December 29, 1945.

MEMORANDUM FOR MR. FRIEDMAN:

Mr. Arthur Paul, one of Mr. Wallace's assistants, came in to see Mr. White today to discuss the proposal for an international organization under the U.N.O. whose purpose would be to protect foreign investments of private persons. Mr. Paul said that they hoped through this means to put the private investor in a better position to protect his interests and that the scope of the organization might even include assistance in the collection of normal commercial obligations.

His original thought was that something should be whipped into shape for presentation to the present U.N.O. meeting in London. At Frank Coe's suggestion he changed his mind in view of the fact that the proposition has not been fully thought out as yet and would be snapped up by a U.N.O. committee which would then carry the ball. Mr. White suggested that Mr. Paul and some of his people meet with someone to be designated by Frank and with you and me to talk the problem over informally. I gather that these preliminary discussions would be for the purpose of getting together as much information as possible with respect to the history of similar efforts to make foreign collections.

After this informal group has clarified its thinking a committee will be formed which will bring into the discussions the State Department, S.E.C. and possibly other agencies. This committee will have the job of drafting a definite proposal for presentation to the U.N.O. Probably at some time prior to presentation, discussions will be held with investment bankers, foreign bondholders, protective associations and other interested groups.

I told Mr. White that I would tell you about it and he asked that we think about it and be prepared to attend discussions which will be arranged by Mr. Paul.

R. Brenner

CONFIDENTIAL

For.Inv.13
Princeton, N.J.
December 1945

LEAGUE OF NATIONS

Economic and Financial Organization

SPECIAL JOINT COMMITTEE ON PRIVATE FOREIGN INVESTMENT

Drafting Sub-Committee

DRAFT COMMITTEE REPORT

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PREFACE

During the course of the war, two regional tax conferences attended by members of the League's Fiscal Committee and other fiscal experts, were held in Mexico City to discuss problems of fiscal policy and international tax relations. At the second of these two meetings,[1] which took place in July 1943, attention was drawn to the fact that important as double taxation treaties were for the promotion of international business and for the movement of capital across national frontiers, there was a wide range of related problems that required simultaneous solution. It was felt that real benefit might be derived by all parties concerned were it possible to establish certain general standards for economic and financial relations between capital-exporting and capital-importing countries.

These views were brought to the attention of the Economic and Financial Committees, at their joint session, at Princeton in December 1943. The Committees, which had discussed on several occasions the conditions conducive to capital export and to the acceptance of foreign capital, recommended that the problem be made the subject of a special study, and that a special joint committee composed of members of the Economic, Financial and Fiscal Committees, as well as other experts, be appointed for the purpose.

Before convening the Special Joint Committee it was thought desirable to carry out certain preliminary consultations on the programme of investigation. The results of these consultations which took place at Princeton and Ottawa, were reported to the joint session of the Economic and Financial Committees, at Princeton, in April 1945.

1. The results of that conference are contained in League of Nations, Fiscal Committee, Second Regional Conference, Model Conventions for the Prevention of International Double Taxation and Fiscal Evasion, 1945, II.A.3.

CHAPTER I

OBJECT OF THE STUDY

1. Scope of Recommendations

Under the heading, "private foreign investment," the Committee confined itself to the problems in the terms of reference which relate to the following:

Direct investment in real property as well as in natural resources and in business concerns owned or operated by a foreign investor, either personally or in association with others:

Equity investment in company shares and similar rights;

Fixed-interest investment by private investors in medium- or long-term loans, credits and advances to private borrowers and public authorities.

Public foreign investment -- i.e., loans and credits granted by governments, bodies controlled by public authorities and international governmental institutions -- and private foreign investment constitute two separable though related problems. These two forms of investment present differences in the motives behind them, in their conditions and terms and in their consequences for the countries involved. While a revival of private foreign investment may be facilitated by governmental credit operations, such operations cannot be regarded as a substitute for private foreign investment between countries in which the system of private enterprise obtains.

It is not the purpose of this report to consider the general political and economic conditions which affect all forms of foreign investment. The purpose is rather to pass in review the specific conditions which most directly affect private foreign investment.

Foreign investment is a long-term transaction which involves lasting and close relations between the foreign investor and the capital-importing country. It is subject to special risks and gives rise to questions which do not present themselves with reference to commercial and short-term transactions.

The terms of reference[1] of the Special Joint Committee were there set out as follows:

> "...to formulate, for the guidance of public authorities, investors and business circles, recommendations on the treatment of private foreign investment, and on the practices of foreign investors and enterprises, which might help to create and maintain, both in capital-importing and capital-exporting countries, conditions conducive to such foreign investment and to its beneficial use."

The Committee was requested to direct its attention primarily to:

> (a) "The legal and administrative conditions and business practices in the capital-importing and exporting countries affecting private foreign investment in its various forms--direct investment, equity investment and fixed interest investment--and
>
> (b) the attitude and practices of foreign investors and enterprises."

It was understood that the Committee should not undertake to report on the general political, social and economic background of foreign investment.[2]

The Committee's work was facilitated by an investigation by the Secretary of the Fiscal Committee in representative countries of the Western Hemisphere.

The Committee held two sessions, at Princeton, from October 23rd to 26th and from November 26th to 29th, 1945, and a drafting sub-committee met in New York on December 13th and 14th, 1945. The following took part in the work of the Committee:

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1 League of Nations Economic and Financial Committees: Report to the Council on the Work of the 1945 Joint Session. C.30.M.30. 1945.II.A.

2 A discussion of these matters may be found in the following publications issued by the League of Nations: Transition from War to Peace Economy, 1943.II.A.3; Economic Stability in the Post-War World, 1945.II.A.2; Commercial Policy in the Post-War World, 1945.II.A.7; International Currency Experience, 1944.II.A.4.

The Hon. Henry F. Grady, Ambassador of the United States, Assistant Secretary of State, President of the Economic Committee, Chairman ex-officio;

Mr. C. Fraser Elliott, K.C., C.M.G., Deputy Minister of National Revenue of Canada, Fiscal Committee, Co-Chairman, accompanied by
Mr. H. Heward Stikeman, Assistant Deputy Minister of National Revenue of Canada, alternate;

Dr. Antonin Basch, Lecturer in Economics, Columbia University, Former Research Director, National Bank of Czechoslovakia;

Mr. Mitchell B. Carroll, Counsellor-at-Law, Former Special Attorney, United States Treasury, Fiscal Committee;

Dr. D. Crena de Iongh, President of the Board for Netherlands Indies, Surinam and Curacao, Netherlands Economic Committee in the United States, Financial Committee.

Mr. Medardo Goytia, Director of Internal Taxes, Ministry of Finance of Chile, Former Minister of Lands and Colonization;

Mr. Arthur Guinness, Guinness & Mahon, London, Chairman of the British National Committee of the International Chamber of Commerce, and
Mr. Redvers Opie, C.M.G., Economic Adviser, British Embassy in the United States, alternate;

Mr. Albert Jansen, Chairman of the Société Belge de Banque, Former Minister of Finance of Belgium, Financial Committee;

Mr. Max Horn, Counsellor of the Government of the Belgian Congo;

Dr. Ta-Chung Liu, Acting Commercial Counsellor, Chinese Embassy in the United States, alternate for
Dr. Kan Lee, Commercial Counsellor, Chinese Embassy in the United States, absent;

Mr. Victor Schoepperle, Vice-President, National City Bank of New York, alternate for
Mr. James H. Drumm, Vice-President, National City Bank of New York;

Dr. Emilio Toro, Minister Plenipotentiary, Colombian Embassy in the United States, Former Director of the Banco de la Republica de Colombia;

Mr. Luciano Wiechers, Adviser to the Mexican Government, and

Mr. Rafael de la Colina, Minister Plenipotentiary, Mexican Embassy in the United States, alternate;

Mr. Christian Valensi, Financial Counsellor, French Embassy in the United States was unable to attend.

The need for capital has never been more keenly felt over wide areas of the world than it is today. But the obstacles to foreign investment, even though in certain countries capital is in plentiful supply, have seldom, if ever, been greater. These obstacles have their origins in conditions obtaining both in the capital-exporting and in the capital-importing countries. In the former, the incentive to incur the risk of foreign investment has been greatly weakened by the present abnormally high rates of taxation. The inability of many of the capital-importing countries to meet the service of their outstanding loans owing to the protracted depression of the 'thirties has rendered long-term lending, except between governments or through government institutions almost impossible.

In these circumstances, the renewal of private foreign investment is likely to be a slow process. But it may, we believe, be to some extent expedited if a better understanding of the common interests of capital-exporting and capital-importing countries can be achieved, and if conditions more favourable to foreign venture can be created, if principles governing the conduct of both parties can be agreed. It is to the task of formulating such principles that we devote our report.

The need for an international code relating to private foreign investment is felt in various quarters. According to its advocates a code should provide certain general standards of conduct for the guidance of the various interests concerned in capital-receiving countries and the guidance of private investors and enterprises engaged in capital venture abroad. It is, moreover, suggested that such a code, or certain of its parts, could be formalized through international conventions.

Some of the ground has been prepared by various committees of the League of Nations, such as the Economic Committee, the Fiscal Committee, the Committee on International Loan Contracts and also by other organizations, such as the International Chamber of Commerce and the Inter-American Development Commission. These various bodies have made useful contributions on particular points; but no comprehensive body of rules has been formulated to cover the subject as a whole.

The elaboration of practical norms fully embracing the various aspects of private foreign investment in its many ramifications is a task which this Committee may not have the opportunity to conclude; nevertheless, it is urgent. These facts have prompted the Committee to publish without delay the first results of its discussions, as a preliminary contribution to the problem. But our report is not more than an attempt to indicate the essentials of an international code relating to private foreign investment. The competent organs of the United Nations will, it is hoped, pursue the work towards the formulation and recognition of international standards in respect to private investment relations.

The report opens with a chapter which defines the subject matter considered by the Committee and refers to the economic significance of private foreign investment. This is followed by a discussion of the conditions for a favourable climate for private investment in capital-poor countries and by the formulation of certain criteria which foreign investors might follow in their own interest and in that of the capital-receiving countries. Special aspects of fixed-interest investment are considered before a more detailed examination of the various questions that relate more particularly to equity and direct investment. Consideration is then given to Domestic tax problems and international tax relations. Finally, there is a summary of the Committee's basic conclusions.

2. Private Foreign Investment and the Economic System

Private foreign investment will thrive if there is national and international political security, price stability, exchange convertibility and freedom of trade. Conversely, sound foreign investment contributes to the creation and maintenance of these conditions.

Private investment abroad opens business opportunities to the capital-exporting countries, assists in the expansion of their exports and imports and promotes employment. These benefits are, however, conditional on the degree to which countries receiving foreign capital are capable of meeting their external financial obligations. This in turn depends not only on the capacity of capital-importing countries to export, but also on the willingness of capital-exporting countries to receive imports under a system of multilateral trade. For such trade to flourish, it is moreover essential that governments prevent unfair commercial practices, such as dumping or undue restriction of production and distribution.

An inflow of resources and skills from abroad enables the recipient country to develop its productive capacity, diversify and stabilize its economy, to improve its general standard of living and to increase its exports and imports with greater rapidity and less cost than if it were to rely exclusively on its own savings and technical experience. To constitute an enduring contribution to economic and social advancement, private foreign investment should be mutually advantageous to both capital-importing and capital-exporting countries.

The responsibility for establishing and safeguarding the conditions conducive to private foreign investment falls largely on governments. Government action may take the form of domestic legislation or administrative measures. It may also involve the conclusion of agreements with other governments and participation in the activities of international institutions to maintain peace, to stabilize exchanges and prices, to expand trade and to raise standards of living. Under a system of private enterprise, however, the conditions conducive to foreign investment, and therefore the extent and outcome of such investment, must also depend on the judgment, initiative and behaviour of the business community as a whole and, particularly, of those who invest abroad or obtain foreign capital.

CHAPTER II

THE INCENTIVES TO FOREIGN INVESTMENT

1. Essential Conditions

A country's capacity to attract foreign capital in adequate quantity on satisfactory terms and to meet the external obligations resulting from capital imports, depends mainly on the following:

a) That natural conditions and resources offer remunerative possibilities for economic activity;

b) That political, social, economic, fiscal and administrative institutions and conditions permit the secure and remunerative conduct of business;

c) That equality of opportunity and fair competition exist in the realm pertaining to individual and corporate business;

d) That economic and social progress is not obstructed by vested interests acting from within the country or from abroad;

e) That foreign capital and skills are allowed to enter and are granted fair treatment;

f) That domestic enterprise, capital and labour are able and willing to cooperate with foreign enterprise and to use foreign capital and skills;

g) That the external trade of the country develops a foreign surplus adequate to cover dividends, interest and capital redemption accruing to foreign investors;

h) That the fiscal and monetary policy of the country is such that the sums accruing to foreign investors can be freely remitted, without being subject to any transfer, remittance or foreign exchange tax, and that the value of their holdings is not exposed to depreciation.

i) That in general, the treatment of foreigners is such as to promote relations of mutual respect and understanding.

In the following sections of this chapter some of the above points are further elaborated.

2. Rules Governing Business

Whether private capital is or is not likely to go to any particular country will to a large extent depend on the conditions in which its nationals can carry on business and engage in capital venture.

Business security requires above all that the executive,

legislative and judicial institutions and the general internal conditions of the country offer adequate protection to the fundamental personal and property rights of the individual and regulate, without impeding, business in a manner that provides equality of opportunity and the possibility of earning a profit through private initiative. This implies legitimate and honest government, honest and efficient administration, the rule of law,

, speedy justice accessible to all and equitable taxation. In addition to the responsabilities which rest with governments, it is also important that there should be responsible behaviour among the citizens in public and private affairs, which may be promoted by general education and better living conditions.

Fiscal legislation is of especial significance because, before investing abroad, businessmen calculate the taxes that they will probably have to pay. In this connection, they will weigh the added burdens resulting from international double taxation, as well as discriminatory and extraterritorial taxation, against the taxes which they would pay if they confined their business or investments to their home country.

3. Integration of Foreign and Domestic Interests

All countries should accord to foreigners equality of treatment with nationals, in business and tax matters. Whenever foreign capital or skills are needed, it will be to the advantage of all to promote community of interests between foreign investors and domestic business. This can be done by encouraging, though not demanding, participation by domestic investors and employees in foreign enterprises, which in turn, will facilitate the integration of such enterprises in the economic system of the country and promote the development of domestic capital and skills.

The association of domestic and foreign capital and skills will diminish the risk of the policies of foreign investors running counter to national policies, and may provide less costly insurance against this risk than would restrictive or discriminatory measures against foreigners.

Even when a country presents apparently attractive opportunities for foreign investment by virtue of its economic possibilities, foreign capital may fear to avail itself of them if

xenophobic tendencies exist among the authorities and the population. Whether they are historically explained or not, such tendencies are harmful; whether they can be dispelled will depend not only on the attitude of foreign governments and enterprises, but also on educational and economic measures which can be taken only by the government of the country where they occur.

4. Financial Organization

Domestic financial institutions constitute important instruments by which a country can attract and canalise foreign funds for the use of enterprise. These institutions may facilitate direct investment from abroad by providing the local credit facilities required by foreign entrepreneurs. The association of local and foreign capital may also be assisted by the institutions which encourage and actively use domestic savings. At the same time, this may improve the terms on which foreign capital is obtained, by confining the demand for such capital to what is necessary to finance the import of equipment or other goods and services which can be best acquired abroad. Lastly, an adequate financial structure will have a salutary influence on the country's attraction for capital by contributing to monetary stability.

The establishment of branches of foreign banks and the activities of foreign investment companies may accelerate economic development by furnishing an additional mechanism for credit and savings, by furthering the introduction of foreign capital and enterprise. Any resulting diversification of business may help to diminish local depressions.

As a country advances towards economic maturity, local stock and commodity exchanges may become increasingly useful as a means of attracting foreign funds. But the willingness of foreigners to trade on such exchanges will depend on their organization and practices. The development of such institutions may, at the same time, constitute a useful mechanism for bringing about a repatriation of securities and for keeping and using domestic capital at home.

It is a matter of general international interest that capital markets should permit the issue and quotation of foreign securities or securities pertaining to companies doing business

abroad only after investigation of intrinsic worth and future solvency. It might be appropriate to permit foreign issues or their quotation only when they conform to certain internationally accepted standards.[1]

5. <u>Economic and Technical Information and Education</u>

Technical advancement often requires equipment from abroad and technicians with a foreign training. At the same time, it generates business opportunities and paves the way for new enterprise. Consequently, industrialized countries have an interest in sharing their technical knowledge and administrative experience with other countries, in promoting the study of the possibilities and problems of foreign countries among its technicians and businessmen and in assisting to raise the level of technical and general education in other countries.

Such a policy may be carried out not only by public authorities, but also by business and professional associations, such as chambers of commerce, technical societies, and individual firms. It may be promoted by such measures as the following: special travelling, study and residence facilities for foreign teachers, technicians, students and business apprentices; scholarships; technical and educational missions; exchange of scientists and teachers; encouragement of research on foreign countries; distribution of publications and educational material; promotion of close relations between national technical societies and business associations; exchange of information between business firms. The supply of domestic skills necessary to make full use of foreign and domestic capital requires an ever improving level of general and technical education.

CHAPTER III

TREATMENT AND CONDUCT OF FOREIGN INVESTORS

Legality, equity and good faith should be cardinal in the treatment of foreign investment by all countries. But the individual attitude of each capital-importing country, as well as the freedom and facilities to foreign investment, will be determined largely by the special interests of the country and by the stage and direction of its social and economic development.

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[1] League of Nations, <u>Report of the Committee for the Study of International Loan Contracts</u>, Geneva, 1939.II.A.10.

It is a natural concern of any self-governing country to preserve its national integrity and to keep the direction of governmental policy free from foreign control and interference, subject always to treaty obligations and international law. No country will long suffer the presence of any foreign interest which tends to obstruct or distort governmental action or which exercises and uncontrolled and preponderant influence over the national economy.

Foreign enterprises and investors will, no doubt, appreciate the interest they have in complying in letter and in spirit with the domestic laws of the country in which they do business and in seeking no illegal favour or undue advantage from public officials. Having regard to their special position, they will see to it that nothing they do will be considered as an interference in the conduct of national affairs. It goes without saying that foreign enterprises and investors should not induce domestic interests to conclude contracts which they know to be detrimental to the other party or impossible to fill.

Foreign investors can only expect to receive fair treatment assuring the security and remuneration of their investment if it is a contribution to the economic development and social welfare of the country.

In the long run it will be to the advantage of all if investors place their funds in undertakings which not only assure a direct return, but which also further a balanced and properly diversified economic development. Concerns engaged in primary production should seek to develop processing and complementary industries. If foreign enterprises established in a country follow a consistent policy of reinvesting part of their profits in the country such policy is likely to prove beneficial to all parties concerned.

Whenever feasible, foreign enterprises will be well advised to encourage early participation of domestic interest in their business by facilitating, for instance, the purchase of some of their equities and securities by residents of the country. The association between foreign and domestic interests should be not merely formal, but effective and _bona fide_.

Harmony may be promoted if foreign enterprises engage local executives and technicians to the greatest possible extent, train local employees and workers and, above all, apply decent standards of remuneration and conditions of work and living, taking into account the prevailing levels in similar branches of activity in the country.

Investment in less developed countries frequently offers prospects of larger returns than investment in more advanced countries. The fundamental rules of business, however, always require caution, responsibility and foresight. Many of the disappointments that occur are due to ignorance of local conditions, laws, customs and national traits. Misunderstandings and failures will be avoided by careful market surveys, cost estimates and well thought out agreements before the investment is made.

The governments of capital-exporting countries must make it possible through the various channels of multilateral trade for debtor countries to service the investments they have received. Their nationals should be prepared to leave their capital abroad for long periods and to make reasonable arrangements for accommodation in periods of crisis.

By conducting their diplomatic relations in a manner which dispels any fear of political or economic imperialism, the government of capital-exporting countries can contribute to the avoidance of restrictive policies against their nationals in capital-importing countries.

To protect the person and the interests of nationals abroad is a recognized function of the state, but this responsibility should not be fulfilled in a manner which engenders distrust in countries where the nationals have interests. In no case, should a state protect its nationals abroad whose conduct does not conform to internationally acceptable standards. On the other hand, capital-importing countries should not invoke the technicality of local incorporation to deprive foreign investors of the right to protection by their own governments.

CHAPTER IV

FIXED INTEREST INVESTMENT

1. Economic Policy and Transfer Capacity

External financial obligations must ultimately be paid for by exports of goods and services. The need for increased exports is one which the country receiving capital should consider when planning not only its production, but also its general economic and financial policy.

Imported capital must be put to a productive use. It should be so invested as to stimulate directly or indirectly the exports of the country, unless that country can count, in any case, on a balance of payments adequate to cover the service of such capital. The balance of payments position may be improved either directly or indirectly: by increasing exports or by diminishing the dependence on imports. Investments resulting in a genuine reduction of costs are likely to make available the foreign exchange required for their service.

The transfer capacity of a capital-importing country does not depend only on its trade with the capital-exporting countries, but also on its and their trade with the rest of the world.[1] Any check to multilateral trade is likely to reduce the transfer capacity of capital-importing countries and consequently the return on foreign investments which thus decline in value while new investments are discouraged. The success of international investment depends on measures of international economic policy and the negotiation of agreements tending to restore a world-wide multilateral trading system, so as to open "transfer routes" from debtor to creditor countries through third countries.

Unless capital-exporting countries pursue a financial and commercial policy that facilitates the acquisition by capital-importing countries of foreign exchange through exports of goods

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1 League of Nations, The Network of World Trade, 1942.II.A.3, pages 88, 95.

and services, foreign investment can only result in complications and eventually in loss for the investors. The position of debtor states may be rendered difficult, not only by high tariffs and quantitative trade restrictions, but also by government subsidies or restrictive marketing agreements.

Participation of capital-exporting and other countries in the International Monetary Fund and the International Bank for Reconstruction and Development and intergovernmental credit transactions, if properly conducted, should exercise a beneficial influence on private foreign investment by minimizing exchange fluctuations and transfer difficulties. On the other hand, private capital movements may be impeded by transfer priorities in favour of the service of public loans and credits granted by governments and international institutions. It is most desirable that governments in default should regularize their position towards foreign bondholders as soon as possible.

2. Debtor and Creditor Relations

The terms on which a country will be able to obtain foreign capital will depend on the opinion of foreign investors regarding the future of its internal development and external trade and on its past record of promptness and good faith in fulfilling its financial commitments. Excessive borrowing can only lead to disaster. Default blemishes financial reputation for many years and default by one borrower may sometimes redound to the discredit of other borrowers. It will thus be in the interest of capital-importing countries to adapt their public and private recourse to foreign capital to their capacity to service it. Non-industrialized countries, especially, will need to take into account the variations to which their balance of trade is subject owing to the particularly wide fluctuations that characterize the demand for the raw materials or the yield of the crops which they export.

It has been said earlier that capital-exporting countries, on the other hand, may jeopardize their own interest by failing to realize that earnings on and repayment of foreign investments can only be made available through the import of goods or services.

Before granting loans, lenders should be satisfied that the borrowers will use the funds productively and will be able to meet their obligations on account of interest and amortization

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Before granting loans, lenders should be satisfied that the borrowers will use the funds productively and will be able to meet their obligations on account of interest and amortization

without prejudice to other creditors or hardship to themselves.

If a temporary shortage of foreign exchange makes it difficult to service a debt, creditors may suffer less by adopting a co-operative rather than a rigid legal attitude when the debtor in good faith seeks a compromise. A realistic arrangement based on actual transfer capacity is preferable to a default. It would, in our opinion, be desirable for loan contracts to provide for an agreed procedure to realize and enforce, when necessary, such temporary adjustments of debt service. While thus recognising the special risks to each party that arise from trade fluctuations, it is important that loan contracts should be sufficiently unequivocal and complete in their provisions to assure punctual performance in good faith under all conditions, without litigation or other friction.

In this connection, we would draw attention to the recommendations, made shortly before the war by a committee of the League of Nations, on the drafting of international loan contracts.[1]

3. Equity versus Fixed Interest Financing

Equity financing and direct investment do not involve the same risk of causing a strain on the balance of payments of a capital-receiving country as bonded debt.

The service of a loan constitutes a fixed monetary obligation which must be met irrespective of the state of trade or the level of prices. When prices fall and exports shrink, the service of foreign debt may absorb so large a proportion of the reduced proceeds of external trade that the capital-importing country is unable to purchase the foreign goods and services which are essential to its economic existence. The country may thus be forced to default.

On the other hand, when money has been obtained in the form of equity capital it is probable that during periods of falling prices and shrinking exports the transfer problem will be mitigated, since smaller profits are likely to be earned in such periods. Countries in need of foreign capital may therefore find an advantage

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[1] League of Nations, Report of the Committee for the Study of International Loan Contracts, Geneva, 1939.II.A.10.

in encouraging equity financing, or direct investment in preference to long-term borrowing. This may be done through fiscal or administrative measures which facilitate the development of corporate business and assure protection to shareholders and persons willing to make direct investments. Equity financing and direct investment may also be promoted by the regulations applied to capital issues and capital imports.

There are, however, fields of endeavour the risks of which foreign capitalists will not assume as entrepreneurs or shareholders. Private investors, foreign or domestic, may be debarred from participating in some public enterprises. Moreover, certain entrepreneurs in order to preserve control over their business, may prefer to finance their venture through borrowing. It is therefore unlikely that any country will be able to satisfy all its needs for foreign capital without resort to borrowing. Preference shares with limited voting rights may sometimes offer a middle course between equity financing and loan financing.

CHAPTER V

EQUITY AND DIRECT INVESTMENT

1. The Admission of Foreigners and the Utilization of Foreign Capital

The volume and form of foreign investment in any country will be influenced by the rules and practices governing the admission of foreigners, whether as visitors or immigrants. Import of capital may be of little value and may indeed only lead to waste if skilled labour or experienced entrepreneurs are not available.

In the past some countries have imported too much capital relatively to the inflow of skilled labour. Health and social conditions in some countries have been unattractive to highly skilled foreign labour. But in other cases there have been an unwillingness to admit foreigners and a reluctance to see them receive wages greatly in excess of those paid to domestic workers. Yet, the import of foreign skills may prove cheaper in the long run than the import of foreign capital; in some cases it may be essential.

Some countries requiring foreign capital are suffering from population pressure and would view any large-scale immigration with anxiety. But the risk of large-scale immigration

into such countries is negligible. If they suffer from an excess of population and a scarcity of capital, wages must inevitably be low. The prospects to the immigrant, except perhaps the highly skilled, are therefore relatively unattractive. If skilled labourers or technicians are attracted at all, they are likely not to remain in the country but eventually to return home where living conditions are better. These countries will therefore benefit by adopting, if only for a transition period, a liberal policy on the admission of foreigners.

Countries which owing to a scarcity of labour offer a real attraction to the immigrant may desire so to regulate the admission of foreigners as to receive the type of person most suited to their economic conditions and social atmosphere and to prevent the entry of national groups which they are unable to assimilate. The rapidity with which their economic advance can be achieved with the aid of foreign capital may be largely determined by their willingness to admit immigrants and their success in creating conditions which will attract the most desirable. Although some regulative control of admission is no doubt necessary, a negative policy of passing the immigrant through a sieve of formalities may not produce such beneficial or such rapid results as a constructive policy of attracting the best.

Whether there is a surplus or a lack of population, countries in need of foreign capital will serve their own best interests by allowing those responsible for the provision of that capital ready access and every facility for the successful conduct of their affairs.

The control over the admission, stay and departure of foreigners should be as considerate, as expeditious, and as inexpensive as possible. Special entry and departure facilities and tax exemptions should be granted to travellers staying in a country for a short time, such as business visitors, tourists or students. Indeed, personal contacts between foreign and local businessmen, tourist travel and knowledge of the country by foreigners are all factors which in various ways tend both toe foster foreign investment and promote trade.

2. Treatment of Foreigners

Countries which desire to attract foreign capital and skill must make it clear that they will conform with the recognized principles of international comity in dealing with foreigners. Foreigners are entitled to the same inviolability of their person and property and to the same non-political rights as nationals. On the other hand they should not enjoy or seek any right or privilege not granted to nationals. The fundamental principle on which the civil status of foreigners should be based is that they should have the same non-political rights as nationals and equality of treatment. If the treatment of foreigners falls below the standards accepted under international law, the import of foreign capital and enterprise will naturally be impeded.

Equality of treatment should be effective. It should be applied in good faith. It should not be undermined by apparently general laws which in fact apply only to foreigners. Nor should the administration enforce the law of the land with greater rigour in the case of foreigners than of nationals.

To the extent that foreign enterprise is to be fostered,, it is advisable that foreigners should be recognized as having the same right and capacity as nationals to enter into contracts on their own behalf or for the account of another, to purchase, lease, inherit, hold, use, transfer and convey personal and - perhaps subject to certain restrictions - real property, and to appear as plaintiff or defendant before the domestic courts.

Though the basic rule should be to grant the same property rights to foreigners as to nationals, it is generally held that deviations from this rule are admissible as regards certain kinds of property for reasons of national security and public order. These restrictions should obviously be applied with circumspection and should not be used to protect special private interests. At the same time, circumstances may arise when it may be desired to obtain foreign assistance in undertakings that it is felt prudent to keep under direct national control. In these cases the government should permit leases and concessions, management contracts and other special arrangements.

Any discriminatory tax measure against foreigners will

render the country less attractive to foreign investment. There should be effective equality in the tax treatment of all taxpayers, whether foreign or domestic, and discriminatory, extra-territorial and double taxation of foreigners should be avoided.

Foreigners should have access to domestic courts as plaintiff or defendant under the same conditions as nationals, without any special requirements as regards legal representation, procedure and security for costs (cautio judicatum solvi). The rules of service and pleading should enable them effectively to enter an appearance and argue their case.

Bilateral or plurilateral treaties of friendship, commerce, navigation and establishment, and tax treaties should redound to the security and advantage of all public and private interests concerned in the relations between capital-importing and capital-exporting countries. Negotiations on such matters and the growth in uniformity of international practice would be aided by the use of the model conventions that have been prepared by the Economic and Fiscal Committees of the League.[1]

3. <u>Nationalization and Expropriation</u>

Nothing is more likely to render the foreign investor reluctant to venture his capital than apprehension that a government may contemplate expropriating private property or enterprise or forcing foreigners to transfer their assets or their business to nationals. In such cases, it is essential that the owners should not be dispossessed before payment of an appropriate compensation in freely transferable currency and that the expropriation or nationalization should be conducted with due legal formality.

The laws dealing with expropriation or nationalization should define its purposes and conditions. The principles on which the compensation will be assessed and payment made should be clearly stated in the law itself. Greater security to the owner will be assured if the actual assessment is made by a board of independent referees. Judicial appeal against any administrative act concerning expropriation or naturalization should be allowed.

1. See <u>International Conference on the Treatment of Foreigners, Preparatory Documents</u>, 1929.II.5, and <u>Model Bilateral Conventions for the Prevention of International Double Taxation and Fiscal Evasion</u>, 1945.II.A.3

4. Status of Foreign Firms

Foreigners can contribute fully to the economic life of a country by direct business investments only if they are entitled to carry on trade and business on the same basis as nationals. This would imply freedom for foreigners to pursue in same conditions as for nationals the commercial, financial, agricultural and mining activities which are open to them.

To achieve equality of treatment, foreign firms should be allowed, in principle, to establish branches in a country provided that they submit to the same formalities as nationals with regard to registration, publicity, bookkeeping and other provisions of the mercantile, industrial, social, sanitary and other laws and codes.

In principle, it is undesirable that the laws of any country grant foreign firms special privileges or subject them to special restrictions. The best protection for a country against conflicts with foreign concerns in its territory is adequate general laws and an efficient administration which assures the observance by all firms, large or small, foreign or domestic, of the standards required in the common interest.

The technical and other requirements that it may be desirable to apply to certain types of enterprise in order to protect employees, consumers, clients, creditors and the public in general, to prevent unfair competition, to maintain production and marketing standards and to avoid waste should be inspired by the requirement of sound business practice and public welfare, not by narrow nationalism or the protection of vested interests.

It is desirable for the protection of domestic creditors and the public revenue that branches of foreign firms should maintain complete accounts and records showing their transactions with the rest of the enterprise abroad in the same form as is adopted for transactions with separate firms. It would also be generally appropriate for a foreign enterprise to be represented in a country where it has a branch by a resident manager with sufficiently wide powers to carry on current business without continual reference back to the head office abroad.

Some companies may find it advantageous to carry on their activities in a foreign country by means of a subsidiary company rather than a branch. Governments would be well advised in such cases not only to allow but to facilitate the formation of subsidiary companies by means of up-to-date corporate and tax legislation. Subsidiary companies are likely to integrate themselves more intimately and more rapidly than branches in the economic structure of the country.

The legal status of a subsidiary as a separate entity from its foreign parent should be fully recognized in all business, judicial and tax matters, subject, of course, to any legal remedy which may be available to creditors and fiscal authorities in case of illegitimate transactions.

Capital-exporting countries may facilitate direct as well as equity investment abroad by removing any provisions in their legislation that may unduly restrict the freedom of banks, insurance companies, etc. to organize branches or subsidiaries abroad and to acquire interests in foreign concerns.

5. Employment of Foreigners

Willingness to invest in any foreign country is likely to be largely influenced also by the extent to which foreign technicians and executives can be employed in both foreign-controlled and domestic concerns. Investment from abroad will be promoted if foreigners have access to professions and salaried employments in the same conditions as nationals, except in the case of public and semi-public functions.

The employment of foreign executives and professional men is likely to afford to economically less advanced countries benefits similar to those derived from the employment of skilled foreign workmen on intricate machinery with which local labour is not yet familiar. In both cases a skill is imported, the one to deal with the machinery of administration, the other with the machinery of production. In both cases those skills will not only help to assure the most profitable use of the capital imported, but will gradually be assimilated by the community in which they are exercised.

It should be understood that foreign technicians and professional men have a moral obligation to train nationals so that they may succeed them when their capacities are adequate.

Limitations on the carrying on of professional activity by foreigners may also restrict foreign investment. Foreign enterprises and investors are likely to require professional advice and assistance with nationals of the country may not be able to give to the satisfaction of the parties concerned.

The legislation of a number of countries prohibits any firm from employing more than a certain percentage of foreigners or paying to foreign employees more than a given percentage of the payroll or requires the progressive replacement of foreigners by nationals. Such provisions may sometimes overreach their purpose and limit not only the employment of foreigners, but also the supply of foreign capital and may retard technical advancement. The prospect of almost all foreign employees being replaced by nationals may give rise to the same apprehensions as expropriations on the part of foreign entrepreneurs.

6. Employment of nationals

As a general rule, foreign enterprises would be well advised to employ nationals of the country in which they operate to the fullest possible extent and to see that those employed gain access to responsible positions.

When ability and trustworthiness are equal, it will often be less expensive to employ local executives, technicians and workers. Indeed, salaries and wages paid to nationals need not include the expatriation indemnity which is demanded in the case of persons accepting employment outside their own country. Moreover, the employment of nationals should contribute to good relations with domestic authorities, the public and labour.

When foreign companies fail to grant opportunities of employment to domestic executives or professional men or to domestic labour, they themselves infringe upon the principle of equality of opportunity.

7. Labour Conditions

Equality of treatment should apply to labour. It is a function of government to protect all interests from exploitation and unfair treatment, irrespective of occupation or fortune.

The foreign investor will naturally expect the labour employed in concerns operated or financed by him to be neither more nor less privileged under the law or its administration

than when employed by domestic concerns. Foreign capital will tend to recoil from a country in which there is a tendency for labour employed by foreign firms to demand wages out of line with the earnings of other workers and the general price structure. On the other hand, when labour legislation is defective, foreign interests may regard the country as socially unsafe and economically unattractive. Moreover, a country with an unreasonably low wage level may find other countries unwilling to admit its exports or finance its economic development.

As national income increases with economic development, wages will naturally tend to rise. An increase in wages that reflects increased efficiency among domestic labour would not harm the country's competitive capacity in world markets or its attractiveness to foreign investors.

Special difficulties may arise because enterprises using modern technique offer wages and living conditions higher than those current in the country. Such difficulties cannot be overcome by labour policy but require for their solution an overall policy capable of bringing about an improved economic balance.

8. Company and Partnership Laws

The laws on companies and partnerships are naturally of the greatest importance to the foreign investor, These laws determine the conditions under which foreign enterprises may function, organize subsidiaries and associate themselves with local interests. They also affect the capacity of domestic concerns to obtain funds abroad through banking and private credit and by means of capital issues.

These laws should allow entrepreneurs and investors to select a form of organization appropriate to their proposed business. At the same time they should afford protection to the several interests of the individual shareholders or partners, the other persons doing business with the concern and the general public.

Those objectives can be achieved by laws which are clear, comprehensive and up-to-date. Their observance will be assured, not only by civil or penal sanctions, but also by stipulations regarding registration and publicity, and, possibly, through licensing and supervision by an appropriate authority.

The safeguards required for the protection of the various interests concerned vary according to whether the members of an association want their personal liability to be limited or not and whether the capital is raised privately or by public subscription. For this reason the legislation of each country should allow at least the four following types of association:

a) Ordinary or general partnerships administered jointly by all the partners, in which each member is personally liable as partner to the full extent of his property for the obligations of the partnership.

b) Limited partnerships in which the liability of general or managing partners is unlimited while that of the silent partners is limited to their agreed share.

c) Private companies administered by a board of directors, in which the liability of each member is limited to his agreed share, which he cannot transfer without the consent of the other members or the company.

d) Joint stock. companies or corporations administered by a board of directors under the supervision of an assembly of shareholders, in which the shareholders, whose liability is normally limited to the shares which they own, are in principle entitled to transfer their shares without the consent of the company.

Provisions requiring that a certain proportion of nationals should participate in any business association, that a certain proportion of the capital should be subscribed or owned by nationals, that nationals should have a minimum number of votes in the general assemblies or of seats on the board of directors, that certain officers should be residents or nationals, or that meetings should be held at a given place, are likely to check the influx of foreign capital. Nevertheless, foreign investors have an obvious interest in associating with nationals and in making their business

a part of the local economic and social structure.

The requirements of legal publicity should be adapted to the type of entity concerned. They should be less extensive in the case of partnerships and private companies than in the case of joint stock companies.

Company and partnership documents and records should render it possible to ascertain the identity of any person who has or has had a participation in the concern in any capacity whatsoever, such as promoter, underwriter, director, partner, auditor or shareholder. Access by administrative and judicial authorities to such information, when needed, is essential for the protection of the participants in the venture, private creditors and public revenue.

If a country desires to foster medium and large-scale enterprise and to induce capitalists to invest in shares and equities, it may be well advised to entrust the supervision of companies and partnerships to some special public authority.

The scope of the supervision will vary according to the object, nature and size of the entity. It should not involve interference with the current and regular conduct of business.

Foreign investors may wish, on certain occasions, to invest or hold funds not in companies or partnerships, but in trusts, the institution of Anglo-Saxon law under which title to property is vested in a "trustee", who holds and administers it in the interest of a "beneficiary", and which has been adopted by some countries of Latin America under the name of "fideicomiso". Capital-importing countries might recognize such institutions in their laws, regulate their legal existence and determine their tax status.

9. <u>Holding of Real Property</u>

Conditions governing real property are important to the inflow of foreign capital and the establishment of foreign enterprises. The willingness of foreigners to acquire

real property and lend on its security will be increased by measures tending to stabilize and guarantee their rights. Mention has been made above (page) of the guarantees that must accompany any resort to expropriation.

Quite apart from that question, the smooth conduct of business involving real estate depends on the extent to which the laws and practices governing real property protect the owner against trespass and permit him to convey, lease and mortgage his property without unduly cumbersome formalities.

It is desirable that persons holding a right in real property should be able to secure from the competent registration authorities a clear title and evidence of the validity of the transfers of the property involved, its nature and boundaries, as well as the mortgages, liens, charges and encumbrances.

Difficulties may be occasioned by the absence or inadequacy of land registers. Even in partially developed countries a register system should function and be extended as the area brought within the ambit of a modern economy spreads. Such registers should contain a physical description of each lot, based on up-to-date land surveys, together with a record of its legal ownership. From a fiscal point of view, an exact knowledge of real property holdings and values is necessary for a sound real property tax system and is also significant in connection with other taxes.

Both excessive concentration and excessive subdivision of land ownership may turn foreign investment away from a country, owing to the obstacles they put in the way of economic advancement and the social unrest they may cause.

10. Development of Natural Resources

Foreign capital has played a large part in promoting primary industries in undeveloped areas. A country can influence the development of these industries in its territory and their contribution to economic and social advancement by the following means: legislation on geological prospecting

and the development and conservation of natural resources; such as: mining and forestry laws; terms of concessions; regulation of the transport; grading of primary products; organization of research on the treatment, use and marketing of such products.

The policy that may be enforced through these various means and particularly concessions, while providing adequate facilities and guarantees to attract, when desired, private prospecting, operation, financing or technical assistance, should take into account the permanent interests of the country and assure adequate labour standards. Steadiness of output, avoidance of wasteful processes, fair and progressive treatment of workers and greatest possible stability of employment are cardinal points in this connection.

I n the initial stages of economic development, exploitation and export of primary products may prove to be the only course to follow while labour is unskilled. In most cases further progress will depend on the development of processing industries and of ancillary industries, notably for local needs. Governments and foreign undertakings should realize that such an evolution is desirable if a balanced economy is to be assured. If on the exhaustion of the natural resources no new source of employment has been developed, there is a danger of social agitation against private enterprise on the part of those thrown out of employment.

When the exploitation of natural resources entails a consumption of wealth, the state would be well advised to apply fiscal receipts from such exploitation to debt redemption and to capital expenditure that promotes economic development.

11. Public Utility Concessions

Public utility concessions constitutes an important field for foreign investment. The amount of capital required by such enterprises is large and a substantial part of the equipment is often imported.

The terms of public utility concessions should be such as to offer security to the foreign concerns involved and

to assure the protection of the public and labour as well as of the shareholders and bondholders.

Rates should be fixed according to a formula flexible enough to maintain a fair revenue for the capital invested in case of changes in labour or other costs and thus avoid indirect expropriation. Holders of concessions and public authorities should be entitled to seek a revision of rates by agreement or through arbitration. It may be desirable that a superior public authority appoint a competent and independent board composed of men with business and administrative experience to regulate rates

Perpetual concessions may prove in the long run to be neither wise nor respected, since they are apt to be regarded as impinging on territorial sovereignty. Short and even medium-term concessions involve the need for high and rapid returns. There is a risk that the operator will not maintain the equipment in good condition and will fail to improve the services in the final period of the concession. When drawing up the terms of a concession, public authorities should take pains, therefore, to assure that such maintenance and improvement are conditions precedent to its continuance and that the operator is fully compensated for all legitimate outlay.

12. Patents and Copyrights

Industrial development by foreign investment in any country is likely to be affected by laws and practices relating patents, copyrights and similar property. There may be an unwillingness on the part of manufacturers to establish plants in countries with inadequate patent protection.

A patent law should guarantee the inventor or his assignees exclusive exploitation for a reasonable period of years, subject to registration and publication of the patent and its effective use at least in one of the countries where it is registered. Countries seeking foreign capital and the introduction of an up-to-date technique examine their

patent legislation and subscribe to the various international agreements relating to patents.

In countries where compulsory licensing exists permits should be issued only to persons evidencing their technical and financial competence and should bear a fair royalty fixed by agreement or arbitration.

Trademarks, trade names, models and designs should also be regulated to maintain rules of fair competition and public protection, which are conditions of sound investment.

CHAPTER VI

PUBLIC FINANCE AND TAXATION

1. Fiscal Policy and Foreign Investment.

The government's capacity to cover current expenditure by current receipts is of utmost significance to foreign investors and private business in general. Likewise, an orderly borrowing policy is required as regards the financing of capital expenditure. It is a matter of primary concern for all that a country pursue a programme of public expenditure which harmonizes with its needs and possibilities and that it establish and maintain an adequate tax system.

A deficit, however, if only temporary, is not in itself a symptom of unsound public finance nor indicative that investment may be unwise. Such deficits may indeed promote economic stability. It is not advisable to strain a nation's economy so as to achieve an unconditional budgetary equilibrium each year, whether the times are good or bad. But it is essential that deficits of bad years should be compensated by the surpluses of favourable years. Chronic deficits, on the other hand, which lead to inflation and direct or indirect debt repudiation undermine confidence and threaten business stability.

The general trend in fiscal policy, as countries advance towards a developed and diversified economy, is inevitably from customs duties to internal taxes, and from indirect to direct taxation. The direct taxes to be preferred as major sources of revenue are those on private incomes and successions.

At the same time, it is important, especially in countries relatively poor in capital equipment, that taxation should be so devised as to have the least possible adverse influence on business venture, savings and investment, and that the transition towards a modern tax system be smoothly effected by prudent legislation and competent administration. It is, however, always urgent to remove obsolete, costly and arbitrary forms of taxation and to make the provisions of the tax laws clear and easy to administer and to follow. Many countries

may derive benefit from the codification, co-ordination and stabilization of their tax laws and procedure.

2. Taxation of Business and Investment.

Of all the taxes borne by business, true income taxes bearing on the real net income are the least discouraging to enterprise, provided their rates are not unreasonably high. Taxes which have to be paid without regard to earnings or become part of costs are inferior to income taxes in the promotion of a balanced distribution of investment and of equality of opportunity. Thus levies on business plants according to arbitrary factors, such as rental value of the building and number of employees may prevent new undertakings, and taxes on transactions may increase prices. While less adverse to economic venture than fixed business taxes, taxes on gross receipts are apt to favour the more integrated and monopolistic business organizations.

Taxation of income should, however, conform to its name. It should bear an effective net return by permitting the deduction of all expenses and charges incurred in earning the taxable income, together with allowances for wasting and diminishing assests, so as to permit of the full recovery of the capital or, preferably, the effective replacement of the plant and equipment in which such capital was invested. In order to ensure equality of treatment between enterprises with variable earnings and those with stable profits and to adjust tax burdens to economic risks it may be advisable, if tax rates are high, to allow the carry-forward of losses and the averaging of yearly profits in the computation of taxable income. The carry-forward of losses is of special interest to new enterprises which may well start with erratic earnings, however sound they may be.

The imposition of relatively heavier tax burden on dividends than on interest from loans is likely to impede enterprise and distort company finances. Such discrimination often occurs because, while interest is taxed only once in the name of the creditor, the earnings of equity capital are taxed, a first

time as corporate profits and a second time as shareholder income upon distribution. Where possible, it may be preferable that the taxation of companies should proceed on the basis that a company is but an economic instrument through which individuals are acting, and that any tax on a company is in fact a tax on its shareholders.

A tax on capital gains has little or no place in the fiscal system of a capital-poor country. Succession duties, however, in so far as they make it easier to maintain relatively moderate income tax rates, may facilitate the financing of public expenditure with less detrimental effect on business activities.

3. Special Exemptions.

Some countries may find an advantage in offering special tax conditions to foreign investors. Exemptions are often granted on foreign loans and new investments. Considerations of equity and revenue may, however, make it undesirable to extend these privileges more than is essential. Such favours should be based on a special national interest, and should not place foreign enterprises in a preferred position vis-a-vis their domestic competitors. They may, therefore, be justified in the case of enterprises of a type which cannot be financed or operated by nationals, owing to the capital or the technique they require.

Exemptions for new investments arising from domestic or foreign initiative may take the form of reductions in taxes or real property, industrial plants, new construction, corporations, capital issues, imports or purchases of equipment and raw materials. They may also consist of special deductions from taxable income in the form of accelerated rates of depreciation allowances, write-off of initial capital outlay and the like.

Care should always be taken that such facilities are sufficient to have a positive economic result; otherwise they are mere waste of public monies. Privileges of this nature are only justifiable when granted to industries the development of which is of genuine national interest and the maintenance of

Such international agreements should safeguard the taxing rights of the country where the taxable income is produced. The expansion of international intercourse requires that enterprises be subject to income and similar taxes on business income only in the country where they maintain a permanent establishment. The taxable profits of that establishment should be computed as if it were an independent national enterprise distinct from the foreign firm to which it belongs. Profits from maritime and air transport should be taxed only in the country of the company operating the ships of aircraft[1]. Registration duties and other taxes on the capital or assets of foreign companies should in no case be based on their total capital or assets, but only on the capital and assets used or held in the country.

It is notable that treaties of this kind merely remove penalties on foreign investment and tend to place it on the same apparent tax basis as domestic investment in the capital-exporting country. A positive tax incentive to foreign investment can result from agreements providing that when one country exempts income produced in its territory, the other country will grant a corresponding credit against its tax.

From a revenue standpoint, capital-exporting countries will generally be in a more favourable position to grant relief from international double taxation than capital-importing countries. In the first place, the interests owned abroad by their nationals and residents will usually represent a relatively smaller part of the country's taxable base than will, for capital-poor countries, the interests owned by foreigners. In the second place, tax rates in capital-rich countries, where public expenditure is large, are in most cases substantially higher than in capital-poor countries.

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1. See League of Nations, Fiscal Committee, Reports to the Council, Geneva 1928-29, Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion, Vols 1-5, Geneva 1928-1936. Second Regional Tax Conference, Mexico, 1943, Model Bilateral Convention for the Prevention of International Double Taxation and Fiscal Evasion, Geneva, 1945.

which, once they are fully established, will not require tariff protection or direct publicbounties. Fiscal exemptions should never encourage monopolistic tendencies.

The formation of savings and their investment in active business may be encouraged, especially in less developed countries, by a policy of exempting from income tax, possibly within certain limits, that part of income that is effectively invested in plant or equipment.

4. International Tax Relations.

The gravest fiscal obstacles to capital movements and the establishment of enterprises abroad are caused by discriminatory, extra-territorial and double taxation of foreigners. With current tax rates on incomes and successions, international double taxation alone may not infrequently prove an absolute deterrent to the venture of capital abroad. Discriminatory and extra-territorial taxation on the part of capital-importing countries may not only aggravate such danger but in addition diminish public revenue.

The existing high rates of taxation borne by capital in many industrialized countries necessarily tend to check enterprise. An investor will prefer safety to profit if the profit accrues not to him but to the state. Foreign investment is as a rule considered to carry greater risks than investment at home. Consequently, high rates of taxation are a marked deterrent to foreign ventures.

Foreign investment may be completely stopped by international double taxation when rates are high. The conclusion of tax treaties, therefore, may prove a necessary condition for certain international capital transactions. These treaties should provide that investors and enterprises do not pay a larger amount of taxes if they invest abroad than if they confine themselves to their own country or not morethan the foreign rate if it is higher. Furthermore, these treaties should guarantee investors and entrepreneurs against discriminatory and extra-territorial taxation abroad.

Unqualified exemption by the investor's home country of income derived from abroad would jeopardize progressive taxation and might in some cases place an excessive premium on foreign investment. It would seem however advisable that income from foreign sources become subject to tax only if its is brought home to the domestic jurisdiction. Such a rule would encourage reinvestment of profits in the country where they were earned and might give impetus to the development of less advanced countries.

If double taxation is to be fully avoided, foreign taxes should be credited against the amount of domestic taxes based on the same income. The relief, in order not to discriminate against equity investment should apply not only to taxes paid by the taxpayer personally in each country, but also take into account the taxes paid by the corporation on the income distributed to shareholders.

To yield their full beneficial results, tax treaties should deal with succession duties on the same principle as income taxes. The matter of succession duties is indeed of great concern for the private individual investor and businessman.

Tax authorities in many countries are confronted with substancial tax evasion. High taxes stimulate the taxpayer's desire to excape or reduce his liability and this tendency is accentuated in certain countries by the demoralizing expedient of imposing higher rates so that the tax burden of the fraudulent individual is carried by the honest taxpayer, in addition to his own.

The problems of tax evasion have to be met by sound legislation, the imposition of tax rates which do not place too high a premium on dishonesty and effective and impartial administration. At the same time agreements for the mutual co-operation between tax administrations, such as those drafted by the Fiscal Committee, are useful in preventing and detecting fiscal evasion on an international scale.

SUMMARY

The Committee feels that it may be useful to conclude this report by restating its main findings in an abridged form.

1. General Considerations

For an economically developed country, private foreign investment provides business opportunities, assists in the expansion of exports and imports and promotes employment.

Those benefits are, however, conditioned by the degree to which countries receiving foreign capital are capable of meeting their external financial obligations, which in turn depends not only upon their capacity to export, but also on the willingness of creditor countries to receive imports from other countries under a system of multilateral trade and on the prevention by governments of unfair or restrictive commercial practices.

For a country that receives foreign capital and enterprise, such an inflow of resources and skills should enable it to develop its productive capacity, diversify and stabilize its economy, improve its general standards of living and increase its exports and imports.

While a revival of private foreign investment may be facilitated by governmental credit oprations, these operations cannot be regarded as a substitute for private foreign investment in countries with a system of private enterprise.

The responsability for establishing and safeguarding the conditions conducive to private foreign investment falls largely on governments. Under a system of private enterprise, however, the success of private foreign investment will also depend on the actions of the business community as a whole and particularly of those who invest abroad or obtain foreign capital. Above all, an atmosphere of security and of mutual respect and understanding is necessary for such success.

2. Internal Conditions in Capital-Receiving Countries.

A country's capacity to attract foreign capital and to fulfill the external obligations resulting from capital imports depends on the security and return on investments which private business can expect within its frontiers, the treatment offered to foreign capital and skills, the willingness and ability of domestic capital and labour to co-operate with foreign enterprise, the commercial and fiscal policy pursued and export capacity achieved and on the freedom enjoyed by foreign investors to remit their earnings to their own country and repatriate their capital in due course.

The general legislation of countries desiring to attract foreign capital and enterprise should enable business to operate unimpeded by restrictions other than those required for the safeguard of national security and integrity, the protection of individual rights, the orderly development of the national economy and the steady promotion of social welfare.

These countries have a special interest in seeing to it that their legislation on banking and financial institutions, companies and partnerships, real property, patents and copyrights, labour and taxation is technically adequate and meets the demands of economic and social development.

Progressive labour legislation will be favourable to private foreign investment provided increases in labour costs do not exceed increases in labour efficiency. Defective labour legislation may lead foreign capital and enterprise to regard a country as socially unsafe and economically unattractive. Both excessive concentration and excessive subdivision of land ownership are apt to turn foreign investment away from a country owing to the obstacles they put in the way of economic advancement and the social unrest they may cause.

Legislation on natural resources and concessions for their development should take into account the permanent interests of the country and assure adequate labour standards. Primary industries should contribute to economic advancement and

labour stability by bringing about the development of processing and other industries. When the exploitation of natural resources entails a consumption of wealth, it is desirable to apply fiscal receipts from such exploitation to the redemption of public debt and to capital expenditure that promotes economic development.

The terms of public utility concessions should be such as to offer security to the operating concerns and to assure the protection of the national and foreign interests involved. Service rates should be fixed according to a formula flexible enough to maintain a fair revenue for the capital invested in case of changes in labour or other costs and thus avoid indirect expropriation. Holders of concessions and public authorities should be entitled to seek a revision of rates by agreement or through arbitration.

Public finance should be so managed as to contribute to economic stability. Chronic deficits which lead to inflation and debt repudiation undermine confidence and may check enterprise.

Taxation should be so devised as to have the least possible adverse influence on business venture and investment. Of all the taxes borne by business, true income taxes bearing on effective net income are the least discouraging to enterprise, provided their rates are not unreasonably high. The imposition of a relatively heavier tax burden on dividends than on interest is likely to distort company finances and impede enterprise. A tax on capital gains has no place in the fiscal system of a capital-poor country.

It may be advantageous to offer special tax conditions to new enterprises and investments. The use of savings in active business may be encouraged by a policy of exempting from income tax, within certain limits, that part of taxable income that is effectively invested in plant or equipment.

3. Relations with Foreign Investors.

Legality, equity and good faith are of cardinal importance in the treatment of foreign investment. But any self-governing country is naturally concerned in preserving its national integrity and keeping public affairs free from foreign control or interference.

The fundamental principle on which the civil status of foreigners should be based is that they should have the same non-political rights as nationals and equality of treatment. Community of interests may be promoted by encouraging, though not demanding, the participation of domestic capital, skills and labour in foreign enterprise. This will facilitate the integration of foreign enterprise in the economic system of a country and contribute to economic and technical advancement.

Foreign enterprises should seek no illegal favour from public officials, abstain from any action that might be considered as an interference in the conduct of national affairs, refrain from inducing domestic interests to conclude contracts which they know to be detrimental to the other party or impossible to fulfill and comply in letter and in spirit with the domestic laws of the country in which they do business.

Foreign investors can expect to receive fair treatment assuring the security and remuneration of their investment only if besides offering a direct return it is a contribution to the economic development and social welfare of the country. They should make an adequate use of the resources at their disposal and refrain from restrictive practices. As stated above, concerns engaged in primary production should endeavour to promote processing and complementary industries.

Foreign investors and entrepreneurs will be well advised to encourage the early participation of domestic interests in their business, to employ local employees and workers and, above all, to apply adequate standards of remuneration and conditions of work and living.

The governments of countries desiring to foster investment abroad can hasten the abandonment of restrictive policies against their nationals in other countries by conducting their foreign relations in a manner which dispels any fear of imperialism or disregard for the principle of juridical equality of nations. They should not intervene in favour of nationals whose conduct does not conform to internationally acceptable standards. They should conduct their economic policy in a manner which enables capital-receiving countries to pay their external obligations by exports of goods and services. They should prevent private interests from retarding the economic development of other countries through restrictive practices and dumping.

4. Transfer Capacity.

Imported capital should be so invested as to stimulate production and improve the balance of payments of the recipient country. The success of international investment depends on measures of international economic policy tending to restore a world-wide multilateral trading system so as to open "transfer routes" from capital importing to capital exporting countries through third countries. Any check to multilateral trade reduces the transfer capacity of debtor countries.

Unless capital-exporting countries pursue a financial and commercial policy that facilitates the acquisition by capital-importing countries of foreign exchange through exports of goods and services, foreign investment can only result in difficulties and, eventually, in loss for the investors.

Before granting a loan, lenders should be satisfied that the borrowers all use it productively and will be able to meet their obligations without prejudice to other creditors or hardship to themselves. If a temporary shortage of foreign exchange makes it difficult to service a debt and the debtor is of good faith, creditors may suffer less through a co-operative than a rigid attitude. A realisitc arrangement based on

actual transfer capacity is preferable to a default.

Equity financing and direct investment do not involve the same risk as bonded debt of causing a strain on the balance of payments of a capital importing country when prices fall and exports shrink. Countries in need of foreign capital may therefore find an interest in encouraging equity financing and direct investment. It is, however, unlikely that any country will be able to satisfy all its needs for foreign capital without resort to fixed interest financing.

5. Treatment of Foreigners.

Import of capital may be of little value if skilled labour or experienced entrepreneurs are not available. The import of foreign skills may prove cheaper and more productive than the import of capital.

Whether there is a surplus or lack of population, countries in need of foreign capital will serve their own best interest by a constructive immigration policy and by attracting the type of immigrants who, by their abilities or their capital can give the greatest contribution to the country's development. The control over the admission, stay and departure of foreigners should be as considerate, as expeditious and as inexpensive as possible.

Countries that desire to attract foreign capital and skills should of course conform with the recognized principles of international comity in dealing with foreigners and with the fundamental principle of equality of non-political rights and equality of treatment in business and tax matters. Restrictions on the employment of foreigners and provisions requiring their progressive replacement in firms where they are employed by nationals may overreach their purpose and reduce the supply of foreign capital.

It is unwise for capital-importing countries to subject foreigners to discriminatory and extra-territorial taxes. They should refrain from applying any transfer or foreign exchange tax on the remittance abroad of earnings on foreign capital and

on the repatriation of such capital. They should moreover negotiate with other countries treaties for the prevention of international double taxation.

Treaties of friendship, commerce, navigation and establishment, and tax treaties will redound to the security and advantage of all concerned in the relations between capital-importing and capital-exporting countries.

Foreign investors will be reluctant to venture their capital in a country if they are apprehensive that its government may contemplate expropriating directly or indirectly private property or forcing the transfer of foreign property or enterprise to nationals. When measures of expropriation or nationalization are adopted they should provide for appropriate compensation, in freely transferable currency, before the owner is dispossessed. Greater security to the owner will be assured if this compensation is fixed by a board of independent referees.

The best protection for a country against conflicts with foreign interests in its territory is adequate general laws and an efficient administration which assures the observance by all firms, large or small, foreign or domestic, of the standards required in the common interest. These laws and their application should in no case be inspired by narrow nationalism or the protection of vested interests.

Foreign firms should be allowed, to establish branches in a country provided they submit to the same formalities as domestic firms. Governments would be well advised not only to allow but to facilitate the formation of subsidiary companies by foreign concerns by means of up-to-date corporate and tax legislation. Similarly, capital-exporting countries may facilitate direct and equity investment abroad by allowing greater freedom for their enterprises to organize branches or subsidiaries abroad and to acquire interests in foreign concerns.