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## Legal aspects of private foreign investment

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- cost estimates and business analysis from the financial point of view,
- knowing industrial costs, cost categories, structures and analysis,
- reduction of costs,
- increasing batch sizes,
- knowledge in industrial economics,
- know-how in budgetary control,
- thinking in technical alternatives and economies, considering costs of each alternative,
- working with "make" versus "buy" or "lease" considerations,
- familiarity with market and with costs elsewhere and in competing enterprises, cost and profit thinking<sup>9</sup>,
- making cost budgets,
- distributing overhead on direct costs, overhead cost absorption,
- standard costing and increase of standards, measurement of variances not only in physical

units (quantities and labour time) but also in monetary units.

#### Investments

- project identification, elaboration, implementation and control<sup>10</sup>,
- discounted payback period and cash flow analysis,
- technical and economic feasibility studies<sup>11</sup>,
- technical alternatives in terms of costs,
- making projections and risk analyses,
- break-even point analysis,
- purchase of equipment which does not create bottlenecks,
- substitution of machines and equipment in view of costs.

<sup>9</sup> cf. G. Nowak: Das Kostendenken des Ingenieurs (The Cost Thinking of the Engineer), Düsseldorf 1973.

<sup>10</sup> cf. R. v. Gersdorff: Suggestions for the Elaboration of an Operations and Office Services Manual for Plan Control and Implementation, United Nations Economic Commission for Africa, Addis Ababa 1967, UN Document No. E/CN.14/CAP/25.

<sup>11</sup> cf. R. v. Gersdorff: The Making of Feasibility Studies, in: International Handbook of Management (New York: McGraw-Hill Book Co., 1965).

### Foreign Capital

# Legal Aspects of Private Foreign Investment

by Dr Günter Wiedensohler, Hamburg \*

**The marked dependence of the safety and commercial success of direct investments upon regulations enjoined by law or treaty poses a problem of topical significance.**

There is less scope today for financing development projects inside the countries of the Third World than there has ever been. International private initiatives are for this reason of growing importance in addition to the public capital aid, and the legal position deserves being given particular attention in this context because commitments in overseas areas by foreign firms depend largely upon the extent to which such activities are protected and encouraged by legislation. It is understandable that private investors avoid transferring capital to states where undue restrictions are imposed upon independent commercial activities through economic enactments.

To create a climate for successful investment a fair balance has to be struck between the interests of the capital owners and those of the host country. The status of foreign investors is governed by a wide spectrum of legislative measures:

regulations about administrative procedures, taxation and public charges, employment of local labour, ownership and transfer guarantees, injunctions against discrimination, price controls, social security contributions, etc.

The main impediment to the increased investment of foreign private capital is fear among business firms that their assets may one day be expropriated or nationalized without compensation by the country in which the investment is to be made. Various warranties for their security are in fact offered by the laws of overseas countries for the encouragement of foreign investments but few of them give absolute protection — for a certain period or all time — without qualifications against measures of this kind. Most legislators assume *a priori* that private foreign property rights may be infringed by sovereign acts when, although only when, these acts serve a public interest, and guarantee fair compensation which may be trans-

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ferred without hindrance to the investor's own country.

Legal provisions guaranteeing the transfer of profits and repatriation of invested funds contribute significantly to improving the climate for investments. Appropriate assurances are of value because business firms are justifiably concerned about their ability to export their earnings and any proceeds from a liquidation in convertible currency from the host country. The currency reserves of the states in question are however throughout closely limited because of their chronic budget worries. The capital owners therefore often receive only relative transfer guarantees from the governments. The latter sometimes stipulate that transfers abroad must be made in instalments fixed by law, or only after a certain time, or in the case of approved investments only, or within the limits to which the investment has helped to improve the foreign currency position of the host country. Some capital importing countries besides reserve the right to decree general exceptions from the promised freedom of transfer when required by strains on their balance of payments.

Since World War II the industrialized countries have made increasing efforts to protect the foreign investments of their nationals against infringement by other governments by concluding bilateral treaties. The Federal Republic of Germany has concluded standardized agreements of this kind with more than 30 developing countries for the express purpose of reducing the non-commercial risks to which business firms are exposed when they engage themselves in overseas countries. The essential element of these Treaties for the Promotion and Mutual Protection of Investments is the proviso that German investments may only be expropriated for the public benefit and against compensation which shall represent the equivalent of the investments affected. Such compensation shall be actually realizable and freely transferable in the currency of the other contracting party without undue delay. The transfer of investment returns and proceeds of liquidation is guaranteed at the rate for current transactions.

The contracting parties further enter into a mutual undertaking to treat foreign investments and commercial activities connected with them no less favourably than domestic or third-country investments. Disputes are to be settled by the parties and if this fails by submission, upon the request of either party, to an arbitral tribunal. Although the agreements are largely confined to a reiteration of existing international law, such a formal reaffirmation may nevertheless assist significantly in creating an atmosphere of mutual trust to stimulate international capital movements.

If a project to set up a local establishment is of high priority for the host country, or an exceptionally large one, or promises to become profitable only in the long term, the status of the investor is often governed by an individual arrangement under which the Government grants rights or imposes obligations transcending the generally mandatory schedule. In such agreements, unlike the accords between governments, the development contribution of the investor and his security interests may be set out in greater detail and allowance be made for the particular circumstances of the individual project by means of graduated promotional measures.

Agreements of this kind are concluded more and more often. As a general rule they include an investment programme laid down in detail, provide for tax relief during the starting-up period and contain special impositions in regard to prices, employment, training and social welfare. To obviate disputes as far as possible, it is advisable for the parties to settle all details with great care and to take pains over the drafting of the agreement. It is not uncommon for the parties to submit to the World Bank Center for the Settlement of Investment Disputes in case differences should arise regarding the interpretation or application of their agreement.

The legal position is only one element, albeit an important one, of the complex of factors influencing international capital movements which determine the decision of the investor and the outcome of his investment. The non-commercial risks of an enterprise can only be judged against the political, economic and social background in the particular instance, if at all. For the would-be investor it is especially important to know whether the host country lays more emphasis on the collective idea or gives more consideration to the well-weighed interests of the individual. All developing countries however provide an increased measure of authoritarian direction. This does not necessarily imply that their economic order leans towards centralism.

Foreign capital is particularly liable to constraints resulting from the specific requirements of the host countries. The latter are often interested in local capital participation, minimum wages for native workers, a share in management decisions and adequate financial returns. A different matter is state intervention of an expropriatory nature which is outside the field of calculable risks and often forces the investor to discontinue all his operations in a country. A state showing such obvious disregard for the rules governing international economic relations impairs the basis of trust on which its relations with foreign partners rest and incurs a risk of economic isolation.