LEGAL STRUCTURES FOR THE RESOLUTION OF INTERNATIONAL PROBLEMS IN THE DOMAIN OF PRIVATE FOREIGN INVESTMENTS: A THIRD WORLD PERSPECTIVE NOW AND IN THE FUTURE

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I. INTRODUCTION

For better or for worse, probably for the worse in view of their overwhelming negative economic, cultural and psychological consequences in most underdeveloped countries, many Third World countries believe that private foreign investments have a critical role to play in the process of development. Yet even the most liberal of these countries have, in varying degrees, introduced or begun to introduce national measures intended to direct and control the extent, nature and areas of operation of foreign private enterprises within their national economies.

With the changing nature of foreign private investments, national measures have in general been adapted to cope with the new situations as they arise. Investments are no longer limited to ownership of subsidiaries and affiliates or branches but are increasingly taking the form of equity shareholdering in joint ventures, technological input, personnel and management. Problems that generally arise with respect to private foreign investments include those relating to nationalization, taxation, remittance of profits and royalties as well as professional fees, and terms and conditions of employment of both local and expatriate personnel.

These problems have been and continue to be resolved by various legal and non legal techniques. If the experiences of the past decades are any indication, one would expect further erosion of the traditional patterns of private foreign investments. Increased local participation, whether government or private, is to be expected. The "technojurist" can then be expected to devise legal structures to cope with the new situation.

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1 The expression "technojurist" is used here to designate a jurist who confines himself to purely legal aspects of a social phenomenon to the detriment of other basic meta-legal factors.
This paper intends to analyse the evolution of practices with respect to the resolution of international problems relating to private foreign investments. It is hoped that an historical approach will assist us in predicting the direction of change in the next forty years.

There are, however, certain definitional and substantive problems that must be resolved in order to enable the reader to understand the focus of the paper. The definitional problems relate to the terms, "legal structures," "international" and "problems."

On the face of it, the term "legal structures" would seem to relate only to the institutional framework for the resolution of international problems. Since institutions by themselves, though necessary, are not enough for the resolution of problems, it is our understanding that substantive and procedural rules are intended to form part of the "legal structures."

The term "international" is capable of a narrow or wide interpretation. In classical international law, or indeed international relations, the term was used to cover only relations between subjects of international law which, before the emergence of international organizations endowed with international legal personality, embraced only States. It is now widely accepted that private persons, even when they do not possess international personality, have a role to play in international relations; and that insofar as their operations cut across national boundaries they can be categorized as international. Furthermore, even if one were to regard such activities as initially purely private and, therefore, falling outside the ambit of international regulation, international law either in the form of ever controversial minimum standards or treaties is invariably invoked.

In ordinary parlance the word "problems" is very wide and could be used to cover all manner of issues including disputes that may arise at the international level. Since, however, the subject matter deals with legal structures, it is presumed that we are concerned with judicial or quasi-judicial methods of settlement of disputes and/or problems. It is not unusual for international agreements to provide for nonjudicial methods of resolving international problems such as by negotiation or conciliation.\(^2\)

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such circumstances it is the legal structure that creates the basis for the nonjudicial processes.

Finally, the substantive issue relates to the apparent assumption that "legal structures" are the primary means for the resolution of international problems. It is one of the fundamental postulates of this paper that the resolution of international problems is not a purely mechanical affair. The law, including its institutions and substance, has invariably, though not exclusively, responded to the basic structure of society often characterised by social relations which have been determined by the control of economic and political power.

In interstate relations power has invariably determined the nature of economic relations, and in the field of private property, and indeed private foreign investments, this pattern can be amply demonstrated.

The point is that in making a prognosis as to the resolution of international problems in the next forty years, it will serve little or no purpose to concentrate on purely legal techniques, rules and institutions. The ultimate determinant of legal phenomenon must form the point of departure for our efforts. Thus the balance of forces, such as competing ideologies and the state of development or underdevelopment, among others, will form part of the equation of our analysis.

This paper will deal with the resolution of problems arising from private foreign investments both at the national and international levels. While it is recognized that effective resolution of such problems may involve questions of recognition and enforcement of foreign judgements, time and space will not allow for their treatment in this paper. Nor will the problems that might arise where, as is increasingly the case in many Third World countries, states are becoming parties to foreign investment ventures be dealt with here.

II. PROBLEM RESOLUTION IN HISTORICAL PERSPECTIVE

The expansion of capitalism, especially after the industrial revolution, led not only to the conquest and appropriation of foreign lands but also to the extension of capitalist philosophy as well as economic relations to the new world. Increased economic

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relations with non-European states led to the establishment of norms that would govern such relationships. It was during this period that the so-called minimum standard of international law was established. Initially enforced by the United Kingdom, at the epoch the leading maritime and financial power, it was subsequently strengthened and supported by other capitalist countries, among whom was the United States.4

It was sought to apply the minimum standard, enshrining as it did capitalist principles, a concept that had already been applied between European states, to the new actors in international relations. This standard was reinforced by the principle of state responsibility which purported to impose obligations on states to make reparations in the event of a breach of the minimum standard of international law.

It has proved difficult to determine the exact contents of the minimum standard of international law. Proponents of this standard conceded to the State the right to rectify alleged wrongs relating to private foreign investments which have taken place in areas or by persons within its jurisdiction. If the state failed to meet the requirements of the minimum standard, such as by denial or delay of justice or by the nonexistence of due process, that state was said to have committed a breach of international law. Thus, a dispute originally within the purview of domestic regulation was transmuted into an international dispute.

Apart from the imprecise nature of the minimum standard of international law the very validity of the concept has been subject to constant challenge. The Russian Bolshevic Revolution of 1917, the Mexican Constitution of 1917 providing for nationalization of agrarian lands, and the emergence of states hitherto under colonial rule to independence, shattered the foundation and apparent stability of the international economic legal order.

With respect to nationalization of alien property, the argument has been advanced that for the requirements of the minimum standard to be met, the taking must be for public purpose and the compensation to be paid must be full, i.e. adequate, prompt and effective. It has been refuted that such requirements were met during nationalization in Europe, and many Third World countries have challenged the validity of such requirements. In fact, the decisions in two recent cases arising from the Anglo Iranian Oil

4 SCHWARZENBERGER, supra note 3, at 61.
nationalization measures do not support the existence of such a minimum standard of international law.\(^5\)

From the foregoing discussion, it is already clear that even the very substance of the law that should govern private foreign investments is not agreed upon. At the national level there have been variations of the so-called minimum standard. Compensation where it is paid is normally "fair," although it may be argued that what is fair could be full or adequate. In some cases it is paid out of future profits, and in others, by agreement, the payment may not be "effective" in the sense of being paid in convertible currency.

Related to the question of the minimum standard are two issues which have gained importance in recent years. These are the extent to which international law should impinge upon the right of a state to regulate private foreign investments and the competence of state tribunals or agencies to finally determine issues arising out of investment transactions.

It is not necessary for us to determine in this paper whether the passing of national regulations allegedly infringing on the minimum standard of international law by itself constitutes a breach of international law. What is clear is that if we accept the existence of such a minimum standard, we automatically impose a limit, in certain respects, on the right of a state to make laws and regulations as to the treatment of foreign investors in a host state.

It may further be argued that since the constitutions of many developing countries contain formulations similar but not necessarily identical in all cases with the traditional prescriptions for nationalization, in general espoused by the capital exporting countries, these could be regarded as general principles of law recognized by civilized nations. This argument does not hold much water since national constitutions are domestic legislation, albeit of a special type, and can be changed at will. Furthermore, experiences in many African countries show that the constitutions are susceptible to being overthrown or suspended and cannot, therefore, be regarded as sacrosanct.

We are left then with treaty law as the only solid base on which to construct concrete rules that should, to the extent that they are

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\(^5\) See Anglo Iranian Oil Company Ltd. V. Societa Kaisha, Japan ILR, 1953, at 305; Anglo Iranian Oil Company Ltd v. Societa Supor XXX. Italy, ILR, 1955, at 23. The British Case of Anglo Iranian Oil Company Ltd Jaffarate (The Rosemary) Aden ILR, 1953, at 316—was in favour of the status quo.
not governed by national regulation, govern and regulate problems that may arise from private foreign investments. As will be demonstrated later, even treaty law is inadequate to deal with the situation since it must invariably refer to other bodies of substantive law that should regulate problems arising out of private foreign investments.

There are certain areas, however, in which the competence of a state to legislate cannot be questioned. Thus in the fields of taxation, exchange control, labour legislation, immigration matters, and limits of foreign participation, all of which affect foreign investments, states have the untramelled right, subject only to international obligations expressly undertaken by them, to regulate them by national laws, regulations and policies.

Another related problem is that of machinery for the resolution of problems arising out of foreign investments. We have already shown that classical international law recognized the right of a host state to remedy a wrong that has been committed by persons or entities within its jurisdiction. Thus, it is not only the substantive and procedural laws of the host state that come into play, but also the relevant institutions that are empowered to apply regulations on private foreign investment. But the problem is not that simple. National laws, including conflicts of law rules, responding to the "free enterprise spirit" of western Europe and extended to most of the Third World during the colonial days, allowed parties to choose the law which should apply to their contracts, as well as the tribunal which has competence to deal with the matter. If no law was chosen, the parties were presumed to have chosen a particular system with which the transaction had some form of connection. This could mean that while the courts or tribunals of the host state might be seized of a problem, they could be obliged to apply some laws other than those of the host state. Where a tribunal other than that of the host state has been chosen, the conflict of law rules, where no express choice of law has been made, would determine what law is applicable.

III. VANISHING CONSENSUS ON TRADITIONAL RULES FOR THE RESOLUTION OF PRIVATE FOREIGN INVESTMENTS PROBLEMS

We have already indicated in connection with the minimum standard of international law with respect to conditions and terms of compensation for nationalized property, that there has been a diminishing consensus on its actual contents that renders it rather
precarious as a base for the resolution of investment problems. If some states have paid compensation, apparently on the basis of the traditional rules, the reason must, for the most part, be found outside the confines of normative rules. Pressures of all forms from the country of the investor, sometimes in alliance with other capital exporting countries, and the somewhat ambivalent need for future good relations with capital exporting countries would seem to suffice in many, if not in most, cases to induce compliance.

Third World countries are increasingly asserting the finality of national regulation in the field of private foreign investments. We have already referred to the Bolshevik Revolution of 1917 and the Mexican Agrarian Revolution as laying the foundations for assault against the traditional practice. Deriving rationalization from the Calvo Clause, Latin American states started inserting in their concession contracts clause under which foreign investors denounced their right to diplomatic protection. Subject to certain limitations with respect to the right to diplomatic protection if there was delay or denial of justice, arbitral tribunals tended on the whole to uphold the validity of Calvo Clauses. There had been in the interval various attempts by some Third World countries and Third World organizations to exclude international law as the final basis on which to resolve investment problems.

The Charter of Economic Rights and Duties of States, voted against by the majority of western capital exporting countries, confirmed this Third World posture by accepting that disputes arising from nationalization of alien property are to be settled by national courts and tribunals unless otherwise agreed.7

Given this state of uncertainty, western capital exporting countries have sought to use certain devices to restore the acceptance of some minimum norms of conduct that would regulate foreign investment transactions. Reliance is placed primarily on bilateral agreements which not only provide what law should govern a private foreign investment transaction but also the modalities and institutions for resolution of any problem arising therefrom. Some

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4 The Calvo Doctrine is the doctrine that a government is not bound to indemnify aliens for losses or injuries sustained by them in consequence of domestic disturbances, where the state is not at fault, and that therefore foreign states are not justified in intervening to secure the claims of their citizens on account of such losses or injuries. Such intervention, according to Calvo, is not in accordance with the practice of European States towards one another, and is contrary to the principle of state sovereignty. Black's Law Dictionary 257 (4th ed. 1951).

of these arguments, as already indicated, provide for non judicial methods of settlement of investment disputes before resort is had to judicial or quasi-judicial organs or tribunals.

Where judicial settlement is envisioned both domestic and international law, the latter either concurrently or at a later stage, are deemed to be applicable, thus leaving the problem of the extent of applicability of international law to private foreign investments unanswered.

At the multilateral level the IBRD (International Bank for Reconstruction and Development) Convention on the settlement of investment disputes could not provide a means around the impasse. What the Convention did do was to codify the status quo with all of its unresolved issues. Article 42 of the Convention contains the kernel of what law should apply to investment disputes. Under this provision the tribunal is to decide the dispute either in accordance with such rules of law as may be agreed by the parties, or the law of the contracting state party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.8

These unresolved problems remain some of the basic areas of divergence between the developed countries, including Eastern European countries, and the developing countries in the current effort to elaborate an International Code of Conduction of the Transfer of Technology under the aegis of UNCTAD. The developed countries of the west, in consonnance with the spirit of "free enterprise" and minimum interference in contractual relations, and the Eastern European countries, now internally much better organized and in a position to deal with and contain destabilizing effects of external forces, have opted on the whole for the traditional rules which allow, with certain limitations, free choice of law by the parties.9 The position of the Third World countries has remained essentially the same. Initially their position was that the law of the technology acquiring country should be applied by the courts or tribunals of the same. Even where some foreign law was to apply, the tribunal of the technology acquiring country would have competence to decide on the matter.

The current proposal of the Group of 77, which was circulated during the First Conference, makes a distinction between matters

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of public policy (ordre public) and sovereignty and matters of private interest. With respect to the former the law applicable shall be that of the acquiring country. It is further declared that "any contractual clause which would be in violation of the public policy (ordre public) and sovereignty of the acquiring state, particularly in matters concerning its governmental prerogatives or its legislative, regulatory or administrative powers, shall be null and void." The law applicable to matters of private interest is that which has a direct, effective and permanent relationship with the transaction. Parties can only choose a law which conforms with these requirements.

We do not intend in this paper to go into a juridical analysis of the terms used. Suffice it to say, however, that the Group of 77, even while adopting a somewhat less rigid position than was hitherto the case, has managed to indirectly retain the notion that, essentially the law of the technology acquiring country should govern transfer of technology transactions. This line of reasoning is confirmed by sub-paragraph 5, of paragraph A, which provides that "The law of the acquiring party shall apply to questions of characterization. In particular, it alone shall be applicable for the determination of matters that may not be submitted to arbitration or which concern public policy or sovereignty." While Group D countries are more interested in arbitration tribunals as avenues for the settlement of disputes, the Group of 77 and Group B countries lay more emphasis on judicial settlement of disputes. According to Group B, parties to a technology transfer agreement should be freely permitted to chose the court before which disputes relating to the agreement shall be tried. Any such choice should be given effect unless there is no reasonable basis (referring apparently to the traditional criteria enumerated in paragraph 7 (2) of Group B's text) or the choice places an onerous burden on one of the parties. In addition, parties are to be freely permitted to choose arbitration or other third party procedures.

Group of 77, consistent with its position on the applicable law, maintains that the courts and other tribunals of the technology acquiring country "shall have jurisdiction over disputes arising from

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10 Id. at 41-42, para. A.
11 Id. para. A(2).
12 Id. para. A(5).
13 Id. para. 7(4).
the conditions or effects of the contract which concern public policy (ordre public) or sovereignty. They shall also have jurisdiction over conflicts of characterization."

Contractual relationships, here clearly referring to matters of a private nature, may be subject to choice of forum or arbitration clauses, unless the technology acquiring country, prohibits, by express rules, such a free choice. Even where a choice of forum is allowed, such forum must have a direct, effective and permanent relationship with the contract. Exclusion, whether explicit or implicit, of the courts or tribunals of the technology acquiring country is declared null and void.

Essentially, therefore, arbitration is allowed only with respect to matters of private nature and even then, the choice has to conform to certain set criteria.

The problem of possible limits to the power of a state to legislate on matters of private investment has not been resolved by the Code negotiations. All are agreed that states have the right to adopt laws, regulations and rules, and policies with respect to transfer of technology transactions, but the perennial problem as to what extent international law impinges on this remains unresolved. Group B countries maintain that such a right is to be exercised in accordance with their international obligations under international law, treaties and other agreements, taking into account the provisions of the Code.\textsuperscript{15} Group D's position is somewhat more restrictive than that of Group B. According to the former, the right to legislate and adopt other regulatory measures is to be exercised on the basis of universally acknowledged principles and norms of international law and treaty obligations and with respect to the provisions of the Code.\textsuperscript{16} The requirement of universal acceptance obviously excludes the blanket application of the so called traditional customary international law and general principles recognized by the civilized nations. The Group of 77 has moved from its earlier position of insisting on no reference to international law at all, to accepting that parties to transfer of technology transactions should take into consideration "their commitments arising in this field from international treaty obligations to which they have subscribed and the provisions of

\textsuperscript{14} Id. para. B(1).

\textsuperscript{15} Id. at 9, para. 3(1).

\textsuperscript{16} Id.
the Code" maintaining as they do that the latter should be a legally binding instrument.

There are, thus, major divergences with respect to various aspects of the resolution of problems arising from private foreign investments. The three Groups have different views as to what law should apply, what tribunals should be seized of the problem, and the limits to the state power to control, by legislation or otherwise, transactions involving foreign private investments.

**IV. PROSPECTS FOR THE NEXT FORTY YEARS**

Why forty years? The period is arbitrary. So is the choice of the year 2000 or any other. The period seems reasonable however, to the extent that one might begin to have some impressions as to how the present bottlenecks epitomized by the failure of the North-South Dialogue, the two U.N. Development Decades, and perhaps the outcome of the third, fourth, fifth and sixth U.N. Development Decades, if they have not in the meantime been overtaken by events, to contribute to universally acceptable norms and institutions for the resolution of international problems arising out of private foreign investments.

One discerns some basic contradictions in the relations between the western developed countries and the developing countries. Neither trusts the other's laws or institutions. The developing countries, because the laws have been fashioned in such a manner that they consider them as antithetical to their basic interests insist on the position not only that their own laws apply, but that they should be applied by their own tribunals. They fear that even if their laws were to be applied by the tribunals of developed western countries, there is the danger of their being rejected or interpreted contrary to the intentions of the drafters of these legislations.

The developed western countries, on the other hand, would prefer that the traditional laws they have fashioned over centuries should, with marginal modifications, be applied to private foreign investments by their own tribunals.

When it comes down to it, however, it is neither the law nor the institutions by themselves that are the obstacles. It is the economic policies embodied in the laws and the orientation of the lawyers who interpret and apply these laws that make prospects of removing the stigma of underdevelopment from the social science dictionary most improbable. Some Third World countries
like Brazil, Mexico or India among others, might be under the illusion that they are about to join the club of the developed countries because either oil has been found in abundance in their territories or they can count a large number of industrial complexes, irrespective of who owns or controls them, the percentage of value added, or the extent to which the technological processes and managerial knowhow needed to produce both the capital and consumption goods have been internalized. This had led to certain authors predicting a schism in the Group of 77. For the moment, however, all the members of Group of 77 are dependent and none can count itself as developed. They, therefore, have a common interest in maintaining a unified front against the rest of the developed world.

As long as there exists a basic inequality between the developed and undeveloped countries the struggle to alter or maintain the rules of the game will persist. The prediction is that the struggle will last out the next forty years. But there will be a net gain for the Third World. Education, or maleducation is becoming increasingly available, and there is bound to be increasing consciousness among the peoples of the developing, or rather underdeveloped countries, even among the maleducated. Consequently, there is going to be a clearer understanding of class interests leading to further polarization of the classes. Governments, whether left or right, but more logically the former, are bound to be more responsive to the basic needs of the population of the Third World countries. The developed countries, in spite of their capacity to adjust to new situations and to overcome new crises, will learn that even they have limitations. The more and the better Third World countries are organized the more they will realize that there is no hope in striving to maintain the status quo underscored, as it is, with basically exploitative tendencies.

Both sides are bound to give and gradually by the time the forty years run out the world will have accepted the primary role of national regulation. Some rules might have been evolved at the international level, but they will create minimal norms or standards. The fact of the matter is that in the field of international

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17 Some people would like to call them developing without indicating from what base development is to be gauged.

18 It must be pointed out that India has achieved a considerable measure of industrialization, but still remains underdeveloped.
economic transactions, international law is still in an embryonic stage. It is bound to remain more or less the same in the next forty years. This is why we believe that those states that have the capacity and right political orientation to do so will resort more and more to national action.