

## INVESTMENT REGIME IN THE WESTERN HEMISPHERE

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**A** worldwide tendency towards economic globalization is reflected in the increase of international investment flows. Trade and investment are closely interrelated for they mutually reinforce each other. The importance of this activity as a building block to guarantee trade flows must be recognized by governments, who must work upon establishing a commitment to create a liberalized, stable and secure investment environment. A strong legal framework must be provided through the negotiations of bilateral, regional and multilateral agreements for the promotion and protection of investments.

«... we share a conviction that the free flows of worldwide investment is a good thing. For the business community, investment breaks down border barriers to markets and overcomes obstacles to success such as distance from markets and ignorance of local tastes. For the host economy, the issue of foreign investment has been largely divested of the ideological overtones of the 60's. Investment is recognized for what it is: a source of extra capital, a contribution to healthy external balance, additional employment [and training], effective competition, rational production, technology transfer and a source of managerial knowhow. Investment is no longer seen as a threat.» (1)

At the beginning of the 1980's many Latin American countries had vast access to voluntary loans by commercial banks. But by the mid 80's these countries were facing a debt which was setting them apart of the international capital flows. These countries had to turn their eyes to international financial assistance organizations and submit themselves to their adjustment programs. The new globalization tendency of the

1990's has renewed the chance of developing countries to get involved in capital flows through investments (direct and portafolio).

This phenomenon is due to the change in the development policies adopted by these countries which emphasized in trade and investment liberalization, markets deregulation and involvement of the private sector. (2) Some specific actions that illustrate this fact are: the consolidation of macroeconomic and political policies, the reduction of the external debt weight on exports as a result of promotion policies and the Brady Plan, the NAFTA process, liberalization processes to admit foreign capital access to several sectors, and the improvement of regional market perspectives. (3)

The flows of Foreign Direct Investment (FDI) in Latin America have increased from an average of 8.3 billion dollars in 1989-1990, to 23.6 billion dollars in 1994-1995. (4) FDI has favorably responded to a continuous effort of the developing countries to adopt liberalization and economic stabilization policies.

However, it is important to note that traditionally, Latin America was the main recipient of FDI in the developing world. But since the mid 80's South and Southeast Asia have taken this place. Between 1990 and 1994 Latin America received 28% of the total FDI flows towards developing countries, while Asia (including China) received 62%. (5)

The definition of an hemispheric investment policy, whose objective must be the improvement of the investment climate, is more and more important each day to guarantee capital flows in our economies. This is vital not only for the development of

the region, but also to create better regimes to the attraction of foreign investments within a world where a great number of countries and regions compete for that capital.

In general terms, foreign investment seeks a regime that provides transparent and stable laws and economic policies, fair and equitable treatment, certainty with respect to capital transfers, protection against expropriation by a justified procedure and compensation regime, predictable investment climate, and adequate dispute settlement procedure, and compensation for losses due to armed conflicts or similar events.

National regimes in the Americas may vary from country to country, but generally they all have constitutional regulations «guaranteeing private property, free enterprise, and equal treatment of both nationals and foreigners. Some... countries [have] express references to foreign investment in their constitutions, indicating that equal treatment of national and foreign investors is expressly guaranteed, as well as the possibility of recourse to national or international arbitration in case of dispute». (6) Basically these regimes recognize several general principles regarding treatment given to investors and their investments: fair and equitable treatment, full protection and security, non-discrimination, transparency, national treatment, and most-favored-nation treatment.

Even though there are differences in the way the countries of the Hemisphere grant these basic principles, in general terms, they are applied consistently. These principles also set the basis for the regulations of more specific and concrete issues such as basic definitions and scope of application (defining what will be considered investment and who will be seen as an investor), expropriation and compensation, performance requirements, foreign key personnel, compensation for losses, transfers, country-specific reservations, general exceptions and dispute settlement.

The approach stated in Jakarta in November 1994 of Non-Binding Investment Principles, in the APEC model, differs from the treatment so far given to these topics in the FTAA process, in the sense that APEC does not distinguish between issues and principles. The Non-Binding Investment Principles list both what we consider general principles and the subjects that should be regulated by an investment legal framework.

During the Summit of the Americas held in Miami, the Presidents of the countries of the Hemisphere recognized in the Declaration of Principles, the need to promote prosperity through economic integration and free trade. The mandate given is to start building a FREE TRADE AREA FOR THE AMERICAS (FTAA), «in which barriers to trade and investment will be

progressively eliminated,» (7) and the negotiations would be concluded by the year 2005. Preparatory Works for future negotiations have been carried out since the Ministerial Meeting held in Denver, Colorado in 1995. Since then, twelve Working Groups have been created, including the Hemispheric Working Group on Investment.

Although the FTAA is still in a preparatory period, the Ministers have elaborated several principles to be followed throughout the preliminary works by the Working Groups and other instances, and that may be adopted in the negotiation phase. These principles include the use of consensus for decision making; consistency with WTO Agreements; individual or joint negotiation of the countries; coexistence of other regional or subregional integration processes; a single undertaking agreement; and recognition and consideration of the needs and possibilities of smaller economies.

The Working Group on Investment was given five mandates, and in order to comply with them, the Group holds periodical meetings with the participation of more than twenty countries. It also counts with the technical support from the OAS, the IDB and ECLAC.

The mandates are:

1. Create an inventory of investment agreements and treaties, and the protection therein, that exist in the region.
2. Compile in the most efficient manner possible an inventory of investment regimes in the region and, on the basis of this information, determine areas of commonality and divergence and make specific recommendations.
3. Publish a guidebook on investment regimes in the Hemisphere.
4. Publish the inventory of investment agreements and treaties in the region.
5. Promote accession to existing arbitral conventions.

On the basis of the studies prepared and the discussions, the Working Group identified several areas of commonalities and divergences in the treatment of investment in the Hemisphere.

## COMMONALITIES

1. There is an important level of convergence not only regarding the progress of economic liberalization and openness

towards foreign investment, but also regarding the perception that investment has a positive impact on the economies of the hemisphere. Therefore, countries have recognized the need to create solid mechanisms to promote and protect investment flows in the region, as well as to promote the development and progressive integration of capital markets.

2. The new trend that recognizes investment as one of the main engines for growth is reflected in the significant reforms undertaken by countries within their domestic legislation in areas such as: liberalization of international capital flows, granting guarantees regarding expropriation, signing agreements and international conventions on investment-related dispute settlement procedures, and a progressive elimination of performance requirements as a condition to allow market access to foreign investment.

Although there are sectors where foreign investment access is totally or partially limited, the degree for openness of the investment regimes in most countries of the Hemisphere is greater than a decade ago.

3. Almost all countries in the Hemisphere are part of or becoming part of some kind of investment agreement. This puts in evidence the importance given to the promotion of foreign investment in our countries. These agreements usually include the issues previously identified in the first part of this exposition.

4. The convergent trend towards granting foreign investment further legal guarantees and protection, is also evidenced by particular provisions existing in various economic integration agreements within the Hemisphere. Practically all subregional integration agreements such as MERCOSUR, NAFTA, Andean Community, the G-3, and other free trade agreements, incorporate chapter dealing with this subject.

5. The bilateral investment treaties and the relevant provisions included in subregional economic integration agreements enable the identification of a basis of convergence which, at the level of principles, it is important to emphasize. This, without prejudice that, on more detail, differences remain among each country's regulations. Among the main areas of convergence generally identified are the following:

- Protection, at a constitutional level, of private property, freedom of enterprise, equity between aliens and nationals, and the principle of due process of law.

- All investment treaties applicable among countries of the region are based upon the principles of national treatment and most-favored-nation. Although, most agreements contain

exceptions to these principles due to specific sectors reserved for the State or for nationals of that State, or due to economic integration agreements, agreements on taxation, and bilateral concessional financing schemes.

- Most domestic regimes and treaties allow transfers related to an investment to be freely made, without delay, in a freely convertible currency all the prevailing rate of exchange on the date of transaction. However, exceptions to this rule are found in cases of serious problems in the balance of payments.

- Regarding expropriation, convergence is found with respect to the justification for and expropriation decree, the criteria used to determine the amount of compensation, the existence of a compensation, the means of payment, and the right to a due process in an expropriation procedure.

- There is similarity in the application of dispute settlement procedures. Besides, almost all agreements recognize the possibility to enforce arbitral awards. When the dispute is between a foreign investor and the Host State, all countries guarantee access to the judicial system and due process of law on a non-discriminatory and national treatment basis, and the possibility to solve the problem through international arbitration.

- A great number of countries have eliminated performance requirements as a prerequisite to grant access to foreign investment. The few performance requirements still in place tend to be used to condition export incentives grants, which are generally applied in a non-discriminatory basis.

- Very few countries in the Hemisphere have taxation regimes applicable exclusively to foreign investment.

- A large number of countries in the continent do not impose nationality or previous residence requirements to limit the appointment of top personnel.

6. The Group has recognized the importance of counting with hemispheric data on investment flows statistics, as and information source for future negotiations and transparency in the region.

## DIVERGENCES

1. The existence of different legal traditions in the Hemisphere which is reflected in national regimes and investment agreements in the region. Some are inspired in a civil law system, which has its bases on Roman Law, and as a result, they explicitly state all the rights and obligations for the Parties. Others are inspired in a common law system where

rules are developed through consuetudinary practice and the rights of the parties are established through a system where something is allowed unless it is specifically prohibited.

2. The definition and scope of application of the concept of foreign investment, as well as the criteria used to determine the nationality of a legal person, are not the same in every country.

3. Owing in part to the differences in the power enjoyed by sub-federal governing bodies in some nations, countries maintain differences regarding the authorization process and registration of foreign investment, as well as with regard to the existence of a national authority responsible for investment.

4. The scope of application of natural treatment and most-favored-nation principles is not the same in all regimes and agreements. Some countries offer this protection only to investment already established in accordance to their legislation, and other countries offers this treatment also in the pre-establishment phase, with exceptions.

5. There still are some differences in those countries which offer incentives for foreign investment.

6. The sectors that may be accessed by foreign investment are not the same in all the countries.

The FTAA construction is still in a preliminary phase. Most of the work carried out has a preparatory nature for future negotiations. It has not been decided yet how the negotiations are going to be carried out, and that is a discussion we are looking forward to in the coming months. However, following a global tendency, we might expect to count with a comprehensive agreement on investment, guided by modern trends, that widely promotes liberalization, promotion and protection of investment.

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- (2) Banco Interamericano de Desarrollo, **Inversión Extranjera Directa en América Latina en los años 90**, Madrid, 1996, p. 1.
- (3) Ministerio de Comercio Exterior, **Estrategia Nacional de Atracción de Inversiones** (Borrador), San José, 1997, p. 3.
- (4) **Ibid.** Ver además en igual sentido el Gráfico 1 y el Cuadro 1 del Informe de 1996 de la CEPAL sobre Inversión Extranjera en América Latina y el Caribe.
- (5) BID, **Inversión Extranjera Directa en América Latina en los años 90**, Madrid, 1996, p. 3.
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