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MEASURES TO FACILITATE FOREIGN INVESTMENT[1/]

1/ This document has been reproduced without formal editing.

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Issues for [illegible]

[illegible] economic [illegible]

[illegible]

I. [illegible]

1. It is generally recognized th[illegible] savings in most developing [illegible] for a satisf[illegible] rate of [illegible] are [illegible] needed to achi[illegible] most developing countries recogni[illegible] in some [illegible] for foreign [illegible] in the form of [illegible] technology [illegible] managerial skills [illegible] way of [illegible]

2. [illegible] of this paper is [illegible] discuss the measures [illegible] country [illegible] to attract foreign [illegible] an inflow of foreign investment [illegible] these measures [illegible] inter-related [illegible] measure considered in earlier [illegible] Papers. Their [illegible] depends on the extent to which [illegible] foreign [illegible] and minimiz[illegible] the risks involved in the [illegible] of potential [illegible]

II. SURVEY OF I[illegible]

3. A range of issues [illegible] can be taken to facilitate foreign [illegible] as [illegible] as possible under the following headings:

A. What [illegible] forms [illegible] investment [illegible]?

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(1) See pref[illegible] to this U.N. publication ([illegible] No. [illegible]) by [illegible] de Seynes, Under-Secretary [illegible] and Social Affairs, 15 [illegible]

[illegible] What measures can be taken to facilitate foreign investment?

[illegible] What other factors influence the decision of a foreign investor?

[illegible] <u>What different forms can foreign investment take?</u>

Foreign investment in the industrial sector of a developing country can take a number of different forms:

(i) Direct investment with foreign control of the enterprise;

(ii) A joint venture between local and foreign partners;

(iii) Portfolio investment in the form of equity shares or loans;

(iv) In addition international financial institutions and Governments sometimes channel funds for investment in industrial projects through a local industrial financing institution.

[illegible] The advantage of the joint venture form or direct investment with foreign control of the enterprise is that a foreign enterprise's industrial experience, technology, and managerial skills are more firmly involved in the operations of the project. Portfolio investment and funds channelled through financial institutions for on-lending to industrial projects mainly may only contribute to a greater volume of financial resources available for industrial development. The issue arises: <u>which of these forms is the most favourable for a developing country?</u> A further issue can be considered at this point. The background papers show that some developing countries have discouraged direct investments in which a foreign company is granted a majority participation. The issue is then: <u>can potential foreign investors be induced by rigid</u> [illegible] <u>legislation?</u>

[illegible] Many developing countries today face heavy external debt servicing burdens. It is generally recognized that the cost of servicing foreign investment in industrial projects over a period of years turns out to be [illegible] than the [illegible] [illegible] or Governments [illegible] [illegible] [illegible] [illegible] is [illegible] in [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] natural result of the inflow of foreign investment.

V. [illegible] can be taken to facilitate foreign investment

7. Measures to facilitate foreign investment can take the form of:

(i) An adequate legal framework;

(ii) Assurances and guarantees;

(iii) A favourable policy on the remittance of capital and dividends;

(iv) Favourable treatment under international tax agreements;

(v) Favourable policy on employment of foreign personnel.

(i) An adequate legal framework

8. The existence and effective operation of a suitable legal framework can facilitate the operations of foreign investors in developing countries. There are two aspects to the legal framework. The first is the set of general laws and regulations under which both domestic and foreign investors must operate. The second is a special set of rules applicable to foreign investors.

9. In many developing countries, this second set of rules is enacted under a Foreign Investment Law which [illegible] of foreign investors. Such laws usually indicate that foreign investors will be granted the same protection and incentives as domestic investors. In addition, a number of the considerations listed below are included.

10. The issue arises: is the establishment of a [illegible] legal framework including a clear policy statement of [illegible] affecting foreign investors an essential precondition for attracting foreign investment?

[illegible] Assurances and guarantees

[illegible] investment laws of some developing countries [illegible] that the Government will not [illegible] investments or [illegible] is proved necessary [illegible] national interest (or some similar phrase), adequate [illegible] a fair and equitable basis (or some similar phrase) [illegible] issue arises: [illegible] a sufficient guarantee [illegible] it is [illegible] under a [illegible] host Government and the Government of the country [illegible] foreign investor is [illegible]?

[illegible] such guarantees [illegible] Japan, the United States of [illegible] and a number of European countries, have signed [illegible] investment guarantee [illegible] with a number of developing countries. [illegible] issue arises: Do these treaties give effective [illegible] to the foreign investor?

[illegible] importance which some businessmen in the industrially [illegible] have attached to bilateral investment insurance [illegible] led to the study of [illegible] multilateral schemes. Without [illegible] details here, an issue of principle can be raised: [illegible] that further action in this field be conducted on a multilateral basis?

[illegible] guarantee treaties are frequently a pre-[illegible] Government of [illegible] industrially advanced country [illegible] investments made by its own business enterprises in the relevant developing country. The oldest and largest of these [illegible] programmes [illegible] United States of [illegible] and Japan, the Federal Republic of Germany and more recently [illegible] and Denmark offer similar programmes. The issue [illegible] programmes a [illegible]? If so, what action [illegible] to ensure that such programmes apply [illegible]

[illegible] background papers show that a majority of the 20 [illegible] signatories [illegible] Convention for the Settlement of Investment [illegible] arises therefore: [illegible] of creating a favourable condition for foreign investment

(iii) A favourable policy on the remittance of capital and dividends

16. The different types of incentive measures discussed in the Seminar all aim at increasing the potential profitability of industrial projects. However, these incentives can only be effective for a foreign investor if he is assured he can remit that part of the profits which he wishes to transfer out of the developing country. It is also common practice for foreign enterprises to charge royalties or other fees for the technical know-how and management skills made available to the project. Freedom to remit these is also important. Finally, many investors will place importance on freedom to remit capital in the event that they wish to liquidate their interest in the project.

17. The Foreign Investment Laws of many developing countries includes policy statements designed to reassure potential foreign investors on these points. The issue is: are these policy statements by themselves effective or does a foreign investor [illegible] record of the country on this type of transaction [illegible] general balance of payments prospects?

(iv) Favourable treatment under international tax agreements

18. The fact that the profits and other income of a foreign investor are in principle subject to the taxes of both the home country and the developing country raises some special problems. The foreign investor must consider the combined effect of both systems when he calculates the effective tax burden on a contemplated investment. It is in the interest of the Government of a developing country to take what action it can to overcome any deterring effects which may result. In particular, the Government needs to ensure that tax concessions provided at its own expense are not frustrated when the remitted income is taxed in the home country of the foreign investor.

[illegible] number of developing countries (e.g. Jamaica) and the [illegible] of harmonizing tax incentives in the Central [illegible] Market, have included clauses in the incentive [illegible] the benefits of [illegible] tax incentives to those [illegible] the benefits granted will not be [illegible]. However, [illegible] it appears that developing countries have not [illegible] sufficient attention to this problem. The issue [illegible] the tax incentives [illegible] encourage foreign invest- [illegible] absence of suitable [illegible] national tax arrangements?

[illegible] is a complex issue and will have to be discussed in detail [illegible] referred to other and more detailed discussions[2].

[illegible] Favourable policy on employment of foreign personnel

26. The Country Background Papers show that most of the developing countries [illegible] have some regulations which affect the employment of foreign personnel in industrial enterprises established by a foreign investor. The general issue arises: is a favourable policy [illegible] employment of foreign managerial and technical personnel an [illegible] foreign investment [illegible]?

27. [illegible] arises: which are [illegible] the foreign investor [illegible] he requires freedom to employ as many foreign managers and technicians as he deems appropriate, or does he also recognize that it is in his interest to train as high a proportion of local personnel as possible? Can a Government set rigid rules when the technology used varies so greatly from project to project?

28. In developing countries where a system is in operation to control the outflow of foreign exchange, foreign personnel can be adversely affected either by delays or by restrictive general rules designed [illegible] that situation in mind. The issue arises: [illegible] the

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(2) [illegible] introduction, see pages 20 - 2[illegible] of United Nations [illegible] Investment in Developing Countries [illegible] [illegible] developing [illegible] tax treaties between developed and developing [illegible] 1[illegible] [illegible] and [illegible] by A. [illegible] Gumpel [illegible] the industrially advanced countries [illegible] take [illegible] Private Investment in Developing [illegible] 1965.

genuine savings from earnings of foreign personnel [illegible]

24. The Background Papers show that a number of developing countries grant employment permits for a relatively short period of time (e.g. one year) and require this to be renewed regularly thereafter. The issue arises: can such formalities be a discouraging factor to foreign investors?

C. What other factors influence the decision of a foreign investor?

25. A number of measures have been considered above which help to facilitate an inflow of foreign investment. Some of them are designed to ensure that the different types of incentive measure considered earlier in the Seminar can be fully effective for the decision of the foreign investor. The issue arises: have these measures by themselves taken care of all the factors which induce a foreign investor to invest in a country?

26. One further point can be made: that is that the mere enactment of liberal legislation will not be effective by itself. Its effectiveness will also depend on the way in which the rules are administered. The issue arises therefore: how much does the past record of fair, speedy and effective administration of the measures enacted influence the decision of potential new investors?

27. Another general issue which arises is: is profit the only motivating force in the foreign investor's decision? Much has been written on this subject. Experience suggests that many of the larger foreign companies invest to gain a foot-hold in the country where they see a good potential market in the future and the danger of competing firms obtaining a large share. Can this process be accelerated by the introduction of higher tariffs or other measures to protect the local market from imports?

28. Foreign investors usually look at the role which the private sector plays in the Nation's industrial development and the Government's attitude towards private investment in general and foreign investment in particular. The issue arises therefore: is it sufficient for a Government to make policy statements favouring private foreign investment, or does the investor [illegible] the past record of the country? Can one event such as [illegible] nationalization

[illegible] there must be a serious determining factor whether or not [illegible] compensation is paid?

[illegible] issues arise here: [illegible] of adequate [illegible] the possibility [illegible] foreign [illegible] that their [illegible] will never [illegible] criteria for determining the [illegible] to the Government [illegible] foreign investor alike?

IV. [illegible] DISCUSSION

[illegible] range of issues have been raised in this paper. In [illegible] the session devoted to this subject of maximum [illegible] suggested that discussion might concentrate on the [illegible]

[illegible] the experience of countries represented at [illegible] participants might indicate:

(a) [illegible] volume of foreign investment has been attracted to the industrial sector in the last five years;

(b) [illegible] form this foreign investment has taken;

(c) what are the major measures taken by the Government to attract foreign investment;

(d) whether their country has a sufficient network of international tax agreements to make [illegible] effective.

[illegible] more general issues might be discussed, [illegible]:

(a) [illegible] the incentive legislation of some countries resulted in substantial [illegible] foreign [illegible], without promoting the development of local entrepreneurs?

(b) [illegible] the Government place any limit on the [illegible] of a foreign investor [illegible] so, how [illegible] of the [illegible] financed with local [illegible]?

(g) Are there sound <u>economic</u> reasons for limiting foreign equity participation in most industrial projects to 50% or less? Are there sound <u>business</u> reasons for a foreign investor requiring a majority control of the equity of a local enterprise (i.e. greater than 50%)?

(h) Are there <u>any other</u> issues in which the interests of the foreign investor and the receiving country may be in conflict? If so, how can they be harmonized?

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