect the direct distribution by foreign manufacturers of their own products on the retail level, the immediate objective appears to aim at supplanting Chinese retail business by Filipino enterprise. In the case of banks, 60 per cent of the share capital must be owned by Philippine nationals who must also constitute at least two-thirds of the directorate. Existing banks, however, do not have to conform to these requirements, provided a license is obtained from the Central Bank permitting them to continue in business.

Finally, another law was passed in January 1941 excluding all persons not nationals of the Philippines or of the United States from engaging in business in the public markets for rice, hemp and other goods. This law also appears to have affected mainly Chinese nationals.

The Philippine law also prohibits any person, association or company to operate or engage in any business unless 60 per cent of the permanent personnel, including officers, clerical workers and labourers consist of Philippine citizens.

The restrictions on foreign investments mentioned above do not appear to be

/derived

derived from any general policy to extend the economic activities of the Government at the expense of private enterprise. On the contrary, governmental pronouncements on industrial policy have always been to the effect that the government would initiate and develop only such ventures as private initiative and capital are unwilling or unable to undertake, in spite of the constitutional provision that "the State may, in the interest of national welfare and defense, establish and operate industries and means of transportation and communication, and upon payment of just compensation transfer to public ownership utilities and other private enterprises to be operated by the Government".1/ At one time, the Philippine Government in fact announced that it was prepared to lease, sell or place under private management all government-owned enterprises operating at a profit with the exception of those in cement-making and rice-marketing. It may be noted, however, that both the Philippine Relief and Trade Rehabilitation Administration, set up in August 1947 as a government trading company, and the National Development Company, created before the war to provide government investment in fields where private capital was not forthcoming and as a counterweight to foreign enterprise, have assumed considerable importance in certain industries, transportation, agriculture and wholesale trade.

Prior to the establishment of Philippine independence, United States investments in the area enjoyed special tax concessions arising from United States legislation exempting from United States income taxes income earned in the Philippines by United States enterprises the activities of which were substantially confined to that area. This concession lapsed with the establishment of the independent Philippine Republic. In general, the Philippine tax system does not discriminate against foreign enterprise, although special taxes apply to the mining industry in which foreign investments are substantial. In 1946 the Government announced a four-year tax holiday for all new enterprises approved by the executive authorities.

Although controls on imports were established in January 1949, free convertibility existed between the Philippine peso and the United States dollar until December 1949, when pressure on the balance of payments resulted in the establishment of exchange control, which was concurred in by the United States pursuant to the provisions of the executive agreement referred to above. The effect of this control on remittances relating to foreign investments has not yet been ascertained.

1/ Article XIII, Section 6.

B. LATIN AMERICA

Argentina

Private investment in Argentina is limited by a framework of state operation of "basic" industries and widespread governmental intervention in other areas of the economy through regulation of and direct participation in certain industries. The major expressions of this policy as it affects private foreign investment have been nationalization of public utilities, including transportation and communication enterprises, strict control of international capital movements and of the transfer of investment yields and the service of foreign loans, and efforts to attract foreign capital to enterprises, particularly manufacturing, which the Government deems appropriate for such investment.

The Argentine Constitution of 1949 provides, in Article 40, that concessions for the operation of public utilities may not be granted to private entities and that utilities in private hands shall be transferred to the State, by means of purchase or expropriations with prior indemnity. The President of Argentina stated to the opening session of the 1949 Congress that the Government will continue to nationalize all public utilities, including transport, electric power, gas and telephone systems. The Constitution contains the following provision for compensation:

> "The price of expropriation of public service concessionary undertakings shall be the original cost of the assets involved in operation, less the sums that may have been amortised during the period elapsed since the granting of the concession, and sums in excess of a reasonable profit, which shall also be considered as repayment of the capital invested."

The Constitution further provides that "the State may intervene in the economic domain and monopolize any given industry or activity to safeguard the general interest". In conformity with this principle the Government participates widely in various industries other than public utilities. The export of principal products is virtually monopolized by the official Argentine Trade Promotion Institute, which is also engaged in the import of equipment and certain other articles. The Government petroleum organization, known as the YPF, has long dominated the production and marketing of petroleum products; foreign companies operate only in distribution. Reinsurance activities are monopolized by the State. Legislation becoming effective in 1946 provided for governmental participation in "mixed" industrial enterprises. The government contribution

/can be in the

can be in the form of cash or special privileges such as concessions, monopoly rights, guarantee of profits or tax exemption. The Government has from time to time invited foreign interests to participate in such enterprises, offering special concessions made possible by extensive official control over the economy.

Except for industries reserved for exclusive or predominant state operation, the entry of foreign capital is limited only to a minor degree. No new charters for foreign banks are granted, however, although existing banks are allowed to continue operations. Insurance (except reinsurance) activities may be carried on by foreign companies, but they are subject to higher taxation rates than domestic companies; furthermore, all goods leaving or entering the country at the risk of Argentine enterprises must be insured by Argentine companies.

Argentine balance of payments difficulties have resulted in exchange control since 1931. A complex system of differential regulations for various types of international transactions involves the application of multiple exchange rates. As of 3 October 1949 the "free" market rate was 9.00 pesos per dollar compared with "preferential" rates of 3.73 and 5.37 pesos for essential imports and with a "basic" rate of 6.09 pesos for semi-essential imports. The inflow of foreign capital is subject to prior approval by the Central Bank.

The regulations applying to remittances of capital and earnings of foreign investments vary according to the date of entry of the capital.

Capital imported since the beginning of 1948 is treated, at least in principle, more liberally than capital invested in the country prior to that date. Regulations introduced in 1948 provide that earnings on such capital as well as principal may be transferred at the free market rate subject to availability of exchange. Reinvested earnings are counted as capital for this purpose.

Capital which entered the country between 8 July 1947 and the end of that year was, and still is, subject to special provisions. The transferable yield on short-term investment (maturing within twelve months) is limited to 5 per cent per annum and that on medium-term investment (with a maturity up to six years) to between 7 and 12 per cent (depending on the period of the investment); authorized transfers, however, have been much smaller. Repatriation of capital at the end of the investment period agreed upon is permitted; but special authorization of the Central Bank is required for retention of the right of repatriation and of annual remittances if the capital is reinvested at the end of the period. In

/the case of

the case of long-term investments (in excess of six years), repatriation and yield payments depend on special agreement in each case, providing for participation of Argentine capital in the enterprise concerned.

As to foreign capital which entered the country prior to 7 July 1947, there does not appear to have been any provision for the withdrawal of principal. The transfer of earnings of such capital is not subject to limitation, provided that foreign exchange is available; it will be observed, however, that few if any recent authorizations for the transfer of United States dollars are known to have been granted for this purpose.

While basic income tax rates are applied to income derived from Argentine sources without discrimination as to nationality of ownership, certain additional rates are applied to the remission of income abroad and to agricultural enterprises under absentee ownership, and special taxes are levied on foreign transportation companies engaged in international traffic between Argentina and other countries, foreign press services, foreign insurance companies and foreign motion picture enterprises. The income tax rate on both domestic and foreign corporations is 15 per cent of net earnings or of dividends declared, whichever is greater. An additional 5 per cent is collected on dividends remitted abroad. Any other class of income remitted or credited abroad is likewise subject to the total 20 per cent tax. Foreign corporations as well as Argentine individuals residing abroad are subject to a 30 per cent surcharge on income derived from agriculture and stock-raising. Foreign companies engaged in transport between Argentina and other countries pay 10 per cent of their gross revenue, except where international agreements provide otherwise.

While there is no general law in Argentina requiring a fixed percentage of domestic nationals to be employed in industrial enterprises, the "mixed" governmental-private enterprises referred to above must employ a minimum number of national workers, indicated in the charter of each enterprise. A similar trend towards greater utilization of domestic personnel is evident in other areas of the economy directly operated by the Government.

The President of Argentina has indicated in public addresses that the Government is disposed to co-operate with foreign private capital for development of the national economy. He has stated, however, that until the process of nationalization of public utilities is completed, concession contracts with

/private enterprises

private enterprises in this field will have to be revised to assure concrete benefits to the people, to avoid excessive profits, and to facilitate participation by Argentine interests on an equal, if not dominant, basis. The President is critical of the tendency of foreign direct investments in the past to engage in commercial activities offering exceptionally high profits and to seek security in public utilities in which minimum profits have frequently been guaranteed by the State, rather than in manufacturing. The official attitude, accordingly, is that foreign equity capital contributing to the diversification of the economy through the establishment of manufacturing enterprises is desirable, within the existing framework of state regulation of the economy.

Brazil

During the 1930's substantial restrictions were introduced on the participation of foreign capital in various sectors of the Brazilian economy both through constitutional provisions and specific legislation. With the adoption of the Constitution of 1946, however, this trend has been considerably modified. The new constitution establishes the general principle of equality of foreign and domestic nationals in matters affecting foreign investments. In a few fields such as aviation, radio broadcasting, coastal shipping and insurance, specific legislation continues to exclude or limit the extent of foreign ownership. In the more important fields of petroleum production, mining and hydroelectric power generation, previously reserved to nationals, foreign participation is permitted if effected through locally organized enterprises. The constitution also includes guarantees against expropriation without adequate compensation.

Significant as an indication of the more liberal spirit of the Constitution of 1946 towards foreign investment is the absence of a counterpart to Article 144 of the Constitution of 1937 which provided that "The Law will regulate the progressive nationalization of mines, mineral deposits and waterfalls or other sources of power, as well as those industries considered basic or essential to the economic or military defense of the Nation". No measures were taken to carry this Article into effect, and its omission from the 1946 Constitution may be taken as indicative of the reversal of trend in official policy.

Although the new Constitution provides that authorization for the exploitation of mineral resources may be granted to concerns incorporated in Brazil and to

/Brazilian

Brazilian nationals, no new mining code conforming to it has been enacted. The position of future foreign investments thus appears uncertain. The 1934 Constitution limited such authorization to nationals, but existing companies were exempted from this limitation. Some relaxation of this policy occurred in 1944 when a law was enacted permitting foreign nationals to own up to 50 per cent of the capital of domestically incorporated mining companies, provided specific authorization was granted.

Under the Constitution of 1946, petroleum concessions may be granted to corporations organized in Brazil as well as to Brazilian nationals. The emphasis of the Constitution of 1937 and of a law of 1938 dealing with petroleum has thus been changed: production of petroleum and ownership of refineries had previously been reserved to concerns owned exclusively by nationals. The status of future foreign investments will be determined by specific legislation, a draft bill for which was presented to Congress by the President in February 1948. Under this bill foreign capital would be permitted to engage in exploration and production of crude oil; refining and transportation for the domestic market would be limited to "mixed" corporations formed by State and private capital or to corporations in which at least 60 per cent of the voting shares are owned by nationals.

Provisions of the Constitution of 1946 dealing with hydroelectric power are similar to those for mining and petroleum. Whereas the 1937 Constitution limited operations in this industry to nationals, except for existing investments, they may now be conducted by companies locally organized regardless of nationality of ownership. In this case, however, intervening legislation had before 1946 liberalized the restriction somewhat by permitting new foreign investment at the Government's discretion.

A progressive liberalization of the provisions of the 1934 Constitution providing for eventual nationalization of banks has also taken place. A law of April 1941 provided for the liquidation of all foreign banks within five years, but this period was indefinitely extended in November of the same year. No provisions relating to foreign banking are contained in the present Constitution, which is likewise silent as regards insurance companies. In the case of the latter, however, the Ministry of Labour, with jurisdiction over insurance companies, has been applying legislation antedating the Constitution which prohibits licensing of new foreign insurance companies.

Policies regarding employment of foreigners have permitted the use of necessary foreign technical personnel, but the trend has been in the direction of replacement by nationals as training has progressed. Employment opportunities for nationals are safeguarded by legislation requiring that two-thirds of the employees of all commercial and industrial concerns must be nationals or aliens who have resided in the country more than ten years and are married to Brazilians or have Brazilian children; the same proportion of payrolls must be paid to such persons. Exemptions may be accorded for foreign technicians in the absence of qualified national personnel and otherwise "in special circumstances". Managers of foreign firms must have legal residence in Brazil, and foreign enterprises must assign powers of attorney to nationals. Brazilians and foreigners must receive equal pay for equal work. The practice of professions, which had been restricted to Brazilian citizens under the 1937 Constitution, is open to all nationalities under the Constitution of 1946. The Government's interest in training national personnel is indicated by reported provisions of recent concessions for operations of foreign-owned enterprises requiring that technical and administrative training be given to Brazilians with a view to eventual replacement of foreign nationals.

Although the basic legislative and constitutional provisions do not now present formidable barriers to private foreign investment in most fields, balance of payments difficulties seriously affect the possibility of transfers on account of foreign investments. Exchange controls have been applied to remittances of yields on investments with varying degrees of severity since 1931. Before 1946 the control of remittances was based on availability of exchange, with remittances of yields on foreign investments accorded a status below requirements for government obligations and imports. Since 1946, new regulations have been in force, setting upper limits on remittances of yield and principal; actual remittances may be reduced below these limits, however, owing to the allocation of available foreign exchange to payments granted higher priority. A maximum of 8 per cent of the registered capital can be transferred each year as interest, dividends or profits; capital repatriation is limited to 20 per cent annually. The yield transferred may exceed 8 per cent, but the capital withdrawal permitted is then reduced by an equivalent amount. The authorities have defined capital to include reinvested earnings for the purpose of calculating maximum remittances, and have also allowed the amount of the capital to be computed in the

/currency of the

currency of the capital-exporting country, thus providing some protection against devaluation of the Brazilian currency.

The shortage of foreign exchange has recently kept remittances well below these upper limits. First priority is given to government requirements and "essential imports". Remittances of dividends, profits and interest are included in the second category, and capital transfers in the fourth category. In 1948, for example, practically all available dollar exchange was reserved for first category requirements.

In general foreign enterprises are subject to the same taxes as domestic concerns. Taxes on business incomes are relatively low, ranging to a maximum of 15 per cent on incomes over 500,000 cruzeiros ($25,000). Public utility enterprises with profits not exceeding 12 per cent are taxed at the rate of 8 per cent of net income. The Brazilian income of foreign branch plants or individuals domiciled abroad is taxed at the source at the rate of 15 per cent of gross earnings in addition to normal income taxes, but profits of branch plants reinvested in industrial installations in Brazil are exempt from this additional tax.

The expansion of manufacturing industries has been fostered by protective tariffs on manufactured goods imported in competition with domestic articles, combined with lower tariff rates on raw materials and semi-manufactures, and by exemptions from, or reductions in, duties on capital equipment and raw materials needed by favoured industries. This policy has encouraged foreign and domestic investment alike in the sheltered industries.

Private foreign investments are also affected by the expansion of direct governmental participation in certain industries. This increased participation is connected with the attempt to quicken the pace of economic development, illustrated by the President's presentation to Congress in May 1948 of a five year development project known as the SALTE plan, covering the fields of health, food production, transportation and power. A large scale official programme for the rehabilitation and expansion of railways, already largely owned and operated by the Government, is contemplated. Expansion is also contemplated in development of hydroelectric power and petroleum. Other important fields of government participation have been coastwise shipping and the production of steel, iron ore, chemicals, motors, industrial alcohol and cement.

/The Brazilian

The Brazilian Government has given indications in recent months of a desire to attract foreign private investment. In 1948 a Joint Brazil-United States Technical Commission was formed, the terms of reference of which included the consideration of measures designed to encourage the flow of private capital to Brazil. The report of this Commission, issued in February 1949, contained a special annex prepared by a Brazilian Sub-commission recommending principles that should govern the future policy toward foreign investments. The Sub-Commission recommended that legislation be enacted to implement the liberal provisions of the Constitution of 1946 regarding nationality of ownership of enterprises. In the case of continued foreign exchange difficulties, exchange control is regarded as beneficial to foreign investment since it permits husbanding of resources making remittances on account of foreign capital possible after basic national needs have been met. Investments should be divided into "ordinary" and "favoured" categories so that more favourable treatment under exchange control regulations can be given to the latter so long as exchange stringencies persist; fiscal privileges should also be applied to the latter group, though no income tax exemptions should be considered. "Favoured" investments are broadly defined as those which contribute materially to the supply of foreign exchange and also those in industries considered essential to economic progress or which are highly productive. Reinvestment of earnings should be stimulated by being counted as new capital when the limit to remittances is computed. The Sub-commission also recommended that on investment law be adopted embodying the liberal principles recommended by it so as to give assurances to the foreign investor of "fair treatment, liberty, stimulus and guarantee, without which no new country can attract capital, whatever its possibilities of development". Following completion of the report of the Joint Commission, the Governments of Brazil and the United States announced in May 1949 their intention to begin negotiation of a treaty to stimulate the flow of private foreign investment in Brazil.

Chile

Restriction on nationality of ownership is a limiting factor on capital imports only with respect to a few industries, including fishing, insurance, petroleum, coastal shipping and air transport. However, private investment, both domestic and foreign, is subject to numerous restraints and stimulants applied alike to both. All investment is subject to official scrutiny by virtue of a law

aiming at preventing over-production in the industries concerned. Broad powers regulating price and production are exercised in industries producing articles of prime necessity. Extensive social legislation provides for mandatory employment of Chileans to the extent of 85 per cent of staffs and payrolls (except for technicians not locally available), for contributions to social insurance systems and for profit-sharing with employees.

Exchange control has been applied in such a way as to permit the conversion of profits and other funds associated with foreign investment. The large mining companies, representing the majority of foreign investments, are allowed to retain outside of the exchange control system all of their export proceeds. However, in order to pay local costs and taxes they have had to sell foreign currency at the rate of 19.37 pesos per dollar[1/] as compared with rates ranging from 31 to 43 pesos applicable to most exports. The most favourable legal buying rate of 43 pesos per dollar has been applied to the conversion of all new capital upon entry. Profits on investment in industries other than mining may be remitted in their entirety and capital at the rate of 20 - 30 per cent of the investment annually by agreement with the financial authorities. The selling rate applied to these transactions has been 43.10, which corresponds to the buying rate of 43 for all new capital inflow, equal to the selling rate for the majority of imports. Establishment in the near future of a single exchange rate and related fiscal measures was announced on 7 December 1949. This reform would eliminate the "penalty" rate for the portion of mining company proceeds that has to be sold against pesos. Presumably additional taxation would be levied to replace the income previously derived by the Government from the use of multiple rates.

An "additional" tax of 16.9 per cent on the income of foreign-owned companies applies over and above the normal tax on business incomes. The system of income and excess profits taxation is complex: rates on mining, which is largely foreign-owned, are considerably higher than on other industries; on the other hand, mining and manufacturing industries can obtain some measure of tax exemption. Profits after taxes in excess of 15 per cent of the invested capital must be reinvested in the original enterprise, in other domestic enterprises, or in bonds of the Government's Development Corporation. However, new industries,

1/ The rates here quoted were those in force before the adoption of temporary new rates on 10 January 1950, preceding the planned unification of exchange rates.

/including mining,

including mining, may be exempted from this requirement. Investment in manufacturing enterprises has also been encouraged by protection through the tariff, exchange control and quantitative import restrictions.

Export of nitrates and iodine is monopolized by the State through a public corporation in which private producers are represented. This corporation assigns production quotas, buys production at cost and distributes profits - 25 per cent to the Government and 75 per cent to the producers. Petroleum exploitation and refining has also been reserved as a State monopoly, with no private participation except for exploratory work on a contract basis; but private petroleum imports, in competition with the State, are permitted. The State also participates predominantly in the railways and in the construction of new electric power facilities.

The widespread participation of the governmental Development Corporation is concentrated in the production of steel, the generation of electricity, the extraction of petroleum, the import and distribution of agricultural equipment, and in irrigation. The Corporation makes loan capital available to industries and invests directly in new or established enterprises. Its stated policy is to sell its equity holdings to private investors as soon as the enterprises in question have achieved economic and financial consolidation.

Chilean authorities have welcomed private foreign investment, particularly in association with domestic private as well as government capital, in virtually all major industries. This is true of continued investment in the traditional field of mining as well as in manufacturing industries. The President of the Republic has stated that foreign investors may be assured of treatment "which is just, free from discrimination with respect to nationality, and in an atmosphere of democratic life which is a guaranty of stability and security". He has further indicated that his Government is prepared to enter into agreements with capital-exporting countries to stimulate the flow of foreign capital.

Colombia

There are no legal restrictions on the ownership of Colombian enterprises by foreigners, except in the case of airlines and coastal shipping: 51 per cent of the shares of airlines operating in the country must belong to Colombian nationals and coastal shipping is reserved for Colombian nationals or corporations in which at least 60 per cent of the shares are owned by Colombian nationals. The

/constitution contains

constitution contains provisions according foreign nationals the same civil rights as Colombians, but provides that the law, for reasons of public interest, may curtail these rights. Similarly the constitution provides for due process of law and prior compensation in the event of expropriation, but authorizes the legislature in special circumstances to decide that there shall be no compensation.

Relatively few industries are exclusively reserved for government enterprise, but the government is predominant in transportation, communications and electric power. These enterprises have in the main been acquired by the government from private owners by negotiation or expropriation. Through the Institute of Industrial Development, a government agency, the government has participated in enterprises producing iron, steel, lead, zinc, salt, tires, glass and other products. It has also joined with the Governments of Venezuela and Ecuador in an ocean shipping enterprise. In several instances these enterprises have been partly financed by private foreign capital, but controlling interests have been retained by the Government.

Under an exchange control regulation of August 1947, the import of capital in any form is subject to prior approval by the authorities. Capital imported between February 1935 and August 1947 and earnings on such capital may be transferred abroad at the official rate upon authorization. Remittances on account of capital entering prior to February 1935 may, however, be made at the "free" rate.1/ Capital imported after August 1947 is entitled to transfer of earnings at the official rate, beginning six months after the date of entry, provided it is registered upon entry, is invested in approved enterprises, and that the investment is made for a minimum of five years. Repatriation of the original capital of such investments requires specific authorization and may be made only on condition that the enterprise is liquidated or that the transfer will not adversely affect the stability of the enterprise. The allocation of exchange is favourable to foreign investments; remittances of the yield on such investments are second only to payments on the external debt, and come before payments for imports.

Colombia's tax legislation involves no formal discrimination against foreign investments. Exemptions from the property tax have been accorded to certain new industrial enterprises, domestic as well as foreign.

1/ The average "free" rate in November 1949 was 2.895 pesos to the dollar, as compared with the official rate of 1.96.

/Labour

Labour legislation provides that no more than 10 per cent of the wage earners and no more than 20 per cent of salaried employees may be foreign nationals; managerial personnel, however, is exempted from this rule. Similarly, 80 per cent of wages and 70 per cent of salaries must go to Colombian nationals. Exceptions are provided in the case of specialized technical personnel, but only for the period required to train Colombian replacements. The Petroleum Law of 1931 provides that preference in employment in the petroleum industry shall be given to Colombians both in the category of manual workers and among the more highly skilled employees. Nationals are to be paid at the same rate as foreigners for equal work.

Cuba

Governmental intervention in the Cuban economy has been on a limited scale, being confined largely to the marketing of sugar, some anti-cyclical public works programmes, and temporary management of public utilities and occasionally other industries through a "government intervention" in periods of labour-management difficulty. There has been no government participation in enterprises in any important sector of the economy.

The policy of non-intervention in the private economy is in general paralleled by a policy according foreign investors the same opportunities and status as nationals. According to the Constitution of 1940, foreigners are granted the same right as nationals to engage in "agricultural, industrial, commercial, banking, and other enterprises or business".

For the most part the principle of "national treatment" applies to the operation of foreign-owned enterprises. Taxation in general is on a non-discriminatory basis, with the qualification that foreign companies may be required to pay a special tax of 3.6 per cent of their total gross receipts in Cuba should the Government establish to its own satisfaction that the profits of the local branch or subsidiary are understated as the result of intercompany transactions. There is also a tax of 2 per cent levied on all remittances abroad, including income and capital of foreign investments.

Except for a brief period in 1939-42 remittances abroad have been free of exchange control of any sort. Until 1934 the effective internal currency was the United States dollar. Since that date peso certificates have circulated side-by-side with United States currency. Maintenance of parity with the dollar has been facilitated by substantial balance of payments surpluses during the war and post-war years.

Cuban legislation concerning the employment of foreign personnel affects the operation of foreign investments. A Law for the Nationalization of Labour of 1933 requires that at least 50 per cent of the payroll of any enterprise be paid to native Cubans, and that at least 50 per cent of the wage earning and salaried personnel be native Cubans. These minima, moreover, apply not only to each enterprise as a whole, but within each enterprise to each of a number of established categories (referring to the kind of work performed) according to which the personnel is classified. Vacancies must be filled by native Cubans if qualified personnel is available, and, in the case of release of employees, aliens must be discharged first. Foreign technicians can be employed only when it is shown that no Cuban is qualified and available. Technicians permitted by the Cuban Ministry of Labour to enter Cuba generally can stay for only one year and must train Cuban apprentices to replace them. This permission may be renewed for two additional years provided no replacements are available.

Mexico

Private investment in Mexico is subject to widespread intervention of the government. The Constitution of 1917 embodies numerous restrictions on property rights and vests in the State title to all lands, waters and subsoil and surface deposits. Foreigners can obtain rights to own or work lands, waters and subsoil deposits only by agreeing to consider themselves Mexicans in respect to such rights and not to invoke the protection of their governments in matters relating thereto.

Foreign investment requires, furthermore, the specific permission of the Ministry of Foreign Relations. This permission may carry with it a requirement that 51 per cent of the capital stock be owned by Mexican nationals and that the majority of directors or partners of any individual enterprise be Mexicans. While each application is judged on an individual basis, the requirement of 51 per cent domestic capital participation has been confined in practice to a limited number of industries: radio broadcasting; motion picture production, distribution and exhibition; domestic air transportation; urban and interurban surface transportation; fishing; soft drinks; and publishing. The Government's power to pass upon individual foreign investments is supplemented by powers under a Law of Monopolies to control investment and production generally in the interest of avoiding excessive competition or over-production. In general, the requirement

/that permission

that permission must be obtained for foreign investment has been applied liberally, particularly in manufacturing, both as regards securing necessary permission and the requirement of domestic participation.

An Expropriation Law has been the basis for expropriations of agrarian properties, railways and petroleum interests. Foreign investment in agricultural properties has been greatly reduced by application of the policy of expropriating large estates and redistributing holdings, principally to "ejidos" or communal landholding groups. Investment in this field is limited by the size of holdings allowed under the Agrarian Code and by the expropriation of properties for redistribution as "ejidos". Private investment in railways has also been reduced by the policy of governmental acquisition and expropriation of private interests. At present, 85 per cent of the railway system is owned by the government. Mexican petroleum legislation precludes the acquisition by foreigners of petroleum properties but has been interpreted to permit participation in drilling activities under contract with Petróleos Mexicanos (Pemex), the government corporation which operates the nation's petroleum industry. Several such contracts have recently been negotiated. Under these arrangements Pemex operates wells successfully drilled, the foreign enterprise being reimbursed for costs and receiving profits at an agreed rate from the production obtained.

In connexion with the question of expropriation attention may be drawn to the position taken by Mexico at the Ninth International Conference of American States, held at Bogota, Colombia in 1948. Article 25 of the draft economic agreement signed at the Conference establishes the principles to govern compensation in the event of expropriation of foreign investments. The Mexican government expressed a reservation to the Article to the effect that the principle established should be subordinated to the constitutional laws of the expropriating country. Similar reservations were made by other governments, including Argentina, Guatemala, Uruguay and Venezuela.

Participation by foreign interests in certain other industries is also limited. Foreign insurance and commercial banking companies, while permitted to establish branches upon securing special authorization, have liquidated most of their investments pursuant to legislation of the middle 1930's. Objection has centered principally on investment requirements for reserves; furthermore, capital requirements for foreign insurance companies are higher than for domestic

/companies.

companies. Foreigners are virtually excluded from participating in concessions granted for the operation of automotive transport services on federal highways. Also, the captains, owners and officers of national public service merchant ships must be Mexicans.

There has been no exchange control and profits and other funds associated with foreign investment have been freely remitted. Balance of payments pressures in the post-war period have resulted, however, in the prohibition of imports of luxury goods, increased tariffs, and a devaluation of the peso from a rate of 4.85 to 8.65 pesos to the dollar (the latter rate having been fixed on 17 June 1949) in addition to internal fiscal and credit policies designed to reduce inflationary pressures.

Foreign investment is also affected by various general economic controls relating also to domestic investment. Enterprises employing more than five workers are required to employ at least 90 per cent Mexican personnel, but this restriction does not apply to managers, directors, administrators, superintendents or the general heads of concerns. The immigration of labourers is not permitted, and technicians may be admitted only when qualified persons are not available locally.

Taxation is applied to foreigners and nationals alike on a non-disciminatory basis. The burden of taxation is relatively light, except in mining, and liberal tax-exemption privileges may be obtained by "new or necessary" manufacturing industries. Mining, controlled largely by foreign interests, is subject to higher income tax rates than other business income and to a special tax on the value of production, which representatives of the industry contend has had the effect of stimulating excessive exploitation of high-grade ores. Manufacturing industries have been stimulated by a protection, particularly in the post-war period, through increased tariffs on competitive products, quantitative import controls and exemption from duty on raw materials and capital equipment imported by favoured industries.

The government participates directly in numerous manufacturing industries through a development corporation, Nacional Financiera, S.A. This organization, originally set up to create an internal market for bonds to finance public works programmes, has become chiefly an instrument for financing industrial development. Its intervention in the economy is intended to supplement and stimulate, rather

/than replace,

than replace, private initiative and investment. Similarly, the Federal Electricity Commission participates directly in the generation of electric power, accounting for about 20 per cent of the total investment in this field.

Manufacturing has been made the field most attractive to private foreign investment through official policies. These policies have been applied to insure a low rate of taxation, protection against foreign competition and the possibility of governmental financial assistance. Governmental direct participation has been supplementary, rather than competitive. Nationalization and expropriatory activities have been limited to petroleum, agriculture and certain transportation and communications industries. Regulations on permission to invest and nationality of employees have not been seriously limiting factors; and, as noted above, earnings and other funds may be freely remitted in the absence of exchange control.

Peru

The scope of private investment in Peru has been affected by the establishment of various types of state enterprise. In fields not so affected, there is recognition of the need for foreign investment as evidenced by a general lack of restrictions on the entry of private capital and by certain features of the exchange control offering limited assurance of transfer of earnings and capital of foreign investments.

The government maintains state monopolies on the distribution of such products as salt, tobacco, guano (a fertilizer) and industrial alcohol and in addition participates directly in the manufacture of these products as well as in the production and distribution of petroleum. Other government enterprises exist in coal mining, construction, hydroelectric development and the distribution of foodstuffs.

Aside from activities exclusively reserved for state operation, foreign capital may enter practically all sectors of the economy on the same basis as domestic capital, with important limitations as regards insurance, shipping and petroleum. A majority of the shares of insurance companies operating in Peru must be owned by Peruvians, who must also constitute a majority of the directors. Seventy-five per cent of the shares of shipping companies incorporated in Peru must be domestically owned, and 25 per cent of the shares of oil companies must be offered to Peruvian investors or to the Peruvian Government. There appears to be no discrimination against foreign enterprise in the granting of mining concessions.

/Generally low

Generally low taxes on business incomes apply to foreign and domestic enterprises alike. Foreign enterprises are subject to a "complementary" tax on income amounting to 12 per cent of net profits and interest paid by subsidiary companies to main offices abroad.

Labour regulations require that not less than 80 per cent of all persons employed in an enterprise must be nationals of Peru, and 80 per cent of the payroll must be paid to such nationals. Management personnel is not affected by this regulation and there is no special limitation on the employment of technical personnel.

Pursuant to a decree of 13 December 1947 a system of authorized minimum remittances on account of new foreign investments was established within the existing exchange controls. Under this arrangement, capital in the form of foreign currency or equipment must be licensed upon entry. Approval for the investment is contingent upon proof that the capital will be invested within the country for the stimulation of national production, and the investment must be made for a period of not less than five years. Among the criteria used in judging the acceptability of new investments are whether they will increase exports or replace imports and whether they will compete "uneconomically" with existing investments in the country. Foreign investors are required to sign an undertaking renouncing recourse to invervention by their home government in connexion with the investment authorized. When granting permission for a new investment, the authorities specify the amount, not less than 10 per cent of the capital involved, which may be remitted each year as interest, dividends or withdrawal of capital. The decree provides that incoming capital should be transferred at the official rate of exchange and that authorized remittances should be made at the same rate. Prior to November 1949 the exchange control authorities maintained a system of multiple rates, introduced early in 1945, under which the official rate was 6.50 soles per dollar and the "certificate" rate and the "free" rate were 16.18 and 16.82 soles per dollar respectively. Prior to November 1949 a complex set of rules affected the remittances of foreign enterprises under this sytem. Foreign enterprises engaged in export to the dollar area apparently were required to sell 55 per cent of the foreign exchange they received at the rate of 16.18 soles per dollar and 45 per cent at the rate of 6.50 soles, except mining companies which were entitled to the 16.18 rate for the entire amount of their proceeds.

/In December 1948

In December 1948 the provisions of the law of 13 December 1947 affecting transfers arising from foreign investments were suspended. Under the new arrangements incoming capital can be transferred through transactions in the free market; the yield of investments is transferable without license in the free market; capital payments, if specifically authorized, may be made at the certificate rate, or, if not so authorized, at the free rate without limitation. The abandonment of the official parity in November 1949 thus does not affect financial transfers.

Uruguay

The Uruguayan Government takes a very active part in business, usually through autonomous state entities which in some cases are endowed with exclusive rights and in others compete with private enterprises. The State Insurance Bank, created in 1911, is empowered to monopolize all forms of insurance risks. This monopoly power has been invoked only in certain lines, but the Bank engaged in all classes of insurance. The Administración Nacional de Combustibles, Alcohol, y Portland (ANCAP) was established in 1931, and was authorized to exercise a monopoly in the import, manufacture and sale of fuels, alcoholic beverages and cement. At present ANCAP monopolizes the refining, but not the import of crude petroleum, the import and sale of coal, and the import and sale of cement for public works. It also manufactures alcoholic beverages. Frigorífico Nacional, the state packing plant, was organized under a law of 6 September 1925, and exercises a monopoly in the slaughter of animals for the meat supply of the City of Montevideo. A portion (23 per cent) of the export market for meat is also allocated to this enterprise. The Administración General de las Usinas y los Teléfonos del Estado (UTE), established in 1912, is empowered with a monopoly right in the supply of electric light and power and of telephone service throughout the country. The State Railway Administration now owns and operates all the railways of the country. The National Port Administration monopolizes all services at the port of Montevideo and, in addition, manages the other ports of the country. Other commercial enterprises of the Government include a monopoly in telegraph services, a commercial radio service, operation of fishing trawlers and processing and marketing of fishery products, and manufacture and sale of fertilizers. In addition to the central bank, the Government owns the Mortgage Bank of Uruguay, which has a monopoly in the issue of bonds and mortgages against the security of real property.

/In fields not

In fields not reserved to the State, foreigners generally have the right to own, buy, sell or otherwise dispose of any property, and to develop and conduct any kind of commercial or industrial enterprise that Uruguayan nationals may own, develop and conduct. Moreover, there is no regulation of the extent to which foreign capital may participate in any enterprise that may be conducted by private interests. One exception derives from the war-time restrictions against nationals of enemy countries. Another exception relates more to domicile than to nationality: only Uruguayan citizens and companies domiciled in Uruguay are eligible to obtain licenses for surveying mineral resources.

Uruguayan taxation applies to foreigners and nationals without discrimination, with certain minor exceptions.

Control of foreign exchange transactions has been exercised in one form or another since 1931. The exchange control system has been primarily concerned with transactions arising from the exportation and importation of commodities. Transactions in foreign currencies arising from the investment of foreign capital in the country and from the payment of yields on invested foreign capital are, and for the past several years have been, carried out in the legal free market, unaffected by official intervention except in cases where the foreign currency involved is that of a country with which Uruguay has entered into a payments agreement. Such agreements have been concluded with Argentina, Belgium-Luxembourg, Western Germany, Italy, the Netherlands, France, Sweden, Yugoslavia and the United Kingdom. Remittances to these countries on capital account require the prior approval of the Bank of the Republic of Uruguay. In addition, there is a "gentleman's agreement" between the Bank of the Republic and other banks under which the latter undertake to avoid remittances for speculation and other questionable purposes, and to consult with the Bank of the Republic in respect to unusually large transactions.

Extensive labour legislation regulates the conditions of work, but ordinary commercial and industrial enterprises are not required to employ a fixed percentage minimum of Uruguayan nationals. However, organizations which will employ a large number of personnel are sometimes required, under a special clause in their charter, to engage a certain number of Uruguayans, which may vary from 60 to 90 per cent. There is no restriction on the immigration or employment of foreign technical, managerial or administrative personnel, or members of the boards of directors, of industrial or commercial enterprises.

/As indicated

As indicated in Part I, Uruguay has been the first Latin American Republic to enter into a bilateral treaty with the United States designed to encourage the flow of capital, skills and technological assistance to promote industrial, commercial and general economic development. This "Treaty of Friendship, Commerce and Economic Development", signed by the United States and Uruguay in Montevideo on 23 November 1949, must be ratified by the Congresses of both countries to become effective. Implementation of the undertakings embodied in the treaty, will involve no important change in the laws, regulations and policies of Uruguay affecting private foreign investment from the United States.

Venezuela

The salient features of Venezuelan economic policy as it affects private foreign investment are equal opportunity for foreign and domestic investment in most fields and a system of taxation based on the principle that half of the net profits from the petroleum industry, the country's principal economic activity, shall accrue to the State.

Direct governmental participation in business is relatively limited. However, the government has, through various official agencies, participated in air transport, shipping, and the distribution of essential foodstuffs. Under the Venezuelan Constitution the same rights are granted to foreigners as to nationals with respect to investment in industrial, agricultural, commercial, and mining activities. In the case of banking and petroleum concessions foreign participation must be through enterprises organized under the laws of Venezuela.

Under the income tax legislation of November 1948 the government receives at least 50 per cent of the net profits of the principal mining and oil companies, which are foreign-owned. Such enterprises pay royalties and normal taxes on business income and are subject, in addition, to a tax designed to achieve the stipulated division of profits. If annual profits are less than 10 per cent of the value of the investment, however, the last-mentioned tax is not levied. Apart from this, taxation is generally non-discriminatory, although the personal income tax is slightly higher for non-residents than for residents. Business income taxes are characterized by progressive surtax rates ranging up to 26 per cent of income in the highest bracket, but moderate reductions are allowed in the higher surtaxes for reinvested earnings. It will be noted that the progressive surtax rates depend only on size of income and not rate of return on

/investment

investment and to that extent may discriminate against foreign enterprises should these tend to be larger than domestic.

Another significant aspect of Venezuela's policy affecting foreign investments is the requirement that a portion of the crude oil extracted be refined within the country. Under the concession legislation of 1943 new concessionaires have to refine within the country the equivalent of one-tenth of the production from the concession and undertake that none of the remaining production be refined in the Caribbean area outside of Venezuela. Exemption from import duty on refining equipment is granted to facilitate the operation of the refineries.

In general, Venezuela has imposed no special restriction on the transfer of funds accruing from foreign investments. For some years the petroleum companies have been required, however, to purchase Venezuelan currency for their local expenses at 3.09 bolivares per dollar as compared with the official rate of 3.35 bolivares per dollar. Exporters of other products have no obligation to surrender exchange to the authorities and acquire local currency requirements at the official rate, and at preferential rates for certain favoured export products such as coffee and cacao.

Labour regulations require that at least 75 per cent of salaried employees and labourers in any enterprise be nationals of Venezuela, but a temporary reduction of this percentage may be authorized. Foremen and other employees, other than specially qualified technical experts, that are in direct contact with workers must be Venezuelans. No wage differentials are permitted because of nationality.

/C. THE MIDDLE

C. THE MIDDLE EAST

In the Middle East legislation dealing specifically with foreign investments and statements which clarify the policy pursued with regard to such investments are the exception rather than the rule. This is particularly true of countries in which foreign investments are engaged chiefly in the extraction of petroleum and in which the main expression of policy is found in the terms of specific concessions for the exploitation of that product. In Egypt and Turkey, however, numerous regulations have established what may be called a general framework of policy relating to foreign investment. More recently, the Government of Israel has introduced legislation aimed at establishing a favourable "climate" for private foreign investment.1/

Restrictions on entry and operation of foreign enterprises

The granting of concessions for engaging in petroleum and other extractive industries is usually subject to specific arrangements in each case, the general character of which is described below. Outside the extractive industry, foreign enterprise appears to be free to engage in a wide range of activities, subject in a few cases to specific legislation relating to the participation of domestic capital and personnel.

1/ In December 1949 a "Bill for the Encouragement of Captial Investments" was introduced into the Israeli Parliament, according a number of privileges to investments in "authorized establishments". These privileges mainly consist of (1) exemption from real estate taxes for five years, a relatively low income tax on dividends from authorized investments, and special amortization allowances in computing the taxable income of new enterprises, (2) exemption from customs duties on imported raw materials and equipment, and (3) special transfer facilities for foreign investors. By "authorized establishments" are meant all enterprises which in the opinion of the authorities would contribute to the development of the country's productive capacity, the absorption of mass immigration, the increase of its exports and decrease of its imports, the rational distribution of the population and the planned exploitation of Israel's natural resources.

/A few

A few instances of minor limitations on entry may be noted. The acquisition of land sometimes requires special governmental permission, as in the case of Lebanon. In Iran, a foreigner may not engage in the purchase and sale of real estate as a business and may not own any real estate except his residence, his place of business, and one warehouse. In Egypt, a bill restricting the acquisition of agricultural land by foreigners has recently been introduced. No restriction on foreign ownership of land appears to apply in Israel. The establishment of foreign banks and insurance companies often requires special permission and the operation of such enterprises may be subject to special requirements.

Restriction of the scope of operations of foreign capital as a result of a general limitation of private enterprise by the State and a corresponding expansion of the latter's economic activities, does not appear to be a common feature of the Middle Eastern countries. An exception to this general rule, however, is Turkey, where the Government reserves to itself the right to develop heavy industries, transportation and public utilities and where entry by private enterprise into an established industry and the establishment of new industries are allegedly often hampered by the competition of government enterprises enjoying various subsidies. To a smaller extent this situation exists also in Iran. While other forms of government intervention, such as import and export controls, are prevalent, they exist more as ad hoc measures for the correction of balance of payments and other difficulties than as a permanent policy of government control.

Restrictions specifically affecting the operations of foreign enterprises are found in some countries. In Iran a law was passed in June 1948 limiting the granting of import licences to Iranians or to companies owned entirely by them. In Turkey until June 1947, reinvestment of profits by foreign enterprises was subject to government approval. In the case of Israel at least 30 per cent of the capital transfers into the country by established enterprises must be in cash, the import of goods thus representing not more than 70 per cent.

Policies regarding the participation of domestic capital and personnel are fairly liberal in most of the countries in the region. With Egypt as probably the sole exception, there is generally no legal requirement for the participation of local capital. The same is also true of participation in

/control.

control. The Lebanese law stipulates that one-third of the directors of a company incorporated in Lebanon must be Lebanese nationals. But foreign enterprises may freely establish branches in the country on the condition that a resident Lebanese representative is appointed. Similar restrictions do not exist in certain other countries such as Syria, Turkey, Iran and Israel. In Egypt, however, the formal restrictions appear rather rigid. The Company Law of August 1947 limited the number of foreign directors in a company to 25 per cent of the total number, and the participation of domestic capital was fixed at a minimum of 51 per cent of the shares both in new enterprises and in new issues of established businesses. However, such requirements may be waived by administrative action, and it is reported that the Government is considering a revision of these requirements establishing a maximum of 40 per cent of foreign directors and a minimum of 40 per cent of domestic capital.

In respect of the employment of domestic labour, requirements are generally not very restrictive. In Syria and Lebanon, however, restrictions are applied on the employment of unskilled foreign labourers. In Turkey, in addition to the provision that unskilled labour must be recruited among Turkish nationals, the use of foreign technical workers is contingent upon payment of a special semi-annual fee. This requirement does not apply to the personnel employed by Turkish branches of foreign companies, but the exception appears nullified by a requirement that any firm whose business activity is confined mostly to Turkey must be registered as a Turkish company.

Egypt again provides a contrast to the generally liberal policies. The Egyptian Company Law of 1947 stipulates that at least 75 per cent of the administrative or clerical workers must be Egyptian nationals who shall receive a minimum of 65 per cent of the total salary paid to this category of employees. Furthermore, not less than 90 per cent of the labourers employed must be Egyptian nationals, receiving at least 80 per cent of the payroll in question. At the time of enactment of the Company Law it was ruled that full compliance to these provisions should be established within three years, one-third of the requirements to be fulfilled every year. The establishment of a minimum percentage of employment for domestic labour has so far not been coupled with an explicit insistence on the training of local personnel by foreign enterprises. The employment of foreign managerial and technical staff is not subject to limitation.

/Concessions

Concessions for petroleum extraction and mining

In countries like Iran, Iraq, Saudi Arabia and some of the Sheikdoms, petroleum is the only major industry which has attracted foreign investment on a large scale. Conditions under which such investments have been made are defined in concession contracts and are little affected by policies of a general nature, except in certain instances by measures of exchange control. Generally speaking, the major oil-producing countries in the Middle East do not at present have occasion to formulate a policy towards foreign investment except insofar as a revision of existing concession contracts may be contemplated. In Iran, however, a law of 1947 forbade the granting of new petroleum concessions to foreign interests for a period of five years pending a thorough investigation of oil resources. In Syria the granting of new mining concessions has been suspended pending the passage of a new mining law.

While the terms of individual petroleum concession contracts differ, the subjects covered by them, in addition to the duration of the concession, the area covered, and the installation rights of the company and the right of domain of the concession-granting country, include chiefly (1) the financial obligations of the company in terms of lump sum payments, annual rentals, royalties and sometimes share of profit, (2) the minimum amount of drilling which must be carried out over a period of years before oil is produced on a commercial scale, and (3) the supply of oil by the company for local use either free of charge or at a price lower than the market price. Sometimes, as in Saudi Arabia, the concession-granting country may undertake to give up any claim on the foreign exchange proceeds of the oil exports. Furthermore, full exemption from taxation is sometimes accorded by the concession-granting country in consideration for an agreed schedule of royalties.

An important factor affecting the rate of profits on foreign investments in some cases is the rate of exchange applying to the conversion of such of the export proceeds as the oil companies require to meet local expenses. The Anglo-Iranian Oil Company, for example, is required to sell such exchange at the rate of 32 rials to the dollar as against the usual rate for exports of approximately 45 rials to the dollar.

Exchange control

With respect to exchange control on remittances arising from foreign investments, the countries of this area fall into three broad groups. Insofar as petroleum investments are concerned the situation described above applies, the main issue in most cases being the rate at which local currency can be acquired by foreign companies for current costs, royalties and other local requirements.[1] A second type of arrangement exists in countries like Syria and Lebanon in which transfer at the official rate of exchange is more or less restricted, but transfer at the officially tolerated free rate may be made by foreign investors as well as others, unless the free rate is considered excessively high. In several other countries, such as Turkey, Egypt and Israel, a more comprehensive control covers all outward remittances at least to "hard-currency" areas, and the question is largely one of the degree of priority that is granted for remittances by foreign investors.

Prior to May 1947, foreign firms in Turkey were allowed to transfer their profits abroad only by exporting certain Turkish products. The list of these commodities was revised from time to time. Since then, however, the Ministry of Commerce has been allowed to guarantee transfer of profit and capital by foreign investors, retaining discretion as to the amounts to be transferred, however. More recently, the Government was reported to be considering legislation authorizing the Minister of Finance to guarantee the repayment of foreign loans negotiated by private Turkish interests with either private or governmental creditors up to an amount of T₺ 300 million ($107 million).

The Government of Iran announced in 1947 its readiness to guarantee the transfer of "reasonable" amounts of investment yields and capital withdrawals.

1/ Apart from the question of the rate of exchange applying to export proceeds, United States oil companies operating in the Middle East and selling a large portion of their output for sterling are faced with the problem of the extent to which such sterling receipts may be converted into dollars for payment of profits and for purchase of equipment. In recent months such conversion has been increasingly limited.

/In Israel

In Israel, recently proposed legislation would permit the transfer of interest profits and "depreciation" at an annual rate of 10 per cent of the capital invested in the case of "authorized establishments".

In the case of Egypt restrictions on remittances, at least to the dollar area, have been severe. Under the terms of an exchange control law of 1947 the income accruing to foreign enterprises is placed in blocked accounts and can be transferred in whole or in part only after approval in each case. It is reported that except for one or two special arrangements, applications for transfer of profits to the United States have been denied.

Other policies

In some countries, for example Iran and Israel, official statements of policy indicate either explicitly or implicitly that foreign investors who are permitted entry would enjoy the same status as national enterprises. The protective tariff is often mentioned as a special attraction both to domestic enterprises and to foreign investors. So is tax relief for new enterprises and other privileges.[1/] No discrimination in taxation against foreign investments as such is generally found in the region, although in Egypt foreign investors may be adversely affected inasmuch as earnings and capitalization of units outside the country affect the computation of local tax liabilities. Levels of taxation in the region do not appear to be heavy, and, in the case of oil-producing countries, taxation is often excluded by provisions in the concession contracts.

1/ The Israeli bill of December 1949, for instance, provides for the exemption of buildings constructed since the establishment of the new State from the urban or rural property tax for five years, an income tax of not more than 25 per cent on dividends paid by "authorized establishments", permissible amortization deductions in new enterprises at double the present rate for the first three years, and at 150 per cent of the present rate for the two subsequent years.

/D. BRITISH

D. BRITISH COLONIAL TERRITORIES 1/

Information on legislation and other measures affecting foreign investment in British Colonial territories, based on a memorandum prepared by the Colonial Office of the United Kingdom Government, has been made available to the United Nations Secretariat by the United Kingdom Delegation. The following account, including the material quoted, is derived from this source.

Exchange Control and Import Licensing

A number of exchange control and import licensing measures which aim at safeguarding the balance of payments position of the Sterling Area are uniformly in force throughout the United Kingdom and the Colonies. It is stressed that these controls are not intended and are not used to discriminate against foreign investment as such, but they affect the terms and conditions under which new investments may be made as well as the status of existing investments.

The policies toward foreign investments in the light of balance of payments considerations are described in the following terms:

> "In both the United Kingdom and the Colonies ... if any resident, including any resident branch, subsidiary etc. of any foreign company sought to borrow either in foreign currency or sterling for investment purposes, it could only do so with the prior permission of the appropriate authorities. This procedure is followed because investment by non-residents involves a contingent liability, for which exchange is normally made available at the appropriate time, for the payment of dividends, interest and repayment of capital according to the terms of issue, and it is necessary to ensure that such contingent liability is not contracted on terms unfavourable to the Scheduled Territories on Exchange Control grounds. 2/ Particularly, no provision would be allowed in the financial arrangements relating to such investments for:
>
> (a) repayment of the capital invested within at least 10 years, 3/ and

1/ Material on policies affecting foreign investments in other colonial territories has not been included in the present report owing to the lack of readily available information.

2/ The "Scheduled Territories", as defined in the United Kingdom Exchange Contr Act of 1947 include, in addition to the United Kingdom and Colonies, the Dominions other than Canada and Newfoundland, Burma, Iraq and several other areas.

3/ With effect from January, 1950, this regulation has been modified to allow capital transferred in the case of new investments in approved projects to be taken out up to the value of the original investment at any time, without requiring the capital to be blocked for a minimum of ten years. Repatriation will be allowed only to the country from which the investment originated.

(b) withdrawal of non-resident capital upon liquidation.

Furthermore, if any appreciable part of the total capital to be employed is being subscribed by residents of the Scheduled Territories, the latter should hold a reasonable amount of equity (ordinary share capital) so that a fair proportion of the profits will accrue to the residents."

Subject to the above considerations, the authorities at present permit non-residents to invest in the colonial territories (by the acquisition of shares, debentures, or by way of loan) "provided that their investments are made in full by means of a remittance ... by the method appropriate to their country of permanent residence, that the capital is invested in productive long term enterprises whose operations would be of economic benefit to the sterling area and that the foreign investors do not expect guarantees of profit". It is indicated that these criteria apply not only in the colonial territories but generally in the countries included in the Sterling Area.

An interesting feature of the policy is the requirement that new investments are to be made by remittances <u>in full</u> to the area concerned. Thus, the investor is not necessarily allowed to use the capital involved for import from sources of his own choice. As regards the importation of capital equipment, it is stated the "it is necessary to submit capital in the form of equipment or other goods to import licensing procedure because, although there is no immediate loss of exchange, there is, nevertheless, a contingent liability in respect of such capital to release exchange for the payment of dividends, interest, etc." When the requisite imports for investment purposes are available from the United Kingdom or from other soft currency sources, "it is expected that colonial requirements will be obtained from the latter, subject always to the obligations of the United Kingdom in the matter of import discrimination. In general, however, where the import of capital equipment from the United Kingdom or from other sources would be difficult or would lead to undue delay, and where the licensing of the equipment would not lead to discrimination against other imports, and where the import of such equipment would, in view of the importing authorities, be economically justified in the light of all the circumstances, importation of capital equipment by non-resident investors would receive favourable consideration." In any case, it is stated, there would not be any discrimination between foreign and domestic investors in respect of applications to import.

Local Legislation Affecting the Exploitation of National Resources

Mineral rights in the British colonial territories are generally vested in the Crown, while control of their development is in the hands of local governments. According to the memorandum, there is no discrimination against foreign interests in connexion with the grant of mineral rights. Rights for mineral oil are granted on a basis of reciprocity, that is to say, only if such rights are granted to British subjects and companies in the foreign countries concerned and on comparable terms.

Prospecting rights may be granted either for a limited period for one or more minerals or, if exclusive rights are involved, for a longer period, but generally in respect of one mineral only. The latter type of grants carry the right to the grant of a mining lease in respect of the mineral in question. Mining leases are granted for periods of 21-25 years, renewable for a similar period, but are given only to persons or companies having the necessary financial resources and technical qualifications. Where the mineral deposit is not large enough to justify the grant of a mineral lease, "mineral rights" or "claims" are granted instead.

Royalty payments in connexion with mining concessions are either on an ad valorem basis or in the form of a specific levy per unit of output. However, it is stated that the colonial governments are adopting a new system of royalty which is related to the profitability of the mining undertaking, the royalty increasing or decreasing with any increase or decrease in profit. The Government also levies a minimum royalty, on the ground that it is entitled to some return for the removal of a wasting asset.

A "Memorandum on Colonial Mining Policy" (Colonial No. 206) was issued in 1946 by the Secretary of State for the Colonies to Colonial Governments suggesting the general lines to be followed with respect to the development of mineral resources. The objectives laid down relate to the efficient management of the mines, the size of the unit of operation, which must be "economic", the protection of other natural resources, labour conditions, the rate of development with respect to social as well as economic considerations, provisions for the indigenous population to fit themselves for the higher administrative and technical posts, and the retention of an adequate share of the mining proceeds in the colony.

/For working

For working and cutting timber, rights are granted on a non-discriminatory basis in respect of the nationality of applicants either for short periods up to five years and usually for a definite volume of timber in a specified area, or for longer periods up to 25 years. In the former case, royalty payments are computed on the basis of the volume of timber removed, while in the latter case they are defined in the terms of the agreement.

Legislation Affecting Other Industries

Investment in secondary industries in British Colonial territories is generally encouraged and in some cases positive inducements are offered. The inducements usually consist of exemption from customs duties on machinery and articles of capital equipment required for the particular project. In Jamaica, there are, in addition, reliefs from income tax and "tonnage tax" for pioneer industries. Both the inducements and legislative controls are equally applicable to foreign and domestic enterprises.

With respect to governmental control on entry, investors seeking to establish new enterprises in a number of industries in East Africa have to secure a license from the East African Industrial Council, licenses would be withheld if, in the opinion of the Council, the choice of location is not suitable from the point of view of the availability of raw materials or power or proximity to consuming centers, or existing productive capacity is actually or potentially capable of satisfying demand within the area at a price not less favourable than would be necessary for the potential investor in order to yield a reasonable return on his investment, or if the applicant's financial, material and technical resources are not adequate for the purpose while his failure would prejudice the future development of the industry in question.

The establishment of marketing organizations by legislation to improve and regularize marketing methods and particularly to prevent the exploitation of producers by traders is fairly widespread in British colonial territories. In some territories such marketing organizations have been made the sole legal exporters. For a number of commodities, arrangements are in force to reserve a part of the export price for future price stabilization purposes. In some instances this is done by special levies, in other through statutory marketing organizations. In addition, in many Colonies export duties are levied for revenue purposes.

Labour Legislation

It is stated that most British colonial territories have legislation, modelled on United Kingdom practice and conforming with ILO Conventions, regulating the recruitment, employment and conditions of service of labour. Where the drain of rural labour to other employments threatens local food supply, the local governments are generally empowered to regulate or stop recruitment in the affected areas.

As for the employment of foreign labour, control is exercised through the immigration laws. The employment of technical and skilled foreign personnel, however, is not prevented. It is the policy of the local governments in certain colonial territories to stimulate the training of native personnel to the standard which will enable them to replace foreign skilled labour later.

Taxation

Most of the income tax laws of the British Colonial territories have been based on a "Model Income Tax Ordinance" drawn up by the Colonial Office and the Board of Inland Revenue, and therefore have many common features. All the Colonies charge any income accruing in, derived from, or received in the Colony in respect of gains or profits from any trade or business for whatever time this may have been carried on or exercised. Some Colonies, notably in Jamaica and Barbados, also charge residents on income accruing or derived from outside the Colony, whether it is received in the Colony or not.

In general, in the case of a non-resident company, the liability as regards trading profits is restricted to profits gained by trading in the colony, and profits arising outside the Colony as a result of trading with the colony are not so liable. Jamaica again provides an exception to the rule.

Thus, as a rule, companies which are resident (i.e., managed and controlled) in a colony have a wider scope of tax liability than non-resident companies. One exception is in the Falkland Islands where the chargeable income of a company registered in a colony is reduced by 20 per cent if residents hold a majority of shares.

Most colonial territories having income tax laws have concluded double taxation arrangments with the United Kingdom on lines similar to those between the United Kingdom and the United States. Discussions between the two countries in respect of an extension of the latter arrangements to cover some twenty colonies as well have already taken place.
