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Formulation of Government Financial Regulations and Incentives for Foreign Private Direct Investment: A Methodological Inquiry

by Thomas B. Trumpy

I. INTRODUCTION

Government regulation of foreign private direct investment is almost a universal fact. Foreign investment is subject to specific regulation in most countries simply because it has a different base country. Even the United States, formerly a bastion of economic laissez-faire, and the leading base coun-

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1. An investment is an economic activity engaged in for profit by the investor. Foreign direct investments are investments in assets and non-marketable securities which cannot easily and rapidly be made, or liquidated into the investor's base currency, or on a securities market.

While a local investor regards return on investment only at the site of investment (local profitability), a foreign investor usually regards the ultimate after tax risks and return in his base country and base currency (net base country return on investment).

Elements affecting base country return, such as currency fluctuations, the relation between local, third country and base country tax rates, the local deductibility of all investment-related expenses, base country tax credits for local income taxes, and exchange controls, may cause a foreign investor's appreciation of the attractiveness of an investment to vary substantially from the viewpoint of a local investor or an evaluation based solely upon the local return at the site of investment in the host country and its currency.

2. The basis for such a reaction is discussed in Vagts, The Host Country Faces the Multinational Enterprise, 53 B.U.L. Rev. 261 (1973).
try for foreign investment, has managed to convince itself that foreign investment in the United States should be reported because it is foreign.

The study of financial regulation of foreign investment which gave rise to this article led to the conclusion that the economics of foreign investment and its benefits and inconveniences are little understood by the host countries to such investment. In considering how a potential foreign investor should

3. The term 'base country' has been chosen as in the author's opinion it reflects best the place the taxes, exchange controls, accounting rules and currency of which are used to measure ultimate return on investment and permissability of business options and strategies. The term 'home country' might be confusing in the case of a true multinational corporation (MNC) and refers more to the legal fact of situs of the registered office, a concept hardly applicable to interlocked groups, as in Japan, for example. 'Home Country' is the term used in the basic study, MULTINATIONAL CORPORATIONS IN WORLD DEVELOPMENT, U.N. Doc. ST/ECAI90, at 46 (1973) [hereinafter cited as MULTINATIONAL CORPORATIONS].

4. It remains unclear whether the United States has examined whether or not as an economic question it encourages foreign investment. In 1970 it encouraged foreign investment. The foreign investment encouragement program was organized within the Bureau of International Commerce of the U.S. Department of Commerce. Reverse investment offices were also set up in several overseas locations. See U.S. DEPT OF COMMERCE, INVEST IN THE USA (1973). The European promotion and representation program was launched in 1967. U.S. SEeks to Promote European Investment in American Factories, Wall St. J., Oct. 12, 1967, at 1, col. 5. The program was discontinued when funding was not renewed after 1976. The U.S. government presently favors but does not promote foreign investment according to U.S. Embassy sources in Paris. Conversations with representatives of the Commercial and Economic Affairs Office in Paris, France (June 1979).

A recent expression of U.S. policy was issued by the Hon. C. Fred Bergsten, Assistant Secretary of the Treasury for International Affairs. See Hearings before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations: U.S. Policy Toward Foreign Direct Investment in the United States: The Role of the Committee on Foreign Investment in the United States, July 30, 1979, 96th Cong., 2d Sess. (1979) (copy available in the Boston College International and Comparative Law Review offices). In outlining the policy reasons for the Committee on Foreign Investment in the United States (CFIUS) which was set up in 1975, Assistant Secretary Bergsten referred to a formal review of U.S. policy of inward and outward investment:

The review was carried out by the Economic Policy Group, the Administration's top policy-making body for all economic issues. It resulted in a statement, issued in July 1977, confirming the long-standing U.S. commitment to an open international economic system. The statement concluded that:

The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward flows or activities.

The Government therefore should normally avoid measures which would give special incentives or disincentives to investment flows or activities and should not normally intervene in the activities of individual companies regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest.

Id.

5. For an analysis of the motivations and conditions for foreign investment, see G. REUBER, PRIVATE FOREIGN INVESTMENT IN DEVELOPMENT (1973) [hereinafter cited as REUBER]. See also Barnes, Foreign Investment in Canada and Mexico: An Agenda for Host Country Screening, 1 B. C. INT'L & COMP. L. J. 1 (1977) [hereinafter cited as Barnes]. For the effect of such regulation on the private investor, and the private investor's analysis of regulation, see Trumpy, The Analysis of Financial Regulations and Incentives Governing Private Foreign Investment, ANNUAIRE DE L'A.A.A. DE DROIT IN-
analyze the effect of such regulation on its activities, and how a potential foreign investor should prepare to negotiate any special regulatory regime required by its business, certain matrices were prepared. The difficulty in preparing such matrices for the analysis of non-fiscal financial regulation is

**TERNATIONALE DE LA HAYE** (to be published in 1980) [hereinafter cited as Trumpy] (draft copy available in the **Boston College International and Comparative Law Review** offices). The following text is drawn from this article:

What should be the response of the foreign direct investor? Should all regulation be considered as a "cost of doing business," paid for and forgotten? It is submitted that this approach, frequently encountered as a response to taxes, may be inappropriate in the case of certain types of financial regulation, specifically those regulations which may restrict the planned activity of the economic units to be created, or render it impractical or illegal.

The investor's response to such regulation must be logically prepared, even if the regulations do not appear to be coherent. The investor can prepare his plan based upon his base country rules and those of the site of his investment. Alternatively, the investor can seek the regimes, fiscal and otherwise, which will give the greatest protection against the incidences of those host country regulations which are the least acceptable to his business needs. Examples of such 'antidotes' to host country regulation are:

1. Base country tax credits for host country taxes,
2. Base country incentives for investments abroad, and
3. Base country allowance (non-integration in the investor's base country income) of the tax or other incentives granted by the host country.

Each investor, or group of investors, may therefore bring to a host country a different set of parameters which, when integrated with the host country regulations, will permit the investor to determine whether an investment will be attractive. Since an investor can usually seek intermediate bases for investment, the host country must assume that investors will seek the most advantageous combination of base country and host country regimes.

Thus, the regulation shopping investor has created an even more complicated analytical problem. This arises because the exact language used in the financial regulations of foreign investment rarely coincides from one country to another (or even one regulated area to another) and minor variances in text may particularly affect some potential investors.

Id. at 2-3.

The investor will regard the openness, fairness and finality of administrative decision in choosing whether to invest. In particular the investor will consider procedures for exemptions, qualifications for waivers, possibilities of 'grandfather clauses' in regulations, and legal and administrative means of avoiding, delaying and opposing enforcement.

Foreign investors may structure their operations multilaterally, dividing their operations between their base country and one or more intermediary countries to minimize the effect of regulation. This is the form that American acquisitions in the European Community have followed. Acquisitions have often been made via a subsidiary already established inside such zone and entitled to freely establish itself in any other member countries regardless of ultimate ownership. See Treaty Establishing the European Economic Community, March 25, 1957, art. 58, 298 U.N.T.S. 11 (1958).

The right of EEC country companies to claim freedom of establishment rights under Article 58 regardless of ultimate ownership or control by non-EEC persons (e.g., a U.S. company) has now been acquiesced in by all the EEC countries.

6. These matrices are appended to this article in full. Portions of the individual matrices have been selectively reprinted as Tables 1-6 which appear at relevant sections of the article for the reader's convenience.
provoked by the absence of the systematic and schematic approach found in the fiscal regulations of foreign investment in most countries. 7

This article suggests how a host country may organize financial regulation of foreign private direct investment based upon a series of matrices. These matrices make the total set of regulatory options more available for economic analysis and policy making than does the review of existing regulatory texts which include only certain rules. The aim of such analysis is to permit host countries to avoid regulations which may be counterproductive to their development effort, as when regulations stifle the enterprise they encourage, or grant incentives of greater cost to the host country than of net benefit to the investor. 8

After setting out the policy considerations and the economic and political purposes that result in the adoption of financial regulations, incentives and policies, this article examines the scope and methods of the regulation of foreign direct investment. First, this article analyzes the economic consequences of regulation for the host country and provides case analyses of some sample areas of regulations and incentives.

It is the author's conclusion that when host countries are considering instituting a regulatory framework for foreign direct investment they must first formulate the economic and policy goals that the regulatory framework is designed to achieve. Second, they should selectively examine the total range of regulatory options available as well as the effects of those options, as is illustrated by examples of actual regulations in certain countries when analyzed according to the matrices which have been developed. By instituting only those regulations which will produce the desired consequences, host countries can avoid burdensome or inappropriate regulation that is not necessary to achieve the particular economic and political goals and that can have the effect of discouraging foreign direct investment. Only through the selective imposition of foreign investment regulations can host countries further policy goals without discouraging foreign direct investment with functionally ill adapted regulations. International organizations such as the World Bank 9 and the

7. Tax regulation is generally more well thought out from an economic basis and relatively free of glaring inconsistencies and loopholes, even in otherwise not highly developed legal systems. Perhaps this situation is due to borrowing of statutory frameworks from more developed nations. Certainly it is due to an almost universal approach to gross income, deductions, allowances, disallowances, net income, taxes, and tax credits.

8. See Barnes, supra note 5, on the need for host country screening but with flexibility of legal standards to meet economic goals.

Organization for Economic Cooperation and Development (OECD)\textsuperscript{10} should pursue the study of the effect of incentives and regulations compared to host country policy goals, and in consideration of their effect upon the decision of foreign investors to invest.

II. POLICY CONSIDERATIONS

A. Policies and Attitudes

Financial regulations, incentives and policies generally are adopted to effect economic and political goals of the host country.\textsuperscript{11} These goals include:\textsuperscript{12}

1. effective revenue collection (tax policy),
2. industrial development (economic policy),
3. trade (monetary policy), and
4. job creation and upgrading (labor policy).


\textsuperscript{11} The economic intent of regulation is divided by the World Bank Development Committee into three functions:

1. Lowering input costs (capital, labor, technology, energy)
2. Protecting (raising) output prices (Tariffs, quotas, barriers)
3. Increasing after tax cash flows (grants, subsidies, tax relief).

\textsuperscript{12} One could also define the principal policy considerations of a base country as follows:

- avoidance of runaway industries to cheaper labor zones
- protection and expansion of export markets
- avoidance of capital outflows
- avoidance of loss of tax base through expansion abroad
- providing growth for major national industries without local monopolization.

\textit{See} Reuber, \textit{supra} note 5. Note the divergence of interest of the base country investor with his government on the negative considerations. Although four of the above-cited reasons point against foreign investment it is universally recognized that it is essential to provide to national businesses the supporting means so that they may trade overseas and finance major overseas projects. Consider Russia's Amtorg, Banque Commerciale pour l'Europe du Nord headquartered in Paris, the Moscow Narodny Bank in London and shipping and trading offices around the world as a recognition of this business reality. Meyer, \textit{This Communist Internationale has a Capitalist Accent}, FORTUNE, Feb. 1977, at 134, 135. For a discussion of the policies and programs for private economy developed countries, \textit{see} OECD Development Assistance Committee Group, \textit{Investing in Developing Countries} (3d rev. ed. 1975). A detailed example of German regulation appears in H. Goltz, \textit{Forderung Privater Kapitalanlagen (Direktinvestitionen in Entwicklungsländern)} (1975). \textit{See} Annex 3, Table B, column D.

For an analysis of the interplay of objectives and policy of host countries, \textit{see} H. Schneider, \textit{National Objectives and Project Appraisal in Developing Countries} 36 (1975). \textit{See also} Boddewyn, \textit{Western European Policies Toward U.S. Investors}, 93-95 \textit{The Bull.} 51 (1974) [hereinafter cited as Boddewyn]; S. Lall & A. Streeten, \textit{Foreign Investment, Transnationals and...
The types of regulation which may be instituted are affected by the: 

1. policy fallout (some policy goals affect only certain regulatory areas);
2. importance of policy goals in the absolute (normally measured by the internal economic impact) and;
3. relative importance of policy goals (e.g. the need for technology versus the cost of buying or creating technology).

Nevertheless, there exist regulations which are contrary to both local economic and political logic for reasons of historical oversight or chauvinistic, personal or other attitudes of the host country government. Much, if not all, regulation indicates a benign neglect of the necessary interplay of such regulation with existing or proposed tax treaties or with the internal law of the primary existing or expected base countries for local investment. 

Similarly, most legislation does not consider the problems of regulating parallel or serial investments. Such problems are a subject of bilateral negotiations and are beyond the scope of this article.

If we consider the policy considerations for financial regulations which apply to foreign investment we note that the interests of the base country and the site of investment are frequently opposed. The interests of the foreign investor, and of public and private sector institutions and businesses in the site of investment may also be adverse and in each case may be contrary to those of the base as well as the host state.

Foreign investors which already have investments in the site of investment may become the most strident protectionists of their local markets against further competitive foreign investment. The following table presents examples of the differing attitudes toward some economic considerations for foreign investment:

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DEVELOPING COUNTRIES (1977) [hereinafter cited as LALL & STREETEN]. See also REUBER, supra note 5, for an earlier attempt at quantification of these objectives.

13. Trumpy, supra note 5.

14. For a discussion of the host country's unawareness of investor's goals and methods, see MULTINATIONAL CORPORATIONS, supra note 3, at 46. For an analysis of company decision making, see Y. AHARONI, THE FOREIGN INVESTMENT DECISION PROCESS (1966) [hereinafter cited as AHARONI]. On the desire of the investor to minimize capital at risk in the foreign country of investment, see id. at 150.

15. Financial regulations on foreign investment may be imposed by both the host country and base country of the investor, or by intermediate countries which are the 'base countries' of intermediate companies in a multi-national corporate structure. Relative to an investment, regulations can thus be multilateral in parallel (joint or cooperating investors or different base countries) where the laws, regulations and tax treaty relations between the site of investment and such intermediate countries come into play, or both in parallel and in series (Residents of A and B set up a holding company in C to invest in D) (Resident of A invests in D but licenses to D through C).

TABLE 1

<table>
<thead>
<tr>
<th>Host Country Economic Considerations</th>
<th>Base Country Investor Attitude</th>
<th>Host Country Investor Attitude</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>low labor cost</td>
<td>- threat to base country employment</td>
<td>- positive</td>
<td>- desire to increase living standard</td>
</tr>
<tr>
<td>high tariffs</td>
<td>- poor export market</td>
<td>- negative for import of means of production or product. Protected market once established</td>
<td>- desire to protect inefficient local production</td>
</tr>
<tr>
<td>use of natural resources</td>
<td>- neutral, unless competitor (negative) or user (positive)</td>
<td>- positive</td>
<td>- fear of exploitation of low-cost internal labor</td>
</tr>
<tr>
<td>labor intensive investment</td>
<td>- threat to local employment</td>
<td>- positive subject to labor law</td>
<td>- positive</td>
</tr>
<tr>
<td>participation in trade zone</td>
<td>- neutral or positive</td>
<td>- positive unless entrenched competition</td>
<td>- positive need for sheltered export markets</td>
</tr>
</tbody>
</table>

B. Policy Considerations of the Host Country

The principal policy considerations of a host country are:

1. the protection of industries essential for national defense or for other sectors of the national economy (security of supply);
2. the protection of traditional local industries from excessive competition;
3. the prevention of capital outflows of profits, royalties and earnings of foreigners, and protection of the currency;
4. the development of new jobs and new technical industrial capacities or upgrading of jobs and the technical base of industry;
5. the encouragement of capital inflows; and
6. the development of its own export industries and the support services for international business.

17. An earlier attempt to quantify both host and base country interests appears in REUBER, supra note 5. The standards for qualifying an enterprise for incentives are in many cases related to...
Of these considerations the first three generally discourage foreign investment and the latter three encourage it.

The policy choices are neither simple nor evident for host or base country and local interests may be divided on what measures to take. Each country would like to be economically independent and to have a solid currency and established international businesses.

To what extent is foreign investment an acceptable means of providing development towards those goals? For many developing countries there is an initial allure in the creation of labor intensive industries. Where the effect of the failure to modernize and automate a plant is to condemn it to produce goods not of exportable quality, sophistication and price, the absence of expansion of the facility, and the lack of technical upgrading of the local jobs can be a more serious disadvantage for the economy of the host country than the fewer jobs initially created by a modern industry.\(^{18}\)

Regulations on the importation and remuneration of technology\(^{19}\) may be taken as examples of good intentions leading to technological impoverishment of the economy. The expropriation of rights, as viewed by the investor, will give temporary property to the site of investment, but insure that no substantial infusions of new technology will occur subsequently.

Where exchange controls, designed to prevent outflows of capital from a poor country, force a foreign investor to take export sales profits outside the host country because of export financing restrictions,\(^{20}\) one may observe how a well intended rule may be counter-productive when applied to foreign based companies.

If the service sector is closed to foreign investment, the state or a closed club of local firms tends to develop a slow, inefficient system which is often profitable to itself. There is a risk to the whole plan of economic growth with such a system. Thus, a developing country should seriously consider the effects of a policy of maximum encouragement for joint venture investment\(^{21}\) by foreign firms, but should condition work and investment permits for all foreign standards used in screening an enterprise for investment approval. See the list of investment selection criteria developed in H. Perlmutter & F. Lombard, A Survey of Existing Investment Codes, A Report to the United Nations (1975) (unpublished manuscript, Wharton School, University of Pennsylvania). See also H. Robinson, *The Motivation and the Flow of Private Foreign Investment*, 1961 STANFORD RESEARCH INSTITUTE INVESTMENT SERIES No. 4 [hereinafter cited as Robinson].

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\(^{18}\) See Boddewyn, supra note 12, at 11.

\(^{19}\) See § V.C infra.

\(^{20}\) Such as those discussed in § V.D infra.

\(^{21}\) In the widest sense, the "joint venture" comprises any form of association which implies collaboration for more than a very transitory period. . . . Such partnerships show a great variety of patterns. There may be "50-50" partnerships, in which the local investor — public or private — holds one-half of the shares, and the foreign investor, the other half. There may be equity associations in which one partner holds a majority (though often only 51 percent of the shares) and the other partner the minority. An existing enterprise may be transformed into a joint venture with the
nationals on the training of local personnel in the base and third country operations of the investor. Once sufficient local expertise is developed it may be appropriate to restrict further foreign investment in certain sectors.22

The presence of experienced, international business normally will be to the advantage of the site of foreign investment in developing the expertise of the local service sector, e.g., banks, freight forwarders, customs brokers, and travel agencies. The diffusion of knowledge of the techniques of international business to local nationals must not be impaired by letting foreign enterprises tied to foreign investors control these sectors. From the point of view of the host country, foreign investment ultimately involves additions to its capital and technical base, and permits expansion of employment opportunities and export earnings.

Private foreign investment, however, inevitably involves currency export of the return on investment and of the value of any imported products, components or technology, and may bring a strong, experienced competitor onto the local market to the detriment of local firms. Thus, local regulations usually are ambiguous in their effort to make rules which recognize the fact of ultimate foreign ownership yet seek to control the investment as a wholly local enterprise.23

The short term gains for a host country from investments made to create employment or to exploit foreign technology, or from currency protection measures, must therefore be measured on a continuing basis against the economic health and growth of the enterprises created and of existing enterprises and related business sectors.24

III. SCOPE AND METHODS OF REGULATION

Direct investments generally are long term commitments. Nominally this would suggest a fixed regulatory structure permitting maximum predictability for investors. However, the demands of policy call for the greatest suppleness in rulemaking as to specific investments at particular moments in the develop-

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22. See S.V.A infra and Annex 3, Table A.
ment cycle to avoid "overbuilding" of a sector or the excesses of good intent.

Regulatory responses of host, base and intermediary country governments will be determined in part by constitutional considerations and legislative and regulatory policy constraints: what is subject to regulation as a constitutional matter, what is within the normal scope of regulation, what has traditionally been regulated and, who is to make and manage the regulations. These structural considerations often are as important as policy considerations in the formulation of regulations.

Many of the considerations of regulation-making are posed in other areas of concern to business such as environmental or employee safety regulations. Others have special significance to foreign investment due to the overriding effect of treaties, trade agreements and special economic factors.

To the extent that financial regulation of foreign investment is an acknowledged part of a country's body of administrative law and regulation, it will be easier for both the host nation and foreign investors to deal with it as a normal aspect of doing business rather than as a special, and hence political, domain.

A. Regulation of Existing Investments

Foreign investment cannot be regulated once and then forgotten. Regulation must be a continuing process of adjusting local and foreign investors' desires to national needs. How to structure the regulatory process becomes a consideration in itself, since policy goals cannot be generalized and fixed. Much has been written on the economic incentives for investment, but little literature exists from either the point of view of the host country or the investor concerning the effect on both existing investments, and on increases of investments, of continuing and evolving regulations.

The greatest experience has been that of U.S. and British investors whose base country tax laws and habits relating to foreign income are very different. While British corporations normally distribute substantial dividends, a weakening currency and the effective lack of taxation of profits held in overseas investments have encouraged British corporations to reinvest and retain most of their overseas profits in overseas holding companies. U.S. corporations have traditionally distributed small dividends and reinvested most of their earnings. The deferral of U.S. taxation on profits of active investments overseas (excluding financial or intellectual property holding companies since 1966), and

25. B. Belassa, Policy Reform in Developing Countries (1977); Belassa, Export Incentives and Export Performance in Developing Countries: A Comparative Analysis, in World Bank Reprint — Series No. 59 (1978); Frank, Kim & Westphal, Foreign Trade Regimes and Economic Development: South Korea (1975); Landau, Direct Foreign Investment in Developing Countries, 4 J. L. & Econ. Dev. 182 (1969).
26. See Aharoni, supra note 14. On the desire of the investor to minimize capital at risk in the foreign country of investment, see id. at 150. See also Robinson, supra note 17.
27. I.R.C. §§ 951-64.
the regulations of the Office of Foreign Direct Investments during the period 1968 to 1975 have not, however, caused U.S. companies to reinvest foreign earnings locally (or even overseas) and dividends in amounts approximating total earnings have been repatriated.

We must not, therefore, consider the stability of foreign investments solely in terms of major start-ups and shutdowns. The experience in Europe since 1970 has shown that foreign investors will disinvest completely or relatively if economic conditions change unfavorably. Such changes have been unfavorable exchange rates (Germany), higher labor costs forced by inflation (France), escalated wages unrelated to productivity (Belgium), and labor strife (Italy, Britain).

Creeping disinvestment is represented by the investor which fails to increase activities in proportion to local overall corporate means, market or growth rates which allows an enterprise to consume itself through failure to reinvest in new technology and capital equipment necessary for the enterprise to remain economically viable.

B. A Suggested Approach to Host Country Regulations

It is suggested that an analysis of desirable regulation can be facilitated by the preparation of matrices showing the logical sequence of the regulatory text. When the regulatory framework is analyzed as to its subject matter (what is regulated and what is not), universality (chronologically, by industry, and in territory) and administrative methods (rulings, exemptions, etc.), the analysis aids the host country in determining what it has created. In addition, such an analysis permits the investor to avoid pitfalls and plan creatively, using base country and third country investment incentives where available. Table 2 is illustrative of the types of financial regulations of foreign investment, some of which are analyzed in the matrices presented in this article.

29. See Multinational Corporations, supra note 3, at Tables 10, 20 & 37 which for the late 1960's show a return on foreign investments of about 10 percent for both the United States and Britain, but which show repatriated profits at base country level of about 75 percent of earnings for Britain but of slightly over 100 percent for the United States.
32. See Report from Brussels, supra note 30.
34. Report from Brussels, supra note 30.
35. See Trumpy, supra note 5.
| TABLE 2 |

Financial Regulations of Foreign Investment

1) **Regulation of Investment** (Sector, location and capital)
   A. Protected sectors and limits on foreign ownership
   B. Preliminary permissions and investment incentives
   C. The right to expand (linear, diversifying, integrating growth)
   D. Minimum capital structure and equilibrium
   E. Repatriation controls and guarantees

2) **Regulation of Financing Operations**
   A. Use of external loans and guarantees
   B. Borrowing on local and foreign markets
   C. Intercompany loans and interest
   D. Split exchange rates and investment discounts and premiums

3) **Regulation of Currency Transactions**
   A. Sending checks, instruments of payment and securities abroad
   B. Making transfers abroad
   C. The right to have foreign bank accounts
   D. Availability of foreign exchange; set off and paired import and export transactions
   E. Covering forward transactions and capital erosion
   F. Putting up tender bonds domestically-or abroad
   G. Insuring risks and benefits abroad

4) **Regulation of Operations and Trade**
   A. Importation of patents, trademarks, knowhow and payment of royalties
   B. Payment of commissions to foreign agents (affiliates or others)
   C. Management and service fees
   D. Parent company guarantees to third parties to aid operations
   E. Intercompany supply and marketing contracts
   F. Deposits and taxes on payments abroad or imports
   G. Customs and regulations of imports of goods and equipment

5) **Regulation of Profits and Distributions**
   A. Reserves and dividends — Limited rate of return
   B. Withholding taxes on dividends, interest and royalties paid abroad
   C. Loans abroad to related parties
   D. Treaty implications and tax sparing

6) **Regulation of Personnel**
   A. Payment of hard currency salaries and insured or other benefits
   B. Living allowances and advantages
   C. Repatriation of funds of foreign personnel (during and at end of stay)
   D. Currency allowances for foreign business travel; time exigencies
   E. Exemption of foreign nationals from local rules prohibiting foreign financial accounts and investments
   F. Role of foreign managers and technicians

7) **Taxes**
   A. Income
   B. Turnover
   C. Social taxes and transferability of benefits
   D. Capital
   E. Excise and transfer of assets
IV. ECONOMIC CONSEQUENCES OF REGULATION

We are examining a domain in which law is modifying the natural economic parameters of an activity. The economic decision whether or not to invest or reinvest is based upon numerous factors. A site of investment may lose an economic activity entirely to another site of investment if the total effect created, consciously or unconsciously, through policies, rules and treaties is relatively unfavorable for a particular investor. The interaction of base country and host country rules may produce different results in the case of each investor and investment.

The following analysis of the nature and effect of financial regulations is based upon the author's observations as an inside or outside advisor to industrial groups faced on a regular and continuing basis with questions concerning investment, reinvestment, risks, guarantees and methods of implementation.38

The decisions taken in the cases observed were (in approximate order) the result of considerations of business economics, availability of financing, growth opportunities, political risks, and financial and administrative burdens.39 In no case did a decision on an initial investment turn on a one or two percent difference in taxes or interest charges. The economic gain was usually designed sufficiently generous to accommodate some modification in tax and interest rates. In the case of U.S. investors before 1970, exchange rate risks were rarely considered. Because of changes in U.S. accounting rules, they may now be given a disproportionate importance.40

37. Table 2 is Annex 2. It is an attempt at an exhaustive list of types of financial regulation. All regulation of whatever type usually has an economic effect of costing or saving money to an enterprise and its investors. We are here concerned only with those regulations, the immediate point of application of which is financial in the host country for the investment. This article does not attempt to catalog the consequences of all such types of financial regulation. It is hoped that the examples in Section V infra will suffice for discussion of certain of the most obvious consequences of such regulations, leaving for others the task of quantifying their effect in particular cases on both the host country economy and the regulated enterprise.

The Summary of types of positive and negative regulations made by the World Bank Development Committee includes the following:

a. Regulation (and exemption) of business activity
b. Foreign exchange Restrictions and Incentives
c. Guarantees
d. Credit Incentives and Restrictions
e. Tax Incentives and Disincentives
f. Cash Grants and Subsidies
g. Grants and Subsidies in Kind

DEVELOPMENT COMMITTEE, supra note 11.

38. See note 26 supra.
The decision process, particularly in capital equipment or inventory intensive industries, was always a continuing one. After the initial investment provided the means to judge the economic attractiveness more accurately, decisions to continue the development of business in one country or another were frequently based upon very small margins of difference.

It is difficult, if not impossible, for a person outside a corporation to follow the bases of discussion and the decisional process within an investing corporation regarding the evolution planned for each of its investments. The results of a change of host or base country economic policy, business climate or regulations occasionally are observed during negotiations with host country authorities. Unless such policy changes are of initial importance to a planned investment or of catastrophic magnitude to existing investments or their production, no immediate reaction to such changes is observable. The investor simply cites "other business reasons" and does not pursue the investment.41

Scholarly journals discussing legal remedies in cases of creeping expropriation rarely discuss the economic loss to the host country resulting from jobs and economic activity not created from the moment the host country economic climate 'sours.' It is suggested that investments which do not occur because of the absence of an atmosphere of confidence and stability are the keystone for a bridge between the rich and the developing nations which seek investment or its economic benefits.

Financial regulations therefore have great relevance to base and host countries as well as to investors. In choosing the regulatory means to effect economic and political goals, a base or host country must take into account the effect of such regulatory means on foreign investors both as representatives of specific base countries and as a class. What may affect one investor or investors of one base country may not affect others in the same way.

For every means of financial regulation there are also strategies which will be adopted by the investor to preserve or improve his position. The possible pairings of government regulations and investor strategies to achieve maximum benefits are innumerable. They may include serial or multilateral structuring of the investor's position to qualify for the best conditions.

The following matrices, presented in full in Table 3,42 do not attempt to cover all areas of regulation, but seek to present examples for further study of the methods of foreign investment regulations and their intended and unintended economic consequences.

The matrices are based upon the author's review of the financial regulations of a number of countries. Attention in preparing an analysis of a particular area has been directed to regulations which are:

41. See the discussion of incidence of aid on the choice of country of implantation in Les Aides a l'Expansion Industriel Regionale dans les Pays du Marché Commun, La Documentation Française No. 3,917, at 15 (11 Septembre 1972) [hereinafter cited as La Documentation Française].

42. Table 3 is Annex 3, Table A.
1. Particularly detailed, for example the French capital exchange controls, which are almost unique in the detail of the texts as well as in the absence of an overall economic scheme. 43

2. Economically particularly well conceived such as the investment incentives for export transforming industries (South Korea, Taiwan, Greece, Ireland). 44

3. Attempts to codify policy on national economic independence, particularly from multinational enterprises, such as the Andean Pact and Spanish regulations on the remuneration of imported industrial property rights. 45

A. Financing Investments and Operations — Capital Controls

Capitalization and financing of foreign investment in a host country is an area of regulation specifically directed towards the role of foreign investors in the economy. Such regulations are common particularly when it is expected that the foreign investor considers a site of investment to pose substantial risks of erosion or loss of its investment.

When a foreign investor considers a site of investment to pose risks of erosion or of loss of investment, many countries are reluctant to risk their own limited financing ability and, therefore, require investors:

1. to bring new money into the country, 46
2. to limit the extent to which local financing may be obtained at all, or 47

43. The absence of an economically conceived scheme was personally confirmed by the administration to the author in 1977.
45. See notes 65 & 66 supra.
46. See Annex 3, Table A: a1, 2 or 3; b1-10 or 0; c1, 3 or 5; and d1 or 2.
47. See Annex 3, Table A: a3; b0; c2 or 4; and d3.
3. to limit the local financing obtained against the strength of the parent company or group. 

The regulations in Table 3 help to control the flow of foreign exchange into a country. This prevents a foreign investor from using foreign economic power, untaxed locally, to support local operations to the disadvantage of other local enterprises, or to export to foreign markets using financing arranged offshore. Regulations which require a 'normal' local balance sheet guarantee sufficient foreign investment so that the investor will not walk away in case of political or economic reversals, leaving a company with no local assets to pay local creditors and the claims of employees.

The appropriateness of such regulation may be questioned since financing an investment through local debt will permit the foreign investor to shield himself from inflation-caused erosion of the investment and will absorb rather than increase the monetary base, and, consequently reduce the local risk of monetary inflation.

**TABLE 3**

<table>
<thead>
<tr>
<th>a (i)</th>
<th>b shall be supplied by</th>
<th>c from sources</th>
<th>d to the extent of</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The initial investment</td>
<td>1. Authorized In-</td>
<td>1. Outside the host</td>
<td>1. 100%</td>
</tr>
<tr>
<td>2. Total long term capital needs</td>
<td>2. Long term private</td>
<td>2. Within the host</td>
<td>2. At least x% (ii)</td>
</tr>
<tr>
<td>3. Total capital and operating needs</td>
<td>3. Long term bank financing</td>
<td>3. In the base country</td>
<td>3. Not over 7% (ii)</td>
</tr>
<tr>
<td>4. Financing accorded to suppliers</td>
<td>4. Short term loans from (non bank) sources</td>
<td>4. In host country (internal) currency</td>
<td>4. 0%</td>
</tr>
<tr>
<td>5. Financing accorded to customers</td>
<td>5. Short term bank financing</td>
<td>5. In non-host country (external) currency</td>
<td>0. No provision</td>
</tr>
<tr>
<td>6. Financing for any purpose from or to related persons</td>
<td>6. Loans and facilities granted against guarantees provided by a first class host country bank</td>
<td>0. Anywhere (no regulations)</td>
<td>(Any, some or all)</td>
</tr>
<tr>
<td>7. Import financing</td>
<td>7. Loans and facilities granted against guarantees provided by a first class foreign bank or other institution (strawmen)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

48. See Annex 3, Table A: a3; b7, 8 or 9; c2 or 4; and d3.
TABLE 3 — Continued

Financing Investments and Operations — Capital Controls (iii)

<table>
<thead>
<tr>
<th>a (i)</th>
<th>b</th>
<th>c</th>
<th>d</th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Swap transactions with foreign deposits</td>
<td>10. Swap transactions with foreign deposits</td>
<td>10. Swap transactions with foreign deposits</td>
<td>10. Swap transactions with foreign deposits</td>
</tr>
<tr>
<td>11. (For export credit incentives see Annex 3, Table B)</td>
<td>11. (For export credit incentives see Annex 3, Table B)</td>
<td>11. (For export credit incentives see Annex 3, Table B)</td>
<td>11. (For export credit incentives see Annex 3, Table B)</td>
</tr>
<tr>
<td>12. (For tax incentives see Annex 3, Table B(c))</td>
<td>12. (For tax incentives see Annex 3, Table B(c))</td>
<td>12. (For tax incentives see Annex 3, Table B(c))</td>
<td>12. (For tax incentives see Annex 3, Table B(c))</td>
</tr>
<tr>
<td>13. (For reinvested earnings see Annex 3, Table B(c))</td>
<td>13. (For reinvested earnings see Annex 3, Table B(c))</td>
<td>13. (For reinvested earnings see Annex 3, Table B(c))</td>
<td>13. (For reinvested earnings see Annex 3, Table B(c))</td>
</tr>
<tr>
<td>0. Any means</td>
<td>0. Any means</td>
<td>0. Any means</td>
<td>0. Any means</td>
</tr>
</tbody>
</table>

**General Notes to Matrices**

(i) Choices on the matrix are expressed as the sum of the elements selected across the matrix. Thus in A: 1 + 1 + 1 + 1 expresses the initial investment shall be supplied by Authorized Investment capital from sources outside the host country to the extent of 100% or regulatory language to that effect.

(ii) x and y singly or together may equal under 100%.

**Notes to Example A**

(iii) The nature of investment approvals, limits, or guarantees on repatriation of capital and profits, and protection guarantees against capital erosion constitute other matrices not presented here. See Bodewyn, *supra* note 12, at 19. The grounds for such approval are generally those governing the availability of incentives. See Example B column d, and Example D column e item 4. As to base country regulations and incentives see OECD, *Investing in Developing Countries* (3d rev. ed. 1975).

As noted above, few local investments have paid substantial dividends where investors prefer to reinvest in expansion. For that reason there has been little need, and no known attempt to date, to legislate a higher rate or amount of reincorporation of earning and reserves in the case of corporations with foreign shareholders. The withholding of taxes on dividends (as modified by treaty provisions) protects the site of the investment’s short term interest in

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49. See note 29 *supra*.

taxing the economic activity represented by the dividendable profit, but does not protect the local interest in maintaining a more solidly financed employer.

B. Investment Incentives

Certain regulations on foreign investment provide economic (fiscal, financial, etc.) advantages for so-called "Industrial Development" investments. These advantages may be applied to investments in a country uniformly as to place, time and origin, or may be directed specifically to certain regions of a country or offered at differing rates in the case of different types of investment, number of jobs or level of jobs created and the region of implantation.  

51 Particularly in states where there is little or no internal capital, such incentives may be considered related to the desire to attract foreign capital. Table 4 sets out a matrix of the relationship of choices of types of incentives for differing types of enterprises and their potential effects. 

These incentives are frequently of greater interest to the developing host country than to the foreign investor, since they permit the host government to attract capital, knowhow and managers and to provide manpower training. The site of investment expects to realize a benefit in the jobs created and the multiplier effect on the tax base. 

Investment incentives raise two basic questions:

a: Do such incentives discriminate against existing enterprises in permitting new enterprises to function at better profitability or lower cost or with lower exchange exposure risk? 

b: What is the real benefit of such incentives to the foreign investor at the base country level after base country taxes? 

While the first raises troubling questions of standing to challenge acts of one's own state, the second is most interesting because of the complex multinational financial and tax considerations it raises. 

If one examines the usual goals and means of investment incentives, the unintended consequences become clear. If a tax holiday merely shifts tax payments into the hands of the base country or a third state; if low interest

51. On the timing of availability of incentives and the policy considerations and conditions for their grant, see Bodewyn, supra note 12, at 27. For an analysis of the objectives of regulations (foreign inputs, location, sector, technology, ownership, financial flows, etc.) and of the means (foreign exchange, restrictions on investment, guarantees, credits, tax relief, subsidies), see R. Robinson, A Catalog of Industrial Incentives Offered by 32 National and Subnational Governments (1977).

52. See note 17 supra.

53. Table 4 is drawn from Annex 3, Table B. See note 16 supra.

54. Incentives of a value of 20% of the initial investment are estimated to have only a 2 to 3 percent incidence on costs. See La Documentation Francaise, supra note 41, at 15.

55. See, e.g., Law 4171/1961 Concerning General Measures to Promote the Development of the Country's Economy, translated in Greece, in 3 Investment Laws of the World 40:20-1.3 (ICSID ed. 1977), which requires publication of the terms of a grant of incentives for major investments seeking the benefits of this law.

56. See, e.g., the incentives accorded by the French government for the creation by French enterprises of foreign commercial subsidiaries, supra note 36.
rates give rise to untaxed financial profits which permit the foreign investment to underprice local competitors, or if other advantages permit the foreign investor to take his export profits overseas through an untaxed sales company, the incentive may represent not only an advantage to the investor, but a dislocation of income and control of market share to another state. This is a matter which must be considered in view of the tax laws of major investment base countries and the systems of bilateral tax treaties which exist between the host country and potential base countries. Given the options of multinational structures, tax reporting periods, accruals and deferrals, the neutralizing possibilities may exceed estimation by a host country and certainly exceed the scope of this article.

A local tax incentive or holiday for foreign investment thus may only permit the base country instead of the host country to tax the resulting profit with no benefit for the investor. Alternatively, it may encourage the investor also to keep investing in relatively stable high tax countries because of the "taxes paid" credit offset available from his tax holiday investment. For this reason such incentives should be discretionary and should be discussed on a case by case basis with the foreign investor. Unfortunately this procedure is infrequent.

The direct benefit to an investor of a tax holiday is therefore very limited unless the resulting profits can be transferred abroad without a tax upon receipt in the transferee (base) state. The indirect incentives available to the investor through base country tax laws and treaties may be significant, but not directed to the goals of the state giving up the tax base through the incentive.


58. For the initiation of a study of tax incentives (and disincentives) by developing (and developed) countries, and for the proposal of subsidized infrastructure and plant leasebacks by host countries as a solution to tax incentives neutralization by base country tax laws, see Tax Treaties between Developed and Developing Countries, U.N. Doc. ST/ESA/42, at 56 (6th Report 1976); see also Tax Treaties between Developed and Developing Countries, U.N. Doc. ST/ESA/18, at 135 (5th Report 1975).

59. See Guidelines, supra note 57; Bryan, supra note 57; see also Tax Treaties between Developed and Developing Countries, U.N. Doc. ST/ESA/188, at 163 (3d Report 1973). For a discussion of tax policy and development, and in particular the problems of "tax sparing" by base countries of host country incentives, see Geiger, Steuerrecht und Entwicklungspolitik, 15 Deutsches Steuerrecht 423 (1977), and works cited therein.

The permissible limits of "deferral" (5-10-20-50- years) as a means of avoiding foreign recapture of incentive-generated "profits" would require a separate study. Such indefinite deferral can be designed as the discounted tax flow equivalent of a grant. To do this it must be acceptable as a true tax liability in the period originally incurred for base country accrual tax accounting but must not burden the balance sheet in the host country for shorter term financing. Leibman, A Formula for Tax Sparing Credits in U.S. Tax Treaties with Developing Countries, 72 Am. J. Int'l L. 296 (1978).

60. Taxation of Private Investments in Developing Countries by: Federal Republic of Germany (U.N. Sales No. E.72.XVI.3); Taxation of Private Foreign Investments in
<table>
<thead>
<tr>
<th>Table 4</th>
<th>Investment Incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>With respect to a</strong></td>
<td><strong>Enterprise or investment by</strong></td>
</tr>
<tr>
<td>1. new</td>
<td>1. anyone</td>
</tr>
<tr>
<td>2. additional</td>
<td>2. foreign investors</td>
</tr>
<tr>
<td>3. new, additional (modernizing or transforming)</td>
<td>3. local investors under foreign ultimate control</td>
</tr>
<tr>
<td></td>
<td>4. local investors</td>
</tr>
<tr>
<td></td>
<td>5. local investors not having their principal place of business in a designated territory</td>
</tr>
<tr>
<td></td>
<td></td>
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<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

**Investment (ii) (see 25 below)**

10. Cash grants or financing of construction and equipment of a plant at x% of below normal mortgage rates and aid in acquiring plant

11. Aid for investment studies and business promotion

12. National investment company (temporary) investment capital

13. Free infrastructure and utility connections and guaranteed reduced freight and utility rates

**Financing (see 10 above and 24 below)**

14. Guarantees for constructing and equipping plant at prime lender loan rate, or on lease purchase

15. Interest rate rebates, interest free loans or financing advantages and interest subsidies

16. Guarantees for loans for working capital of x% of annual payroll created, y% of needs or z% of turnover

**Personnel (see 5 above)**

17. State aid in recruiting personnel and hiring grants, and worker relocation allowances and housing

18. Training at a cost of up to x units of money for every job created plus bonuses for technical training

19. Facilitation in obtaining work permits for foreign nationals for up to x% of the work force of the plant

20. Temporary tax exemptions of foreign managers

**Commerce (see 1, 7, 15 above)**

21. Aid in acquiring patent and trademark rights

22. Assistance in bidding in state contracts

23. Export incentives and credit guarantees

24. Exchange control advantage

**Research**

25. Grants, interest free loans and incentives for research and development
Table 4 cont’d.

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>d</strong></td>
<td><strong>e</strong></td>
<td><strong>f</strong></td>
</tr>
<tr>
<td>For such investments which in the designated areas (i)</td>
<td></td>
<td>(Host Country’s)</td>
</tr>
<tr>
<td>1. Creates or upgrades at least in jobs (over a minimum)</td>
<td></td>
<td>1. Federal govern-</td>
</tr>
<tr>
<td>a: for every x jobs,</td>
<td></td>
<td>ment</td>
</tr>
<tr>
<td>b: for every y units of wages paid,</td>
<td></td>
<td>2. Local govern-</td>
</tr>
<tr>
<td>c: for every z units of investment</td>
<td></td>
<td>ment</td>
</tr>
<tr>
<td>2. Guarantees to put over x units of money or y% of sales and/or profits into annual re-</td>
<td></td>
<td>3. Industrial De-</td>
</tr>
<tr>
<td>search</td>
<td></td>
<td>velopment au-</td>
</tr>
<tr>
<td>3. Hires handicapped, aged, young, unskilled or technically unemployable persons: for every y</td>
<td></td>
<td>thority</td>
</tr>
<tr>
<td>employees and z units of wages</td>
<td></td>
<td>4. International</td>
</tr>
<tr>
<td>4. Represents a new industry and manufacture of new products</td>
<td></td>
<td>or Regional</td>
</tr>
<tr>
<td>5. Aids depressed/favored industries or areas</td>
<td></td>
<td>Body</td>
</tr>
<tr>
<td>6. Conserves or develops natural resources and provides a sound infrastructure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Promotes exports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Causes the import of significant capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Improves work conditions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Improves productivity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Creates or preserves viable stable industries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Reduces imports</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(i) These regulations frequently include provisions limiting the application of all or part of the advantages to part of the territory administered.

(ii) See Tax Treaties, infra note 59, at 98, on the economic need for incentives to reinvest earnings, and for a general summary of incentives.
Generally, the author has found the specific amount of most incentives to be secondary considerations to investors, compared to a favorable business climate in the site of investment.

C. Importation and Remuneration of Foreign Intellectual Property Rights

It appears that every country wishes to develop the technological level of its enterprises, to encourage basic and applied research and to aid in the technical improvement of the skills of its nationals. Table 5\textsuperscript{61} catalogues present regulation in this area and other methods of regulation which may encourage the diffusion of technology, if one assumes that this is an appropriate and effective area for such regulation.

Unfortunately, this has proved to be the hardest area for legislation and administrative regulation, since the value, utility and useful lives of licenses and knowhow are difficult to control, and are subject to the decisions of the base country enterprise’s management.

This area of regulation is an excellent example of the effects of continuing regulations on the ultimate success and growth or disappearance of the enterprise. Certain countries (Mexico,\textsuperscript{62} Argentina,\textsuperscript{63} Brazil,\textsuperscript{64} the Andean Pact.\textsuperscript{65})

\textsuperscript{61} Table 5 is Annex 3, Table C.


Spanish law has attempted to legislate technological development by restricting payment for technology.

The result has been to discourage the introduction of current highly developed technologies rather than to encourage the creation of industries based on technology existing in the country.

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66. For background information, see Poubo, New Ruling on Transfer in Spain, 1975 LES NOUVELLES 70 (June 1975); Address by Antonio Garriguer Walker, Japanese Investment in Spain, Institute of Business Administration and Management — IBAM, Tokyo, Japan (Jan. 1972) (copy available from the author).

67. See, e.g., Annex 3, Table C: a(15); b(13); c(1 or 2), and d(4 or 0).
The control of payments for knowhow is one of the most subjective and difficult areas to regulate since many valid patents exist for products which are of little or no economic benefit to the host country, i.e., toys, disposable replacements for existing traditional products and import-dependent products of low social necessity. License fees appear to be a logical form of compensation for such patent rights, while valuable knowhow is difficult to define and its remuneration is harder to explain in a regulatory framework.68

This area calls for an administrative structure with a large degree of discretion in the approval (preferably not ex post facto) of the allowable compensation for imported technology, and the period during which such technology must be paid for. Regrettably, such administrative discretion is the essence of the local uncertainty which discourages even serious investors and encourages local corruption and graft in some countries.

It is suggested that a solution to some of these uncertainties might be for the host nation to insist that the host nation enterprise benefit from the most favorable terms extended to any related or third party by the licensor. Such a 'most favored licensee' clause could take account of the declining value over time of technology subject to license.

D. Foreign Banks and Financial Transactions — Exchange Controls

Regulation relating principally to activities after the initial foreign investment is made is exemplified by the exchange controls of many countries which prohibit residents or nationals from maintaining bank accounts abroad. In detail, such regulations may be described as having one or more of the elements set out in Table 6.69

In view of this matrix consider the problem at a(1)-b(3)-c(1)-d(2) for the foreign investor who wishes to give a local national signatory powers on one of the group bank accounts managed from his country but located abroad. Frequently such permission, part of the normal increase of the professional responsibilities of the local employee, is excluded by a law too broadly worded.

Consider the case of France at a(5)-b(4)-c(1)-d(3) where it is forbidden to send any 'check' abroad. An American visiting France who mails his check on a U.S. bank to his U.S. landlord could find his check confiscated by French customs and a penalty imposed equal to five times the face value of the check.70 Fortunately, this rule is rarely enforced except as to French nationals at present. Nevertheless, the U.S. embassy had to obtain a special authoriza-

68. For a discussion of fees for technology as an apparent means of transferring profits, without regard to the real value of the technology, see LALL & STREETEN, supra note 12, at 145-50.
69. Table 6 is Annex 3, Table D. No complete review of exchange controls is attempted in view of the information available in INTERNATIONAL MONETARY FUND, 29TH ANNUAL REPORT ON EXCHANGE RESTRICTIONS (1978).
<table>
<thead>
<tr>
<th>a (ii)</th>
<th>b country &quot;x&quot;</th>
<th>c (ii)</th>
<th>d</th>
<th>e</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. No national of 1. may have 1. foreign 1. bank accounts 1. in any case</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. No permanent resident of (i) 2. may have any 2. foreign currency 2. security amounts 2. without approval of the central bank or Finance Ministry</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. No person ordinarily resident in (i) 3. may have signature on 3. local non-resident 3. overdraft accounts or borrowing 3. except through an authorized intermediary (national bank)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. No resident of (i) 4. may make any transfer of funds to or in or among 4. currency hedging contracts 4. except with respect to re-transfer of authorized foreign investments within a specified period (and earnings thereon)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. No person on the territory of 5. may make transfers or loans of funds between domestic bank accounts 5. securities and means of payment 5. at the favored commercial exchange rate without authorization</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. No domiciliary of 6. may import or export instruments for 6. insurance contract 6. (Specific exemptions for commercial transactions are not covered in the examples.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(i) The word "resident" being variously defined, but including companies organized or registered in a state.

(ii) The counterpart of this regulation, relating to the right of non-residents to have internal accounts, is not here treated. As to controls by the base country on investments and transfers by its nationals and residents, see OECD, INVESTING IN DEVELOPING COUNTRIES (3d rev. ed. OECD 1975).
Similarly, errors in the design of other regulatory schemes to effect specific goals may interfere with business activities outside the scope of intended regulation. France can be cited as a developed nation whose regulations have been written by administrators having little practical business experience and little practical experience with the needs of multinational (non-French base country) businesses.

Regulations such as the French regulations\(^71\) and the Bank of England Exchange Controls of 1947\(^72\) illustrate the broad drafting of legislation. However, these regulations are rarely enforced due to administrative discretion. The uncertainty of such temporarily and informally suspended regulations may cause a foreign investor not to take the risk of a sudden and unforeseeable change of operating rules for his business. This is especially true where the tolerance accorded may be revoked by administrative fiat without legislative action or notice.

With the best intentions, the persons responsible for such regulations have discouraged financial and trading operations which would have only a positive effect on the national economy in terms of employment, investment and expertise generation, and would not eliminate jobs of nationals or divert national funds. The problem appears in several cases to be an absence of analysis of the economic effect of those rules on the matrix\(^73\) which need not apply in certain cases, such as foreign companies or export oriented companies (subsidiaries) of national groups. A liberal policy of exemptions and binding ruling letters on key issues could soften the risk posed by abrupt changes in general regulations, or in their application. When an investor wishes to create such an operation it is suggested that a specific ruling be requested upon the specific set of facts involved and showing the economic benefit to the host country.

V. CONCLUSION AND RECOMMENDATION

Where, then, should financial regulations exist? This important question has not been regarded in sufficient detail in the form of decision matrices to enable political and economic desires to be transformed into a regulatory frameworks. Each set of conditions may require a different approach; how-


\(^73\) See Annex 3, Table D.
ever, each regulatory approach should incorporate national goals and attitudes regarding the desirable scope of regulation.

This author contends that the field of economic regulation of foreign investment is substantially underdeveloped. More detailed work will identify areas which may not be submitted to general regulation with desirable effect and areas where only extreme cases of abuse should be regulated. These must be distinguished from areas which have such clearly definable interest, particularly with respect to controls of currency movements, that general regulations can be justified even if the application in the particular case may seem inappropriate. Such regulation ideally should be conceived by administrators who are in contact not only with affected parties (existing investments and local suppliers, customers and competitors), but also with potentially affected parties and nations, particularly on fiscal questions. Such potentially affected parties are hard to locate and identify, normally would not wish to intervene in a legislative or administrative process, and generally would have no standing before an administrative body or court.

It is therefore suggested that a study of the economic effects and interrelationships of financial controls on foreign investment should be undertaken by the World Bank and the OECD Staff. Such a study would provide a base for greater understanding and efficient resolution of problems both in formulation of policy by government units and in government relations with investors. The concern of many enterprises regarding financial and other regulation of foreign investment appears to be the fear of the unknown as much as the fear of the known. Some of the mystery may disappear when present and proposed regulations are analyzed by the regulating authorities and by investors to determine the economic goals that are being sought and to what extent they are being served.

It is hoped that the matrix analysis system proposed in this article will aid both investors and host countries to investment in accomplishing such negotiations in their mutual best interests.

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74. For a brief discussion of investor attitudes, see note 5 supra.
**APPENDIX**

**Annex 1**

Examples of Differing Attitudes Towards Economic Considerations for Foreign Investment

<table>
<thead>
<tr>
<th>Economic Considerations</th>
<th>Base Country Attitude</th>
<th>Investor Attitude</th>
<th>Host Country Attitude</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>low labor cost</td>
<td>threat to base country employment</td>
<td>positive</td>
<td>desire to increase living standard</td>
<td></td>
</tr>
<tr>
<td>high tariffs</td>
<td>poor export market</td>
<td>negative for import of means of production or product. Protected market once established</td>
<td>desire to protect inefficient local production</td>
<td>usually host country also seeks to export transformed products</td>
</tr>
<tr>
<td>use of natural resources</td>
<td>neutral, unless competitor (negative) or user (positive)</td>
<td>positive</td>
<td>fear of exploitation of low-cost internal labor</td>
<td></td>
</tr>
<tr>
<td>labor intensive investment</td>
<td>threat to local employment</td>
<td>positive - subject to labor law</td>
<td>positive</td>
<td></td>
</tr>
<tr>
<td>participation in trade zone</td>
<td>neutral or positive</td>
<td>positive unless entrenched competition</td>
<td>positive need for sheltered export markets</td>
<td></td>
</tr>
</tbody>
</table>
Annex 2

Financial Regulations of Foreign Investment

1) **Regulation of Investment** (Sector, location and capital)
   A. Protected sectors and limits on foreign ownership
   B. Preliminary permissions and investment incentives
   C. The right to expand (linear, diversifying, integrating growth)
   D. Minimum capital structure and equilibrium
   E. Repatriation controls and guarantees

2) **Regulation of Financing Operations**
   A. Use of external loans and guarantees
   B. Borrowing on local and foreign markets
   C. Intercompany loans and interest
   D. Split exchange rates and investment discounts and premiums

3) **Regulation of Currency Transactions**
   A. Sending checks, instruments of payment and securities abroad
   B. Making transfers abroad
   C. The right to have foreign bank accounts
   D. Availability of foreign exchange; set off and paired import and export transactions
   E. Covering forward transactions and capital erosion
   F. Putting up tender bonds domestically or abroad
   G. Insuring risks and benefits abroad

4) **Regulation of Operations and Trade**
   A. Importation of patents, trademarks, knowhow and payment of royalties
   B. Payment of commissions to foreign agents (affiliates or others)
   C. Management and service fees
   D. Parent company guarantees to third parties to aid operations
   E. Intercompany supply and marketing contracts
   F. Deposits and taxes on payments abroad or imports
   G. Customs and regulations of imports of goods and equipment

5) **Regulation of Profits and Distributions**
   A. Reserves and dividends — Limited rate of return
   B. Withholding taxes on dividends, interest and royalties paid abroad
   C. Loans abroad to related parties
   D. Treaty implications and tax sparing

6) **Regulation of Personnel**
   A. Payment of hard currency salaries and insured or other benefits
   B. Living allowances and advantages
   C. Repatriation of funds of foreign personnel (during and at end of stay)
   D. Currency allowances for foreign business travel; time exigencies
   E. Exemption of foreign nationals from local rules prohibiting foreign financial accounts and investments
   F. Role of foreign managers and technicians

7) **Taxes**
   A. Income
   B. Turnover
   C. Social taxes and transferability of benefits
   D. Capital
   E. Excise and transfer of assets
### Annex 3

**Table A: Financing Investment and Operations — Capital Controls**

<table>
<thead>
<tr>
<th>(i)</th>
<th>(a) shall be supplied by</th>
<th>(b) from sources</th>
<th>(c) to the extent of</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>The initial investment</td>
<td>1. Authorized Investment capital (iii)</td>
<td>1. Outside the host country</td>
</tr>
<tr>
<td>2.</td>
<td>Total long term capital needs</td>
<td>2. Long term private financing</td>
<td>2. Within the host country</td>
</tr>
<tr>
<td>3.</td>
<td>Total capital and operating needs</td>
<td>3. Long term bank financing</td>
<td>3. In the base country</td>
</tr>
<tr>
<td>4.</td>
<td>Financing accorded to suppliers</td>
<td>4. Short term loans from (non bank) sources</td>
<td>4. In host country (internal) currency</td>
</tr>
<tr>
<td>5.</td>
<td>Financing accorded to customers</td>
<td>5. Short term bank financing</td>
<td>5. In non-host country (external) currency</td>
</tr>
<tr>
<td>6.</td>
<td>Financing for any purpose from or to related persons</td>
<td>6. Loans and facilities granted against guarantees provided by a first class host country bank</td>
<td>0. Anywhere (no regulations)</td>
</tr>
<tr>
<td>7.</td>
<td>Import financing</td>
<td>7. Loans and facilities granted against guarantees provided by a first class foreign bank or other institution (strawmen)</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Export financing</td>
<td>8. Loans of related parties</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td></td>
<td>9. Guarantees of related parties</td>
<td></td>
</tr>
<tr>
<td>(a) (i)</td>
<td>(b) shall be supplied by</td>
<td>(c) from sources</td>
<td>(d) to the extent of</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>10. Swap transactions with foreign deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. (For export credit incentives see Annex 3, Table B)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. (For tax incentives see Annex 3, Table B(c))</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. (For reinvested earnings see Annex, 3 Table B(c))</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0. Any means</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**General Notes**

(i) Choices on the matrix are expressed as the sum of the elements selected across the matrix. Thus in A: \(1 + 1 + 1 + 1\) expresses the initial investment shall be supplied by Authorized Investment capital from sources outside the host country to the extent of 100% or regulatory language to that effect.

(ii) \(x\) and \(y\) singly or together may equal under 100%.

**Notes to Example A**

(iii) The nature of investment approvals, limits, or guarantees on repatriation of capital and profits, and protection guarantees against capital erosion constitute other matrices not presented here. See Boddewyn, supra note 12, at 19. The grounds for such approval are generally those governing the availability of incentives. See Example B column d, and Example D column e item 4. As to base country regulations and incentives see OECD, INVESTING IN DEVELOPING COUNTRIES (3d rev. ed. OECD 1975).
Table B: Investment Incentives

<table>
<thead>
<tr>
<th>a</th>
<th>b</th>
<th>c</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>With respect to</strong> a</td>
<td><strong>Enterprise or investment by</strong></td>
<td><strong>The incentive(s) of</strong></td>
</tr>
<tr>
<td>1. new</td>
<td>1. anyone</td>
<td><strong>Taxes (ii) (see 10 below)</strong></td>
</tr>
<tr>
<td>2. additional</td>
<td>2. foreign investors</td>
<td>1. Exemption or reduction of income tax (federal and local): special exemption of export earnings for x years (exemption of incentive payments)</td>
</tr>
<tr>
<td>3. new, additional or existing (modernizing or transforming)</td>
<td>3. local investors under foreign ultimate control</td>
<td>2. Exemption from property taxes and local tax</td>
</tr>
<tr>
<td></td>
<td>4. local investors</td>
<td>3. Exemption from excise taxes, business licenses, stamp, transfer, capital contributions taxes</td>
</tr>
<tr>
<td></td>
<td>5. local investors not having their principal place of business in a designated territory</td>
<td>4. Exemption from turnover or use and sales taxes</td>
</tr>
<tr>
<td></td>
<td><strong>Investment (ii) (see 25 below)</strong></td>
<td>5. Exemption from x years of social charges on (all/loca/technical/manual/old/young) workers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6. Exemption from inventory tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7. Exemption from customs duties and import restrictions or depletion allowances of over 100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>8. Accelerated amortization of capital equipment, or depletion allowances of over 100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9. Tax credits for purchases and construction of assets</td>
</tr>
<tr>
<td></td>
<td><strong>Financing (see 10 above and 24 below)</strong></td>
<td><strong>Personnel (see 5 above)</strong></td>
</tr>
<tr>
<td></td>
<td>14. Guarantees for constructing and equipping plant at prime lender loan rate, or on lease purchase</td>
<td>17. State aid in recruiting personnel and hiring grants, and worker relocation allowances and housing</td>
</tr>
<tr>
<td></td>
<td>15. Interest rate rebates, interest free loans or financing advantages and interest subsidies</td>
<td>18. Training at a cost of up to x units of money for every job created plus bonuses for technical training</td>
</tr>
<tr>
<td></td>
<td>16. Guarantees for loans for working capital of x% of annual payroll created, y% of needs or z% of turnover</td>
<td>19. Facilitation in obtaining work permits for foreign nationals for up to x% of the work force of the plant</td>
</tr>
<tr>
<td></td>
<td><strong>Commerce (see 1, 7, 15 above)</strong></td>
<td>20. Temporary tax exemptions of foreign managers</td>
</tr>
<tr>
<td></td>
<td>21. Aid in acquiring patent and trademark rights</td>
<td><strong>Research</strong></td>
</tr>
<tr>
<td></td>
<td>22. Assistance in bidding in state contracts</td>
<td>25. Grants, interest free loans and incentives for research and development</td>
</tr>
<tr>
<td></td>
<td>23. Export incentives and credit guarantees</td>
<td>24. Exchange control advantage</td>
</tr>
</tbody>
</table>
Table B Cont’d.

<table>
<thead>
<tr>
<th>d</th>
<th>e</th>
<th>f</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For such investments which in the designated areas (i)</strong></td>
<td></td>
<td>(Host Country’s)</td>
</tr>
<tr>
<td>1. Creates or upgrades at least in jobs (over a minimum)</td>
<td>1. Shall be made</td>
<td>1. Federal government</td>
</tr>
<tr>
<td>a: for every x jobs,</td>
<td>2. May be made by</td>
<td>2. Local government</td>
</tr>
<tr>
<td>b: for every y units of wages paid,</td>
<td>3. Shall be within the authority to make of</td>
<td>3. Industrial Development authority</td>
</tr>
<tr>
<td>c: for every z units of investment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Guarantees to put over x units of money or y% of sales and/or profits into annual research</td>
<td></td>
<td>4. International or Regional Body</td>
</tr>
<tr>
<td>3. Hires handicapped, aged, young, unskilled or technically unemployable persons: for every y employees and z units of wages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Represents a new industry and manufacture of new products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Aids depressed/favored industries or areas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Conserves or develops natural resources and provides a sound infrastructure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Promotes exports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Causes the import of significant capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Improves work conditions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Improves productivity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Creates or preserves viable stable industries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Reduces imports</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(i) These regulations frequently include provisions limiting the application of all or part of the advantages to part of the territory administered.

(ii) See TAX TREATIES, supra note 59, at 98, on the economic need for incentives to reinvest earnings, and for a general summary of incentives.
<table>
<thead>
<tr>
<th>(a)</th>
<th>(b)</th>
<th>(c)</th>
<th>(d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To a host country enterprise by</td>
<td></td>
<td>Shall be transferred for a price which shall not exceed (x%) of</td>
<td>Increased/decreased proportionally to the percentage of</td>
</tr>
<tr>
<td>1. All patents sold</td>
<td>1. A foreign entity</td>
<td>1. The value of the goods produced thereby</td>
<td>1. Foreign sales as a percentage of turnover</td>
</tr>
<tr>
<td>2. All patents licensed</td>
<td>2. An entity under foreign control</td>
<td>2. The total turnover of the enterprise</td>
<td>2. Increase of turnover attributable thereto</td>
</tr>
<tr>
<td>3. All trademarks &amp; copyrights granted</td>
<td>3. Any transferor related to the transferee</td>
<td>3. The value as depreciated of the capital equipment operating with respect thereto</td>
<td>3. Increase of employment attributable thereto</td>
</tr>
<tr>
<td>4. All knowhow transferred</td>
<td>4. Any transferor</td>
<td>4. The total related salaries of the enterprise</td>
<td>4. (The percentage of ownership or control of the transferee held directly or indirectly by the transferor)</td>
</tr>
<tr>
<td>5. All knowhow not available locally transferred</td>
<td></td>
<td>5. The lowest rate or price charged to any unrelated user</td>
<td>5. Research investment made in the country</td>
</tr>
<tr>
<td>6. All intellectual property rights sold or licensed</td>
<td></td>
<td>6. Their reasonable value (minimum amount)</td>
<td>6. (Components purchased from, or taxes paid for and fees paid to the licensor)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>7. (Product which must be sold back to the licensor)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8. No provision</td>
</tr>
</tbody>
</table>

(i) The provisions for authorization of such remuneration would present a separate matrix.

(ii) See Tax Treaties, supra note 59, at 45, on gross or net taxation and withholding rates as an additional means of limiting the return to the licensor.
Table D: Foreign Banking and Financial Transactions — Exchange Controls

<table>
<thead>
<tr>
<th>a (ii)</th>
<th>b country “x”</th>
<th>c (ii)</th>
<th>d</th>
<th>e</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. No national of 1. may have</td>
<td>1. foreign</td>
<td>1. bank accounts</td>
<td>1. in any case</td>
<td></td>
</tr>
<tr>
<td>2. No permanent resident of (i) 2. may have any interest in</td>
<td>2. foreign currency</td>
<td>2. security amounts</td>
<td>2. without approval of the central bank or Finance Ministry</td>
<td></td>
</tr>
<tr>
<td>3. No person ordinarily resident in (i) 3. may have signature on</td>
<td>3. local non-resident</td>
<td>3. overdraft accounts or borrowing</td>
<td>3. except through an authorized intermediary (national bank)</td>
<td></td>
</tr>
<tr>
<td>4. No resident of (i) 4. may make any transfer of funds to or in or among</td>
<td>4. currency hedging contracts</td>
<td>4. except with respect to re-transfer of authorized foreign investments within a specified period (and earnings thereon)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. No person on the territory of 5. may make transfers or loans of funds between domestic bank accounts</td>
<td>5. securities and means of payment</td>
<td>5. at the favored commercial exchange rate without authorization</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. No domiciliary of 6. may import or export instruments for</td>
<td>6. insurance contract</td>
<td>6. (Specific exemptions for commercial transactions are not covered in the examples.)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(i) The word “resident” being variously defined, but including companies organized or registered in a state.

(ii) The counterpart of this regulation, relating to the right of non-residents to have internal accounts, is not here treated. As to controls by the base country on investments and transfers by its nationals and residents, see OECD, INVESTING IN DEVELOPING COUNTRIES (3d rev. ed. OECD 1975).
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B. BANQUE FRANÇAISE DU COMMERCE EXTÉRIEUR, LES IMPLANTATIONS FRANÇAISES À L'ÉTRANGER (1975). This work is not referred to in the case analyses as it presents exclusively and comprehensively the advantages of investing abroad, particularly to develop French export. Foreign investors in France can thus reinvest in a third country.


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2. 89/1967 (Ref. Bc).
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Cyprus

A. Letter from Dr. Achilles C. Emilianides, Esq. of Nicosia (Jan. 5, 1978) (Ref. Aa, b, c, d; Ca, b, c; Da, b, c, d).
B. MINISTRY OF FINANCE, NICOSIA, TAX INCENTIVES IN CYPRUS (1977) (referring to the Income Tax Laws No. 37 of 1975 and No. 15 of 1977) (Ref. Ba, b, c, d, e, f).
C. Chrysostimides, The Legal Aspects of Foreign Investments in Cyprus, ANNUAIRE DE L’AAA DE L’ACADÉMIE DE DROIT INTERNATIONALE DE LA HAYE (to be published in 1980).

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B. Yoon, Legal Aspects of Foreign Investment in the Republic of Korea, 10 INT’L LAW. 729 (1975).
C. M. LIN & K. KILIMNIK, LEGAL ASPECTS OF DOING BUSINESS IN TAIWAN (1977) (Ref. Aa; Ba, c, d; De).

Tunisia

B. Law 69-35, Code des Investissements (favoring capital importation); Law 74-74 of 3 August 1974, Incentives for Employment Creation; Law 72-38 of 27 April 1972 (favoring export industries) (Ref. Aa, b, c, d; Ba, b, c, d, e, f; Da, b, c, d, e).